NOT FOR PUBLIC USE

MASTER FILES
ROOM C-525

INTERNATIONAL MONETARY FUND
0404

Minutes of Executive Board Meeting 93/163

3:00 p.m., December 1, 1993

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	A. A. Al-Tuwaijri
	M. Sirat
	J. A. Solheim
	F. Moss, Temporary
H. Fukui	
K. P. Geethakrishnan	L. E. N. Fernando
J. E. Ismael	
	K. Link
	R. Ferrillo, Temporary
A. Kafka	
	E. V. Kotova, Temporary
	E. Quattrociocche, Temporary
	J. M. Abbott, Temporary
	A. Galicia, Temporary
A. Mirakhor	
	J. Mafararikwa, Temporary
	J. Dorrington
	R. Meron, Temporary
	A. R. Ismael, Temporary
	R. Von Kleist, Temporary
	Y. Y. Mohammed
	N. L. Laframboise, Temporary
	Y.-H. Lee, Temporary
	Wang Y. Temporary.
A. G. Zoccali	
	J. M. Abbott, Temporary

A. Leipold, Acting Secretary
C. P. Clarke, Assistant

Also Present

IBRD: N. Ramachandran, South Asia Regional Office. External Relations: S. J. Anjaria, Director. Fiscal Affairs Department: B. J. Clements, E. M. Sunley. Legal Department: P. De Boeck. Monetary and Exchange Affairs Department: D. C. Hardy. Policy Development and Review Department: A. Singh, J.-Y. Wang, K. Watanabe. Southeast Asia and Pacific Department: K. Saito, Director; D. Buyantogtokh, M.-H. Duprat, J. Hicklin, L. M. Koenig, D. J. Robinson, B. J. Smith. Advisors to Executive Directors: M. A. Ahmed, P. Cailleteau, P. A. Merino, N. Toé. Assistants to Executive Directors: T.-M. Kudiwu.

1. EXECUTIVE DIRECTOR

At Seminar 93/5 (12/1/93), the Chairman welcomed Ms. Lissakers as Executive Director for the United States.

2. BANGLADESH - 1993 ARTICLE IV CONSULTATION, AND ENHANCED SURVEILLANCE

The Executive Directors considered the staff report for the 1993 Article IV consultation with Bangladesh, together with Bangladesh's request for enhanced surveillance (EBS/93/174, 11/11/93). They also had before them a background paper on recent economic developments in Bangladesh (SM/93/245, 11/23/93).

Mr. Geethakrishnan made the following statement:

> At the outset, I would like to convey the appreciation of my Bangladesh authorities for the very constructive role that the staff has consistently played in its numerous dialogues with my authorities. The staff's assessments of the emerging trends in Bangladesh have always been precise and correct, and its suggestions quite pragmatic. The report that we are considering today sets out in clear terms the progress that my authorities have made in implementing the various macroeconomic consolidation and structural reform measures and also their plans for the immediate future. Given this excellent summary--I join my authorities in complimenting the staff on the high quality of the report--I need to supplement only a few areas with further information.
>
> The macroeconomic management and stabilization measures have laid the foundation for sustainable higher growth of the economy and reduction of oppressive poverty. The medium-term strategy is characterized by the need to stay the course of reform and, indeed, accelerate the process in some key areas. The economic policies proposed for the immediate future conform to the higher growth scenario discussed in the staff report. My authorities recognize that domestic savings and investment have remained below targets. They, however, expect that continued reforms in some of the important areas will start yielding positive results in stimulating domestic investment and enhancing factor efficiency. Liberalization of the trade and investment and foreign exchange regimes, comprehensive reform of the financial sector, structural reform of major public sector organizations, divestiture of public enterprises, and pursuit of prudent fiscal and monetary policies are indeed enhancing the overall efficiency and external viability and competitiveness of the Bangladesh economy. My authorities' endeavor is to create an enabling environment for market forces to determine the flow of resources to relatively more efficient labor-intensive productive activities.

I would like to briefly touch upon reform in a few select areas. In the area of financial sector reforms, strengthening the financial position of the banking sector becomes crucial for supporting the growth strategy projected for the medium term. For this, the problem of outstanding debt has to be resolved. Under the proposed Jute Sector Restructure Project, a portion of the jute sector's debt is proposed to be restructured. Banks have also launched a scheme for reducing bad and intermittently performing loans, which act as a drag on banks' ability to respond to market changes. The Government has provided necessary support to the banks for augmenting their capital base and loan loss provisions. In order to further increase the resources of the banks, the Government has also issued various negotiable bonds in their favor. Financial loan courts have been set up and measures have been taken to strengthen their functioning and effectiveness. Reform of various commercial laws, including the Company Law, the Bankruptcy Act, and so on, is under consideration. In the areas of banks' capital adequacy and loan classification, much progress has already been achieved. Loan classification regulations are under review of the central bank.

Steps have been taken to improve the supervisory capability, and to strengthen the credit and investment management as well as the macroeconomic analysis wings, of Bangladesh Bank. A new performance planning system has been introduced in the Nationalized Commercial Banks along the lines of management by objectives. Other improvements include streamlined procedures, computerization of basic accounting statements, and a credit risk analysis system. Improved on-site and off-site bank supervision by the central bank is in the process of implementation. A Credit Information Bureau has been set up in Bangladesh Bank to serve as a continuous source of information on bank lending activities. The loss-making branches of the Nationalized Commercial Banks are being rationalized. Various other measures are being undertaken to reduce wasteful expenditures and introduce modern personnel management and recruitment policies. The boards and managements of banks are being made accountable, consistent with the liberalized environment.

Structural reforms in public enterprises, consisting of restructuring, downsizing of capacity, retrenchment of surplus staff and labor, and reduction of costs, are being vigorously pursued. The process has already been initiated in the jute, textiles, steel, and engineering industries. Alongside the voluntary employee separation program in the public sector, under which over 15,000 employees have already left in the current fiscal year, my authorities are devising a social safety net program in the form of credit support schemes to enable the affected employees to invest their compensation funds productively in cottage and small-scale enterprises. In addition, in furtherance of the objectives of effective decentralization of administrative and financial authority, and of improving management efficiency and accountability in the public sector, public enterprises are being restructured as public limited companies, wherever necessary, under a holding corporation setup. This will promote company share transfers through the stock market. Sectors such as power, gas, telecommunications, and so on with high growth potential are also being corporatized, and the capital of operating companies is being structured so as to facilitate their privatization in phases. An important element of government policy in this area is to associate private sector/consumer representatives in the operation of major public utilities. It is hoped that these measure will, inter alia, significantly contribute to the development of the capital market and the broadening of capital formation in the country.

With the establishment of a Privatization Board with the requisite legal, financial, and administrative authority and the further streamlining of procedures, the process of privatization of public undertakings will be accelerated. A number of other measures have also been taken to promote the growth of the capital market in Bangladesh. These include fiscal incentives, deregulation, updating and rationalization of securities and exchange legislation, and the establishment of a statutory regulatory institution in the Securities and Exchange Commission. The establishment of a credit insurance scheme to give a much-needed fillip to investment in small- and medium-scale industries is also under active consideration by my authorities.

