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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/102

10:00 a.m., July 13, 1983

W. B. Dale, Acting Chairman

Executive Directors	Alternate Executive Directors
	L. K. Doe, Temporary
	M. K. Diallo, Temporary
J. de Groote	
B. de Maulde	
	R. J. J. Costa, Temporary
R. D. Erb	
	T. Alhaimus
T. Hirao	T. Yamashita
J. E. Ismael	Jaafar A.
	M. Casey
	C. Robalino
G. Laske	G. Grosche
G. Lovato	C. P. Caranicas
R. N. Malhotra	
Y. A. Nimatallah	S. El-Khouri, Temporary
J. J. Polak	
	K. G. Morrell
G. Salehkhou	
F. Sangare	E. I. M. Mtei
	S. E. Conrado, Temporary
J. Tvedt	A. Lindø
N. Wicks	C. Taylor
Zhang Z.	Wang E.

L. Van Houtven, Secretary
B. J. Owen, Assistant

Also Present

African Department: O. B. Makalou, Deputy Director. Asian Department: S. Ishii, G. Szapary. Exchange and Trade Relations Department: D. K. Palmer, Associate Director; S. Mookerjee, Deputy Director; S. Eken. External Relations Department: H. P. Puentes. Fiscal Affairs Department: C. A. Sisson. IMF Institute: J. Hamad, Participant. Legal Department: G. P. Nicoletopoulos, Director; G. F. Rea, Deputy General Counsel; W. E. Holder, Ph. Lachman, A. O. Liuksila. Research Department: R. R. Rhomberg, Deputy Director. Treasurer's Department: W. O. Habermeier; Counsellor and Treasurer; D. Williams, Deputy Treasurer; D. H. Brown, A. G. Chandavarkar, W. L. Coats, Jr., D. S. Cutler, D. Gupta, O. Roncesvalles, M. A. Tareen, P. van den Bogaerde, G. Wittich. Bureau of Language Services: A. J. Beith, Director. Advisors to Executive Directors: A. A. Agah, C. J. Batliwalla, S. M. Hassan, I. R. Panday, P. D. Péroz. Assistants to Executive Directors: E. M. Ainley, H. Alaoui-Abdallaoui, H. Arias, L. Barbone, J. Bulloch, M. Camara, M. B. Chatah, L. E. J. Coene, T. A. Connors, M. Eran, G. Ercel, A. Halevi, N. U. Haque, M. Hull, H. Kobayashi, P. Leeahtam, W. Moerke, V. K. S. Nair, Y. Okubo, J. G. Pedersen, G. W. K. Pickering, E. Portas, J. Reddy, J. Schuijer, D. I. S. Shaw, M. Toro, A. Yasseri.

1. BANGLADESH - 1983 ARTICLE IV CONSULTATION, AND REVIEW UNDER STAND-BY ARRANGEMENT

The Executive Directors considered the staff report for the 1983 Article IV consultation with Bangladesh and review under the stand-by arrangement (EBS/83/121, 6/10/83; and Sup. 1, 7/8/83). They also had before them a report on recent economic developments in Bangladesh (SM/83/147, 6/29/83).

Mr. Malhotra made the following statement:

The Bangladesh authorities are grateful to the staff for the clear and precise assessment of the current situation of the Bangladesh economy, with which they broadly concur.

The Board has had a fairly extensive discussion of the developments in Bangladesh economy as recently as March 1983 when it approved a six-month stand-by arrangement of SDR 68.4 million for the period through August 1983. As the review and Article IV consultation discussions have come in the short space of four months, the staff report covers the outcome of the stand-by arrangement in the light of data for the full year 1982/83, and considers the outlook for 1983/84. It also addresses the policy issues that would be relevant in the coming year. The staff rightly concludes that "Bangladesh's adjustment effort during 1982/83 has been considerable, and after almost three years of adversities the economy is ready to resume the growth process."

Bangladesh, one of the least developed countries, experienced serious economic and financial difficulties in the past few years due to a combination of adverse developments, including a severe deterioration in its terms of trade, poor crops, and declining levels of aid flows. The deterioration in the terms of trade and stagnation in real aid receipts severely reduced import financing. They also led to budgetary problems as the Government's receipts of local counterpart funds and largely import-based tax revenues were reduced necessitating cutbacks in public investment. These factors, coupled with poor crops, led to a decline in incomes, low domestic demand for goods and services, and reduced activity in industry, trade, and construction. Since, historically, the public sector had led the economy, its stagnation could not but cause stagnation in the economy as a whole. Thus, economic growth which had averaged 6 percent a year from 1972/73 through 1980/81, was a meager 1 percent in 1981/82.

In view of these severe external and domestic resource constraints, the Government took strong and decisive measures to adjust the economy, supported by a six-month stand-by. These measures were aimed at reducing inflationary pressures in the economy, improving the budgetary position through higher resource mobilization and curtailment of expenditures, monetary restraint, improvement of agricultural productivity, better performance and higher profitability of public sector undertakings, rejuvenation of private enterprise, and maintaining the competitiveness of exports. The outcome, as the staff report and supplement indicate, has been satisfactory. The authorities have thus far succeeded in not only meeting all quantitative performance criteria but have improved upon inflation and balance of payments targets. Despite the liquidity expansion arising from a larger than projected inflow of workers' remittances, the inflation rate dropped to 10.7 percent in 1982/83 as against 16 percent in 1981/82. The balance of payments, which was projected to show a deficit of $70 million in 1982/83, is expected on present trends to show an overall surplus of $152 million, with gross reserves standing at $330 million, equivalent to seven weeks of imports at end-May 1983 as compared with $122 million, equivalent to less than three weeks of imports at end-June 1982.

The budget for 1982-83 incorporated a strong tax effort and measures to improve finances of public enterprises. It sought to achieve the fiscal goals through cutrs in current and capital expenditures, rationalization of taxes, better tax administration, price adjustments, and reductions in consumer subsidies. It set the Annual Development Plan (ADP) size at a level consistent with available resources by reducing the number of projects from the 1580 envisaged earlier to a manageable number of 1128 projects. To insulate priority projects from disruptive resource shortages a "core program" within the ADP consisting of productive and quick-yielding projects was developed, and fund release procedures for the core program were streamlined and made largely automatic. As a result of these serious efforts, budgetary developments in 1982/83 remained on course. There was no domestic bank financing and underlying revenue and expenditure balance, excluding food operations, in conformity with program projections. On latest indications, net credit to the public sector was Tk 38.9 billion in May 1983 against end-June program ceilings of Tk 46.8 billion. An important factor contributing to the budgetary improvement was the tariff increases in power, petroleum, gas and transportation.

Budgetary receipts of Bangladesh are largely dependent on foreign trade. With the not too bright prospects for international trade and aid, the authorities are committed to measures of greater austerity in current expenditures, selectivity in development projects, reduction in subsidies, fuller utilization of productive capacity, further improvement in public sector management and profitability, appropriate pricing policies and additional taxes to meet investment needs. Although in March 1983 the authorities had indicated that no new tax measures were contemplated, the budget for 1983/84 has imposed new taxes which will net a modest additional Tk 522 million. The new measures involve increases in excise duties on gas and some other items, turnover tax, water rates for large projects, electricity duties, railway fares, postal and health fees, and a doubling of the export duty in wet blue leather. Besides, simplification and restructuring of import duties is expected to yield an additional Tk 200 million. Some modifications have been made in the income tax law to facilitate tax administration; the scope of exemptions is being reduced. A new income tax law will be promulgated beginning in 1984. The outcome of the proposed revenue measures will be that the tax/GDP ratio would rise to 10 percent. While raising the procurement price of paddy from Tk 135 to Tk 144 per maund and rice from Tk 210 to Tk 225, the authorities plan to adjust the ration prices of these items to ensure a net reduction in unit subsidy for foodgrains and to reduce the subsidy on irrigation equipment further. There would be no change in the price of fertilizers. The authorities feel that an increase in fertilizer prices would adversely affect offtake whose growth has greatly decelerated over the last three years. Fertilizer consumption is 38 kg. per acre in Bangladesh as against 300 kg. in countries like South Korea. The overall reduction in subsidy outlays is programed at 9 percent in the 1983/84 budget. On the expenditure side, the new budget makes provisions for expenditures on education ro rise by 6 percent, on agriculture by 20 percent, on railways by 6 percent, and on health by 11 percent. For the second consecutive year, no resort to bank financing of the budget is planned.

Thus, the 1983-84 budget provides strong evidence of the authorities' determination to press ahead and consolidate their hard-won gains by improving the base and yield of the tax system and gradually phasing out subsidies. However, in an economy poorly endowed with resources, heavily dependent on imports and with no readily available "tax handle," this remains an uphill task. The authorities are fully cognizant of the need to keep inflation and inflationary expectations under check and to avoid pressures on wages, interest rates, and the exchange rate. The stance of monetary policy during 1982/83 will continue to be one of restraint, and the growth of liquidity in 1983/84 will be held about 15 percent. As is evident from the 1982/83 monetary developments, overall credit growth as well as credit to the public sector were substantially lower than programed. The further improvement contemplated in the financial performance of public enterprises should help in keeping their resort to bank finance within reasonable limits.

The authorities intend to pursue a pragmatic interest rate policy designed to provide incentives to savers and to keep investment costs at reasonable levels. Interest rates remain positive and will be kept under review. Such reviews have become all the more important because of the opening up of the banking sector to private ownership and the increasing reliance on the private sector for the development of the economy.

As the Plan has a rural bias, the focus is on Thana as a unit of administration and development. Such units are being provided with legal authority to raise revenue and also to share development funds of the national government. The 1983-84 budget includes Tk 170 crores block provision for Thana infrastructure development. In addition, for the first time, block provision of Tk 166 crores has been made for development assistancce to Thana Parishads. The authorities believe that the devolution of administration will increase the people's participation and improve program execution.

The indications at the last Aid Group meeting of a larger volume and of more quick disbursing aid should help the authorities to consolidate the encouraging gains made in the external sector in 1982-83. The authorities are aware of the structural weakness of their balance of payments and the fact that satisfactory growth with balance of payments viability over the medium-term cannot be achieved without securing higher growth of exports and greater import substitution, while holding down nonessential imports to a minimum. Diversification and expansion of the export sector therefore remain prime objectives. Easier availability of inputs should facilitate strengthening the production base of nontraditional exports. To strengthen the balance of payments, the authorities will continue to follow a flexible exchange rate policy and encourage workers' remittances. The import policy for 1983-84 has placed 99 import items exclusively under the Wage Earner Scheme and Export Performance Licensing Scheme. The new import policy has reintroduced the open general license system for industrial and commercial imports. The Government intends to pursue a liberal policy in respect of imports of industrial raw materials and spares. Industrial importers will be allowed to open letters of credit directly with commercial banks. Thus the thrust of the new policy is broadly in line with staff recommendations.

The better than expected balance of payments outcome has enabled the authorities to reduce considerably their short-term outstanding debt. The debt service ratio as a percentage of exports of goods and services, including workers' remittances in 1982/83, has been revised downward from 19 to 16.9. Contraction of new external commercial debt has remained comfortably below the program ceilings.

The authorities are hopeful that their efforts at improving output and efficiency of agriculture and industry, sound fiscal and development policies, and diversification and strengthening of the export base will enable them to resume growth with greater stability. These efforts would need the generous support of the international community. Bangladesh also hopes that protectionist policies will not frustrate their attempts at adjustment.

Given the success of the current program, the strong political commitment for further adjustment and growth, and the somewhat improved external outlook, prospects for consolidating and building on the gains made in 1982/83 appear reasonably favorable. Accordingly, the Government has planned for a 6 percent growth in GDP in 1983/84, and reduction in the current account deficit from 11.5 percent of GDP in 1982/83 to 11 percent in 1983/84. The inflation rate is expected to be contained at around 10 percent. The actual outcome could, however, be influenced by the weather and the international trading environment. Still, these objectives represent realistic targets in the face of the challenges facing the Bangladesh economy.

