

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 91/64

10:00 a.m., May 3, 1991

M. Camdessus, Chairman

Executive Directors

Alternate Executive Directors

M. Al-Jasser
G. K. Arora

A. A. Al-Tuwaijri

G. C. Noonan
Chen M., Temporary
J. M. Abbott, Temporary

J. de Groot

M. Mrakovcic, Temporary
C. Schioppa, Temporary

M. Finaish
M. Fogelholm
B. Goos

A. F. Mohammed
I. Fridriksson

A. Mirakhor

T. Sirivedhin
J. C. Jaramillo
J.-F. Cirelli
O. Kabbaj
J. O. Aderibigbe, Temporary

D. Peretz

P. Wright
G. P. J. Hogeweg
N. Toé, Temporary
R. Marino

C. V. Santos

A. Vega

N. Tabata

L. Van Houtven, Secretary and Counsellor
K. S. Friedman, Assistant

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Also Present

IBRD: J. Sackey, Asian Regional Office. Asian Department: P. R. Narvekar, Director; C. M. Browne, P. Gotur, A. M. Husain, B. J. Smith. Exchange and Trade Relations Department: A. Basu, K. H. Lee. Fiscal Affairs Department: D. P. Hewitt. The IMF Institute: I. Otani. Legal Department: P. L. Francotte, R. B. Leckow. Treasurer's Department: M. N. Bhuiyan, G. Hacche. Personal Assistant to the Managing Director: B. P. A. Andrews. Advisors to Executive Directors: M. B. Chatah, C. D. Cuong, B. R. Fuleihan, M. Galán, J.-L. Menda, A. Raza, A. M. Tanase. Assistants to Executive Directors: T. P. Enger, S. Gurumurthi, O. A. Himani, K. Ichikawa, W. Laux, J. Mafararikwa, J.-P. Schoder, C. M. Towe.

1. L.A. WHITTOME - RESOLUTION OF APPRECIATION, AND WAIVER OF RULE N-10

The Executive Directors, meeting in executive session, unanimously adopted a Resolution of Appreciation to Mr. L. A. Whittome upon his retirement.

The Resolution read as follows:

WHEREAS on March 31, 1991 Mr. L. A. Whittome has retired from the International Monetary Fund which he served as Director of the European Department, Counsellor of the Fund, Director of the Exchange and Trade Relations Department and, finally, as Special Counsellor to the Managing Director since joining the staff on August 19, 1964, thus dedicating nearly 27 years of a career in public service to the Fund; and

WHEREAS Mr. Whittome brought to the service of the members of the Fund a total personal commitment to the ideals encompassed in the Articles of Agreement and an exceptional understanding of the art of the possible in striving to realize those ideals during decades that presented numerous challenges to the successful functioning of the Fund; and

WHEREAS Mr. Whittome in his collaboration with Executive Directors and staff was unfailing in the clarity, imagination, and thoroughness with which he helped members in the promotion of international monetary cooperation; and

WHEREAS all those with whom he came in contact in his varied career were stimulated by the broad range of his interests, the wisdom of his advice, and the warmth of his support;

NOW THEREFORE IT IS RESOLVED: That the members of the Executive Board place on record their keen appreciation of Mr. Whittome's intellectual and personal attributes, their gratefulness for his long and eminent service, their regret at his departure, and their deeply felt wishes for rewarding further activities.

Adopted May 3, 1991

Mr. Peretz then requested a waiver of Rule N-10 relating to the acceptance by Mr. Whittome of a national honor.

The Executive Board agreed to waive the application of Rule N-10 as requested by Mr. Peretz at EBM/91/64.

Adopted May 3, 1991

2. BANGLADESH - ENHANCED STRUCTURAL ADJUSTMENT FACILITY - REVIEW UNDER FIRST ANNUAL ARRANGEMENT

The Executive Directors considered a staff paper on the review under the first annual arrangement under the enhanced structural adjustment arrangement for Bangladesh approved on August 10, 1990 (EBS/91/69, 4/18/91). They also had before them a communication from the Prime Minister of Bangladesh regarding the impact of the cyclone that hit the country on April 29, 1991 (EBD/91/137, 5/1/91).

Mr. Arora made the following statement:

At the outset, let me convey the appreciation of my Bangladesh authorities and myself to the staff for the objective analysis of the current situation in the country and the midterm review of the first annual arrangement under the ESAF. As we are in general agreement with the staff views and suggestions, I would limit myself to highlighting a few developments for emphasis.

The macroeconomic objectives of attaining higher growth of income with redistributive justice and relative price stability, and moving towards a viable external position, form the cornerstone of the economic policy of Bangladesh. These objectives are to be achieved through mobilizing larger domestic savings, stepping up investment, making more efficient use of external assistance, and assigning a progressively greater role to the private sector. It is within this framework that the three-year arrangement under the ESAF was formulated.

The economy was broadly on course until the Middle East crisis erupted. Its impact on the external position was severe. While workers' remittances, exports, and, to a lesser degree, import duty receipts were greatly reduced, the oil import bill jumped up. As if this was not bad enough, there was a turnaround in the terms of trade; instead of an improvement of 1.3 percent projected for 1990-91, they actually deteriorated by 0.8 percent. The authorities were forced to clamp down on imports, which affected the growth prospects.

The authorities took timely and effective measures to soften the impact of the external shock. Thus, administered prices were quickly adjusted, and public expenditure was effectively contained by, inter alia, freezing fresh recruitment, reducing the budgetary cost of food subsidies as well as interest subsidies on priority lending, and canceling commercial food imports. While on this point, I may mention that retail prices of petroleum were raised on an average by 85 percent to a level corresponding to a crude oil price of \$36 a barrel--significantly above the world market price. The authorities also did not flinch from raising prices of

rationed food even for the poorer section of the population; no doubt, the food account deficit in 1990-91 is estimated to be even less than programmed.

Measures already taken greatly softened the impact of the Middle East crisis. Thus, as the staff has indicated, GDP growth in 1990-91 may turn out to be 3.7 percent, just about one percentage point less than programmed; the authorities feel that it could even reach 4 percent. The inflation rate, at 8.5 percent, would be one percentage point higher; this mainly reflects the one-time pass-through of the higher cost of imported oil and increases in administered prices.

It is a matter of record that despite severe stresses and strains, the targets of the first-year arrangement--particularly those relating to tax revenues, rationalization of tax and duty structures, improvements in procedures, current expenditures, industrial policies, the monetary program, and exchange rate policy--were generally achieved. There have, no doubt, been some policy slippages and time overruns, but I think that they have not affected the steady progress towards structural reform. The most important thing to recognize is that Bangladesh has implemented significant decisions in regard to macroeconomic stabilization in extremely difficult circumstances, and at considerable cost to the population. Moreover, the authorities have demonstrated their strong commitment to market-oriented reforms, which have already yielded positive results.

Import growth until now has been slower than the program target. There appears to be some scope for augmenting imports, particularly by relaxing restrictions imposed during the Middle East crisis. With this in view, margin requirements for letters of credit have already been lowered in quick succession; the latest reduction--from 25 percent to 20 percent--became effective on April 21, 1991.

The authorities have already taken measures to strengthen market forces with a view to achieving higher growth rates. They intend to intensify efforts in this direction. Steps are being taken to step up the rate of domestic savings. The economy is also being further deregulated. The authorities are planning to initiate measures to further rationalize the existing regulatory framework and to encourage direct foreign investment. These measures will go a long way to encourage private investment and allow market forces to play a more decisive and dynamic role. At the same time, the growth strategy will be oriented towards a more equitable distribution of benefits.

While the authorities have taken decisive actions on the domestic front, and are convinced of the need for greater

self-reliance, they are genuinely concerned about the lower than programmed disbursements from the existing food and commodity aid program. As the staff has indicated, with the larger current account deficit the projected overall balance of payments surplus could disappear. I share the staff's view that the balance of payments need remains larger than originally programmed; hence, the paramount need for additional concessional assistance. Now that the Bangladesh authorities have proven their resolve to take strong--even though unpopular--policy actions, we hope that the international community will make its valuable contribution to sustaining growth and reform in Bangladesh.

The Chairman commented that a powerful cyclone--whose magnitude was unprecedented for the current season of the year--had struck Bangladesh on April 29, 1991, leaving much tragedy and destruction in its wake. Many thousands had been killed, crops and herds of cattle had been extensively damaged, and the people in the affected areas lacked food, shelter, water, medicine, and clothing. He had sent a message of sympathy on the Fund's behalf to Prime Minister Khaleda Zia and he had had the opportunity on May 1 to meet Finance Minister Rahman to express his sympathy in person as well as to discuss Bangladesh's economic situation and prospects.

While the Government had initiated a comprehensive relief effort, prompt assistance from the international community was essential, the Chairman said. He was confident that Directors would agree with him that the Fund should stand ready to help in every appropriate way.