On the fiscal side, my authorities have been quite successful in restraining the growth of current expenditure below the nominal GDP growth rate. At the same time, revenue performance--both tax and nontax--has been in line with the targets and structural benchmarks despite a significant reduction in tariff rates. This has been due mainly to the improvement of tax administration and measures taken to expand the tax base, prevent tax evasion, and improve tax compliance. This has facilitated the reordering of priorities and the allocation of more resources to social sectors and other priority areas. It may be mentioned that over the past three years, the domestic contribution to Annual Development Program funding has increased from below 20 percent to over 30 percent.

One other aspect to be stressed is the fact that the flow of investments to rural sectors such as agriculture, agriculture-related activities, and other labor-intensive activities in the rural area is growing. My authorities attach high priority to the development of these sectors. Grameen Bank, which targets the landless rural and urban poor in labor-intensive activities, is receiving significant government assistance. Enabling private sector institutions and organizations to play a more active and vigorous role in areas of human resource development and poverty alleviation is an important component of the Government's development strategy.

Mr. Mirakhor made the following statement:

The economic performance of Bangladesh under the enhanced structural adjustment facility (ESAF) has been excellent. Significant progress has been made in macroeconomic stabilization, inflation has fallen to its lowest level in two decades, and the balance of payments position has been strengthened. All quantitative performance criteria have been met. Progress in the structural area has also been satisfactory, although, given the complexity of the task, there have been areas where implementation has been somewhat slower than expected.

While much has been accomplished, and in some areas the economy has actually overperformed, the issue of repeated shortfalls in growth performance is still with us. Indeed, the failure to achieve even modest growth targets seems to have become a recurrent feature. There is a very real risk that unless Bangladesh can engineer a breakthrough onto a higher growth path, a "frustration of expectations"--as the staff calls it--could set in and undermine much of the progress that has been made. The staff report has focused on this vital issue in its appraisal, underscoring the urgent need to enhance the vitality of the economy. The authorities' program for 1993/94 represents a comprehensive and major undertaking, focusing on structural reforms. However, some concerns remain to be addressed, the most important of which is the interest rate issue. This chair has repeatedly called for a deeper and more comprehensive look at the question of high interest rates in the context of low demand for credit. We continue to believe that while delays in implementing key aspects of the authorities' program of structural reform have been a factor in the sluggishness of economic activity, the persistence of high interest rates in Bangladesh has had a dampening effect on investment and is perhaps an immediate cause of low growth. Clearly, this is a matter of great concern, and one would have expected the staff report to have contained a more detailed analysis of this issue, especially after the extensive discussion that took place in the Board during the review under the third arrangement for Bangladesh under the ESAF.

Turning to the reform agenda, public enterprise reform remains critical to the adjustment effort. While progress was made in implementing restructuring plans for the jute, power, and railways sectors, these efforts need to be extended as rapidly as feasible. We have sympathy with the recent wage award given to public sector employees--this being the first adjustment in pay since 1989. However, the impact on the enterprises' financial position could be significant and would have to be offset through sustained efforts at raising efficiency and productivity. Substantial progress continues to be made in reducing the excess labor force in key public sector corporations. We welcome these steps and hope that in addition to the resources being set aside from the budget to cover these costs, sufficient funds are available from external sources to retrain and redeploy displaced workers. It is important that the public acceptability of the need for retrenchment--a remarkable accomplishment in a low-income country such as Bangladesh--not be lost through an insufficiently funded social safety net. Progress on privatization should also be helped by the removal of procedural and institutional problems. We join the staff in urging the authorities to redouble their efforts in this area.

In the external sector, we agree that Bangladesh's exchange rate policy has served it well. However, the authorities will need to keep the appropriateness of the exchange rate under close review if external viability and competitiveness are to be maintained. The staff had, in the report on the third annual arrangement for Bangladesh, indicated its intention to analyze in greater detail the impact of exchange rate policies in a broader, regional context. It was disappointing to note the absence of any reference to such an analysis in either the staff report or the background paper.

Let me say a few words on Bangladesh's post-ESAF relations with the Fund. During the previous meeting on Bangladesh, the Board was told that "the authorities expressed keen interest in a continuation of Fund support for the upcoming more ambitious phase of their reform program." A number of Directors expressed support for such an arrangement. The staff report now says that the authorities have, instead, requested that their program for 1993/94 be monitored under the enhanced surveillance procedure. No explanation is given in the report of reasons for this decision. In my view, Bangladesh would seem to be an excellent and deserving candidate for further Fund financial support. While moving to a stage of monitoring under enhanced surveillance following successful completion of an ESAF arrangement should be seen as a sign of strength, my concern is that the absence of commitment of financial resources by the Fund is likely to be misunderstood by the donor/creditor community and could have negative effects on donor confidence. I make this point especially because this has been the experience of another country, namely, Ghana.

There is also the closely related issue that was raised in the more recent Board discussion on balance of payments need. While Bangladesh may at present have a relatively comfortable level of reserves, the staff's medium-term high growth scenario suggests that a pickup in activity, combined with further liberalization, can be expected to lead to a reduction in reserve cover. When combined with Bangladesh's vulnerability to large and sudden exogenous shocks, it is unclear whether the present or projected level of reserves provides an adequate cushion against such risks. In addition to being inherently deserving, Bangladesh would appear to fall into the upper range of the so-called grey area mentioned in the November 30, 1993 discussion on the ESAF successor (EBM/93/161 and EBM/93/162) and, thus, be worthy of further Fund support commensurate with a careful assessment of need. Perhaps Mr. Geethakrishnan or the staff may wish to comment on this issue.

We are pleased to support the proposed decision and wish the authorities continued success.

Mr. Fukui made the following statement:

I would like to commend the authorities for their strong efforts to implement economic reform measures since 1985, in close consultation with the Fund, and for having recorded a good macroeconomic performance, including the containment of inflation and the reduction of external imbalances.

I also welcome the authorities' decision and their new initiative to prepare a full-fledged economic and financial program for 1993/94 and to request the Fund to monitor the program under the enhanced surveillance procedure, even though Bangladesh does not have a balance of payments need. In particular, we note that this monitoring program is as specific as the third annual arrangement for Bangladesh under the ESAF. This is an appropriate approach for those countries that are on a graduation course from the ESAF but whose economies have structural weaknesses and whose economic reform is still under way. The benefit of this approach is quite clear, in that, first, technical assistance will continue to be provided by the Fund in a timely and effective manner; second, donors will be more confident that sound policies are being pursued; and, third, the program prepared in consultation with the Fund will give some leverage to the authorities in proceeding with economic reforms, which are not always acceptable to some political pressure groups.

That said, the most crucial thing is the implementation of the program to its full extent. I would like to emphasize above all that Bangladesh is now at a very critical point in the economic reform process, and it might lose all that it has gained in the past eight years through strenuous economic reform efforts. This is easier said than done. In view of their good track record, however, we believe that the authorities will continue, and even accelerate, the economic reform under this program.

I would like to make some brief comments on Bangladesh's economic problems.