Mr. Hirao said that he was in broad agreement with the staff appraisal. After experiencing a sharp deceleration in growth in 1981/82, due to the deterioration in the terms of trade and to a poor harvest, the Bangladesh economy had shown marked improvement in 1982/83. The better than expected performance had been observed both in the balance of payments and in the rate of inflation. Although helped partly by the return of favorable weather, it was primarily attributable to the implementation of the economic program undertaken by the authorities in 1982/83. The main policies having favorable effects covered the mobilization of domestic resources through tax increases, a reduction in budgetary subsidies, the curtailment of development expenditure, credit restraint, and continued exchange rate flexibility.

Despite the favorable developments, Bangladesh's balance of payments position remained weak, Mr. Hirao continued. Exports were expected to grow slowly, and uncertainties surrounded the future growth of workers' remittances. The debt service burden would also be increasing for several years to come. The important task for the authorities was to consolidate the gains achieved in 1982/83 and to continue to mobilize domestic resources by following a viable investment policy, and by developing the trade sector.

A gradual rise in the level of domestic resource mobilization was essential, Mr. Hirao stated, to ensure an adequate rate of investment, given the likelihood of slow growth in external financing. The staff had noted that Bangladesh's tax effort was low by international standards, and that revenue was heavily dependent on import-related duties. The ratio of tax receipts to GDP was expected to rise primarily as a result of the increase in the value of imports, while some additional revenue was expected from new tax measures. The staff had suggested that there was room to diversify the tax base, and that the authorities could perhaps focus for that purpose on, for instance, domestically produced natural gas, the price of which was below the world price. He hoped that the authorities would consider those suggestions in the coming years.

With respect to the operation of public enterprises, Mr. Hirao added, it was encouraging to note that their financial performance had improved, reflecting adjustments in administered prices and the introduction of a more flexible pricing system in 1982/83. Nevertheless, there seemed to be a continuing need to adjust prices and strengthen the management of public enterprises.

As to investment policies, Mr. Hirao continued, he welcomed the authorities' efforts to give greater emphasis to projects that would assist in the mobilization of resources and improve the balance of payments position. It was also welcome that the Government had expanded the number of sectors open to participation by the private sector and had simplified the procedures for sanctioning investment. The "new" owners of jute and textile mills that had been nationalized and were being returned to their former owners under the divestment program were beginning to rehabilitate and upgrade the divested units on their own initiative. The greater role being played by the private sector would have the beneficial effect of stimulating private savings.

Referring to external policy, Mr. Hirao mentioned that the diversification of exports remained an important goal. He welcomed a number of measures taken recently, including the establishment of a National Council for Exports for the coordination of export development efforts. On the import side, he commended the authorities for the measures of import liberalization taken during 1982/83. Further efforts in that direction would contribute greatly to the efficient use of resources.

The flexibility and pragmatism with which the authorities had managed exchange rate policy since late 1980 were signs of a valuable turn in the right direction, Mr. Hirao considered. The economy had benefited from the greater incentives provided to producers in export sectors, the increase in workers' remittances, and higher receipts from import duties. The authorities should be encouraged to shift more imports from the official to the secondary exchange market, and should aim over the medium term at a unification of the exchange markets at an appropriate rate. As the staff had suggested, such a unification would help to dismantle the complex system of exchange and trade controls.

Despite the easing of immediate balance of payments pressures and the prospective improvement in the availability of foreign exchange, Mr. Hirao remarked, great uncertainties remained in the external environment. He hoped that the authorities would continue to follow a cautious and prudent approach, and succeed in consolidating the gains achieved through their substantial adjustment efforts in 1982/83. He supported the proposed decisions.

Mr. Taylor said that he had been struck by the staff's observation, which seemed to summarize the essence of Bangladesh's problems, that "the level of imports needed to sustain a reasonable development effort is about four times larger than exports." The economy was clearly undeveloped, heavily dependent on aid, and vulnerable to external and climatic developments. As Mr. Malhotra had remarked, consolidation of the gains won so far under the stabilization program would be an uphill task.

Nevertheless, a number of recent developments in the public sector finances seemed particularly encouraging, Mr. Taylor remarked. The core program, giving priority to certain projects in the Annual Development Plan, seemed to be leading to an efficient implementation of projects; real development expenditure was rising for the first time in three years; and a number of welcome measures had been taken to raise tax rates, broaden the tax base, and simplify the system of import duties. But he would endorse the staff's view that if lasting benefit was to be achieved from the measures begun in the past fiscal year under the auspices of the Fund, the authorities should continue with their adjustment measures so as to promote effective consolidation of the progress already made.

As the staff had pointed out, a continued reduction in subsidies could release further finance for much needed development, Mr. Taylor went on. In theory, if the subsidy on fertilizers were cut, less use might be made of fertilizers, which would in itself be undesirable; in practice, the cuts made so far seemed to have had only a limited effect partly because the greater availability of credit to the private sector had enabled farmers more easily to finance their fertilizer purchases. As a point of interest, he wondered whether the staff would agree that the price elasticity of demand for fertilizers in an economy like that of Bangladesh was rather low, and that a policy attempting to increase fertilizer use through subsidizing its cost was likely to be relatively inefficient and to have little economic effect other than to raise farmers' incomes.

He had noted from the supplement to the staff report that a number of new tax measures had been announced in the 1983/84 budget, and that they would yield a modest amount of additional revenue, Mr. Taylor continued. He wondered whether those tax changes had been inspired by the findings of the Taxation Inquiry Commission, which had been described in the staff reports for the 1982 Article IV consultation. Because the tax effort might be considered rather low by international standards--although admittedly Bangladesh was a poor country--and because tax revenue was heavily dependent on import duties, he would certainly support the staff view on the need to expand and diversify the tax base, possibly through the introduction of further taxes on natural gas, personal income, and land. He asked whether further information was available on the timing and content of the new income tax law to be promulgated in 1984.

Mobilizing domestic resources to the full remained one of the most difficult problems, and the maintenance of positive real interest rates could be an important incentive, Mr. Taylor considered. The staff's interesting idea about developing alternative financial assets, such as stocks and bonds, might be worth exploring further; in due course, Bangladesh might be able to introduce the kind of national unit trust scheme that had been adopted in India and Pakistan with fairly encouraging results.

The improvement in the balance of payments was extremely welcome, as it had made possible some much-needed replenishment of external reserves, Mr. Taylor commented. The turnaround seemed to be due primarily to the growth of workers' remittances, and he shared the staff's concern about the rather fragile nature of that source of income. A growth rate of only 4 percent in export earnings illustrated the urgent need to diversify exports away from the traditional ones, especially jute and its products. He was glad to note that the flexible exchange rate policy had been having an impact in that respect. Like Mr. Hirao, he would encourage the authorities to move toward the unification of the exchange markets as soon as practicable.

The staff had rightly expressed concern about the cost of Bangladesh's debt service payments, which had risen sharply in the past year as a proportion of exports of goods and services and were expected to rise again sharply in 1983/84, reaching a peak of about 33 percent in 1986/87, Mr. Taylor observed. If allowance was made for projected workers' remittances, the ratio would be lowered considerably, but the fact that growth in those remittances could not be counted on with any degree of certainty re-emphasized the conclusion that there was a need for meticulous debt management. Any increase in nonconcessional debt must be kept to an absolute minimum.

In conclusion, Mr. Taylor expressed admiration for the authorities in their courageous efforts at stabilization under the stand-by arrangement. It would be important for them to persist with their adjustment efforts, perhaps taking the opportunity of a slightly brighter world economic outlook and better export prices to pursue active but still cautious development and general economic policies, along the lines of the staff appraisal. It would be a pity if the hard-won progress of the past six months were placed in jeopardy by a general relaxation of policy at the present time.

Mr. Ismael commended the authorities in Bangladesh for having taken strong and decisive measures during the recent difficult period. As described in the staff report, the adjustment efforts had proven to be successful.

In view of those developments, Mr. Ismael observed that Bangladesh's balance of payments was still fundamentally weak and that it would require adjustment over a long period. From what he understood, the Fund had approved an unusually short and small stand-by arrangement with Bangladesh in March 1983 because of the uncertainty of the economic prospects and the desire of the authorities not to commit themselves beyond the fiscal year. Now that the situation seemed to be easing and a new fiscal year had just started, he wondered whether there was any intention to review the present arrrangement.

Commenting on the presentation of the statistics on external aid, Mr. Ismael remarked that his understanding was that aid to the public sector was normally treated as part of the flow of income in the government accounts and was at the same time treated as a current transfer flow in the balance of payments account. Thus, the practice was usually to be to place external aid above the line in both accounts. However, for

Bangladesh, external aid to the public sector was shown as a financing item in the government accounts, and as a flow of capital in the balance of payments accounts; thus, in the presentation in the staff reports, it was treated below the line in both accounts. He raised the question because including external aid above the line, instead of below it, would substantially change the picture both of Bangladesh's fiscal deficit and of its current account deficit, and thereby the appraisal of its policies.

Mr. Grosche remarked that as called for by the difficult circumstances with which Bangladesh was confronted, the authorities had undertaken strong and far-reaching measures to restore financial discipline and to lay the ground for renewed growth and balance of payments viability. Like other Directors, he commended the authorities for having clearly demonstrated their commitment to make effective use of economic instruments.

The measures taken had led to a marked improvement in the financial position of public enterprises and the Central Government, Mr. Grosche continued. He had been glad to read in the supplement to the staff report that total domestic credit and net credit to the public sector continued to remain below the program ceilings. However, the expansion of broad money had continued to accelerate in May. The rate of inflation had also picked up. Those were signals that should keep the authorities on the alert. Prudence was required in monetary policy and resource management. Bangladesh was still far from having reached self-sustaining economic growth. As Mr. Taylor had pointed out, the external balance remained structurally weak, with exports covering only about one quarter of necessary imports, and with aid flows closing most of the gap. There were clearly uncertainties about future inflows of aid and workers' remittances, and foreign borrowings accumulated over the years were claiming a growing share of export earnings. Thus, he fully shared the staff's view that the objective of achieving sustained growth could be frustrated if the longer-term adjustment effort initiated in 1982/83 were not pursued with firmness and determination.

According to the staff report, Mr. Grosche noted, the authorities would like 1983/84 to be a year of consolidation. With all the uncertainties in mind, he interpreted that to mean pressing ahead with the implementation of reforms to consolidate the success already achieved. In that respect, the 1983/84 budget would mark an important step. Although he understood the authorities' desire to promote economic growth, the targeted increase of 20 percent in the Annual Development Program would contribute to an underlying fiscal deficit nearly as large as the one in the past fiscal year. But he welcomed the intention to continue the practice introduced in 1982 of establishing a priority list of projects within the Annual Development Program, thus enabling the authorities to cut back expenditures in an orderly fashion, if necessary.

On the external side, Mr. Grosche remarked, further efforts had to be made to broaden the export base, although it might not be easy for Bangladesh to break into world markets with its primary or semifinished products. The market for jute and jute products would certainly not show strong expansion in the future. A broader export base was also of crucial importance in arresting the steady increase in the ratio of external debt service to exports, which might rise to 33 percent in 1986.

In the fiscal area, Mr. Grosche commented, there seemed to be room for maneuver to strengthen the public sector performance. It was somewhat disturbing that the new tax measures contemplated by the authorities for the new budget were not expected to yield notably greater revenue. A widening of the tax base appeared appropriate. Furthermore, a decrease in reliance on trade-related taxes would be desirable. Therefore, he welcomed Mr. Malhotra's announcement that a new income tax law would be promulgated in 1984, and that the tax/GDP ratio would rise to 10 percent.