Taking into account the impact of the Middle East crisis and the severe impact of the cyclone, the staff believed that an augmentation of the access under the arrangement under the ESAF would quite likely be justified, the Chairman remarked. Scope for such augmentation existed, as access under the present arrangement was only 90 percent of quota, compared with average access of 150 percent under all arrangements under the ESAF. Of course, a precise evaluation of the damage and its impact on the balance of payments would have to be made. The scale of the augmentation could be determined after the return of the mission that was scheduled to discuss the second-year arrangement in Dhaka beginning May 10, 1991. That mission would assess the balance of payments prospects, taking into account the damage from the cyclone, prospective foreign aid inflows, and the country's adjustment policies. The mission would also look into the possibility of providing Fund resources under the emergency assistance policy. However, his feeling at present was that there would be merit in augmenting the access under the ESAF rather than in providing emergency financing. In the light of the mission's assessment, he would propose to the Board the choice of the instrument and the magnitude of further Fund support for Bangladesh.

Mr. Arora said that he tended to agree with the Chairman that in helping Bangladesh the Fund should consider augmentation of the access under the ESAF rather than the provision of ordinary emergency assistance. A

final view on that matter could of course be taken after the mission returned and more precise information about the situation in the country was available.

The staff had recently circulated a useful paper on the impact on the poverty situation of the economic reforms in Bangladesh, Mr. Arora commented. It was encouraging to note that the economic reforms that had been undertaken had had a beneficial impact on the incomes of and employment among the very poor. Of course, there was still a long way to go. The economic reforms were not complete. But if the current strategy remained in force, and if new consideration was given to the kinds of problems that Bangladesh faced, the impact would be beneficial.

Mr. Finaish made the following statement:

I wish to begin my remarks by expressing our constituency's deep sorrow and sympathy with the people and Government of Bangladesh for the devastating natural disaster which hit the country this week.

The Bangladesh authorities are to be commended for adhering to the targets of the first-year program under the ESAF in the face of an exceptionally difficult external environment and domestic political situation. It is therefore extremely regrettable that the country has once again been hit hard by a natural disaster this week. It may be too early to assess the full extent of the economic damage, but if its magnitude so warrants, it may be necessary to explore the need for emergency help from the Fund of a concessional character, such as by an augmentation of the access under the ESAF. In this connection, as the Chairman pointed out, the commitment of ESAF resources under the current arrangement is only 90 percent of quota, an amount substantially below the average level of access under a three-year arrangement. Therefore, augmentation is the best way to help this country in these circumstances.

The direct impact of the Middle East situation is estimated at approximately \$336 million in 1990/91, of which the country is absorbing one half by way of reduction in imports of goods and services through policy adjustments; the remainder is being met by additional donor support plus the proposed rephasing of ESAF disbursements. It is a matter of concern that a country as poor as Bangladesh is being required to bear fully half of the burden of a wholly exogenous external shock. This is particularly important since at least some of the consequences of a temporary event such as the Middle East crisis might well prove to have a more enduring character, especially for the budget in Bangladesh, given the need to provide cost of living supplements in order to meet the impact of higher energy, transport, and distribution costs.

In this connection, the decision to raise domestic petroleum prices by 85 per cent to a level corresponding to a world crude oil price of \$36 per barrel is a matter for concern from the point of view of the long-range competitiveness of the economy. The staff appears to acquiesce in such a large adjustment on the basis that it would "generate the targeted budgetary revenue." While not wishing to question the importance of strengthening the revenue base, I would expect the staff to keep very much in mind the necessity of protecting the competitiveness of the tradable goods sector.

The treatment of exchange rate policy calls for some comment. The staff appraisal favors a "stable nominal effective exchange rate"; earlier in the report, the staff endorses the intention of the authorities to maintain competitiveness and provide external adjustment primarily by tight demand-management policies. At another point, however, it is stated that if the expected supply response in the export sector is not forthcoming, the authorities "would try to identify measures that might be necessary to enhance the supply response, and reconsider whether further adjustment of the exchange rate might be appropriate." It is not clear whether the staff would favor the use of the exchange rate instrument in such circumstances.

It is useful to find a brief analysis of the social and environmental impact of the program and to be told that "many of the structural reform measures implemented during the first-year program are benefiting the poor." It is nevertheless recognized that changes in administered prices of public goods and services, including food ration prices, will reduce the real incomes of the poor, but not substantially. However, in a country as poor as Bangladesh, even small losses in real income can have severe effects for large numbers of the poor.

The Bangladesh authorities have consistently displayed courage in taking prompt and decisive measures to strengthen their adjustment effort and to protect the balance of payments, and thus they fully deserve the support of the international donor community. This support may well have to be augmented in order to meet natural disasters of the kind now being experienced as well as to deal with other exogenous developments. We would like to convey our fullest support to the valiant efforts of the authorities.

Mr. Al-Jasser made the following statement:

I would like to convey this chair's condolence and sympathy to the People of Bangladesh for the human tragedy that is taking place. Although the circumstances are not most opportune to



address the technical details of the program, Bangladesh's record of perseverance in the face of adversity makes me less hesitant to address them.

Over the past several months, economic policy implementation has been complicated by a series of exogenous shocks, including political uncertainty leading to a change in government along with the Middle East crisis. The most recent natural disaster is a vivid reminder of the continuous barrage of natural calamities that have plagued Bangladesh. Therefore, the authorities' continued commitment to comprehensive structural adjustment, as indicated in Mr. Arora's statement, is highly commendable, and their attempts to mitigate the effects of these shocks on the program are very encouraging. It is particularly noteworthy that prior to the recent cyclone all quantitative benchmarks for end-March and end-June were expected to be attained.

It is quite evident that recent developments have adversely affected both growth and inflation targets. The former is especially worrisome, given the low level of per capita income in Bangladesh. Moreover, the effects of the cyclone could dramatically reduce agricultural production and exert severe strains on the external position. Therefore, it is hoped that adequate emergency assistance will be forthcoming. Nevertheless, and abstracting from the dimensions of the recent catastrophe, it is clear that the authorities need to persevere in their adjustment efforts, since greater economic flexibility will enable the economy to withstand unforeseen exogenous shocks.

In this regard, it is imperative to enhance agricultural production and to diversify the industrial base. In the short run, the existing scope for increasing credit should help promote economic activity in both sectors. However, over the medium term, it will be essential that agricultural production incentives are enhanced and that industrial policy is streamlined. In the latter regard, the rationalization and dismantling of existing regulations are crucial.

In view of the tragic circumstances and the forthcoming unexpected reassessment of the program--including the fiscal content--I will not comment on fiscal policy, especially my concerns about the treatment of revenues. But I will forward those comments to the staff for their consideration during the time of the reassessment of the program.

Regarding external policies, the commitment to eliminate import restrictions is encouraging. The authorities' intention to reverse the intensification of foreign exchange restrictions is also welcome. However, I urge the authorities to unify the exchange market, particularly since the presence of psychological

incentives to channel remittances through the official markets due to the existing spread is doubtful.

The arguments presented by the staff in favor of a rephrasing of the remaining drawings under the arrangement are convincing, and I can support this proposal. Moreover, I welcome the Chairman's statement indicating his willingness, in principle, to augment the arrangement. I can support such a request and call on the staff to expedite the necessary procedures. I am glad that a mission is going soon, and I hope that something will be done in due course.

With these remarks, I can support the proposed decision.

Mr. Tabata made the following statement:

I would like to express my authorities' deep sympathy with the Bangladeshi people for the suffering caused by the recent severe cyclone. The flood damage is reported to be the worst in the country's history. The Japanese Government has already decided to provide emergency assistance to Bangladesh, with the United States, the United Kingdom, and India. I sincerely hope that international aid will be extended in a timely manner. I am pleased to hear, also, that the staff will visit Bangladesh on May 10. I appreciate this quick response to the present situation in the country.

The economic performance under the first annual program was broadly satisfactory. The authorities successfully responded to the adverse oil price developments and the decline in workers' remittances in the latter half of 1990 by taking adequate and timely corrective measures. The interim Government has maintained a tight financial stance, despite the political instability. Thus, while the introduction of the value-added tax (VAT) has met with some difficulties, the program objectives were broadly achieved. In light of the good track record and the relatively small access envisaged under the program, I do not have any difficulty with the proposed rephrasing.

Turning to the policy recommendations, I have little to add to the staff's appraisal. The ultimate objective over the medium term is to enhance domestic savings and to improve the poverty situation. To this end, the program adequately addresses structural rigidities in the public sector and external policies, along with the strengthening of macroeconomic policies. In this regard, emphasis should be placed on the rationalization of public enterprises, together with the timely adjustment and progressive liberalization of administered prices. In order to support the promotion of the private sector, it is imperative to maintain



prudent fiscal and monetary policies and to create a stable macroeconomic environment. In light of the continuing inflationary pressures, it is appropriate that the staff called for a gradual approach in relaxing credit restraints.