First of all, the authorities should give the highest priority to gearing up the economy to a path of higher growth. Obviously, a mere continuation of the present growth rate will not come close to alleviating poverty. As the staff rightly points out, after nearly a decade of adjustment effort, expectations for the reduction of poverty, if frustrated, would undermine domestic support for the reform process.

On the other hand, the objective of higher growth should not be pursued at the expense of the continuance of prudent financial policies, including the containment of inflation. An acceleration of growth should be attained through the implementation of the economic reform measures envisaged in the current program.

It is obvious that the slower than expected implementation of public sector projects under the Annual Development Program and sluggish private sector activity are the main obstacles to higher growth. Priority should be given, therefore, first to public investment, as any further delay will adversely affect the confidence of the donors that provide assistance for public investment in Bangladesh, including Japan. I urge the authorities to make every effort to observe all the benchmarks on public investment stipulated in the program. I would like to ask the staff what is the main reason for this delay.

In order to stimulate private investment, reform of the financial system, public enterprises, and the trade and exchange system is of great importance. In practice, reform of the financial system, especially improvement of regulation and supervision of the banking sector, is crucial and a matter of urgency, as it is directly related to stimulating direct private investment by increasing the supply of credit and lowering interest rates through improved profitability of banks. I hope that the Fund will play a major role in this area by providing technical assistance.

Generally speaking, as the authorities themselves recognize, success in the macroeconomic area has not been fully backed up by the necessary reforms in the structural area. What is now expected of the authorities is to expedite structural reform while preserving the gains in the macroeconomic area, not only to enhance growth as much as possible but also to maintain the momentum of economic reform. Structural reform measures cannot be implemented without pain, but now is the time to tackle them, while Bangladesh is enjoying a relatively good economic performance.

However, in view of the still fragile economic structure, we cannot rule out the possibility that during the course of this effort, Bangladesh may encounter more difficulty with the external balance. In that case, Bangladesh will be required to take every measure to keep its economy on the path of steady growth, which is just emerging after a long and strenuous effort. In that context, in view of its good track record, Bangladesh will deserve timely support through the use of Fund resources.

With these comments, I support the proposed decision.

Mr. Al-Tuwaijri made the following statement:

Under its ESAF arrangement, Bangladesh has made substantial progress in achieving macroeconomic stability and external viability over the past few years. Inflation continues to decline, the external position is stronger than programmed, and the fiscal position is on target. The Bangladesh authorities deserve commendation for their perseverance in implementing a wide range of macroeconomic policies in the face of very difficult circumstances. The efforts and the results are very impressive indeed.

Notwithstanding the progress achieved so far, economic growth is still below potential and domestic savings and investment remain below target. Therefore, more rapid progress in implementing structural reform measures is necessary to accelerate economic growth and improve living standards. This is especially true in light of the country's vulnerability to external shocks and natural disasters, which could destabilize the economy and derail the Government's reform efforts. In this regard, I welcome the authorities' 1993/94 program, which is consistent with the medium-term objective of achieving a substantial increase in the growth rate while consolidating the improvement in macroeconomic performance already achieved.

During the last year of the three-year ESAF arrangement, the authorities continued their efforts in fiscal consolidation, which resulted in a further increase in the ratio of revenue to GDP as well as an additional containment of current expenditure. As mentioned in Mr. Geethakrishnan's helpful statement, these results have been due mainly to improvements in tax administration and measures to expand the tax base, prevent tax evasion, and improve tax compliance. However, the significant shortfall in spending under the Annual Development Program and the weak performance of the public enterprise sector are of particular concern owing to their effect on the level of investment.

With regard to financial sector reform, I welcome the substantial liberalization of interest rates in recent years and the steps taken to improve the regulation and supervision of commercial banks. Moreover, I am heartened by the authorities' recognition of the importance of a further strengthening of provisioning and classification regulations in order to bring them in line with international practices within two years. In addition, I welcome the intention to privatize one of the four nationalized banks and to restructure the development finance institutions. These measures should enhance confidence in the financial system and could reverse the recent deterioration in the banking system.

The external sector has also continued its impressive performance. In 1992/93, exports rose by 20 percent in dollar terms as a result of strong exports in garments, and workers' remittances increased sharply. As a result, gross official reserves rose to about $2.1 billion and the debt ratio declined further. Moreover, the authorities took further commendable steps in the areas of import liberalization, tariff rationalization, and reduction of exchange restrictions on current international transactions. In this regard, it is very important to pursue further trade liberalization, which will facilitate rapid expansion in industry and improve the efficiency of resource allocation in the economy.

The 1993/94 program is ambitious and deserves the Board's support. While consolidating the success achieved thus far, the program aims at higher growth rates supported by a substantial improvement in public investment. Needless to say, the achievement of this program depends on the continued implementation of sound macroeconomic and structural reform policies. In the case of Bangladesh, as stated by the staff, without a significant acceleration of reforms in key areas, constraints on growth are likely to remain. This being said, however, Bangladesh continues to maintain its impressive record of policy implementation and cooperation with the Fund. Its continued efforts to improve the living standards of the population warrant our encouragement and support. Therefore, I welcome the Fund's involvement in the form of post-ESAF enhanced surveillance.

Finally, I support the proposed decision.

Mr. Dorrington said that the authorities should be commended for the reforms that had been implemented, which had led to the maintenance of macroeconomic stability in recent years. The record was clearly set out in the staff report, and he fully endorsed the staff appraisal. However, like the staff and earlier speakers, he was particularly concerned about the disappointingly low growth rates and the repeated failure to reach investment targets, particularly under the Annual Development Program.

Better implementation of the Annual Development Program would be vital both to achieve targeted growth rates and to maintain and increase aid disbursements, Mr. Dorrington considered. More generally, much more progress on structural reform was necessary. Particularly important was the implementation of a comprehensive banking reform program, including improved regulation, capital adequacy, and supervision. There was also a need to remove remaining interest rate bands and floors on deposit rates. Running in parallel was the long-standing need to restructure public enterprises, many of which had nonperforming debt to the banks. He would also urge the authorities to press ahead with the privatization program, which had faltered.

Bangladesh clearly needed to continue to work very closely with the international financial institutions, Mr. Dorrington remarked. The multilateral development banks would be taking the lead in many areas, but he supported continued Fund involvement in developing and monitoring the reform efforts, which for the time being needed to be effected through the use of the enhanced surveillance procedure. He agreed with the staff's assessment, however, that it was questionable whether the reforms currently planned for the coming year--welcome as they were--would be sufficient to move Bangladesh to a higher growth path. Bangladesh needed to accelerate structural reforms to the extent that would be necessary to satisfy the conditionality of an ESAF arrangement, namely, to make and implement plans that were ambitious but realistic. In his view, although the program for 1993/94 was worthy of monitoring under the current guidelines for enhanced surveillance, it certainly would not bring the same comfort to donors, creditors, or potential investors as a program that could pass a higher test. In that context, it should be clear that the key issue was the strength of the program rather than the presence or absence of financing. Apart from the obvious implications for the level of poverty in Bangladesh, further delays in taking decisive action could also put at risk the present relatively stable macroeconomic position.