Finally, Mr. Grosche remarked, delays in reducing subsidies, and thus in increasing publicly controlled prices, might be explained by social constraints due to the low per capita income. It had, however, been proven in other cases that a flexible and adequate pricing policy yielded positive economic results, permitting social objectives to be envisaged that had seemed out of reach before. The authorities might think of freeing a number of controlled prices to improve the allocation of resources.

Mr. Erb said that he was in broad agreement with the staff appraisal and could support the proposed decision. As other Directors had remarked, the Bangladesh authorities were to be commended for their commitment to a strong adjustment effort and for their successful performance thus far under the stand-by arrangement. The actual outturn reflected appropriate policy measures, rigorously implemented. He would encourage the authorities to continue their prudent course toward a reliable economy.

Budgetary performance had improved in 1982/83, Mr. Erb noted. The numerous reforms of budgetary procedures had apparently contributed to a more efficient implementation of priority projects. Further progress would be necessary, however, in the 1983/84 fiscal year. More generally on fiscal policy, he was concerned that expenditure plans for the coming year might be too ambitious in light of the uncertainties facing Bangladesh in the external sector. In addition, he was concerned about the recent growth in money. The authorities would have to adopt measures to augment their effort to mobilize domestic resources. He concurred with the staff view that gradually raising the level of domestic savings would be essential to ensure over time an adequate rate of investment, which in turn was a crucial element in the drive to achieve sustainable real economic growth as well as a stronger balance of payments position.

As for external policies, Mr. Erb commended the Bangladesh authorities for their pursuit of a flexible and realistic exchange rate policy during the past year; he strongly encouraged them to continue pursuing such a policy, which should increase the flow of resources to the export sector and the import-competing sector. Furthermore, his authorities believed that Bangladesh should move as quickly as possible to unify the exchange markets. In the meantime, in supporting the efforts under way to liberalize the import system, he also concurred with the staff's recommendation that import liberalization be continued, by channeling more imports through the secondary exchange market.

The balance of payments position remained structurally weak, despite the improvement in 1982/83 and the further improvements anticipated in the coming year, Mr. Erb observed. Policies to strengthen the balance of payments would have to be pursued vigorously if a sustainable current account position was to be achieved. That was all the more important because aid flows in real terms could not be expected to increase at the same rate as in the past. In addition, as the staff had pointed out, debt servicing could be expected to claim a growing share of the country's future foreign exchange earnings.

In that connection, Mr. Erb stressed that a large part of Bangladesh's debt service in the near future would be due the Fund, and given the precarious external prospects facing the country, it would seem desirable for Bangladesh to maintain a close working relationship with the Fund. That might be accomplished, for instance, in the form of a precautionary stand-by arrangement, an approach that his chair had suggested previously, and one that had been quite commonly used in the past. The resources committed under such a stand-by arrangement would be treated by the authorities as truly stand-by resources that could be drawn if unforeseen developments beyond the control of the authorities resulted in an unexpected deterioration in the external payments position during the coming year. A precautionary stand-by arrangement would also inspire confidence and serve as a potential catalyst for assistance from foreign official sources.

Mr. Tvedt said that in general he agreed with the staff's analysis and could support the proposed decision. Like other Directors, he commended the authorities for the strong and decisive measures undertaken in 1982/83 to restore financial discipline and move toward the medium-term goal of achieving sustained growth with balance of payments viability. Mainly as a result of the policies pursued, a significant improvement had been achieved in the balance of payments situation.

Another favorable result of the adjustment policy followed in 1982/83 was the marked reduction in the financing requirement of the public sector, Mr. Tvedt continued. Until recently, credit expansion had been in line with, or even below, the program target, and inflation had moderated significantly. However, as Mr. Grosche had already mentioned, according to the most recent information in the supplement to EBS/83/121, the expansion of broad money had continued to accelerate in May, reflecting a better than expected improvement in the external accounts; at the same time, the rate of inflation had also accelerated.

Against that background, Mr. Tvedt asked whether the staff would still hold to its view in the appraisal that "the recent acceleration in liquidity expansion brought about by the improvement in the balance of payments does not appear to have placed pressure on prices, as the faster liquidity growth had served to satisfy an increased demand for money." He had also noticed with some surprise in Supplement 1 to EBS/83/121 that the authorities had announced a target growth rate of 15-17 percent for broad money during 1983/84. Compared with the program target of 11 percent for 1982/83, the new target seemed to indicate a significant--and worrisome--relaxation of monetary policy. He would therefore be interested if the staff or Mr. Malhotra could comment further on that point.

Mr. Alhaimus observed that in the past two years, like many other less developed countries, Bangladesh had found itself vulnerable to a worldwide recession. Real output growth rates had declined significantly while the current account deficit had widened and the already weak reserve position had grown weaker still, falling from five to three weeks' imports. Both the level of external debt and the debt service ratio had increased in recent years, although the burden on the economy had been somewhat lessened by growing remittances from workers abroad.

Bangladesh continued to face the problem of inadequate domestic resource mobilization, which placed the burden of investment on the public sector, Mr. Alhaimus noted. Large fiscal deficits had thus been incurred, leading eventually to a review of expenditures. Bangladesh was currently in the process of successfully implementing a program under a stand-by arrangment. It was encouraging that all performance criteria under the stand-by arrangement had been met, as noted in the staff report.

The recent measures taken by the Bangladesh authorities had shown their commitment to moving toward a more streamlined and efficient economy, Mr. Alhaimus continued. Subsidies were being eased out to bring prices in line with market forces. Revenue projections for 1983/84 showed an increase of 27 percent, as indicated in the supplement to EBS/83/121. Various new measures aimed at further increasing revenues had been outlined by Mr. Malhotra. The practice of establishing a core program within the Annual Development Program, with the intention of protecting the core from any ensuing revenue shortfall, was certainly a step toward greater planning efficiency. Despite the Goverment's efforts, the fiscal deficit would grow a little from 11.9 percent of GNP in 1982/83 to a projected 12.1 percent in the coming year. However, the authorities had indicated that the deficit would be financed by external borrowing in order not to crowd out the private sector from domestic financial markets.

In moving to implement an adjustment program, Mr. Alhaimus remarked, the authorities had slowed down quite considerably the growth of the money supply, from 19 percent in 1981/82 to 11 percent in 1982/83. While the expansion of overall domestic credit was being restrained, falling from 29 percent in 1981/82 to about 17 percent in 1982/83, efforts had been made to restrict public borrowing and to increase credit to the private sector. Restricting the growth of money had contributed to curbing high inflation rates.

As shown in the staff report, the exchange rate depreciation had helped to increase workers' remittances and revenues from import duties, leading to a balance of payments surplus for the current year. He had noted the authorities' intention of unifying the markets in the existing exchange system and their efforts to route more trade through the secondary exchange market at the market-determined rate.

The authorities in Bangladesh were committed to a policy of expenditure restraint and prudent money management, Mr. Alhaimus concluded. The country's immediate future was looking better, and the current strengthening of the economy might provide the authorities with the opportunity to make the public sector even more efficient.

Mr. El-Khouri commented that it was clear from the review under the stand-by arrangement with Bangladesh that significant progress had been made during the past year in reducing the imbalances in the economy. Output growth had risen to 3 percent in 1982/83, from about 1 percent the year before, while both the rate of inflation and the current account deficit had been reduced considerably. The progress had been achieved mainly as the result of an impressive adjustment effort by the authorities, who were to be commended for their courage in adopting some difficult corrective measures.

Looking ahead, the staff projections indicated some easing of pressures on the balance of payments during 1983/84 and 1984/85, Mr. El-Khouri went on. The ratio of the current account deficit to GDP was projected to decline gradually, and the authorities would be able to add modestly to their reserves. But that ratio was expected to remain above 10 percent and reserves would rise only to the equivalent of five weeks' imports. The authorities should therefore press ahead with their adjustment effort.

Concerning the effort to mobilize domestic resources, Mr. El-Khouri noted the staff's contention that it should be strengthened through the adoption of various measures to increase the tax/GDP ratio, to reduce subsidies, and to stimulate private savings. He agreed with the staff that there was some scope for further domestic resource mobilization, particularly through a diversification of the tax base and flexible pricing policies in public enterprises. But pragmatism dictated that the process be gradual, given the low income level of the people and the substantial effort at mobilizing domestic resources that had already been made in 1982/83.

The authorities were to be commended for scaling down their original investment program for 1982/83 to a level more in line with available resources, Mr. El-Khouri said. It was also encouraging that they had reaffirmed their commitment to the concept of core programming in annual development programs whereby expenditures were undertaken only if adequate funding was available. It was a sensible approach, given the existing financial constraints.

In the external sector, Mr. El-Khouri observed, the authorities had followed an exchange rate policy that aimed at preventing an appreciation of the taka in real effective terms, as stipulated in the current stand-by arrangement. Furthermore, steps had been taken during the past year to liberalize the import system. On balance, those policies seemed to have had beneficial effects on the economy. Therefore, he could concur with the staff that the authorities should be encouraged to continue with their flexible exchange rate policy and with the process of import liberalization. In light of the progress made in those areas, it was not entirely clear to him why the staff was not recommending that the Board should approve the exchange practices of Bangladesh. Was it because Bangladesh did not have an adjustment program with the Fund that ran for the duration of the period for which the exchange practices might be approved? He supported the proposed decisions.

Miss Diallo noted that the aim of the 1982/83 economic program had been to correct the financial imbalances and to create the conditions for sustainable economic growth, the sine qua non for a continuous uplifting of the standard of living of the population at large. In fact, the economic and financial situation of Bangladesh had worsened since 1980 owing among other things to the sharp deterioration in the terms of trade, the declining trend of external aid, and the unfavorable weather.

As underlined in the staff reports, Miss Diallo added, the authorities had made commendable efforts to cope with the situation. Substantial price adjustments and an appropriate investment program had been undertaken. Administered prices such as those for gas, electricity, and petroleum as well as prices for locally manufactured goods had been adjusted upward. That move in the right direction should be continued. She also shared the staff's view that the authorities should follow a more flexible exchange rate policy and manage their resources prudently.

In the fiscal field, discretionary measures had been taken to increase duties on imports with the aim of raising government revenue, Miss Diallo remarked. The authorities should be commended for their efforts in reducing budget subsidies, increasing revenue, and liberalizing the prices of local enterprises. Those measures were having encouraging and important results: the overall balance of payments was expected to show a surplus in 1982/1983 of $112 million, following the large deficit of $245 million recorded in 1981/82.

Tight monetary policies had contributed to a significant reduction of the inflation rate, Miss Diallo noted. The most urgent task at present was the mobilization of domestic savings to compensate for the declining inflow of capital. There was no doubt that Bangladesh could improve its performance. In that respect, despite low levels of income, there was substantial scope for making greater use of available revenues and for increasing revenue by means of an appropriate reassessment of taxes on domestically produced natural gas, personal income, and land.

In conclusion, Miss Diallo observed that Bangladesh had maintained a good record of cooperation and collaboration with the Fund. In light of the successful achievement of the recent adjustment program, her chair supported the proposed decisions.

Mr. Casey commented that the staff report, which he could broadly support, would lead to guarded optimism about economic developments in Bangladesh. Although the past three years had been particularly difficult for the country and much remained to be done, the economic initiatives undertaken by the authorities in fiscal year 1982/83 had borne fruit. But like Mr. Grosche, Mr. Erb, and other Directors, he hoped that the latest data in the recently issued supplementary paper, on the money supply and the rate of inflation in particular, did not imply slippages on the demand side.