This being said, the unprecedented and enormous damage caused by the cyclone has placed the adjustment program at great risk. Significant difficulties are expected to arise in the program's implementation. At the beginning of today's discussion, the Managing Director mentioned emergency assistance or augmentation of the possible drawing amount under the arrangement under the ESAF. This chair supports either of these two measures.

With these comments, I support the proposed decision.

Mr. Mirakhor made the following statement:

I would like to join the Chairman and other Directors in extending my authorities' deep sorrow and sympathy, as well as my own, to the people and the authorities of Bangladesh for the devastating consequences of the recent disaster. I would like also to support the Chairman's position on the augmentation of ESAF resources; over the years, such events have played an important role in diverting much-needed resources away from growth and development. I strongly believe that the international community has an obligation to help Bangladesh in providing a long-term solution to insulate the country from the adverse effects of natural disasters. In this context, the World Bank, along with the Fund, must step up efforts with financial and technical assistance to assist the authorities.

Turning to the matter at hand, as was stated in Mr. Arora's helpful statement, the Bangladesh economy was seriously threatened by the Middle East crisis early in the first year of the ESAF program. The balance of payments came under pressure due to sharply reduced workers' remittances and a higher oil import bill. The budget was confronted with the prospects of revenue shortfalls and additional public expenditure. Nevertheless, a second consecutive year of agricultural growth and a prompt policy response appeared to have protected the external position and maintained financial stability. The retail petroleum prices were raised by 85 percent to the then prevailing international oil price of \$36 per barrel while the increases in profits from domestic sales of petroleum products were transferred to the budget, thus offsetting lower import duty receipts, and public expenditures were retrenched. In addition, monetary restraint, combined with cutbacks in commercial food imports and other measures reducing current external payments, contributed importantly. All quantitative performance criteria for

end-December 1990 were met by a wide margin, as was the structural performance criterion.

Again in early 1991, economic activity was disrupted by political disturbances surrounding the change in Government, thereby dampening investment and imports. However, the interim authorities maintained financial discipline in order to protect the external position. Despite lower petroleum prices and an acceleration in public capital spending (matched by additional revenue through improvements in collection), industrial production remained sluggish.

In 1990/91, real growth is expected to be 1 percentage point below the annual program target of 4.7 percent, while inflation is likely to be somewhat higher. However, the external payments position remains vulnerable because of lower remittances from workers abroad. Therefore, additional highly concessionary assistance is required if the country's needs are to be met without unduly weakening its debt-service capacity. Taking into account the unforeseen events and the prompt and decisive response of the authorities, this chair supports the authorities' request for an increase of the amount to be made for the second disbursement under the first-year arrangement through a rephasing under the existing arrangement.

For the remainder of the ESAF program, the staff and the authorities should consider the original policy objectives and target achievable in terms of both reducing financial imbalances and accelerating the pace of reform. Real growth is expected to be 4.5 percent annually over the next two years. The budget deficit is to remain broadly at 6.5 percent of GDP through a series of revenue-enhancing and expenditure-restraint measures while adhering to the public investment target, facilitated by the completion of the prioritization exercise. Faster growth in private investment is to be encouraged through industrial deregulation and simplification of foreign investment guidelines. The external current account deficit, targeted at 6 percent of GDP, is expected to be financed by concessionary external assistance, although there is uncertainty surrounding commodity aid. These projections, however, appear to be quite sensitive to the underlying assumptions. For instance, if aid disbursements were unchanged in real terms, rather than increased by 5 percent annually, higher deficits in the external current account could not be sustainable and stronger policies would have to be pursued.

The central issue confronting the authorities is not just to protect the external position but also to accelerate growth. While the annual target growth of 4.7 percent appears modest, it compares with about 3.5 percent achieved during 1983/84-1989/90. In a country with a population growth of 2.4 per annum, even this

modest target envisaged in the ESAF program barely allows per capita income (of less than \$200) to increase by about 2-2 1/2 percent a year.

Low growth is a consequence of low investment and saving rates, neither of which have shown a fundamental shift in trend. During the 1980s, gross investment averaged below 12 percent of GDP; private investment weakened in the latter half of this decade, while public investment was trapped at around 5.5 percent of GDP. The issue, therefore, is to raise the level of investment and domestic savings in order to generate growth and maintain a viable external position.

All the Fund-supported programs, including the arrangement under the ESAF, have concentrated on raising the level of public investment. The poor performance of public investment was attributed to the shortfall in domestic savings due to inadequate tax revenue and the poor financial performance of public enterprises. It was believed that liberalization of the external sector, combined with fiscal restraint, would raise output and, hence, domestic savings. This appears to have been the underlying idea behind all the Fund programs in the 1980s. This argument, however, did not fully recognize a connection between domestic savings in the presence of restrictions in the domestic economy and the liberalization of the external sector. Indeed, opening up the external sector will only have a limited impact on output and export diversification when the domestic economy is encumbered with restrictions. In such a situation, domestic private investment will be unable to respond adequately to the expansion intended by the liberalization of the external sector. Diversification will be further limited by a restraint on public investment. Consequently, policy measures to increase public sector saving are likely to have only a limited impact.

Until recently, Bangladesh had a host of domestic restrictions, such as price regulation of key commodities, and industrial and investment licensing. Despite some liberalization of the external sector in the 1980s, private investment was restrained, declining from 7.5 percent of GDP in 1980/81 to 5.9 percent in 1987/88. Consequently, growth in nonagricultural output and imports was much less than expected by the external sector liberalization efforts. Thus, it is not surprising that tax revenue, which depends heavily on imports, showed no upward trend; in real terms, imports declined in 1980/81-1982/83 and 1985/86, although the decline in 1990/91 was due to the Middle East crisis, and nonfinancial public enterprises performed poorly. Indeed, the meager improvement in domestic savings resulted primarily from domestic private saving since 1982/83.

Against this background, rationalization and dismantling of the existing investment regulation, the completion of import liberalization, and encouragement of foreign investment as called for under the ESAF program are sound structural measures. These need to be implemented as soon as possible. In particular, dismantling of investment licensing and regulations should be carried out immediately if tax reform is to be successful in raising the revenue ratio to 9.7 and beyond. Tax effort must focus on streamlining tax administration in order to reduce lags in collection of taxes. Elimination of all domestic restrictions in the next year or so are expected to enhance domestic savings over the years and, hence, raise investment even if, as the authorities anticipate, a reduction in commodity aid materializes in 1990/91-1992/93.

In Bangladesh, the key to real growth is agriculture and export diversification, as well as enhancing investment efficiency. Substantial progress is being made in the area of agricultural policies. Procurement prices are being realigned with market prices, and the private sector's role in the distribution of agricultural inputs is being strengthened. These efforts, however, must be supplemented by investment in infra-structural and institutional developments in order to enhance competition. Simultaneously, diversification efforts need to be buttressed by the promotion of export marketing and information facilities as well as the development of credit lines with foreign buyers. Investment is expected to increase as the effects from these policies work through the economy. In this context, the simplification of investment regulations should encompass a complete dismantling of investment licensing. Such a move, combined with a new foreign investment code, is expected to attract foreign capital. These measures, together with a rationalization of the tax system, can enhance investment efficiency.

Finally, I wish to make an observation about the high level of real interest rate in Bangladesh. During most of the 1980s, the real rate on one-year deposits was around 4-5 percent. Despite the positive real rate, domestic savings have remained low. Does the interest rate work in the same way in low-income countries as it is supposed to work in middle- and high-income countries? Or, can interest be an effective instrument of resource mobilization and allocation when there are restrictions on domestic investment, as in Bangladesh? In such circumstances, is it possible that high real interest rates may deter investment more than encourage saving? It would be of much interest if the staff could look into these issues and come up with some analysis of the implications of high real interest rates on investment, savings, and growth in the developing countries.

Ms. Miakovic made the following statement:

Like other speakers, let me start by expressing our sympathy to the Bangladesh authorities on the recent tragedy suffered by their people, and in particular the loss of human lives as well as the number of people left homeless by this most recent natural disaster. It is difficult, if not impossible, in these circumstances, to stand back and offer concrete advice on what might be expected in the period ahead, when the precise dislocative effects are as yet unknown, although additional time will bring with it greater knowledge of the impact and of the extent to which the program and its targets or emphasis need to be adjusted and revised. The Fund mission to Bangladesh to take place shortly will I hope make us better placed to reassess the situation in greater detail with a view to offering additional assistance through the available instruments.

Looking back on performance over the first half of the first-year arrangement under the ESAF, while the news has not been all good, we believe that the authorities deserve to be commended for the tight financial policies and structural reforms implemented to date. We believe that the fact that the program has remained broadly on track to date notwithstanding the adverse impact of the Middle East crisis on oil import prices, workers' remittances, and loss of export markets, can be taken as a positive sign of the authorities' resolve. We note that output is now projected to be lower, inflation higher, and the current account deficit larger than targeted, but the shortfalls appear fairly moderate and the reasons for them put forward in the staff appraisal acceptable.