Bangladesh had taken some welcome steps to liberalize the exchange system in 1993, Mr. Dorrington noted. Nevertheless, exchange restrictions remained, and he urged the authorities to stick to their timetable for removing them. In that connection, he wondered whether the authorities intended to move promptly to Article VIII status after the removal of those restrictions; whether consideration had been given to making acceptance of the obligations of Article VIII, as well as the removal of restrictions, a structural benchmark; and, given that there was a reasonable timetable for the removal of the exchange restrictions, why the proposed decision did not provide for Fund approval of those restrictions until June 30, 1994.

Mrs. Kotova made the following statement:

> As I fully concur with the staff appraisal of developments in Bangladesh under the ESAF arrangement, I want to compliment the authorities in particular for their successes in macroeconomic stabilization. It was not an easy task, given the fact that the

general economic environment was not conducive to policies of austerity and tight financial management.

The success in the area of stabilization has not yet been translated into progress in development, although it has certainly created the necessary preconditions. Economic activity remains at a low level, as do the investment and savings dynamics. The revenue mobilization efforts are insufficient. In light of these circumstances, the relatively low budget deficit of 5.3 percent of GDP and the current account deficit of 1.8 percent of GDP, as well as the comfortable level of gross official reserves equal to six months of imports, cannot, unfortunately, be regarded as signs of qualitative economic improvements. This might even bring into question the general rationale for financial austerity, and there is probably no lack of criticism of this policy in the country. Nevertheless--and I want to stress this point--we are fully convinced that the country is on the right track, and with additional, though sizable, efforts on the structural or development front, the present adherence to tight financial policies will eventually bring about the desired economic growth and qualitative improvements. I believe that this is an important message, aimed at providing moral support to the authorities of Bangladesh, who are now following a challenging path.

However, the structural changes that need to be undertaken to translate stabilization into growth are sizable and challenging, indeed. Even then, visible improvements are most likely to be achieved--and here again, I concur with the staff's opinion--in a medium-term perspective. Almost all of the mechanisms and tools of financial and structural policies implemented to date remain quite immature. The judgment that "the necessary conditions for a sustained upturn in private business investment and activity are not yet fully established" provides a general explanation of the ongoing stagnation of the economy. Given these circumstances, I would warn the authorities against turning to other classical recipes for dealing with sluggish growth, namely, easing the financial stance for the sake of the provision of new incentives to producers. This would not work in this particular case, because what producers lack is not so much incentives but the whole range of institutions that comprise a market infrastructure, without which the private sector per se would remain for many years as it is now, in its infancy. In fact, a widening of the general government deficit to 6.3 percent of GDP, as envisaged under the program, is a worrisome symptom, because it seems to me that its beneficial contribution to growth is more doubtful than its contribution to inflation and imbalances in the public finances.

Large spreads between lending and deposit rates, a large proportion of nonperforming loans, and excessive liquidity of the banks are all features indicative of not only the weakness of the banking system, as the staff report stresses, but also of the deeply rooted, limited absorptive capacity of the economy and its weak ability to respond to the improvement in macroeconomic conditions. I would agree that part of the medium-term strategy should be a policy package specifically targeted at private investment promotion. However, I would argue that this package should comprise more measures of institution building--in the fiscal and financial sectors, market infrastructure, and communication--than of further macroeconomic adjustment. It is commendable that with no recourse to bank financing by the Central Government, and with continued adherence to the generally prudent credit policies, credit to the private sector is programmed to expand by 14 percent. It is not quite certain, however, whether this will actually allow room for the targeted increase in private investment and economic activity.

The other area of structural policies promising to contribute to economic activation is the comprehensive trade liberalization strategy, coupled with a further streamlining of the exchange system. I support the proposed decision and the general message of the staff report, urging the authorities to eliminate the remaining restrictions on payments, other transfers, as well as multiple currency practices. The rationale for their elimination is particularly strong in the case of Bangladesh. While in the short run their removal may bring undesirable difficulties in balance of payments management, the present inward-looking strategy could turn out to be detrimental for the labor-intensive and stagnant economy of Bangladesh. Opening up the economy would facilitate the assessment and capitalization of the country's comparative advantage. It would also optimize the patterns for private sector development and induce further public enterprise restructuring.

Finally, I would stress the importance of a careful prioritization of policies, as the medium-term program of reforms needs to be particularly comprehensive and challenging. Too many areas are of immediate concern. Therefore, the authorities' request for monitoring under the enhanced surveillance procedures is justified and appropriate.

Let me convey my authorities' hope that the persistent efforts of the authorities of Bangladesh in building a self-sustained healthy market economy will be rewarded in the near future, and I wish them all the necessary luck in realizing a breakthrough in economic development.

Mr. Sirat made the following statement:

Let me at the outset commend the staff for this very interesting report, which rightly concentrates on the main issue for Bangladesh, namely, growth. I greatly appreciate the candor with which the report tackles this issue. Indeed, Bangladesh is a rather peculiar case of overperformance in the macroeconomic stabilization area, and yet of a rather deceptive rate of growth, probably linked to incomplete efforts in the structural sphere. Accordingly, I will first briefly address issues related to macroeconomic stabilization before concentrating my statement on the issue of growth.

My country would like to join other chairs in congratulating Bangladesh for its macroeconomic record: under the ESAF arrangement, and despite difficult circumstances, Bangladesh has maintained the program on track and achieved macroeconomic stability. In fact, all indicators show that, from a financial point of view, Bangladesh has done more than expected under the program. Obviously, some elements of fragility remain, and the macroeconomic framework should certainly be kept under review. First, the 1992/93 reduction in the rate of inflation was partially due to a sharp and rather exceptional fall in food prices, which count for about two thirds of the consumer price index. Second, concerning fiscal policy, while the adjustment has been substantial, notably given the lower than expected foreign aid inflows, it was largely related to a level of public investment that was below target, which is certainly detrimental to growth. Third, on the external side, I share the view of the staff that the present level of the exchange rate is broadly appropriate. This being said, it is clear that the present exchange rate stability has been facilitated by a sharp increase in the level of exports, notably to the European Union, while diversification of export products and markets remains limited. Finally, the level of foreign reserves, while relatively high compared with the level of imports, should certainly remain at such levels, given Bangladesh's vulnerability to exogenous shocks, which are unfortunately relatively frequent.

The macroeconomic framework for 1993/94 follows the same path of prudent financial policy, while allowing for an increase in the fiscal deficit--notably, in connection with a substantial increase in Annual Development Program expenditures--and the current account deficit. The explicit assumption of the report is that no sustainable acceleration of growth is conceivable without prior structural reforms in a number of areas. I do not have major difficulties with these proposed reforms. Let me just make two remarks in passing.

First, cuts in nonproductive budgetary outlays--especially subsidies to public enterprises, which must be restructured or privatized--are certainly warranted, as they would allow for a highly needed increase in social spending and public investment in infrastructure. This being said, it is clear that these cuts have by and large been postponed. It is also true that they would probably have negative short-term effects. Could the staff elaborate on the existing safety net in Bangladesh and on whether an improvement in such a scheme might help to accelerate a welcome shift in the allocation of public resources?