There were two specific areas where the authorities should receive strong commendation even though more needed to be done, Mr. Casey continued. First, with reference to parastatals, almost all of Bangladesh's public sector corporations, which were almost 50 in number, were relatively large enterprises. The particularly weak economic performance of those corporations during the three years from 1980 to 1982 had been an onerous drain on the economy. Therefore, he welcomed the improvement in the nonfinancial public enterprises in fiscal year 1982/83, which had been achieved largely by significant price measures. Further welcome improvements in pricing policy had been made recently, as indicated in the supplementary paper. One benefit of the turnaround in the financial position of state enterprises had been the sharp decline in the public sector's credit requirements. However, the financial performance of the enterprises remained poor, and internal financing of most capital projects was difficult. Indeed, as the staff had noted, approximately one third of the Annual Development Plan went to meet public enterprises' capital requirements. It was thus essential for the authorities to continue to take further action, especially on the pricing policies of those enterprises, so that capital costs could be covered.

Second, further action was needed on the supply side of the economy, Mr. Casey noted. The authorities had taken several commendable steps that would facilitate investment and growth, notable among them the establishment of an investment program that gave priority to the private sector and the denationalization of several industries. Additional structural corrections were needed, particularly to diversify exports and promote efficient import substitution in order to offset the still fundamentally weak balance of payments, despite its recent improvement.

Bangladesh would remain heavily dependent on development assistance, as the medium-term projections in Table 5 of EBS/83/121 showed, Mr. Casey remarked. It was important for the international community not to consider further Fund assistance as a substitute for the continuation and, he hoped, the expansion of concessional development assistance.

In addition, the authorities should aim over the medium term at unifying the exchange markets at an appropriate rate, Mr. Casey said. Like Mr. Zhang, he had some doubts about the present exchange rate policy. As indicated in the report on recent economic developments, the exchange system remained largely restrictive and administratively complex, despite the introduction of several good measures. But why was there a need to shift more transactions to the secondary market, if the official exchange rate was flexible? Moreover, it appeared from Chart 6 in EBS/83/121 that although the gap between them had widened recently, the two rates had been very similar not many months before. Presumably, Bangladesh would be covered in the promised study on multiple exchange rate systems.

As to what assistance the Fund could provide to Bangladesh in the future, Mr. Casey remarked, it was clear that the authorities would have to continue their adjustment efforts, for which Fund support would no doubt be important. However, as he had already mentioned, assistance from the Fund could not be viewed as a substitute for overseas development assistance. Rather, the Fund's resources should be used judiciously, paying due regard to the likely profile of debt service and to the ever-present possibility of unforeseen contingencies.

In general, Mr. Casey concluded, Bangladesh was in a vulnerable position because of relatively large short-term debt, low reserves, high dependence on jute exports, and a revenue base that depended largely on external trade. Even bad weather was a constant threat, as Mr. Malhotra had pointed out. Aid donors, bilateral and multilateral, should be made aware of that vulnerability and of the need for diversification and development in Bangladesh.

Mr. Caranicas observed that Bangladesh had carried out an admirable adjustment effort in a relatively short time, proving that it could overcome its difficulties and restore economic growth. That effort had been undertaken despite great handicaps, including the heavy burden of external debt, the weaknesses mentioned by other Directors, and the fact that the country had been in a difficult situation for three years.

He shared Mr. Casey's views on both the strengths and the weaknesses of the Bangladesh economy, Mr. Caranicas said. Overpopulated and handicapped as it was from so many points of view, Bangladesh was one of the least developed countries and deserved to be supported generously by the international community. The Fund was only one source of future financing. It was also incumbent on the international community to support Bangladesh as much as it could, and at the same to reduce the extent of protectionist policies, all the more so because Bangladesh had liberalized its imports. In conclusion, he agreed in general with the thrust of the staff appraisal and approved the proposed decision.

Mr. Mtei noted that he was in broad agreement with the staff appraisal of the Bangladesh economy. The staff report showed clearly that the authorities had made tremendous efforts to implement the adjustment program approved by the Executive Board in March 1983. He commended the authorities for meeting all performance criteria under the stand-by arrangement. He could therefore support the proposed decisions.

As might be recalled from the Executive Board's previous discussion (EBM/83/54, 3/28/83), the economy of Bangladesh had been severely affected by adverse developments in the world market for jute, and by bad weather, Mr. Mtei continued. As a result, internal and external imbalances had grown, and the terms of trade had deteriorated. It was against that background that the authorities had embarked on an adjustment program that had proved appropriate and adequate in dealing with Bangladesh's problems.

On the fiscal front, resource mobilization efforts did not appear to be sufficient to foster substantial gains in revenue, Mr. Mtei observed, and there was clearly a need for an improved tax effort, which had been relatively low. In that respect, as the staff had recommended, diversification of the tax base was an indispensable measure, because revenue was heavily concentrated on import-related duties. As far as expenditures were concerned, the question of subsidies was equally pertinent; in line with the projected reduction in the budget deficit, the financial performance of public enterprises should be closely monitored. Increasing the role of the private sector should reduce the need for public transfers, provided that it would also improve domestic savings. He noted the steps being taken to open up the banking business to private sector participation.

Monetary policy had played an important role in reducing inflation, Mr. Mtei remarked. The achievement of positive real interest rates was to be commended and should promote the mobilization of domestic financial resources.

As for the external position, the recent improvement was encouraging, Mr. Mtei considered. The balance of payments was projected to show a significant overall surplus, reflecting in part favorable developments in workers' remittances. However, the balance of payments was structurally weak, and reliance could not be placed on such remittances, which depended greatly on world economic recovery. Furthermore, export diversification and efficient import substitution were essential ingredients of a viable and sustainable balance of payments position. In that regard, the measures of energy substitution that had already been taken were commendable.

Finally, Mr. Mtei mentioned his one point of concern, the level of external debt. Like Mr. Casey, he had noted Bangladesh's heavy reliance on external borrowing for financing economic development, and would draw the authorities' attention to the danger of contracting high-cost borrowing. In light of the rising debt service ratio, the authorties might need to re-examine the term structure of their financing.

Mr. Polak joined other Directors in commending the authorities on their economic policies. Referring to the financial relationship between Bangladesh and the Fund, he recalled that when the five-month stand-by arrangement had been agreed in March 1983, there had been a general desire in the Executive Board that it should be the forerunner of an arrangement for a longer, more normal term. It was clear from the staff report that such an arrangement was not at present the wish of the authorities in Bangladesh. He fully respected their opinion that they could handle their problems of stabilization and adjustment, severe as they were, by themselves. Without an arrangement with the Fund, Bangladesh had the benefit of not accumulating additional indebtedness that was both relatively short term and, compared with many other sources of financing made available to Bangladesh, relatively expensive. On that point, he shared Mr. Erb's views.

But, if at some time in the future Bangladesh did feel that it needed a Fund arrangement, Mr. Polak considered that any of the Fund's facilities should be open to it. And because of the severe structural problems with which the country was still dealing, an extended arrangement between Bangladesh and the Fund might be quite appropriate, if it seemed necessary.

Mr. Salehkhou stated that he was in broad agreement with the staff's appraisal of Bangladesh's economic developments and prospects, and that he could support the two proposed decisions. He concurred in particular with the staff's recommendations that insisted on the need for the authorities to continue in 1983/84 the cautious stabilization and adjustment policies successfully implemented in 1982/83. He would add, however, that growth was crucial in a country like Bangladesh, with its high rate of population expansion and severely limited domestic resources.

It was encouraging to note that performance under the stand-by arrangement adopted in March 1983 had to a large extent been satisfactory, Mr. Salehkhou went on. All performance criteria had been met, and developments with respect to every sector of the program were generally better than expected. Although such a favorable outcome had also been the result of better weather and other exogenous factors, it undeniably stemmed from the positive impact of the authorities' new policies aimed at restoring financial discipline, correcting domestic and external imbalances, and, in the medium term, achieving sustained growth.

The performance had been particularly favorable with respect to the balance of payments, which had improved markedly and registered a relatively large overall surplus equivalent to $112 million in 1982/83, Mr. Salehkhou observed. That surplus compared with an overall deficit of $245 million in the previous year, and with a deficit of $70 million projected under the program with the Fund. The most prominent factor in the improvement was the substantial increase in workers' remittances, which had responded to the more favorable and flexible exchange rate policy adopted by the authorities and to special initiatives such as the increase in the number of branches of Bangladeshi banks in host countries. Other factors responsible for the good performance of the external sector included a relative improvement in the terms of trade and a large reduction of nonfood imports.

However, although those developments had resulted in a welcome build-up of international reserves, and in some attenuation of external debt, Mr. Salehkhou noted, Bangladesh's balance of payments remained weak. The imports needed for sustainable development were still large in comparison with exports, and the external debt service burden was projected to increase sharply in the medium term. In that connection, and as suggested by the staff, it was crucial for the authorities to continue and to intensify policies initiated under the program and aimed at the diversification of exports and the substitution of imports.

With respect to budgetary developments, Mr. Salehkhou continued, performance had also been broadly in line with programmed targets, despite the decision by the authorities to import 0.8 million tons of foodgrains in order to replenish stocks that had fallen considerably below the minimum level needed for a smooth functioning of the food procurement system. Following the important tax measures introduced in 1982/83, and the authorities' efforts to control expenditures and improve project implementation, particularly through the adoption of core programs within the Annual Development Plan, the financial position of the Government had improved markedly. At the same time, the large price adjustments implemented under the program had also contributed to a considerable improvement in public enterprise finances.

The improvements in the financial position of the public sector were welcome, Mr. Salehkhou commented, but they needed to be strengthened further. In that connection, the measures announced lately and reported in the supplementary staff paper were certainly moves in the right direction, especially the introduction of new tax measures, the preparation of a new income tax law for calendar year 1984, and the continuation of the core program within the Annual Development Program.

As for money and credit developments, the faster than expected growth of liquidity had been due mainly to the favorable overall outcome of the balance of payments, Mr. Salehkhou noted, and had resulted in the past few months in a modest acceleration of inflation. Total domestic credit had, however, been 4 percent below the program target, thanks to the better financial position of the public sector, which had also permitted a faster increase in private credit. The latter development was indicative of the favorable impact of the authorities' new industrial policy, particularly the divestment program, on the expansion of private investment and development of the private sector.

In conclusion, Mr. Salehkhou considered that the Bangladesh authorities should be commended for the successful implementation of the stand-by program and for a generally better than expected performance. On the other hand, while their concern with the resumption of real growth was legitimate, the authorities also needed to maintain financial discipline in order to avoid the distortions and bottlenecks that had adversely affected Bangladesh's economic development.

Mr. Wang also commended the authorities of Bangladesh for the successful implementation of strong and decisive measures to adjust their economy in 1982 and 1983. He fully supported the proposed decisions.

The staff representative from the Asian Department, in reply to Mr. Taylor's question about the demand for fertilizers, agreed that the price elasticity was relatively low. Although prices did of course influence the use of fertilizers, it was the price of fertilizer relative to procurement prices for farm products that mattered. If the latter were set at an incentive level, farmers would be less concerned about the cost of fertilizer. The staff was worried about the subsidization of fertilizers because with the expansion of fertilizer use, even a relatively low unit subsidy could become a considerable burden on the budget. The staff's recommendation, fully supported by the World Bank, was for realistic input and procurement pricing. In addition to relative prices, the use of fertilizer was also influenced by the availability of credit and of irrigation equipment; it was harmful to the crop to use fertilizer without adequate irrigation.

As to whether tax measures introduced recently were in line with the recommendations of the tax inquiry commission, the staff representative noted that the simplification of import duties, as well as the higher land tax, had been specifically recommended by the commission. The staff did not know what the authorities had in mind when referring in the 1983/84 budget speech to a revision of the income tax starting in 1984.

He understood that the authorities were interested in exploring the idea of a national unit trust scheme in relation to the need to mobilize additional domestic resources, the staff representative explained. They had mentioned the existence of such schemes in other countries in the region.