The new tax measures and strengthening of tax administration are welcome developments and have been successful in lifting the ratio of revenue to GDP. The authorities are to be commended particularly for their decisive action in mitigating the impact of withdrawn revenue measures and increased expenditures associated with the Middle East crisis through compensatory revenue measures and tighter controls on budget expenditures.

It is disappointing that a number of fundamental issues of long standing remain to be resolved. Of critical concern is the poor investment performance that has long characterized Board discussions of Bangladesh's programs. The latest paper gives no indication of further substantive developments. With the slower than expected progress in preparatory work on the prioritization of the public investment program, and with disbursements of funds based on projects under this plan, it is doubtful that the strong development expenditure will be forthcoming in the second half of this year. Poor implementation capacity and poor policies have in the past depressed public investment performance and stood as a major stumbling block to strong growth. With the latter now

corrected, it is essential that the former be urgently addressed. More generally, I suspect that both the staff and the authorities are too optimistic with respect to their investment target for the year.

It is disturbing that implementation of the VAT continues to be delayed, and I hope that the new deadline can be observed.

The importance of raising national savings has often been highlighted in the past. In this sense, it is disturbing that the estimate of national savings as a proportion of GDP in 1990/91 has been revised downward and represents only a moderate increase over the 1989/90 ratio. While a more substantive budgetary effort would assist and should form part of increased savings, the fall largely reflects a sharp decline in private savings. The reasons put forward by staff are no doubt correct, but there is little doubt that private savings could be raised by further financial sector reform. We welcome the progress that has been achieved to date in this area and the issuance of a Bangladesh Bank security, and we agree that it should do much to facilitate development of a short-term money market and to permit open market operations. We note with concern the continued, albeit lower, interest rate subsidy provided by the Government for priority lending and the authorities' intention to reduce this subsidy, but we believe that it should be removed completely.

On the point of subsidies generally, we remain in favor of their removal as soon as possible, not least because they represent an opportunity cost in terms of other budgetary areas where money could be more appropriately spent, including social programs and development.

We continue to believe that the forecasts for the external sector are optimistic. In addition to the concerns raised before on export volume growth, which is projected to increase in 1991 by less than the 8 percent average growth per annum over the program previously envisaged, and on aid disbursements in view of poor implementation capacity, there are now further uncertainties associated with the effects of the Middle East crisis. The sensitivity of the projections to alternative assumptions outlined in the report makes it clear that a number of not insignificant downside risks put into doubt the sustainability of current account deficits in the short to medium term and therein carry implications for, if anything, the pursuit of stronger policy efforts. With that in mind, discussions on steps to ease financial policies could be precipitate in the current circumstances.

Finally, we hope that the exchange market is unified in line with the authorities' current intentions, and that the authorities continue to make progress on the removal of all quantitative import restrictions.

In view of the effect of the Middle East crisis and the measures taken by the Bangladesh authorities, we can support the proposal to increase the amount of the second disbursement under the first-year arrangement under the ESAF through a rephrasing of drawings.

Mr. Abbott made the following statement:

On behalf of my authorities, I would like to express our sincere sympathy to the people of Bangladesh for the terrible loss they have suffered as a result of the recent cyclone. Bangladesh has suffered more than its share of natural disasters, but this is a calamity on an epic scale. We will be working closely with the Government of Bangladesh to provide all assistance possible. I am told that a team from the U.S. Agency for International Development has already been sent to Bangladesh to coordinate our assistance and to examine what further support can be provided.

The Bangladesh authorities are to be commended for their disciplined management of macroeconomic policy over the last year. The adverse effects of the Middle East crisis and the spike in oil prices were well contained by prompt fiscal actions and firm control of monetary policy. As a result, the program under the ESAF remains on track and the economy is positioned to benefit from a waning of external economic disruptions. The demonstrated capacity of the authorities to take timely and decisive corrective actions reinforces our confidence in their commitment to the objectives of the program under the ESAF.

We are pleased that substantial progress has been made on all of the first-year objectives for the program. The program objectives are well focused, generally requiring specific actions rather than comprehensive or radical reforms. We believe that it is essential that the objectives be fully implemented. The quantified fiscal, monetary, and exchange objectives all appear to be firmly on track and well within program limits. On some of the objectives that are more qualitative, however, reinforced effort seems to be in order. This is particularly true of the annual development program, where clear prioritization has been a longstanding problem and where progress under the program has been slow. Development assistance is too important to the economy of Bangladesh to allow this part of the program to slide. Likewise, progress on reducing subsidies is reported to be slow. We believe that it would be useful in the next review to establish specific

targets for the reduction and elimination of individual subsidies. The objectives for public sector enterprise reform also are cast in fairly general terms. Steps toward full-cost pricing are reported and are probably steps in the right direction, but there is little indication in the report of movement toward significant real reform of the public enterprises.

At several points in the review, it is stated that important objectives of the program are to strengthen the private sector and increase domestic saving and investment. We support these objectives, but it is not entirely clear which elements of the program will further these goals. Domestic savings rates are quite low in both the public and private sectors. Budgetary improvements apparently would allow greater self-financing by the Government of incremental public investment, but what can be done to improve the availability of saving for private initiative? While there is discussion of efficiencies in public enterprises, there is little discussion of reduced scope of activity by the public enterprises or outright privatization. Subsidies appear to be pervasive, but the program emphasis seems to be on rationalization rather than elimination of these numerous distortions. While we fully support the improved public sector management required under the program under the ESAF, we would encourage the authorities to consider more radical reforms of some of their interventionist policies. We fully support Mr. Mirakhor's lucid comments on the need for vigorous action to improve the supply-side functioning of the economy. I would appreciate any further thoughts the staff has on how a vigorous private sector could be encouraged and how higher savings rates could be achieved.

The staff estimates that the Middle East crisis imposed additional external financing requirements on Bangladesh totaling \$336 million in 1990/91. Half of this is to be absorbed by reduced imports through measures already implemented. The other half of the costs would be financed. Of this financing, half would be sought in increased donor support, and it is proposed that the other half be provided by a rephrasing of drawings under the three-year arrangement under the ESAF. This would involve disbursing an additional SDR 57.5 million in the first year, with drawings in the next two years reduced proportionately. We think that this is an entirely appropriate mix of financing and adjustment. Although a CCFF drawing might have been possible, we agree that the lower cost and longer maturities available under the ESAF make the proposed acceleration of disbursement preferable. In this regard, we can also support the Managing Director's proposed strategy for responding to the present emergency.

We support the proposed decision.

Mr. Goos made the following statement:

Like previous speakers, I should like to begin by expressing my deep sympathy to the Government and people of Bangladesh on the enormous destruction, human suffering, and loss of life inflicted by the recent cyclone. I am hopeful and, indeed, confident, that the international community, including my own country, will promptly respond to the Prime Minister's appeal for immediate assistance. And in this regard I should also like to associate myself with the Chairman's comments on the possible role of, and assistance to be provided by, the Fund.

Having said that, I, like Mr. Al-Jasser, found it somewhat difficult to discuss developments in, and the prospects for, Bangladesh in the sort of technical terms we commonly use here in the Board because of the lack of a sense of the potential repercussions of the recent catastrophe on the economic outlook of Bangladesh, and particularly the validity of the program targets. Staff comments on the situation would be helpful; I appreciate that such an assessment from this distance is very difficult and that a mission will visit the country shortly to provide a clearer picture.

But having said that, I should also like to welcome the much-improved policy implementation under the current program as compared with the experience under previous arrangements. I was particularly pleased to note the additional measures that were taken to mitigate the effects of the Middle East crisis. I think that it is very encouraging that, with those measures, the program has been kept broadly on track.

As to the further adjustment tasks and needs, I can endorse the thrust of the staff appraisal and I would stress in particular the staff's cautioning against premature easing of financial policies. Apart from the uncertainties in the external situation, this advice is also well taken given the background of the still high inflation rate and the continued strong expansion of broad money, which is worrying and which in coming years is projected to consistently exceed the growth of nominal GDP. The growth orientation of the program does not justify, and would not be compatible with, an easy monetary policy stance--indeed, quite the contrary.

The staff's cautioning against an easing of financial policies is also appropriate in view of the slower than expected supply response of the private sector to the reform efforts, and it has assumed additional relevance in the wake of the destruction of the cyclone. Even in the present tragic circumstances, I feel that, rather than easing financial policies, the authorities should redouble their efforts at reform and promotion of the



private sector, especially because, as previous speakers have stressed, even without including the effects of the destruction, much remains to be done. This applies notably to the rather slow progress in rationalizing the existing regulatory framework and improving the conditions for domestic and foreign direct investment which are so critical to the development of the private sector.