Second, the reform in the financial area appears to be determinant. The low bank profitability owing to the worrisome level of nonperforming loans in banks' portfolios leads to a large difference between funding costs and the lending rate. It follows that intermediation drains off a great part of the monetary easing. Financial reform is therefore an utmost necessity.

This being said, the lag in implementing structural reforms is not a new issue in Bangladesh. Quite frankly, I wonder whether a mere "enhanced surveillance program" would constitute a sufficient incentive to foster their implementation. In other words, there might be some relationship between the strength of a program and the availability of resources. From this point of view, I would tend to consider--and I suspect that the donor community may also consider--the proposed one-year enhanced surveillance program as a "parenthesis" before shifting back to a full-fledged structural reform program supported by the Fund.

An acceleration of the structural reforms would certainly help foster growth in the medium term. In particular, reforms in the financial sector should probably be given a clear priority, as a good intermediation system is well known to greatly contribute to higher growth.

From a strict financial point of view, there seems to be some room for more growth, as all financial indicators are on the safe side. The report mentions a "high-growth scenario" as its central hypothesis and a "low-growth scenario" as an alternative. I wonder whether a third scenario, which might be referred to as a "very high-growth scenario," has been contemplated by the staff.

In other words, in very poor countries like Bangladesh, where it seems that the financial constraint does not in the short run have a direct negative effect on growth, where does the limitation on growth come from? In the short run, given, in particular, the current very low levels of inflation and of the current account deficit, would it have been possible to contemplate a level of growth higher than 5 percent in 1994, possibly leading to an increase in private investment? This is certainly a difficult question.

According to the report, it seems to be difficult for the authorities to enhance growth in domestic demand: interest rates are certainly on the high side, but, given the present fragility of the financial sector, a significant lowering of interest rates may not have a very positive effect. However, I note that interest rates on construction loans in particular are very high, at 13 percent. Could the staff elaborate on whether any reduction in interest rates, possibly concentrated in some specific sectors, could be contemplated?

On the fiscal side, tax revenue is rather low, at 10 percent of GDP, and no lowering seems reasonable; expenditures could certainly be raised, but it seems that the authorities face an absorption problem and are not able to significantly increase capital expenditures.

If this analysis is correct--and I would appreciate it if the staff could comment on this---then the only source of growth would be the external sector, and the authorities should seek an export-led growth path.

From this point of view, I note that the authorities have rather recently created two free trade zones. Could the staff elaborate on their impact on the level of exports? Similarly, could the staff elaborate on whether a large increase in foreign direct investment could be contemplated in order to enhance the overall competitiveness of the economy?

We have in Bangladesh a very interesting and rather unusual case, where the macroeconomic framework derives from structural factors rather than financial limitations. It is naturally a case where the World Bank can typically have a tremendous impact on growth. But our institution may play a role by supporting a macroeconomic framework that is as expansionary as possible, under a sound financial policy.

With these comments, I can support the proposed decision.

The staff representative from the Southeast Asia Department said that it was clear that the 1993/94 target for expenditure under the Annual Development Program was very ambitious and that there were quite substantial bureaucratic and implementation problems in Bangladesh, of which the authorities were very well aware. The slowdown in project implementation in 1992/93 had been due in part to the abundance of very large start-up projects. The early indications were that implementation had also been somewhat slow in 1993/94, an issue that the staff intended to raise with the authorities, as well as with the World Bank, at the time of the midterm review of the 1993/94 program under enhanced surveillance.

On the question of the social safety net, the staff had asked both the authorities and the World Bank staff during the program discussions for suggestions on how the social safety net could be improved, the staff representative remarked. As Mr. Sirat had mentioned, economic growth in Bangladesh was constrained less by a demand shortage than slow progress on structural reform. Clearly, one aspect of the problem was implementation of both Annual Development Program and social safety net expenditures. Accordingly, the staff had agreed to an increase in expenditure on the social safety net in 1993/94 for the retrenchment of workers in public enterprises, enhanced food-for-work schemes, and vulnerable groups. The staff was willing to revisit the issue with a view to expanding those programs either at the midterm review of the current program or in future programs.

It was clear that dealing with the problem of financial sector reform was crucial to removing many of the obstacles to growth in the medium term, the staff representative considered. Financial sector reform would, in the first instance, help to reduce the spread between lending and deposit rates. There were very few direct instruments at the authorities' disposal with which to affect the structure of interest rates, as most interest rate controls had been removed several years previously. In response to Mr. Fukui's question, there would indeed be a technical assistance mission to Dhaka in early 1994, and it was hoped that a long-term adviser would be in place to help Bangladesh Bank in moving to the next stage of financial sector reform.

On the exchange rate, Mr. Mirakhor had referred to the staff's work on the regional context of exchange arrangements, the staff representative recalled. Indeed, that work was well under way, and it was expected that it would form part of the background material for the 1994 Article IV consultation with India.

With respect to Mr. Dorrington's questions on the remaining exchange restrictions, the staff representative from the Southeast Asia Department said, it was indeed the authorities' intention to accept the obligations of Article VIII, but the staff had emphasized the importance of first eliminating all restrictions on current account. No specific timetable had been given by the authorities for the move to Article VIII status, although the program included a benchmark for the elimination of all remaining restrictions. In the staff's view, one of the advantages of announcing the acceptance of Article VIII was the confidence effect vis-à-vis investors, and there was little point in making that move unless the restrictions had already been removed. For that reason, the benchmark under the program did not deal explicitly with acceptance of the obligations of Article VIII.

Mr. Dorrington stated that, for the sake of clarity, he had not suggested that the authorities should accept the obligations of Article VIII before removing the remaining restrictions. Rather, he had wondered whether they planned to move to Article VIII status immediately after removing all restrictions or only after a protracted period.

The staff representative from the Southeast Asia Department replied that the authorities would want to wait for an appropriate time before announcing their acceptance of Article VIII so as to obtain the maximum benefit from the announcement effect.

With respect to Mr. Dorrington's final question, the staff had not sought approval of the restrictions subject to Article VIII for technical reasons, the staff representative remarked. In order to seek Board approval for the remaining restrictions, it was necessary to show that there was a clear timetable for their removal and that they were not discriminatory in nature. The restrictions still subject to Article VIII with respect to the bilateral payments agreements had recently been deemed to be discriminatory in nature, and therefore the staff had not sought approval for their retention. In addition, in the absence of complete information on the existing contracts entered into under the forward-cover scheme and the nonresident foreign currency scheme, the staff had not been prepared to state that there was a specific timetable for their removal.

Mr. Dorrington said that it was not clear to him how, if the staff could not be confident that there was a timetable for the removal of certain restrictions for the purpose of the proposed decision, the staff could be confident in including their removal as a structural benchmark under the program.

The staff representative from the Southeast Asia Department noted that there were very few restrictions left on current account transactions, and the staff was confident that the authorities could take the required action to eliminate those restrictions before June 30, 1993. In fact, the staff had learned that morning that the authorities had removed the restrictive elements of three of the remaining bilateral payments agreements subject to Article XIV; some further action was required to remove the restrictions on education, travel, and remittances abroad.