The foreign aid received by Bangladesh was divided almost equally into concessional loans and grants, the staff representative noted, in response to Mr. Ismael's question about why foreign aid was presented below the line as a financing item both of the current account deficit of the balance of payments and of the budget deficit. Typically, loans were presented below the line because they generated payments obligations; most of the time, although not always, grants were put above the line because they did not generate such obligations. However, in Bangladesh, grants were important, and the overriding question was what the analysis should convey. In the balance of payments, grants were presented as a financing item of the current account deficit because the staff had wanted to show that imports consistent with a reasonable rate of growth were about four times higher than exports, leading to a large current account deficit. The deficit was being financed by aid, partly in the form of grants, over which the authorities had no control. In judging whether or not the balance of payments position was sustainable, analysts would underestimate the need for external financing if foreign grants were included in the current account. However, for purposes of information, the staff had given the ratios of current account deficits to GDP both including and excluding grants. A similar approach was used for the operations of the Central Government. By presenting grants as a financing item, the staff intended to show the extent to which the current account deficit of the balance of payments could be linked to government operations.

The data on monetary developments, up to the time of the staff mission in April, indicated that even though there had been a faster than expected expansion of liquidity, inflation had not accelerated, the staff representative continued. However, the staff had noted with concern at that time that a continued rapid rate of growth of monetary growth could create a problem, concern flagged in the staff appraisal. The data received for one additional month provided further justification for that concern, and the staff hoped that the authorties would slow the rate of monetary growth in the months to come. There were indications that they would in fact do so. The budgeted liquidity growth of 15-17 percent for 1983/84 mentioned in the supplement--on a June-to-June basis--would imply a slowdown, considering that the rate of growth of broad money on a month-to-month basis in May 1983 had been 23 percent. That was not to say that a rate of growth of 15-17 percent was necessarily appropriate; it might be excessive in light of the recent rapid growth of liquidity.

The official exchange rate of the taka was a directed and not a free rate, in the sense that it was set by the authorities on the basis of various indicators, the staff representative explained. On the other hand, the secondary exchange market was virtually a free market. True, the authorities had followed a flexible exchange rate policy, which should be continued. The authorities wanted to use the rate in the secondary exchange market as an indicator of an appropriate exchange rate. The staff had suggested that the secondary market should be as free and cover as many imports and exports as possible if the rate in that market was to be used as a true indicator of an appropriate exchange rate at which the two markets should be eventually unified.

With respect to the future use of Fund resources by Bangladesh, the staff representative from the Asian Department said, the authorities had indicated that due to the easing of the balance of payments pressures and the increase in reserves, they did not intend to request a stand-by arrangement for the coming year. They had designed their polcies for a year of consolidation. They had also made the point that Fund resources were short term and were not a substitute for development aid, which was what Bangladesh really needed.

The Associate Director of the Exchange and Trade Relations Department confirmed that Bangladesh would be one of the countries covered in the staff paper on multiple currency practices.

Before recommending approval of exchange practices under Article VIII, the Associate Director continued, the staff would as a general matter look to see whether two conditions had been satisfied before making a positive recommendation to the Executive Board. The first condition was that the member should be ready to undertake that over a reasonable period of time it would cease to apply any such practices. The authorities of Bangladesh had not felt that they were in a position to carry out such an undertaking if they were to make it. The second condition was that the current policies of the country should offer a good prospect that the restrictive practices could be abolished. In other words, the staff would want to be able to assure Executive Directors that it was confident that the member could carry out its undertaking; that did not imply identity between such a judgment and a stand-by arrangement with the Fund. Many countries had decided to impose restrictions, if they had experienced a deterioration, for whatever reason, in what had been a reasonably satisfactory balance of payments performance. If the staff was satisfied through the annual consultation that policies had been strengthened and that the member wanted to make the undertaking, it would recommend approval of the practices under Article VIII. In other cases, the staff might recommend approval of such practices under a stand-by arrangement. It was stated repeatedly in the staff report for the 1983 Article IV consultation with Bangladesh that the balance of payments position was structurally weak, and it would be difficult for the staff to attempt to reach such a judgment in the absence of a stand-by arrangement. It was true that Bangladesh had been following a flexible exchange rate policy, which would be one of the requirements for the staff to satisfy itself that a member could carry out its undertaking. But since the program under the stand-by arrangement had been in effect, exchange rate adjustments had only maintained the real effective exchange rate. Before the program went into effect, the rate had depreciated substantially, by about 7 percent. Over the medium term, however, the staff would in no sense consider the rate to be an equilibrium rate; there would have to be further movement.

Mr. Malhotra said that he had taken note of the widespread commendation of the Bangladesh authorities for the success achieved in the course of 1982/83 with their adjustment efforts, and the wish of most Directors that the authorities should persist in those efforts. The 1983/84 budget should be sufficient evidence of the desire of the Bangladesh authorities to continue to follow sensible policies, which would be compatible both with the need for adjustment as well as with the need for speeding up the development tempo. It was remarkable, as the staff had noted in its supplementary paper and as he had mentioned in his opening statement, that for the second consecutive year, the budget would not depend on domestic bank financing at all, a clear indication of what the authorities were trying to achieve. A second example of the authorities' intention of maintaining discipline in expenditures was the continuation of the practice of core programming; the core program had been set at 73 percent of the total Annual Development Program.

The staff had presented Bangladesh's debt service position in relation to exports of goods and services, without counting the receipts from remittances by Bangladeshi workers abroad, Mr. Malhotra observed. However, the normal practice was to include such inflows under service receipts, and the staff had, in its previous report, said that that was the way in which Bangladesh's debt service ratio should be computed. He recognized that there might be doubts about the future rate of growth of such remittances, but they now constituted a stable and substantial component of service receipts in the balance of payments. Fluctuations were inherent in all export receipts in a changing world economic environment, but to exclude such an important element while calculating the debt service ratio tended to give an exaggerated picture of Bangladesh's debt service. As he had already noted, the debt service ratio in 1982/83 would show an improvement over the projections in the program, declining from 19 percent to about 16.9 percent. Moreover, in assessing the debt picture of Bangladesh, Directors should note that over 90 percent of its debt consisted of long-term concessional loans, from which it benefited as a least developed country. Such concessional assistance would, of course, have to continue over a long period of time, and would entail increases in debt service. Short-term debt was indeed small, and the authorities were not keen on contracting such debt. The other element of debt was that owed to the Fund, mainly related to adjustment programs. He therefore urged the staff to consider the need for changing the way in which the picture of Bangladesh's debt service was presented.

As for whether some elements of foreign aid should be treated above or below the line, Mr. Malhotra remarked that when the Executive Board had taken up Bangladesh's request for a program in March 1983, he had raised the broader question of the relevance of the concept of overall budgetary deficit to Bangladesh and many other countries, especially low income countries, which had to have a deficit both on current account and on the budgetary account in order to absorb external aid. The biased budgetary view of such countries' positions that might be stimulated by a high overall deficit that was a corollary of aid absorption had to be avoided, if the countries concerned were to see their aid flows continued and increased. He suggested that, in Bangladesh, grants should be shown above the line, as was the practice in most countries. Loans, even if they were long-term loans, could continue to show below the line.

There had been an interesting debate at EBM/83/54 about the staff's medium-term scenario, Mr. Malhotra recalled, which saw the Bangladesh economy growing at a rate of only 2-3 percent, given normal weather, right up to 1987. Yet, in less than four months, the balance of payments position had improved, and the authorities--and perhaps also the staff--regarded as reasonable a growth rate of about 6 percent in 1983/84. That, despite the fact that the authorities were wedded to financial discipline and would not artificially increase investment, which was why they had taken a number of steps to reduce budgetary expenditure. It was thus important not to be carried away by enthusiasm for adjustment to the point of overlooking the fundamental issue for poorer countries like Bangladesh, which was development and the need to proceed with the development process within a stable policy framework.

For that reason, Mr. Malhotra added, he had emphasized in his statement that international support was of the utmost importance to Bangladesh. His authorities were grateful for the greater responsiveness of the donor community at the most recent aid group meeting, especially for changes in the composition of aid, whereby the proportion of program or quick disbursing aid had been raised. Although the Fund focused more on adjustment, it had nevertheless emphasized the need to diversify Bangladesh's export base and to set up efficient import substituting industries, all of which required considerable investment. In addition, there were real structural problems in many countries that could not effectively be resolved in the short term. The present improvement in Bangladesh's balance of payments outlook should not be allowed to conceal the basic, long-term problems of poverty, overpopulation, and a low economic base, which would remain and would continue to affect the external sector.

The terms of trade of Bangladesh appeared to have improved by 12 percent in 1982/83, compared with a decline of 40 percent in the previous two years, Mr. Malhotra noted. If that development could make such a vast difference in the perception of the country's feasible rates of growth, the important conclusion to be drawn was that at the margin, a greater commitment and support to the developing world could bring about gains that were out of proportion to the assistance that might be provided.

Although the present view of the Bangladesh authorities was not to seek another arrangement with the Fund, Mr. Malhotra commented, they would continue to follow strong adjustment policies. Should external developments deteriorate and reveal the need for greater support by the Fund, they might at that time consider a further arrangement; if they did, he was quite sure that it would be for an arrangement providing real financial support, and not an empty stand-by arrangement.

Mr. Erb said that he agreed with Mr. Malhotra that it was important for Bangladesh to return to a stable and reasonably strong growth rate. His concern had been whether the plans of the authorities for the coming year might not be too ambitious because of the uncertainties facing them on the external side. The staff had referred to the fiscal and general plans of the Government for 1983/84 as being consistent with the outcome that it had in mind for the Bangladesh economy. Although it might be too soon for the staff to be able to evaluate the plans for the year ahead, he wondered whether it could give any indication of whether the authorities were not pushing for rather too strong a growth rate, based on their present fiscal and monetary policies.

The staff representative from the Asian Department noted that although there had been relatively little time to review the budget, it was not far from the staff's expectations. The staff considered that the 1983/84 budget probably overestimated revenue, primarily because it was based on too optimistic a target for imports, given the availability of financial resources and the type of external adjustment that should be sought in the year to come. The staff believed that the effort to mobilize domestic resources in the current year was relatively modest; the same was true of the reduction in subsidies. It would be important to make progress in those areas in 1983/84 to lay the basis for stronger growth in the following fiscal year when revenue from import duties would not show the same strong growth as in 1983/84, when imports were recovering from the low level of 1982/83. The staff would also have liked to see a more significant effort to improve the financial position of public enterprises. The authorities had introduced certain measures, but there was room for additional action, particularly in the energy sector.

Mr. Malhotra remarked that there was presumably a difference of opinion between his authorities and the staff. He took Mr. Erb's point that it was important for the Bangladesh authorities to pursue the objective of restoring growth within a framework of stable policies as valid. As he had explained, the authorities had given clear indications of how they would approach that task, especially by avoiding domestic bank financing to prop up the budget, and by continuing the core programming practice with respect to investment expenditures. Similarly, the resort of the public sector to bank financing had declined considerably in 1982/83. He would hope that such financing would also remain within reasonable limits in 1983/84.

The Acting Chairman made the following summing up:

Directors noted with satisfaction that Bangladesh had achieved considerable adjustment during fiscal year 1982/83, and they commended the authorities for the decisive measures taken in the course of the year that included tax increases, reduction in budgetary subsidies, a realistic Annual Development Program, increases in key administered prices, credit restraint, and continued exchange rate flexibility. Largely as a result of the adjustment measures, and aided by an improvement in the terms of trade and a rapid increase in workers' remittances, the current account deficit of the balance of payments declined significantly, and the overall balance moved into surplus, enabling Bangladesh to build up reserves somewhat. Inflation has moderated while the rate of economic growth has accelerated following a recovery in agricultural production.

Directors noted that all performance criteria under the stand-by arrangement had been observed. The substantial improvement in the financial position of the public enterprises and the Government was a source of satisfaction. The result had been a reduction in the financing requirements of the public sector, allowing for a faster growth of credit to the private sector, even though the growth of total domestic credit has slowed considerably. Nevertheless, the better than expected improvement in the external accounts has led to a faster than expected growth of broad money. Several Directors stressed that the situation should be monitored closely and that, if necessary, timely action to slow the liquidity expansion should be taken in order to avoid a rekindling of inflation.