In that regard, I would hope--and this remark is prompted by an observation in Mr. Arora's statement--that the potential benefits of these efforts will not be undermined by undue emphasis on the objective of securing a more equitable income distribution. There might be a potential conflict there. This concern, to be sure, is to some extent understandable, considering the high share of the population living below the poverty line or even below the subsistence level. But in view of the alarmingly strong population pressure--which, according to some observers, might result in a doubling of the population within the next 30 years--a vigorous and uncompromising promotion of private sector activity would appear to offer the best approach to poverty alleviation.

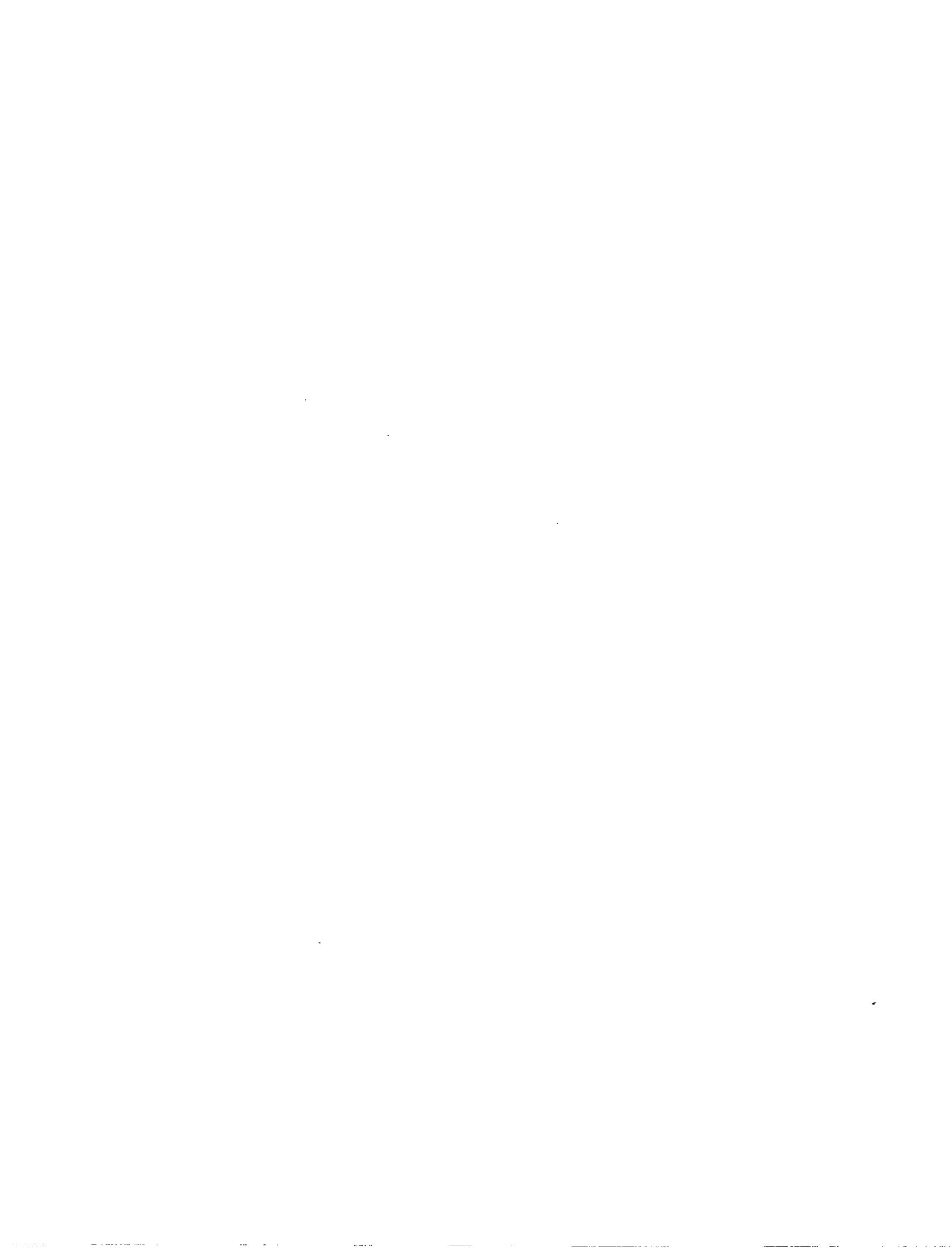
In the same vein, I would encourage the authorities to accelerate the pace of reform of public enterprises and to persevere in their efforts at improving tax collection from those enterprises. Progress in that area would appear to be of particular importance, given that only marginal improvement in the budgetary position is expected in the coming years.

Finally, I was pleased to note the authorities' emphasis on maintaining stable exchange rate relationships and promoting external adjustment primarily through appropriate demand-management policies. But I found their decision to further postpone the unification of the exchange market somewhat unfortunate in view of the urgent need to enhance the efficiency of the use of the available resources.

With these observations, I can support the proposed decision.

Mr. Toé said that he, like previous speakers, wished to express his deepest and heartfelt sympathy to the people and the authorities of Bangladesh for the natural disaster of unprecedented proportions that had struck the country and inflicted a heavy toll, including heavy loss of life and great damage to the economic and social infrastructure.

He wondered whether the staff appraisal, which he broadly endorsed, as well as the main objectives of the program, had not been overtaken by the tragic developments, Mr. Toé continued. In view of the magnitude of the damage caused by the cyclone, it was clear that Bangladesh, with its limited resource base, would find it difficult to meet by itself the challenges of



adjustment and to mitigate the suffering of the population. It seemed that the authorities would also find it difficult to implement in the time frame agreed many of the policy measures envisaged under the program under the ESAF.

In the circumstances, it would be appropriate for a mission to visit Bangladesh as soon as possible to review the objectives and measures outlined in the program and make the adjustments necessitated by recent developments, Mr. Toé considered. He was therefore pleased to note from the Chairman's statement that a mission would be departing soon for Dhaka to assess the situation and make appropriate recommendations to the Board. Finally, he wholeheartedly supported the authorities' call on the international community to swiftly provide the assistance needed to help alleviate the human suffering. As to Fund assistance, the seriousness of the situation appeared to be clearly established, and, therefore, emergency assistance would have been in order. In that respect, he supported the Chairman's proposal for an augmentation of access under the arrangement under the ESAF. Finally, the proposed decision should be approved.

Mr. Cirelli made the following statement:

At the outset, I would like to ask Mr. Arora to convey to the authorities of Bangladesh the deep sympathy and sorrow of my authorities for the very dramatic circumstances that they are facing today.

Under these circumstances, as several speakers have noted, it is difficult to comment on the program. But I wish to associate myself with the positive assessment expressed by the staff concerning the authorities' management of the first year of the arrangement under the ESAF. It is especially encouraging that, despite the adverse consequences of the Middle East crisis, they have managed to keep the program on track: all of the quantitative targets and most structural performance criteria, with the exception of the introduction of the VAT, were met.

This achievement is especially commendable since Bangladesh's economic situation remains fragile and vulnerable to external shocks. The measures promptly adopted by the authorities to offset the impact of the Middle East crisis, including the full pass-through of the oil price increase and new fiscal revenue measures, have proved efficient in limiting the deterioration of the current account. Therefore, I have no difficulty in approving the proposed rephrasing of the arrangement under the ESAF. I am also prepared to consider with an open mind an increase in the access under the arrangement or use of emergency assistance.

Turning to the program itself, I am very much in agreement with the staff and will only make a few brief comments. First, on macroeconomic policies, the utmost attention must be paid to the



fiscal accounts, where the maintenance of strict discipline is necessary in order to leave the necessary room to increase the level of savings and investment. Therefore, the objectives of raising revenue by 1.5 percent of GDP during the program period and improving the elasticity of revenues must remain a priority. Therefore, I welcome the measures adopted by the authorities to reach the target of 9.7 percent of GDP and urge them to proceed with the implementation of the VAT as soon as possible.

The reduction of current expenditures is also an important element. The authorities will have to monitor closely developments in this area, particularly with respect to the level of the wage bill. As noted previously by several speakers, the prioritization of the public investment program will also be an important step toward more efficiency.

I have little to add to the staff's comments on monetary policy. Continued restraint on bank lending is certainly necessary, and we would caution the authorities against any early relaxation. The pursuit of the comprehensive reform of the financial sector, in collaboration with the World Bank, will also be of the utmost importance.

Second, a few words on structural reforms, to encourage the authorities to intensify their efforts in two important areas-- public enterprises and trade liberalization. Concerning public enterprises, could the staff tell us what progress has been registered in the process of rationalization, particularly in the jute sector?

Third, as regards the external sector, we believe that the emphasis by the authorities on exchange rate stability, coupled with tight financial policies, is appropriate in order to reduce external imbalances as well as the rate of inflation. At this stage, I would also encourage the authorities to unify the exchange market.

In conclusion, it is clear that the recent disaster will make the task of the authorities more difficult and calls for a reassessment of the program. In any event, an additional effort on the part of the international community is called for, and we will strive to do everything possible to take part in this effort.