The export zones were an increasingly important element in the recent improvement in economic performance, and a large part of the recent upsurge in export performance was related to ready-made garments, which were produced in the export zones, the staff representative remarked. Foreign direct investment was seen by the authorities as a very important component of growth over the medium term. Although the figures were very rough, the level of such investment was currently very low, and the authorities were fully aware that they needed to undertake many of the reforms that the staff had proposed to attract further foreign direct investment.

On the more general issue of the Fund's relationship with Bangladesh, it was important to put that relationship in context, the staff representative said. The Fund's relationship with Bangladesh since the country's establishment had been a long and very effective one. In the recent past, progress under the ESAF arrangement and subsequently had been substantial and went in the right direction. As several Directors had noted, however, Bangladesh was clearly not yet out of the woods. In the circumstances of a very poor country with tremendous problems of institution building, there was a long way to go before the country would break out from the present position of pervasive poverty. Even under the staff's high-growth scenario, per capita income in Bangladesh in the first decade of the next century would still be extremely low; the question that Mr. Sirat had raised in that regard was very relevant. In principle, the staff would obviously prefer to target a higher growth rate, but it had to be realistic in the short run. Clearly, if policies were to take hold, a faster growth rate could be achieved, but the difficulties ahead and the amount of assistance required from the international community to achieve that goal should not be underestimated.

The resolution of many of the structural problems impinged directly on macroeconomic performance, the staff representative commented. Therefore, although the World Bank and the Asian Development Bank might take the lead in that area, the staff saw a continuing intensive role for the Fund in Bangladesh. The basic aim, of course, was to raise the level of the authorities' reform efforts.

On the question of balance of payments need, the staff representative continued, there were several considerations that contributed to the judgment whether there was a balance of payments need in Bangladesh. That judgment was clearly a function of the set of policies being undertaken by the authorities, and it was expected that the wide range of reforms that the staff was advocating would have an impact on the balance of payments. That would be an important consideration, particularly as private sector activity increased and growth started to take hold. It was also true that the country's economic position was somewhat incongruous with the very large nominal level of reserves, even at a time when it had essentially met most of the policy targets. In the staff's view, the slow pace of structural reform implementation had led to the current situation, which the staff expected would unwind as structural reform took hold. A further consideration, as mentioned by some Directors, was that there was clearly a need for a relatively high level of reserves in a country that was continually subject to shocks in order to give confidence to the authorities to implement the necessary reforms.

With respect to enhanced surveillance, the relevant procedure had been very useful in 1993, as the authorities themselves had recognized, the staff representative from the Southeast Asia Department said. However, it was fair to say that recent experience had raised questions in the staff's mind about the leverage that was available to the Fund in trying to encourage implementation of some of the important structural reforms.

The staff representative from the Policy Development and Review Department remarked that, as Mr. Mirakhor had suggested, the staff's assessment of balance of payments need was based on the current situation and would be subject to change, in particular in response to an acceleration of reforms. The staff would, of course, keep the matter under close review.

Mr. Sirat said that the preparation of medium-term scenarios was usually facilitated by the existence of a financial constraint; ordinarily, given the financial constraint imposed by the balance of payments, it was possible to derive the sustainable level of growth in the economy. In Bangladesh, however, the situation was different, as there did not seem to be a constraint on growth. He would appreciate further elaboration from the staff on what, in a country like Bangladesh, it would consider to be reasonably high growth.

The staff representative from the Southeast Asia Department replied that the main constraint on growth in Bangladesh in the medium term was the ability of institutions to implement projects that were in the pipeline and to radically change the financial sector and so allow the emergence of a healthy banking system to support private sector activity. There were also tremendous constraints on improving educational and health standards in the country, all of which would take a long time to resolve. It would be unrealistic, in the staff's view, to expect that a higher growth rate could be achieved in the very short run.

Returning to Mr. Mirakhor's question about the very high level of real interest rates in Bangladesh, the staff did not anticipate a fundamental solution to that problem until the health of the banking system was addressed, the staff representative stated. At present, there was a very high level of nonperforming loans, and the supervision of Bangladesh Bank needed to be strengthened. Until the restructuring of the banking system had taken place, real interest rates were not expected to fall significantly.

Mr. Mirakhor remarked that the case of Bangladesh was very frustrating. If an observer were to have considered the case ten years previously, he would have concluded that Bangladesh suffered from a classical vicious circle of low saving, low investment, and low economic growth. If an observer were to consider Bangladesh's current situation, he would reach the same conclusion. With that in mind, it was worth examining the result of Bangladesh's various Fund-supported programs over the years. On a number of occasions in the past three years he had asked in vain for some elaboration of the staff's thinking on the apparent dilemma faced by Bangladesh. There did not appear to be any evidence of financial repression, given the extent of financial sector reform, but the very wide spread between lending and deposit rates and the very low rates of savings and investment had seemingly become entrenched. In his view, the key to solving the problem of low growth in Bangladesh lay in the coincidence of low levels of savings and investment with financial sector reform.

The Acting Chairman said that the issue that Mr. Mirakhor had raised had been extensively discussed among the staff for a long time, and the staff shared Mr. Mirakhor's frustration.

The staff representative from the Southeast Asia Department stated that the problem of low savings and investment was indeed the key question in

Bangladesh, and one that was always addressed in the staff's internal discussions and in those with the authorities. It was clear that the answer lay in a shortage of demand in the economy, but the problem could not be addressed by lowering revenues, for example, which the staff strongly cautioned against; in fact, increasing the overall revenue effort would be one of the more important structural reforms over the medium term. There did appear to be some scope for increasing government expenditure, but such a move required careful implementation, as the staff was very concerned to avoid large increases in unproductive expenditures. For the private sector, the staff had tried to identify the key areas for improvement. The financial sector was obviously important in that respect, and the Fund, the World Bank, and the Asian Development Bank would continue their work in that area.

The staff representative from the Policy Development and Review Department noted that the staff's frustration with the low level of savings and investment was not confined to Bangladesh; indeed, the issue was of concern to other countries in the region as well. The very low level of foreign direct investment in Bangladesh was, in a sense, one useful summary indicator of the problem: Bangladesh was still not a very attractive country for investors. An increase in infrastructure expenditure was clearly an essential prerequisite for improving both domestic and foreign investment, which in turn was clearly a key determinant of growth. For that reason, previous programs had specifically targeted a certain minimum level of spending under the Annual Development Program, but, as Directors had noted, such spending had consistently fallen short of expectations.

Mr. Mirakhor remarked that the comments of the staff representative from the Policy Development and Review Department underlined a deeper problem: if the lack of sufficient investment in infrastructure was the key to the poor growth performance, then even full implementation of the needed structural measures would not yield sufficient savings and investment. His immediate concern, however, was to ensure that the Board was brought into the staff's internal discussions on the broader problem of the coincidence of high real interest rates and low savings in developing countries, a problem that he had repeatedly tried to address over the previous three years. In his view, the problem was critical to the growth prospects of a number of developing countries, and it should be discussed by the Board in more detail, perhaps in seminar format.