Directors emphasized that, despite the recent improvement in the external position, Bangladesh's balance of payments remained fundamentally weak, with exports being concentrated in jute and jute goods and export earnings covering only a small portion of the imports needed to sustain reasonable growth. In addition, the country was faced with a rapid growth in its external debt servicing payments during the years to come. In this connection, the Bangladesh authorities were encouraged to continue to exercise caution in contracting external debt at commercial terms. Perseverance over a prolonged period to consolidate the adjustment initiated in 1982/83 was therefore essential. In view of the structural weaknesses of the economy and the projected heavy debt burden, adjustment will need to be supported by continued substantial levels of external aid on concessional terms.

Directors urged the authorities to continue their efforts to increase the mobilization of domestic resources to ensure full utilization of available external resources and to maintain investment at adequate levels without causing inflationary pressures. Emphasis was placed on raising the tax effort, which is still relatively low and narrow, on reducing budgetary subsidies, and on higher prices for domestically produced natural gas; the need to further strengthen the financial position of public enterprises was also stressed. While noting the improved prospects for a higher rate of growth in 1983-84, Directors welcomed the continuance of a system of core programming in the Annual Development Program and underscored the need for maintaining the investment program at a level that was consistent with a realistic assessment of resources.

Directors stressed that continuation of a flexible exchange rate policy will continue to be needed in order to channel resources into the export and import-competing sectors. The steps taken in the course of 1982/83 to liberalize imports, particularly in the secondary exchange market, were welcomed. Several Directors encouraged the authorities to continue along those lines, ease exchange controls, and establish a unified exchange rate at an appropriate level as early as practicable.

It is expected that the next Article IV consultation with Bangladesh will be held on the standard 12-month cycle.

The Executive Board then took the following decisions:

Decision Concluding 1983 Article XIV Consultation

1. The Fund takes this decision relating to Bangladesh's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1983 Article XIV consultation with Bangladesh, in the light of the 1983 Article IV consultation with Bangladesh conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes that Bangladesh maintains certain restrictions on payments and transfers for current international transactions and multiple currency practices as described in SM/83/147. The Fund welcomes the reductions in the advance import deposit requirements implemented in 1982/83 and encourages Bangladesh to eliminate these requirements, to channel more imports through the secondary exchange market, and to terminate the bilateral payments arrangements with Fund members.

Decision No. 7466-(83/102), adopted
July 13, 1983

Stand-By Arrangement

The Fund and Bangladesh have completed the review contemplated in paragraph 3(b) of the stand-by arrangement for Bangladesh (EBS/83/56) and in paragraph 2 of the letter of March 9, 1983, attached thereto, without the need to reach new understandings as contemplated therein.

Decision No. 7467-(83/102), adopted
July 13, 1983

2. SDR INTEREST RATE AND RELATED MATTERS, AND OFFICIAL ADOPTION OF TERM "SDR"

The Executive Directors considered a staff paper on the SDR interest rate and related matters (SM/83/137, 6/21/83), together with a proposal to adopt officially the term "SDR" (SM/83/139, 6/21/83).

Mr. Wicks said that he supported the proposals in both staff papers. The changes, particularly those relating to the more frequent fixing of the interest rate of the SDR and the switch to quarterly payment of interest, should lead to a modest improvement of the attractiveness of the SDR compared with other reserve assets, an objective that his authorities had long supported. They also had no problem with adopting the same frequency in fixing the interest rate on indebtedness under the General Arrangements to Borrow, and supported the suggestion that the change should be implemented before the revised GAB came into force.

He had been informed of the thorough discussion in 1982 (SM/82/92, 5/7/82; EBM/82/78, 6/7/82) of ways to improve the SDR, including those on which he hoped agreement could be reached at the present meeting, Mr. Wicks continued. He looked forward to the opportunity in September to discuss more of the ideas explored in 1982. Apart from that, he hoped that the staff would continue its useful work on ways to improve the SDR, whether based on the suggestions made in the papers discussed previously, including those considered in the seminar (SM/82/93, 5/10/82; SM/82/107, 6/4/82; Seminars 82/5 and 82/6, 7/2/82), or on entirely new proposals. Having returned to the subject, the Board should try to maintain the momentum. Perhaps the staff might consider drawing up a systematic program for further work on the SDR, which could be taken up when the Managing Director submitted a program of work for the later part of the year.

Mr. de Maulde said that he could also go along with the proposed changes concerning the SDR interest rate and related matters. The changes would enhance the role and the acceptability of the SDR, a development that his authorities would welcome. He was less happy about the consequences for the Fund's net income, however. The net expense for the coming fiscal year, of SDR 27.8 million, was by no means negligible because it came close to the target of an average annual net income equal to 3 percent of reserves. The increased cost did not raise an immediate issue, given the size of the Fund's estimated net income for the present financial year, but it might have consequences for the future. Like Mr. Wicks, he had no problem with extending the changes to GAB claims.

He could also accept the proposal to adopt officially the acronym "SDR" for the special drawing right, Mr. de Maulde concluded. The abbreviation was not an important improvement, nor did it accurately describe the asset, for which a more suitable name could perhaps be found.

Mr. de Groote said that he supported the proposals, which should improve confidence in the SDR and bring the reference rate closer to the value of other reserve assets. However, the change was not fundamental in nature; it was essentially a cosmetic improvement. As long as a more fundamental overhaul of the SDR system was not being envisaged, little more could be done to improve the quality of the asset. Moreover, the SDR still carried an interest rate derived from the yield on assets in which central banks held their portfolios.

In approving the proposed changes, Mr. de Groote remarked, it was necessary to be aware of the implications for net income and, later, for charges. For 1983, the effects were marginal, and would not call for an adjustment of charges, but that might not be so in future years. He had noted that there was no major argument of principle against daily adjustments of the SDR interest rate. Although the yield on some of the reference instruments did not change daily, it did on others. Daily adjustments might result in an SDR interest rate that was a shade closer to perfection, but he could understand the practical reasons for not going so far.

The possibility of choosing other reference instruments was mentioned in footnote 1 of page 7 of SM/83/137, Mr. de Groote observed, and the staff was apparently going to keep the question under review. He himself had some reservations about the idea. Confusion and uncertainty might result, and the standing of the asset be affected adversely, without much advantage in substance, if minor changes of that nature were made too frequently. Furthermore, any other secondary changes that might be envisaged in the future should, in his view, be considered in the framework of a fundamental reflection on the nature and role of the SDR. In conclusion, he could also go along with the proposal to adopt officially the term SDR, although, like Mr. de Maulde, he would have been more interested in finding another name.

Mr. Casey noted that it had been more than a year since the Executive Board had supported a suggestion by the staff to review the interest rate on the SDR in order to determine whether or not it was in line with the yield on other reserve assets. His chair, and a number of other Executive Directors, had pointed out that central banks, the main holders of SDRs at present, had not actively sought to acquire SDRs. His chair had also agreed with others on the need to move toward an SDR that was seen by those investing institutions as an asset that was as acceptable as a major currency, when all its characteristics--yield, risk, and maturity--were taken into account.

The changes suggested for calculating and paying both the SDR rate of interest and the rate of remuneration would go part way toward achieving that objective, Mr. Casey continued. It should nevertheless be recognized that the SDR was not like other reserve assets, as on the one hand it had no maturity and was always sold at par and on the other, in the absence of a balance of payments need, it might not always be easy to sell at any given time. Thus, to some extent, he agreed with Mr. de Groote that the changes proposed were partly cosmetic, although not necessarily unimportant.

He supported the proposal to fix the SDR interest rate weekly rather than quarterly as at present, Mr. Casey went on. The more frequent determination of the rate would be more in line with the daily valuation of the SDR and, combined with the shorter lag of one day between the base period and the period during which the rate applied, should result in a fully consistent rate. The daily fixing would probably be the ideal, but he appreciated the practical difficulties involved. He also agreed with the proposal to pay the interest on the SDR, charges on SDR allocations, and remuneration on a quarterly basis. That would be in line with the frequency of payments on the underlying instruments, which had maturities of about three months. The greater frequency of interest payments would also augment somewhat the overall yield on the SDR. He was not sure that greater frequency of payment of charges to the Fund would be an administrative advantage for some smaller countries, although no doubt they would learn over time to cope with the new system.

The rate of remuneration was to remain at 85 percent of the SDR interest rate and be determined on a weekly basis in line with that rate, Mr. Casey noted. He reiterated the view of his chair that the rate of remuneration should be brought up to 100 percent of the SDR rate, and looked forward to the discussion of that issue at the Executive Board meeting scheduled for September 1983. The similar nature of both assets--remunerated reserve positions in the Fund and the SDR--was well described in footnote 2 on page 11 of SM/83/137.

He recognized, like Mr. de Maulde, that the proposed changes would have some implications for the rate of charge and for the Fund's income position, Mr. Casey added. For the 1984 fiscal year, however, the costs could be accommodated within the expected surplus.

It was not clear to him whether the proposed change in accounting procedures was consistent with normal banking practice, Mr. Casey remarked. He believed that some banks calculated interest from the day it was due. Moreover, interest was generally paid on the maturity of the instrument, and not some time after the instrument matured, however promptly.

On a more general level, Mr. Casey recalled several ideas that had come out of the IMF Conference on International Money, Credit, and the SDR, which should not be lost from sight. Reference had been made to the need for the Fund to set up a clearinghouse for SDRs; another idea had been to make the yield on the SDR equal not just to the weighted average yield of the instruments in the basket, but to that on whichever reserve currency in the basket offered the best yield at the time. The latter idea might not work out in practice, but along with other proposals, it should at least be kept open for consideration. In that connection, he was attracted by Mr. Wicks's proposal for a miniwork program on the SDR.

He had no problem with "SDR" as an acronym for the special drawing right, Mr. Casey remarked. The only slight difficulty was that it would be better, if possible, not to translate the acronym into other languages. It could be confusing to have SDRs, DTSs, and so on.

The Treasurer explained that, under the Articles of Agreement, the interest rate on the SDR and the rate of charge on the use of SDRs had to be identical. Thus, the staff had worked on the legal presumption that that identity of interest and charges on the SDR required that payment of the one on a quarterly basis meant payment of the other on the same basis.

Mr. Doe said that he could support the proposal with respect to the use of the term SDR. He also supported the recommendations concerning the SDR interest rate and related matters, bearing in mind the net income position of the Fund. However, he had some concern about the possible effect of the proposed changes on the volatility of the SDR interest rate, and most seriously about the repercussions of those changes on the operations of SDR users. The increased frequency with which the SDR interest rate would be changed and paid might not only result in a higher cost to SDR users but also strain their liquidity position. Such a strain hardly seemed opportune when a number of countries using the SDR, including those in his constituency, were overburdened by debt obligations. The long-term financial repercussions of the proposed changes on SDR users, especially the debt-ridden ones, should have been given a little more consideration than was indicated in the staff papers.

Mr. Tvedt remarked that he too was in general agreement with the staff's proposals, as presented on pages 12-13 of SM/83/137. A more frequent setting of the SDR interest rate would reduce the likelihood of divergence between that rate and the interest rates on major reserve assets, and would strengthen the role of the SDR as an international reserve asset, a development favored by his authorities.

The weekly fixing of the SDR interest rate would provide a sufficient correlation between the SDR interest rate and the reference rates, Mr. Tvedt considered. As also pointed out by the staff, quarterly payment of SDR interest would to a large extent reduce the systemic difference between the effective rate of return on the SDR and that on the underlying instruments in the valuation basket. Even though the cost of using the SDR would increase, he was of the opinion that it was proper to try to make use of SDRs easier, and in that way enhance the role of that reserve asset.