Mr. Schioppa said that he, like previous speakers, wished to express the sympathy of his chair to the Government and the people of Bangladesh, who had been hit by a disaster of unthinkable proportions. He was confident that the international community would respond quickly to the appeal of the Prime Minister of Bangladesh, so as to minimize the effects of the disaster.

He broadly agreed with the staff's views on the performance of the country under the first-year program, and he supported the Chairman's view that additional assistance from the Fund could be provided in the context of the arrangement under the ESAF. The authorities' commitment to the objectives of the program was commendable, and the proposed decision should be approved.

Mr. Hogeweg said that he, too, wished to express his deep sympathy to Bangladesh in connection with the recent disaster. He was pleased that the upcoming discussions with the authorities would assess the impact of the cyclone on the balance of payments, and he welcomed the intention to possibly augment access under the three-year arrangement rather than to apply the ordinary emergency assistance policy. The introduction of the staff paper noted that, at the time of approval of the arrangement under the ESAF, the Board had stated that, in the event of a recurrence of natural disasters, additional concessional aid and intensified adjustment efforts would be necessary.

Approval of the current midterm review was certainly in order, Mr. Hogeweg considered. In spite of the large impact on Bangladesh of the Middle East crisis, the authorities had managed to keep the program basically on track. By forceful and prompt adjustment measures, around half of the direct impact of the crisis could be offset. Of the amount to be financed, the proposed rephasing of ESAF access would cover around half. The proposed increased access in 1991 was fully justified in the context of the response of the Fund to the Middle East crisis agreed upon in 1990.

The caution expressed by the staff with respect to the new authorities taking some additional stimulative measures was fully justified, Mr. Hogeweg commented. Some stimulation might be consistent, as the staff had said, with the growth orientation of the program, although he had thought that that orientation meant that the program would be conducive to growth by creating appropriate conditions by way of structural adjustment and maintenance of macroeconomic equilibrium, which was of course a very different matter. As he understood it, the program targets provided room for such a stimulus. However, when the targets had been set, they had not taken into account the additional adjustment undertaken in response to the Middle East crisis. Would use of the remaining room under the targets in those circumstances not mean that part of the additional adjustment was in a sense reversed? If so, what would that mean for the mix of adjustment and financing for 1991 as a whole? Finally, with respect to the promotion of external adjustment, he agreed with the emphasis of the authorities, endorsed by the staff, on tight demand management, a balanced macroeconomic framework, and the supply side, rather than on exchange rate flexibility.

Mr. Wright made the following statement:

I, of course, join earlier speakers in offering profound sympathy for this latest catastrophe to afflict Bangladesh. I would also join others in commending the authorities for acting

promptly to keep the program on track last year when, the combination of the Middle East crisis and domestic political uncertainties threatened to undermine it. The new Government will need to continue these cautious policies--which have received generous support from the international community--even in the much more difficult circumstances that the authorities now face.

I can support the proposed rephrasing of the ESAF access; this is entirely appropriate given the impact of the Middle East crisis. I am also sympathetic to the suggestion that the arrangement be augmented for the reasons outlined by the Chairman, and I agree that we should decide on the amount once the staff has a better perspective on the implications of the disaster for Bangladesh's economic prospects and the scale of international emergency assistance.

In the wake of the cyclone it is inevitable that the authorities will find themselves heavily preoccupied with reconstruction and alleviating the terrible suffering that has been wrought. And this will clearly complicate economic management in the near term; it would be plainly unrealistic to pretend otherwise. However, it remains essential for Bangladesh's long-term development that the authorities not lose sight of the necessity to press ahead as quickly as possible with structural reforms: dismantling the pervasive and inefficient public sector and removing unnecessary restrictions on trade and inward investment which have hampered the growth of the private sector.

These reforms are well articulated in the staff report; recent developments will make it harder to achieve them, I am sure, but they remain no less valid, and very briefly I would stress just four of them. Fiscal adjustment is clearly the cornerstone, as most others have pointed out, and in view of the undoubted pressures on the budget, I hope that the authorities will look carefully at the scope, identified in a recent staff working paper to which Mr. Arora has referred, for improving the targeting of poverty alleviation. And whatever the findings of the recent pay commission, the authorities must avoid increases in the public sector wage bill on a scale which would pre-empt resources for higher priority spending. I note in this connection that the cost of living allowance has already been increased by more than the rate of inflation.

Greater urgency also needs to be given to the reform of public enterprises. I have not too much to add to what others have already said about this, except to say that the new Government should not delay taking steps to put public enterprises onto a commercial footing, including tackling endemic overstaffing in some enterprises, and so pave the way for their privatization in the not-too-distant future.

The third area of the program I would like to mention is trade liberalization. I welcome the steady elimination of quantitative import restrictions, but this must, of course, be accompanied by lower and more uniform tariffs if the economy is to benefit. I would be interested to hear the staff's views on the progress that has been made in this area, and on what more could be done to remove the restrictions and regulations on inward investment.

Finally, I was pleased to see that some headway has been made with financial sector reform. Much will now depend on how energetically debt recovery is pursued and on the authorities' willingness to phase out interest subsidies. In view of the earlier speakers' comments, particularly Mr. Mirakhor's, on real interest rates, I would be interested to hear the staff's comments on the effects of high real interest rates. Perhaps they could preface these with an account of what the structure of effective real interest rates is actually like in Bangladesh; that was not clear to me from the paper, with the existence of interest rate subsidies. Finally, I support the proposed decision.

Mr. Adberibigbe said that his chair wished to express its deep sympathy to the Bangladesh authorities for the human and material losses suffered as a result of the recent natural disaster in the country. He hoped that the international community would rise to that sad occasion by providing needed assistance to ameliorate the impact of the disaster.

He commended the Bangladesh authorities for their commitment to the adjustment program under very difficult circumstances, Mr. Adberibigbe continued. In particular, he applauded the timely manner in which the authorities had strengthened and adjusted policy measures to mitigate the adverse impact of the Middle East crisis on the economy. They should stay the course of their adjustment efforts and take additional economic measures as necessary, particularly in the fiscal and structural areas.

The international community should support their adjustment efforts by providing necessary financing in a timely manner, Mr. Aderibigbe stated. In that connection, the proposal to augment and rephase Bangladesh's drawings under the current arrangement under the ESAF was welcome. Finally, he supported the proposed decision.

Mr. Chen said that his authorities would like to convey their deep sorrow and sympathy to the Bangladesh Government and people for the heavy loss of life and physical damage suffered as a result of the recent cyclone. He hoped that, with the help of the international community, the authorities would be able to overcome their present difficulties shortly. In addition, he appreciated the Chairman's remarks at the start of the discussion and supported his efforts in the direction that the Chairman had mentioned.



He still considered that the ongoing program was a strong and appropriate one, Mr. Chen commented. The Bangladesh economy had suffered a series of external, as well as internal, disturbances, including natural disasters. Most of those factors were beyond the control of the authorities and would have a strong negative impact on the implementation of the ongoing program. He appreciated the efforts already undertaken by the authorities to mitigate as much as possible those adverse effects, and he was pleased to learn from the staff that the targets under the first-year arrangement had been broadly achieved. At the present particular time, the authorities should be encouraged to intensify their adjustment efforts to bring about a successful conclusion of the arrangement under the ESAF. Therefore, the proposed decision should be approved. Any slight slippages that might occur should be looked at within the context of those unfavorable external factors, as well as the overall natural environment, in the first phase of the arrangement under the ESAF. The recommended rephrasing merited the Board's support.

However, he still wished to join the staff in emphasizing that the authorities needed to further their efforts to implement those structural reforms which had been delayed for one reason or another, Mr. Chen continued. Much needed to be done before the program could achieve a satisfactory outcome.

Finally, he wished to stress that the external shocks and natural disasters that Directors had been concerned about on previous occasions had once again adversely affected the economy of Bangladesh, Mr. Chen commented. Therefore, without timely and necessary concessional aid, and further intensified adjustment efforts on the part of the authorities, the program would still be in danger of being thwarted.

Mr. Noonan made the following statement:

I would like to associate this chair with the general expressions of sympathy and support for the people of Bangladesh. It is indeed lamentable that the satisfactory performance during the first year of the arrangement under the ESAF, and the prospects for further adjustment, have been overshadowed by the devastation caused by the recent cyclone. We are pleased that the Chairman has been able to indicate the Fund's proposed response so quickly and we support the course of action he has in mind.

We are in general agreement with the staff's appraisal and support the proposed decision. My comments therefore are limited to a few points.

The first of these arises from the calculations in Table 9, which suggest that the current account impact of the Middle East crisis was \$160 million. On the other hand, the staff's most recent estimate of the current account indicates a deterioration of only \$90 million compared to the program. We were puzzled by



the difference, and we were struck by the coincidence that the difference of \$70 million corresponds to the expected shortfall in external aid disbursements for 1990/91. I understand that such a shortfall would not be compensable under the Fund's policy for responses to the Middle East crisis. However, we inferred from the data in Tables 8 and 9 that the difference is due to a decline in imports, over and above that explained by the impact of the Middle East crisis and the authorities' policy response. The staff may wish to elaborate on the reasons for this additional decline in imports, which may reflect the lower than programmed growth and the associated continuing restrictions on investments referred to by Mr. Mirakhor.