Miss Laframboise made the following statement:

The authorities have made excellent progress toward financial and external viability in Bangladesh. The reduction in inflation, the containment of current expenditures, and the buildup in reserves attest to the commitment by the authorities to macro-economic adjustment. While these efforts are duly recognized by the international financial community, we are also aware that the hardships experienced by the general population of Bangladesh have not been greatly ameliorated. For that reason, and as other speakers have indicated, macroeconomic stabilization must be complemented by thorough structural reforms so that benefits arising from adjustment can filter through the system more completely and reach all economic agents. It is essential that policy measures touch the lives of all the people of Bangladesh, so that the incidence of poverty there can be alleviated.

We would like to commend the staff for a very thorough analysis of recent developments and a comprehensive plan to build on the success achieved to date. We found the alternative growth scenarios particularly useful in illustrating the possible outcomes of different policy choices.

While we fully endorse the staff appraisal, we would like to raise one question regarding the projected increase in expenditures under the Annual Development Program. We note the numerous measures taken by the Government in 1991/92 and 1992/93 to strengthen project implementation, including the revision of procurement guidelines, decentralization of the approval process, and improved reporting procedures. Despite these measures, Annual Development Program expenditures were significantly below program targets last year. In spite of the staff's response to Mr. Fukui's earlier question about project implementation, we continue to question the growth projection for these expenditures of 22 percent this year if no additional measures to improve project implementation are in store.

Investment is expected to contribute significantly to the much-needed growth over the next two years, and a sizable part of the projected increase in this investment is expected to come from the public sector. While we would not dispute this point, an unrealistic projection for expenditures under the Annual Development Program over the near term could jeopardize the outcome of the staff's medium-term high-growth scenario. Indeed, we understand that preliminary first quarter figures for expenditures under the Annual Development Program may be suboptimal. We would encourage the authorities in their commitment to meet the Annual Development Program target within the program period.

While we commend the authorities for the progress achieved on structural reform in some sectors, we would underscore the need to press ahead with reform in the public enterprise sector and the banking sector. The time is particularly opportune in view of the recent progress achieved on macroeconomic fundamentals. The weak financial performance of state enterprises and the lack of control over their borrowing practices will continue to result in a poor allocation of available resources. Furthermore, a serious acceleration in privatization is crucial to generate efficiency gains. The dysfunctional banking system continues to hinder the participation of the private sector and threatens monetary and fiscal stability. We are pleased to hear that the exercise to assess the impact of strengthened provisioning and classification regulations is on track for end-December 1993.

Finally, we trust that the staff is assured that the pace of structural adjustment presently supported or envisioned by the World Bank and the Asian Development Bank complements the pace of reform advocated by the Fund. These programs are a critical part of the medium-term program to place Bangladesh on a higher growth path.

We feel that Bangladesh deserves the support of the Fund at this juncture. Furthermore, the features underlying the current situation in Bangladesh meet those outlined in the enhanced surveillance procedures revised in January of this year. Consequently, we support the authorities' request for monitoring under the procedures for enhanced surveillance.

Mr. Wang Y. made the following statement:

The Bangladesh authorities are highly commended for their impressive achievements in macroeconomic stability, external viability, and poverty reduction during the period of the ESAF arrangement. Restructuring and liberalizing measures were carried out in various sectors of the economy. The exchange system has been substantially liberalized, the external payments position was considerably stronger than programmed, and progress in tax reform and administration was quite remarkable, as tax receipts exceeded the target and the value-added tax base widened, given the less buoyant performance of economic growth. In the financial sector, growth in money and credit was well controlled within the program limits. As a result of the prudent fiscal and monetary policies, inflation was significantly reduced to 1.3 percent in 1992/93 and the role of the private sector has been expanded.

Despite these remarkable achievements, however, the growth and investment targets were not met, the general performance of the public enterprise sector was weak, and the financial health of the banking system remained a source of concern. According to the report, the authorities have taken some important measures, but progress has been much slower than planned. In this respect, we join the staff in urging the authorities to speed up the structural reforms, as our own experience has indicated clearly the great advantages of liberalizing, restructuring, and opening up the economy. I would be grateful if the staff could shed some light on the reasons for the slow progress in this area.

In viewing the authorities' economic and financial policies for 1993/94, the GDP growth target is very cautious. Targets for various economic variables also seem prudent and reasonable. I am impressed and encouraged by their continuing efforts to pursue a vigorous program of structural reforms in all the key economic sectors, aiming to lay the foundation for higher medium-term growth. One area that has captured my attention, however, is investment performance. The staff has made it clear that the GDP growth target is to be achieved through sharply increasing investment expenditure and a further rise in savings. I note that the authorities have proposed a substantial increase in expenditures under the Annual Development Program for 1993/94, and I am, to some extent, optimistic that private sector activity will be more active as a result of progress with reforms. In Table 1 of the report, the projection for gross fixed investment for 1993/94 is 14.1 percent of GDP, while for the current period the estimated level is already about 13 percent. I wonder whether a 1 percentage increase is sufficient to meet the growth target. It would be a pity if the pattern of missing growth targets recurred in 1994. Perhaps the staff could comment on this point.

For the medium-term perspective, I do not think the staff's high-growth "base" scenario is overambitious, but it very much depends on the progress of reforms. Next year's performance will be a good test of this and also of whether the reforms have begun to bear solid fruit.

This chair views the authorities' program implementation as generally successful, although much more was expected and remains to be done. With the current stable macroeconomic environment, we encourage the authorities to seize the opportunity to continue their firm policies and implement the program as planned, in particular in the fields of public enterprise restructuring and financial reform. We concur with the staff that "the authorities should now meet the challenge of designing and implementing a sufficiently strong and decisive medium-term policy program to put Bangladesh firmly on a higher growth path." It is very encouraging to learn about the authorities' policy intentions in the period ahead from Mr. Geethakrishnan's very clear statement. We encourage them to strengthen their cooperation with the Fund and the World Bank and to take full advantage of both institutions' expertise and resources.

Daunting tasks confront the authorities in building a solid foundation for future economic prosperity. We support the proposed decision.

Mr. Ferrillo made the following statement:

We commend the staff for presenting a critical and balanced picture of Bangladesh's macroeconomic and structural adjustment performance. Real progress has been made toward financial stability and external viability. However, structural progress has been much slower, in particular with regard to the financial sector, public enterprises, the fiscal structure, and trade policy. Not surprisingly, GDP growth persistently remains below target and potential, at a level insufficient to offset the rapid population growth.

We share the staff's view that while consolidating the good macroeconomic record, the authorities need now to significantly accelerate structural reforms. As a matter of fact, past experience shows that reliance on foreign aid inflows and prudent macroeconomic policies alone are not sufficient. One may ask whether foreign aid does not at least indirectly help to maintain very inefficient structures.

We think that the economic and financial policies for 1993/94 and the medium term are consistent with the aim of putting Bangladesh firmly on a significantly higher growth path by correcting past inefficiency. As we are in broad agreement with the staff appraisal, we would limit ourselves to specific issues.

The imperative of strong reforms of Bangladesh's chronically sick public enterprises can hardly be contested. With very high annual losses, this is definitely a luxury for such a poor country. But it would be very interesting to hear from the staff whether and to what extent privatization is an appropriate solution to the rehabilitation of public enterprises in a country where the private sector is admittedly weak and often not very competitive. As a matter of fact, the staff described a number of facts that may imply that the private sector is not yet ready to take up the challenge. Moreover, past experience with privatization indicates that, globally, the result has not been thoroughly convincing.