In conclusion, Mr. Tvedt stated, he had no objection to the changes in the Fund's accounting procedures, as proposed on page 13 of SM/83/137. He could also agree to the proposed new Rule B-6 on the official adoption of the term SDR.

Mr. Sangare considered that the proposals in the staff paper represented another step in the direction of adapting the financial characteristics of the SDR to endow it with the attributes of other major reserve assets in order to enhance its attractiveness and ability to compete. The general aim of increasing the SDR's share in international reserves, with the hope of making it the principal reserve asset in the international monetary system, required continuous efforts to improve its financial characteristics. It went without saying that significant improvements could be brought about only by policy measures relating to the yield, liquidity, and distribution of the SDR.

The staff proposals to improve the correlation between the SDR interest rate and the rates of return on alternative reserve assets by means of more frequent fixing of the interest rate and the shortening of the reference period were positive steps toward enhancing the liquidity of the SDR, Mr. Sangare believed, especially in the context of constantly changing market conditions. It was in that context that he viewed with interest the staff's recommendation concerning the improvement of the effective yield on the SDR.

However, Mr. Sangare continued, one point of concern to him, which had been noted by the staff, was that improving the competitiveness of the SDR interest rate by means of quarterly payments could lead to the payment of higher effective charges by the net users of the SDRs, namely, the developing countries. In the effort to improve the attributes of the SDR, Directors should not forget the basic long-term objectives of international monetary reform, one of which was the promotion of the net flow of real resources to developing countries. The steps taken to enhance the competitiveness of the SDR should be consistent with a reformed system capable of promoting an equitable adjustment and of meeting the special needs of developing countries. Moreover, while quarterly payments might have undeniable advantages, some countries might encounter difficulties in finding the resources to make more frequent payments of charges. Countries could perhaps be given a choice between annual and quarterly payments.

Finally, Mr. Sangare stated that although the issue under discussion was confined to an improvement in the characteristics of the SDR, it was easy to see from the present inadequate supply that little could be done by way of such improvements to increase its share in international reserves. Yet it was clear that there was a need for a major expansion of SDR allocations, especially since none had been made so far in the fourth basic period. In addition, the link between SDR allocations and development financing, which needed no further explanation, and the need to increase the share of developing countries in the distribution of SDRs, could hardly be overemphasized.

He shared the view of the staff with respect to the official adoption of the term "SDR," Mr. Sangare commented. International use of the SDR might thereby be promoted. However, as he had already mentioned, much more remained to be done to promote the SDR as a reserve asset.

Mr. Conrado stated that his chair was in complete agreement with the objective of enhancing the SDR so as to make it the principal reserve asset in the international monetary system. Thus, he would support any proposals that would make the SDR more attractive as a reserve asset. For the discussion in 1982 of possible further improvements in the existing SDR, the staff had presented a paper that included several interesting suggestions, many of which had been viewed positively by Executive Directors; some of those proposals had even been considered necessary if the SDR was to be improved. It had also become clear that the various steps that could be taken to that end were closely interrelated, and that careful consideration should be given to the effects of any reforms or modifications on other reforms already adopted. The staff had recognized that fact both in the 1982 papers and in the present paper. Only the collective impact of various specific proposals would significantly increase the attraction of the SDR vis-à-vis other reserve assets. A higher yield, closer to that on other reserve assets, would not by itself enhance the market for the SDR. The market could be enlarged only by removing the restrictions on the use of the SDR. He looked forward to the forthcoming staff paper on simplifying and broadening the use of the SDR.

The modifications proposed in SM/83/137 and SM/83/139 were of only a limited nature and would not by themselves, in the opinion of his chair, enhance significantly the attractiveness of the SDR, Mr. Conrado continued. Thus, those proposals should be regarded as part of a wider range of measures that would in the end tend to make the SDR the centerpiece of the international monetary system. Mr. Wicks's suggestion to draw up a program for studying those matters was appropriate.

On the specific proposals, Mr. Conrado observed, it was clear that in order to maintain a closer correlation between the SDR interest rate and the yields on the assets used in the SDR valuation basket, it was necessary to set the SDR rate more frequently than every quarter. It was also clear that the reference period should be brought closer to the period for which the SDR interest rate was to be set. However, it should be kept in mind that at times of extreme variability of interest rates, a fluctuating SDR interest rate would also introduce greater variability in the charges paid by members that were net SDR users, thus possibly giving rise to a greater degree of uncertainty and making it more difficult for central banks to program payments and receipts. The Fund also had large SDR holdings, and such variability could have implications for its income position, making the already tenuous exercise of estimating Fund income even more difficult. But in a broader context it would be beneficial to bring the yield on the SDR closer to that on competing assets, thus making it more attractive.

With respect to the specific frequency of adjustment, Mr. Conrado went on, daily setting of the SDR interest rate would seem more consistent with daily adjustment of the SDR valuation. However, the problems to which the staff referred suggested that the rate should be fixed less frequently. Although a weekly adjustment would be as accurate as a daily one, without having the same problems, he was not totally convinced that it was the right solution. A more moderate departure from current practice would be a monthly adjustment, which, as presented by the staff in Appendix I of SM/83/137, would represent a substantial improvement over the quarterly setting. Compared with the current method, monthly adjustment would result in a significantly higher correlation coefficient with the daily combined rate, and would diminish the average absolute difference by more than 50 percent, reducing the variation from the daily combined market by almost 75 percent. Thus, his preference would be for monthly adjustment for the SDR interest rate, although he could go along with the proposal to adjust it weekly, if that was the consensus of the Board. As for the duration of the reference period, he could support the use of a single day based on current market practices and those used in the Fund's borrowing arrangements.

On the proposal to pay SDR interest and charges on SDR use quarterly instead of annually, Mr. Conrado noted, the effect would be to increase the effective annual return on SDR holdings, while increasing the effective cost of charges on net use of SDRs. There was a trade-off between making the SDR more attractive by increasing its yield, especially for the more industrialized countries that were the largest holders of SDRs, and increasing the cost for net users, mainly the developing countries. Given the commitment to enhancing the SDR, and the wider benefits that such enhancement would represent for the system as a whole, he could also support the proposal for quarterly payments.

However, he had to voice strong reservations about the proposal to increase the frequency of payment of remuneration, Mr. Conrado stated. Just as for the SDR interest rate, quarterly payment of remuneration would represent an increase in the effective rate of remuneration and would have a significant effect on the Fund's income position. In turn, the increase in remuneration was related to the effective level of charges on the use of ordinary resources. The matter of remuneration should thus be dealt with only in the appropriate context, namely, that of the Fund's income position and charges. Furthermore, he recalled that most Executive Directors had been opposed, during the most recent discussion of the Fund's income position, to raising the rate of remuneration, or to using excess income for that purpose. Thus, the rate of remuneration should not be increased in a roundabout way, thereby putting additional pressure on the rate of charges. In any event, he failed to see how an increase in the rate of remuneration would in any way increase the attractiveness of the SDR. For those reasons, he could not support the proposals to pay remuneration quarterly.

In concluding, Mr. Conrado remarked, he could go along with the proposal to adopt officially the term "SDR." There was already a strong tradition of translating the term into languages other than English, and the tradition should, in his view, be retained.

Mr. Lovato said that he agreed with the staff's recommendations. He would criticize only the long time that had been allowed to elapse since the Executive Board discussion over a year previously of measures on which a broad consensus had already been reached. As had been noted at the time, and as was recorded in the staff papers, the proposals raised no substantial legal complications and might, albeit marginally, contribute to a better role for the SDR among official users.

He had no objection to elevating the letters "SDR" to word status, Mr. Lovato remarked. He was skeptical about the relevance of the term, which was certainly less than ideal, but the search for a better name would only add to the confusion. It would be difficult to change the usage in other languages of the corresponding acronyms. The proposal would not be damaging to the asset, and he could thus support it.

Referring to the more interesting proposals concerning the SDR rate of interest, and the frequency with which it and the rate of remuneration should be paid, Mr. Lovato observed that the tables and charts presented by the staff in support of a weekly setting of the SDR interest rate demonstrated convincingly the consequences of the lack of a market for that reserve asset. Opportunities for substantial profits had existed for protracted periods of time, due to difficulties in arbitraging the various instruments. While those opportunities might be attractive for an aggressive portfolio manager of a central bank, on balance, any such discrepancies between market rates and the SDR rate should be avoided. As to whether a weekly fixing of the rate was better than a daily or monthly setting, he could take the staff's arguments and accept its judgment.

His authorities had not indicated any objections to the proposed changes insofar as they related to the General Arrangements to Borrow, Mr. Lovato said. Similarly, the proposal to pay SDR interest and the rate of remuneration quarterly seemed sensible and worthy of approval. He also supported the change in accounting procedures under Rule T-1(a).

Finally, Mr. Lovato asked the staff for information on the current status of other proposals that had been examined and tentatively endorsed in the course of the Executive Board's discussion in 1982. He was referring specifically to the possibility of allowing official transactions in SDRs to be effected within a band around the official rate, and to the increased role of the Fund in providing brokerage services.

The measures proposed were broadly appropriate, Mr. Lovato reiterated, even though limited in scope. It was obvious that more needed to be done to stregthen the role of the SDR in the international monetary system, and he looked forward to the forthcoming discussion of considerations relating to an allocation of SDRs.

Mr. Nimatallah observed that the SDR was at a crossroads. The Fund had the choice between stregthening it and letting it decline into insignificance. In his judgment, the SDR should be strengthened; not because any one country or group of countries would benefit, but because it was in the interests of all Fund members. He emphasized that the costs and benefits for Fund creditors or debtors were not under consideration, but the promotion of the SDR for the benefit of the whole international monetary system. There had been times when the U.S. dollar and other major currencies had been unable to meet the various burdens placed on them by the system, in particular the burden of meeting global liquidity requirements. The Fund was uniquely placed, as a cooperative international monetary institution, to provide an alternative asset to help the system function more smoothly. The SDR had been created; it had been useful; it should be made more useful. The question was how.

The SDR should be looked at from a dynamic point of view, from both the supply and demand sides, Mr. Nimatallah added. On the supply side, there were compelling arguments for resuming SDR allocations as soon as possible. On the demand side, which was the focus of the present discussion, much had already been done to make the SDR more attractive and more widely used by improving the method of valuation and by raising the yield. However, more could be done to enhance the demand for SDRs. The staff's proposals were relatively modest but they went in the right direction, and he could therefore support them.

The term "special drawing right" had always been awkward and had become progressively less satisfactory, Mr. Nimatallah commented. The term "SDR" would at least be simpler. A name qualified by the adjective "international," like "international dollar," or "international monetary unit" might be more attractive. He was aware that the Articles of Agreement might need to be amended to change the name, but he asked the staff to look further into the matter.

He agreed that the SDR interest rate should be adjusted weekly, on the basis of a one-day reference period, rather than quarterly as at present, Mr. Nimatallah continued, making the SDR a more market-oriented asset. While there was merit in the alternative of daily adjustments, he recognized the technical difficulties, and the staff had provided convincing evidence that weekly adjustments would serve just as well. He also had no difficulty, in principle, with the suggestion that the weekly adjustment should apply as well to the interest paid by the Fund on borrowing from, and in association with, the GAB.

The rate of remuneration should be calculated with the same frequency as the SDR interest rate, as proposed, Mr. Nimatallah considered. SDR holdings and reserve tranche positions were similar Fund-related assets, and it was important to maintain comparability between the two.

The Fund should pay interest on SDR holdings quarterly, Mr. Nimatallah agreed. Although the effective increase in the rate of return would be relatively small, it could encourage surplus countries to hold and acquire

SDRs, the very purpose of the proposals, namely, to enhance the demand for SDRs. The related proposal that the Fund should pay remuneration quarterly was logical and appropriate for reasons of comparability. The Fund's income would thereby be reduced, and the rate of charge could in turn be affected. He was glad to learn that the immediate effects on charges should be small. For the longer term, the staff should examine ways of minimizing those effects so as to keep charges as concessional as possible.