A reference to a shortfall in external aid disbursements is not exceptional in staff reports. I wonder whether the shortfall referred to arises from circumstances that are special and unique in the case of Bangladesh, or whether, given that Bangladesh is not a unique example, that experience may be indicative of a more widely applying set of circumstances. If it is the latter, then it may be necessary to anticipate such delays in aid disbursement in program design.

My third point concerns the proposed VAT. The staff reports that the introduction of the VAT--a structural benchmark under the program--has been delayed until the coming fiscal year, but the staff notes that preparations are well underway. While we would agree that it is crucial to have the necessary administrative procedures worked out and fully in place, we would encourage the authorities to avoid any undue delay.

We have read that the VAT is supposed to be revenue neutral. Given the relatively modest yield of the present tax system and the apparent difficulties in tax administration, we would also encourage the authorities to ensure that exemptions are strictly limited, so as to maximize the self-policing properties of the new tax.

My fourth point arises from the significant increase in domestic petroleum prices in response to the Middle East crisis. The latest world economic outlook discussion reviewed the arguments for the symmetric pass-through of the more recent decline in international energy prices. Nonetheless, we would recommend to the authorities that, in taking a decision on revising energy prices, they should have regard to the fact that the revenue base is otherwise extremely narrow, that it may be difficult to substitute for revenue forgone by a reduction in energy prices, and that energy taxes may represent an economically and administratively efficient source of fiscal financing.

Another point is that the discussion in the staff report is indicative of a legal environment, which is lacking in the rigorous enforcement of commercial contracts and obligations. For example, the staff reports that fiscal revenues were depressed because the gas company was unable to collect charges from customers, while cigarette companies did not pay their excise duties. It would appear that similar difficulties have been experienced in the financial sector, where "efforts are being intensified to improve debt recovery from the 100 largest defaulters for each commercial bank." In our view, the credibility of the authorities' adjustment program will be strengthened if they ensure that commercial contracts and obligations are respected.

Finally, in light of the apparent damage by the cyclone to loan-financed projects, I would be interested in learning whether there is any insurance cover on such projects, or whether the cyclone will leave Bangladesh with both badly damaged physical structures, which no longer can remunerate their loan finance, and the liability to service the loans for those original structures.

Mr. Fridriksson observed that once again Bangladesh had been struck by a natural disaster. Like other speakers, he wished to express his chair's deep sympathy and hope that the international community would respond appropriately to alleviate the immediate difficulties facing the country and the suffering of its people.

It was difficult to discuss the program in detail on the present occasion, and he would be brief, Mr. Fridriksson continued. He was in broad agreement with the staff appraisal. Performance under the ESAF had been satisfactory. He particularly commended the authorities for strengthening the adjustment effort in 1990 in response to the adverse effects of the events in the Middle East. Furthermore, he was pleased to note that the authorities intended to maintain competitiveness and promote external adjustment primarily by relying on tight financial policies.

Nevertheless, the gradualistic approach which his chair had criticized in 1990 continued to concern his authorities, Mr. Fridriksson said. After facing the immediate difficulties arising from the recent catastrophe, for which exceptional assistance was clearly required, he was afraid that an intensification of the adjustment effort would be needed. He was referring, in particular, to fiscal policy, but in addition a further reallocation of public resources from subsidies to productive investments was necessary.

In conclusion, he wondered whether the staff would care to comment on the potential financial implications of the devastation caused by the cyclone and on policy measures which would need to be taken to ensure the continuation of progress under the ESAF program, Mr. Fridriksson remarked. He had taken note of the Chairman's opening comments and would favorably

consider an appropriate Fund response, once the extent of the damage and the balance of payments impact had been assessed. He supported the proposed decision.

The staff representative from the Asian Department said that, with regard to economic developments in 1991 prior to the cyclone, there had been an expectation that, despite all the efforts that had been made, there would be a shortfall in growth from the program targets. As a result, non-oil imports were expected to be lower than programmed, which--in response to Mr. Noonan's point--was the main reason for the difference between the direct impact of the Middle East crisis on the balance of payments and the smaller effect on the current account outcome for the year as a whole.

As to the effect of the cyclone on the economy, the staff's information at the moment was extremely limited, the staff representative continued. There would be an immediate impact on the budget, both in terms of additional expenditure for relief and a reduced ability to collect taxes. There was also extensive damage to the food crops, which would require some additional imports immediately, and other types of immediate relief goods would have to be imported. Reserves were adequate in combination with the assistance that had already been promised by the donor community to meet the country's very short-term needs, including the SDR 100 million available upon the completion of the current review. The main problem in the next few weeks would clearly be implementation capacity rather than a shortage of funds.

An important task of the mission to Dhaka in the coming days would be to make a preliminary assessment of the damage and the financing needs, the staff representative went on. The authorities had already asked the UNDP, in conjunction with local representatives of various aid agencies, to start that assessment, and the Fund resident representative would be participating in those discussions. The staff expected to be able to come to a reasonable preliminary assessment in time for the Paris aid group meeting scheduled for May 29-30, 1991. While clearly all the officials in Bangladesh would be preoccupied with the cyclone over the coming weeks, the Finance Minister had said, during his recent visit to Washington, that he was keen to assure the Fund that the new Government was strongly committed to the new program. The coming mission to Dhaka should be able to make considerable progress in discussing the 1991-92 budget framework and updating the policy framework paper. Obviously, there would have to be some modifications to the program, but the Government clearly remained absolutely committed to pursuing reforms and all the other major elements of the program.

The budget, of course, including resource mobilization, was crucial, the staff representative commented. The staff had been assured that the VAT would be introduced on July 1, 1991. The delay in its introduction earlier in 1991 had been caused partly by political developments in Bangladesh. In addition, however, there was considerable preparatory work involved, and the time needed for that work had been underestimated. Very thorough preparations had now been virtually completed, with the assistance of the

Fiscal Affairs Department advisor, who had been a resident in Bangladesh for the past two years. Therefore, the staff did not consider the delay to be serious, and it was confident that developments in the coming year would make an important contribution to broadening the tax base.

The authorities were also examining the possible introduction as soon as possible of a pre-shipment inspection and duty assessment of imports, the staff representative explained. Having those measures in mind, the staff intended to discuss with the authorities the possible scope for a reduction in taxation on petroleum products. But the achievement of the revenue target of the program was of crucial importance, particularly in view of the shortage of local counterpart resources for the public investment program.

In the area of current expenditure, there was scope for containing wages and salaries, particularly in light of the increase that had already been given in 1991, the staff representative said. There was also scope for reducing subsidies on food, interest rates, and jute, and the staff would attempt to negotiate quantification of reductions for the next program. At the same time, there was also scope for better targeting of food subsidies and other subsidies to assist the poorer groups, and the staff would be looking at that aspect as well in connection with the next program. To the extent possible, the staff would attempt to try to offset the additional cyclone-related expenditure with cuts in other areas to try to stay as close as possible to the fiscal targets that were already in the program.

The new Government had made very clear its commitment to a more open and competitive economy, the staff representative observed. In that connection, it was well recognized that the public enterprises' performance must be substantially improved, and the staff had noted the comments made by Directors in that regard. The Government was keen to pursue a more active privatization policy, and there seemed to be scope for achieving that goal, particularly with regard to industrial enterprises. There was clearly a need to press ahead with shedding labor. Some initial steps had already been taken to reduce recruitment by the jute mills, and a rehabilitation program was being developed with the World Bank. There was a clear need for improved tax collection performance, particularly with respect to the electricity and natural gas companies. The staff would attempt as far as possible to strengthen those elements of the program.

The Government had also indicated its very strong commitment to an enhanced role for the private sector, the staff representative remarked. A comprehensive new industrial policy statement had been prepared and was being considered by the new Government. The staff expected that it would be approved quickly and would contain measures to further encourage foreign investment. The financial reforms were proceeding rather satisfactorily. The Bangladesh bank security had been introduced in December 1990, with Fund technical assistance, and the loan reclassification exercise had been completed.

As to interest rates, there were subsidies on lending to jute, agriculture, and small-industrial sectors, the staff representative noted. The rates for those loans ranged from about 8 percent to 13 percent. There were commitments in the agreement with the World Bank for the financial sector credit to progressively reduce those subsidies over time. Other rates ranged from 13 percent up to about 18 percent. It was true that real rates had been in effect for some years in Bangladesh. They had also been changed infrequently over the past decade. It was not clear to the staff where market-based interest rates might ultimately end up, but one of the things the staff would be looking for in the context of the financial sector reform was more flexibility in interest rates.

