September 21, 1982

To: Members of the Executive Board

From: The Secretary

Subject: Final Minutes of Executive Board Meeting 82/34

The following correction has been made in EBM/82/34 (3/22/82):

Page 32, last para., last line was omitted and should read:

"function in the interest rate. He noted that the authorities had taken"

A corrected page is attached.

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Taking up the question of the potential use of Fund resources in Bangladesh, Mr. Erb observed that, given the fragile and long-run nature of Bangladesh's external financing requirement and the temporary nature of Fund resources--including even those made available under the extended Fund facility--the Fund would have to be careful to make sure that Bangladesh was able to service its relatively short-run obligations to the Fund. Although the Fund's financial resources could be helpful in special cases, in his view there was a limited financing role for the Fund in Bangladesh. Aid donors in particular would have to recognize that it was they who would have to provide long-term assistance; they ought not to press the Fund to use its temporary resources as a substitute. He feared that in response to the current effort by the Fund and the World Bank to provide donors with background on Bangladesh's external financing problems, the potential donors in turn might press the Fund to commit more money.

Perhaps what might be best, Mr. Erb concluded, would be a series of individual stand-by arrangements calling for short-term macroeconomic policies consistent with investment and structural adjustment actions that could be part of a long-term development assistance program. The financial resources made available under the Fund's stand-by arrangement would preferably not be drawn; rather, they would be available to meet major unexpected developments that were not caused by government actions. In brief, the Fund's financial resources would serve as a shock absorber instead of being considered part of the external assistance to be expected by Bangladesh.

Mr. Polak commented that the staff had clearly described the difficult situation of Bangladesh, together with its causes and the policy adjustments that were needed to overcome the difficulties in the longer run. He agreed with the views put forward in particular by Mr. Hirao and Mr. Taylor. Nevertheless, he would comment, along lines similar to those followed by Mr. Kharmawan, on the relations between Bangladesh and the Fund. The staff had said little about the prospects for the interrupted extended arrangement, which was after all one of the largest entered into by the Fund and which put strong emphasis on structural adjustment and investment. The staff had mentioned the areas that deserved special attention over the next few years, but it was not explicit about the efforts that ought to be made either to bring the existing arrangement back to life or to start work on a new arrangement between the Fund and Bangladesh. The worsening current account situation made it clear that matters would become increasingly difficult for the Bangladesh authorities; an arrangement was also clearly increasingly necessary. It was perhaps surprising, and in some ways satisfying, that Bangladesh had been able to borrow $200 million from commercial banks, but it was not in that way that the authorities would overcome their difficulties. Great importance ought to be attached to the Fund's exploring every avenue for coming to terms with the Bangladesh authorities. While the outlook might be bleak, the Fund had after all concluded an extended arrangement with Sri Lanka in 1979 and with India in 1981. There was no lack of evidence that the authorities in Bangladesh were quite willing to consider the adjustment measures that were necessary; they had indeed undertaken many of them already. The present situation was by no means one that had to be considered hopeless because, for instance, the authorities had an entirely different view from that of the Fund. There ought to be a thorough dialogue between the Fund and Bangladesh on provisions for a suitable arrangement, and he hoped that it would lead to conclusions.

Mr. El-Khouri stated that he was impressed with the contents of SM/82/41, and especially Section III on pages 15 to 20. That type of presentation helped Executive Directors to identify the basic issues facing an economy. Bangladesh was only one of a number of countries that had entered into an extended arrangement with the Fund in recent years, and then run into problems of implementation, Mr. El-Khouri noted. One of the difficulties encountered during the period of an arrangement was that the performance of the economy during the program period was dependent on certain assumptions regarding foreign aid inflows, the terms of trade, and other factors beyond the authorities' control. When the assumptions were fundamentally altered, the authorities found that, in order to meet the performance criteria, they would have to undertake a much greater adjustment than had originally been expected. It might, however, well be impossible politically to carry out the new measures. It was not that the authorities did not wish to adjust, but that the required magnitude of adjustment became greater than had been expected. That was what had happened, at least in part, in Bangladesh. Table 1 on page 3 of SM/82/41 showed that foreign aid had declined by 6 per cent in 1980/81 instead of rising by 21 per cent as foreseen in the program. For 1981/82 foreign aid was now estimated to increase by 2 per cent instead of the programed increase of about 9 per cent. The terms of trade had deteriorated substantially both in 1980/81 and in 1981/82, to a much greater extent than had been projected in the program. In those circumstances, how much adjustment could be expected of an economy that was not only poor but also had a limited resource base?

The staff noted what the authorities had already done in the way of adjustment and listed what it itself believed was still required, Mr. El-Khouri observed. So far as the investment program was concerned, the authorities had scaled down the size of the development budget for 1981/82, but little was said of the staff opinion about the desired size of the 1982/83 development budget. He would appreciate some clarification on the point.

He agreed with the staff that there was a need to stimulate private investment, Mr. El-Khouri said. However, the staff was arguing that one way to stimulate private investment was through increased interest rates, on the grounds that the higher rates would lead to a rise in private savings, which would in turn stimulate private investment. On previous occasions he had frequently said that he doubted the validity of that type of argument for the developing countries in general, and for the Muslim developing countries in particular. Even for developed countries, it was questionable whether private investment could be made a positive function in the interest rate. He noted that the authorities had taken