Mr. Hirao remarked that like others he was in full agreement with the general objectives of the staff's proposals for enhancing the attractiveness of the SDR and making it more comparable to other reserve assets. Owing to the possibility of divergence between the current combined market rate and the SDR interest rate during the course of each quarter, the latter rate should be adjusted more frequently. He supported the proposal for weekly adjustment, which would track fairly accurately track the daily combined market rate and could be introduced without causing operational difficulties. He also agreed with the proposal to replace the present 15-day reference period with a single reference day.

More frequent payment of SDR interest and the rate of remuneration would be desirable, Mr. Hirao considered. As the staff had indicated, quarterly payment would bring the effective rate of return much closer to the yield on investments in instruments in the interest rate basket. He also had no difficulty with the minor change in accounting procedures for the payment of charges, remuneration, or the interest on SDRs. Finally, he gave his support to the proposal to admit the term "SDR" as standard usage in Fund documents, correspondence, and publications.

Mr. Malhotra stated that his chair remained committed to the objective of making the SDR the principal reserve asset in the international monetary system. The Fund had recently taken a number of steps in that direction. The prescribed uses of the SDR had been widened, measures had been adopted to improve the yield on SDRs, and another significant step had been the institution of an identical currency basket for determining both valuation and interest.

The changes proposed in the staff paper under discussion purported to be further steps designed to bring the financial characteristics of the SDR more closely in line with short-run changes in market yields on the instruments comprising the SDR basket, Mr. Malhotra continued. In that connection, he doubted whether the SDR need replicate all those financial characteristics in order to be attractive. Basically, the SDR provided a diversified reserve asset, and had certain advantages over national currencies or other currency baskets. Beyond that, the SDR reflected an international commitment to manage liquidity globally.

Referring to the specific proposals in SM/83/137, Mr. Malhotra said that he had no strong objection to a weekly determination of the interest rate on the SDR. As for the duration of the reference period, the staff's study had shown no evidence of any tendency for the combined market rate to be higher on Friday than on other days. While he did not dispute that finding, he could not help wondering whether it would necessarily hold true for the future. Could it be stated with confidence that knowledge that rates on Friday would determine the SDR interest rate would have no effect whatsoever on market participants' perceptions of the five financial instruments comprising the SDR interest rate basket? From a conservative point of view, averaging had some merit in smoothing fluctuations. Therefore, if a weekly system of fixing the SDR interest rate was adopted, the reference period should be the preceding two or three days, based on the average of the combined market rate for those days.

As for the frequency of payment, Mr. Malhotra expressed his opposition to the proposal that interest on the SDR and charges, and remuneration on reserve tranche positions, be paid at quarterly intervals instead of annually as at present. His basic concern was not to increase the financial burden on Fund members that were experiencing great difficulties. Quarterly payment of interest on SDRs would involve quarterly payment of charges by net users of SDRs. Because of the effect of compounding, the increase in the effective SDR interest rate would be about one third of 1 percent for a given SDR interest rate of 8.52 percent under the present system. As net users of SDRs, it was the developing countries that would be called upon to make correspondingly increased payments. To illustrate, the non-oil developing countries, whose cumulative allocations of SDRs amounted to SDR 5.5 billion, currently held only SDR 1.2 billion.

He was also opposed on similar grounds to quarterly payment of remuneration, Mr. Malhotra added. As stated by the staff, the impact would be to increase the Fund's expenditure on remuneration payments by about SDR 28 million in financial year 1984, corresponding to an increase in net charges of 0.14 percentage points for that year. Again, developing countries were mostly the ones that used the Fund's resources, so that the increase in charges would have to be borne by them. It was not very helpful to say that the increase in the Fund's expenditure could be accommodated within the surplus expected for FY 1984. That surplus had arisen as a result of keeping the Fund's charges high, despite the simple logic dictating a reduction in charges. Charges had been raised from 6.25 percent to 6.6 percent for FY 1983 in anticipation of a deficit in that year. There had in fact been a surplus instead, a development invalidating the basis for the increase in charges. The rational course would have been to revert to the charge of 6.25 percent, but that course had not been agreed. It was curious that instead of proposing a reduction in charges, the Board was going to increase effective rate of remuneration.

It was generally acknowledged that the developing countries were passing through a difficult time undertaking adjustment efforts and meeting their debt service liabilities, Mr. Malhotra commented. It was not an opportune moment to add to those countries' burdens, when what they needed was more help. The least that could be done would be to retain the present system of annual payment of interest and charges on SDR holdings, and of remuneration as well.

He could endorse the proposal in SM/83/139 on the official adoption of the term "SDR," Mr. Malhotra said. Finally, no amount of tinkering with the financial attractions or the nomenclature of the SDR would make it the principal reserve asset, unless the decline in its significance in nongold reserve assets was arrested and reversed by a substantial new allocation of SDRs.

Mr. Polak recalled that it had taken from 1967 to 1974 to arrive at a reasonable system for determining the interest rate on the SDR. He was pleased to note the present agreement in the Board on making the final changes to that system. He was willing to support all the staff's recommendations.

He had also been pleased to hear Mr. Wicks's more general view of the Fund's work on the SDR, Mr. Polak said. He himself recalled having complained, during the most recent discussion of the Executive Board's work program, that apart from the interesting and admittedly minor matters on the agenda, no work seemed to be under way on the future role of the SDR. Many Directors had referred to such further work by the staff at the present meeting. He himself felt strongly on the matter, not out of a sentimental attachment to the SDR, but because he was becoming increasingly convinced that the ultimate ability of the Fund to find enlarged resources might well depend on establishing a broader function for the SDR.

It was useful for the Fund to use the acronym "SDR," Mr. Polak considered. Like Mr. Casey, he would encourage the largest possible number of countries to use the term SDR rather than a translation of the three meaningless words "special drawing right," or the equivalent acronyms in national languages. He recommended members to follow the practice of Japan and of the Netherlands, and simply refer in their own language to the SDR.

Mr. Robalino said that he welcomed the proposed change in the method of fixing the interest rate on SDR holdings, because it would enhance the asset and make the system work better. He supported most of the proposals in SM/83/137, but would not give his support to the proposal to make quarterly payments of SDR interest and SDR charges as well as remuneration, because of the financial impact on the least developed countries, which were net users of SDRs and did not have reserve tranches. For many countries in the third world, the financial impact would be significant. He could support the proposal to adopt officially the term "SDR."

Mr. Laske commented that he supported the staff proposal to pay interest on the SDR, charges on the use of SDRs, and interest on GAB claims quarterly in future, instead of annually. He could not be as unqualified in his support for the proposal to adjust the interest rate weekly instead of quarterly. If he could in the end accept that proposal, it would be on the condition that quarterly payment should also be made on other items such as interest on SDRs, and charges.

Raising a technical point, Mr. Laske asked when the Fund would be able to notify members officially of the SDR rate, if it was decided to establish that rate weekly. Germany, as a holder of SDRs, attached great importance to immediate knowledge; if the market rate on Friday was to be the basis of the SDR rate, his authorities would want to know by the opening of business on Monday morning what the rate would be. He asked the staff for assurance that that was technically possible.

On a second technical point, Mr. Laske mentioned the proposal by the staff to change the frequency of payments from August 1, 1983, namely, for the remaining three quarters of the financial year, whereas the interest that accrued over the first quarter would be paid only at the end of the financial year. A somewhat anomalous result would be that holders of SDRs, reserve positions, and claims under the GAB, would receive interest for the second and third quarters of 1983 before they received interest for the first quarter. Was it legally and technically feasible to make payments for the first quarter at the beginning of the following quarter?

The proposals for the weekly establishment of rates and for their quarterly payment would bring rates paid by the Fund closer to market rates, and thereby perhaps enhance the SDR and reserve positions in the Fund, Mr. Laske observed. The staff had taken the view that close similarity of the SDR to other reserve assets was desirable, but his authorities were not fully convinced that that was such a decisive factor in the willingness of monetary authorities to hold SDRs. The comparisons drawn by the staff between the role of the SDR and the role of other reserve assets seemed to his authorities to be somewhat speculative. The SDR had been conceived as an instrument for providing global liquidity to the international monetary system, namely, liquidity for monetary authorities. The Articles of Agreement called on members and participants in the Special Drawing Account to make the SDR the principal reserve asset in the monetary system, not to make it an asset for private use. There was no need to make the SDR as similar as possible to the variety of other instruments held in reserves. His authorities doubted that the SDR would be able to perform the same function as national currencies, which were also used as reserve assets.

Those were wide-ranging considerations, Mr. Laske acknowledged, which might have to be discussed in greater depth when the Executive Board returned to the role of the SDR in the system. And that discussion should take place before any further changes in the quality of the SDR and in its use were proposed. Finally, he accepted the proposal to recognize officially the term "SDR."

Mr. Salehkhou mentioned his general concern about the probable implications of the proposals under discussion for the regulatory role and supervisory functions of the Fund, which should also retain some degree of control over the operative characteristics of the SDR. In addition, he offered a reminder about the further impediments that developing countries might experience, particularly non-oil developing countries, as the result of introducing such proposals. Financial stability was a prerequisite for continued participation by developing countries in the Special Drawing Rights Department.

One general question, Mr. Salehkhou remarked, was whether the proposed measures took into account the possibility that their introduction might make the SDR subject to fluctuating and unpredictable changes in a market that it was beyond the power and influence of the Fund to control, and yet whose ultimate supervision remained one of the goals of the institution. Notwithstanding the widely shared belief that the SDR should be accorded all the benefits and uses of a capital market instrument, the instability that was necessarily introduced into the system as a result of a closer alignment of the SDR system with capital markets might undermine the hopes held since the inception of the SDR. In other words, certain inherent destabilizing features in the financial system would be reflected in the SDR.

The variability of market interest rates was a reflection of a lack of congruence in global economic policies, and more frequent subjection of the SDR to such volatility would in a sense be a reflection of that situation, Mr. Salehkhou observed. That did not mean that the Fund should totally ignore market forces. But, by steering a course for the SDR that was more independent of prevailing market trends, the Fund would be setting an example for the financial community to follow, rather than the other way around. Therefore, the question was: should the Fund introduce some regulatory provisions to deal with the short-term behavior of an uncontrolled market, or should it develop measures that would subject external regulations to its own careful as well as impartial evaluation?

Those reservations were of a more fundamental and perhaps longer-term nature, Mr. Salehkhou remarked. For the immediate future, he would support any proposal that imparted more flexibility and afforded greater market acceptability for the SDR. The staff's proposals, he was sure, had been formulated with that overall objective in mind. However, he proposed that, after a suitable interval, the results achieved from the implementation of the proposals should be evaluated objectively in terms of benefits and associated costs.

With respect to the more frequent payment of charges, and of remuneration as well, Mr. Salehkhou expressed concern over any possible harmful effects on the developing countries. He would welcome a more thorough and in-depth analysis showing the possible impact of the proposal upon their economies. In sum, what was needed was a thorough review after an initial period to assess the progress made. Finally, he concurred with the proposal with respect to the use of the term "SDR".

Mr. Erb said that he supported the proposed decisions.

The Executive Directors agreed to resume their discussion in the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/83/101 (7/11/83) and EBM/83/102 (7/13/83).

3. PENSION COMMITTEE - NOMINATION

The Executive Board approves the nomination set forth in EBAP/83/182, Supplement 1 (7/11/83).

Adopted July 12, 1983

4. EXECUTIVE BOARD COMMITTEE - NOMINATION

The Executive Board approves the proposal set forth in EBD/83/185 (7/8/83).

Adopted July 11, 1983

APPROVED: January 4, 1984

ALAN WRIGHT
Acting Secretary