With regard to import liberalization, the commitment to pursue it had been made, the staff representative commented. In the past, the staff had focused more on removing quantitative restrictions. That effort was currently being increasingly accompanied by steps to reduce tariffs. Much of the discussion in that area was being conducted in the context of negotiations with the World Bank on the industrial sector credit. The maximum tariff rate, other than for certain luxury goods, had been reduced to 100 percent, and the objective of the industrial sector credit program would be to reduce rates to 75 percent as a maximum in 1991-92, and 50 percent as far as possible thereafter.

The exchange rate had been adjusted over the past year to return the real effective rate to approximately where it had been up until 1988, and the staff believed that the present rate was broadly appropriate, the staff representative remarked. Export performance in 1991, despite all the difficulties, had been very strong, and further gains, particularly, in garment exports, were likely to be made. The medium-term export projections were of course optimistic, but there was every indication that the supply response from the export sector would be strong if the liberalization measures proceeded. Exchange rate adjustment was certainly not ruled out in the future by the authorities; but at the present stage, the staff did not expect any immediate large change.

As to exchange rate unification, the commitment from the authorities was to achieve that goal by the end of 1991, the staff representative from the Asian Department commented. They had always been concerned about maintaining the psychological premium--even though it was very small, about 2 percent--to encourage workers' remittances. They had decided to send a study team to the Middle East to look more carefully at the procedures used by workers there to remit earnings to Bangladesh. The authorities had had a team ready to leave in the latter part of 1990, but it had been interrupted by events in the Middle East. That team currently planned to visit the Middle East in the coming several months to ensure that appropriate arrangements were in place for remittances; that explained the authorities' request for the delay until the end of 1991.

Mr. Wright noted that the staff had mentioned that some interest rates were subsidized but others were certainly positive in real terms. Had

deposit rates been similar to lending rates, or had there been a wedge between them because of the nonperforming loans of the banks?

The staff representative from the Asian Department responded that interest rates on deposits had been relatively high in real terms for several years. To the extent that rates had been subsidized on the lending side, that had been reflected mainly in the poor financial performance by the banks, especially public sector banks. One of the aims of the reforms that was being addressed in various ways was to improve the viability and financial performance of the banks. Indeed, that was a major element of the financial sector reform.

Mr. Wright remarked that that process was not likely to help with the problem of the shortage of savings. If deposit rates had been artificially depressed, there might be hope for savings to increase, but that did not seem to be the case.

The staff representative from the Asian Department commented that the savings performance had been very poor in recent months, but there had been many special factors. It would be interesting to see whether private sector savings would perform as hoped if the economy were to grow at a faster rate. That performance was a crucial assumption in the program.

Mr. Arora said that he was grateful for the expressions of sympathy and support in the context of the disaster that had befallen Bangladesh. Directors clearly hoped that the authorities would be able to keep the program on track despite the difficulties that Bangladesh faced, both in regard to the Middle East crisis and in the political area.

With respect to the future of the program, there was general agreement that the basic problem was the shortage of savings and the level of public investment, Mr. Arora said. While structural reform, the role of the private sector, and trade liberalization were all very important in terms of improving the supply response of the economy, it was also clear that, without adequate public investment, sustained both in terms of human resource development and physical and social infrastructure in Bangladesh, the supply response would remain partial and halting. Therefore, the key strategy for the authorities was to increase the level of public savings and, of course, domestic savings, because that performance in the past had kept the economy below its potential for many years. Under the program, savings would be a key factor. Therefore, the importance of public sector investment in Bangladesh should not be minimized.

As Mr. Goos had remarked, there was a conflict between equity and efficiency considerations, Mr. Arora said. Apparently Mr. Goos believed that the conflict could slow the rate of growth of the economy, and thereby potentially defeat the authorities' poverty alleviation objectives. There were, of course, conflicting views on that matter; there was considerable debate on it in the literature. Apart from the purely theoretical considerations, it was important to appreciate that, in Bangladesh and other

countries in Asia, a marginal amount of growth had to be sacrificed to maintain social cohesion and stability. The gains from that sacrifice--in terms of the ability to carry forward a program that would greatly increase the role of the private sector--were substantial. In the short term, the private sector could increase growth and thereby strengthen the capacity of the economy for pursue equity goals.

The Executive Board then took the following decision:

1. Bangladesh has consulted with the Fund in accordance with paragraph 2(c) of the first annual arrangement for Bangladesh under the enhanced structural adjustment facility (EBS/90/132, 7/17/90) and paragraph 5 of the letter of the Minister of Finance and Planning, dated July 15, 1990, attached to the arrangement.

2. The letter from the Minister of Finance and Planning, dated April 17, 1991, shall be attached to the first annual arrangement and the letter of the Minister of Finance and Planning, dated July 15, 1990, together with its attached memorandum on economic and financial policies, shall be read as supplemented and modified by the letter dated April 17, 1991.

3. Accordingly:

(a) The amount of the second loan under the first annual arrangement is increased to the equivalent of SDR 100.625 million and the amounts of the second and third annual arrangements are correspondingly reduced to SDR 57.50 million and SDR 57.50 million, respectively.

(b) The Fund determines that the midterm review specified in paragraph 2(c) of the first annual arrangement and paragraph 5 of the letter from the Minister of Finance and Planning, dated July 15, 1990, has been completed, and that, notwithstanding the nonobservance of paragraph 2(b)(i), Bangladesh may proceed to request the disbursement of the second loan under the first annual arrangement.

Decision No. 9724-(91/64), adopted
May 3, 1991

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/91/63 (4/24/91) and EBM/91/64 (5/3/91).

3. ISLAMIC REPUBLIC OF IRAN - EXCHANGE SYSTEM -
EXTENSION OF APPROVAL

The approval for the retention by the Islamic Republic of Iran of certain exchange restrictions and multiple currency practices, granted under Executive Board Decision No. 9483-(90/104), adopted June 29, 1990, is extended until August 30, 1991 or the completion of the 1991 Article IV consultation with the Islamic Republic of Iran, whichever is earlier.

Decision No. 9725-(91/64), adopted
May 1, 1991

4. SWITZERLAND - MEMBERSHIP - GOVERNORS' VOTE

The Executive Board approves the report of the Secretary (EBD/91/71, Sup. 2, 4/24/91) on the canvass of votes of the Governors on Resolution No. 46-2, with respect to membership for Switzerland, approved by the Executive Board (EBM/91/40, 3/20/91) for submission to the Board of Governors. The Governors' vote on the Resolution is recorded as follows:

Total affirmative votes		920,883
Total negative votes		0
Total votes cast		920,883
Abstentions recorded	0	
Other replies	0	
Total replies		920,883
Votes of members that did not reply		29,142
Total votes of members		950,025

Decision No. 9726-(91/64), adopted
April 24, 1991

5. STAFF RETIREMENT PLAN - AMENDMENTS

The Executive Board approves recommendation of the Pension Committee concerning the amendments to the Staff Retirement Plan, as set forth in EBAP/91/98 (4/23/91), with the dates of effectiveness set forth in EBAP/91/98, Supplement 1 (4/27/91).

Decision No. 9727-(91/64), adopted
April 30, 1991

6. THE GAMBIA - TECHNICAL ASSISTANCE

In response to a request from the Gambian authorities for technical assistance in the central banking field, the Executive Board approves the proposal set forth in EBD/91/130 (4/26/91).

Adopted May 1, 1991

7. JAMAICA - TECHNICAL ASSISTANCE

In response to a request from the Jamaican authorities for technical assistance in the area of the exchange system, the Executive Board approves the proposal set forth in EBD/91/120 (4/23/91).

Adopted April 26, 1991

8. MADAGASCAR - TECHNICAL ASSISTANCE

In response to a request from the Malagasy authorities for technical assistance in the monetary field, the Executive Board approves the proposal set forth in EBD/91/128 (4/25/91).

Adopted April 30, 1991

9. MONGOLIA - TECHNICAL ASSISTANCE

In response to a request from the Mongolian authorities for technical assistance in the central banking field, the Executive Board approves the proposal set forth in EBD/91/131 (4/26/91).

Adopted May 1, 1991

10. STAFF MEMBER - LEAVE WITHOUT PAY

The Executive Board approves the proposal set forth in EBAP/91/99 (4/24/91) concerning an extension of leave without pay for a staff member.

Adopted April 29, 1991

11. STAFF MEMBER - LEAVE WITHOUT PAY

The Executive Board approves the proposal set forth in EBAP/91/101 (4/25/91) concerning an extension of leave without pay for a staff member.

Adopted April 30, 1991

12. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 90/89 through 90/97 are approved.

13. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/91/97 (4/23/91), EBAP/91/102 (4/25/91), and EBAP/91/106 (4/30/91), by Advisors to Executive Directors as set forth in EBAP/91/97 (4/23/91) and EBAP/91/102 (4/25/91), and by an Assistant to Executive Director as set forth in EBAP/91/104 (4/27/91) is approved.

APPROVED: November 26, 1991

LEO VAN HOUTVEN
Secretary