With respect to financial sector reform, we share the staff's view that a comprehensive reform program, aimed in particular at enhancing regulation and supervision of the banking system, is an essential step. However, we wonder whether a last and unique recapitalization of the state-owned banks would be more appropriate to free them to manage their costs and to put them in a position to meet their capital-adequacy requirements with their own resources.

Finally, the report mentions the sharp fall in food prices, especially rice, as the principal reason for the present low inflation rate. This situation reflects an abundant domestic supply, which is likely to persist in the future, as a result of an agricultural policy that puts the emphasis on food grain production. One may also mention that a sharp decrease in food prices may have adverse effects on farmers' income. Therefore, every effort has to be made to ensure that imported food aid is not contributing to a worsening of the situation, while crop diversification must get prime attention in future agricultural development plans.

With these remarks, we agree with the proposed decision.

Mr. Solheim made the following statement:

Like previous speakers, I welcome the fact that Bangladesh has made good progress under the third-year ESAF arrangement. All in all, economic developments and policies have been encouraging. As I agree with the staff appraisal and most of the views of previous speakers, I will only take up a few points. However, I would at the outset like to associate myself with Mr. Mirakhor's comment that it could be useful if more of the staff's internal discussions about Bangladesh's growth performance had been shared with the Board.

Given the very low income level and the widespread poverty, higher economic growth combined with price stability should remain the cornerstone of the authorities' strategy. In order to achieve a significantly higher medium-term growth rate and to improve living conditions, I find the macroeconomic objectives set out in the high-growth "base" scenario as a highly desirable, and appropriately ambitious, goal. This will, however, render it necessary to increase the growth potential of the Bangladesh economy through the stimulation of savings and investment and the implementation of wide-ranging structural reforms.

An increase in public investment should constitute a central element of the medium-term strategy. I fully agree with the staff's comments on this point. As the relative importance of foreign aid is likely to show some decline in the coming years, the rise in public development expenditures is to be financed by an increasing tax revenue ratio, which is still at a low level. Although private investment may be stimulated gradually by higher profits and a brighter economic outlook, the likelihood of bringing about a private investment upswing will also depend heavily upon confidence factors, as well as the general economic environment.

Accordingly, it appears essential to inject more dynamism into the domestic economy, and comprehensive reform measures should be undertaken by the public enterprises. While I have sympathy with the view that privatization should proceed at a faster pace, I would, like Mr. Ferrillo, appreciate comments from the staff on the importance of privatization per se and its likely impact on job creation versus job losses. For instance, in a recent UNDP report, it was stated that "privatization is an undesirable reduction of the role of the state in a country like

Bangladesh, where the private sector is hardly more efficient than the public sector."

The fragile situation in the banking sector gives reason for concern, and the authorities should move ahead without delay with reforms of the banking sector, at the same time as they are addressing the large proportion of nonperforming loans. Further steps to strengthen the supervisory authorities seem necessary. A sound banking system is a prerequisite for achieving sustainable higher growth, and this should also contribute to a decline in the existing large spreads between lending and deposit rates. The authorities are well advised to work closely with the World Bank on the issues of financial reform.

The authorities are to be commended for the many steps that have been taken in the trade and tariff areas. More open trade flows will have a positive impact on the medium-term development of Bangladesh's economy, and the authorities should pursue the trade liberalization process further. In this context, I concur that the existing stance of exchange rate policy appears broadly appropriate.

Finally, it is reassuring that the authorities have requested the Fund to monitor the program for 1993/94 under the enhanced surveillance procedure. In light of Bangladesh's relatively favorable balance of payments situation, I consider this as the right approach at this stage. However, I agree with Mr. Sirat and others that one cannot disregard the connection between the strength of the program and the availability of external financial resources, and a program under, for example, an ESAF successor arrangement should not be ruled out. I support the proposed decision.

Mr. A. R. Ismael made the following statement:

Like previous speakers, we would like to commend the Bangladesh authorities for the significant progress achieved in 1992/93 under the third annual ESAF arrangement. It is, indeed, remarkable that under this program all the performance criteria and benchmarks were met and the macroeconomic environment stabilized, with inflation, as measured by the consumer price index, continuing to decline. Moreover, the balance of payments position strengthened, with gross official reserves representing 6.5 months of imports. However, growth performance and investment levels have continued to be weaker than expected.

As recognized by the Bangladesh authorities, notwithstanding these commendable achievements, much remains to be done to reduce poverty and meet the challenges facing the country. In this connection, we welcome the adoption by the authorities of a program of adjustment for 1993/94 to be monitored under the enhanced surveillance procedures, as, in our view, it addresses many of the existing bottlenecks to sustained economic growth. The program is comprehensive and consistent with the objectives of attaining a higher medium-term growth path and consolidating the performance already achieved in the macroeconomic area.

As we are in broad agreement with the staff appraisal and its policy recommendations, I will limit the rest of my statement to a few comments on the real and fiscal sectors and on structural reforms.

In the real sector, the persistence of growth rates below expectations and potential is a matter of concern. While recognizing that the slower than expected implementation of public sector projects and sluggish private sector activity have contributed to the poor performance, we would note that severe bottlenecks are also constraining growth prospects. In this context, we would encourage the authorities to give more attention to the implementation of structural reforms in the key areas of the economy. We share the staff's views that any delay in undertaking these reforms would entail high risks and could undermine the confidence that the authorities are painstakingly trying to build. The measures envisaged in the program for 1993/94, especially those aimed at promoting greater private sector involvement in agriculture, market-based pricing, and reform of the financial sector, are in the right direction. However, we note that many areas are still reserved for the public sector, and we would encourage the authorities to accelerate the market liberation process, which can contribute significantly to the growth prospects.

There is no doubt that fiscal policy will continue to play a critical role in the adjustment efforts. We therefore welcome the series of fiscal measures envisaged in the 1993/94 budget, which are aimed at broadening the revenue tax base and containing expenditures. We are also pleased to note the steady increase in the ratio of revenue to GDP, and we would encourage the authorities to persevere in their revenue-mobilization efforts and to maintain the momentum of structural improvements in the tax system.

Regarding structural reforms, while welcoming the authorities' intention to pursue a vigorous program incorporating wide-ranging structural measures, we wonder whether the program is not too ambitious, given the limited technical, institutional, and financial capacity of the country and the slippages experienced in the structural area during the recent past. In the circumstances, would not a less ambitious but better-targeted program have been more appropriate? We would welcome the staff's comments on this general point. Nevertheless, we agree with the high priority that the staff attaches to the strengthening of the financial system. The reform agenda in this sector is critical to supporting higher rates of savings and the quality of investment needed to promote sustainable growth in the medium term. As many attempts have already been made to reform this sector, we can only urge the authorities to redouble their efforts and use more efficiently the various bilateral and multilateral assistance that is expected in this sector.

Finally, in light of Bangladesh's impressive track record, established during the implementation of Fund-supported programs, and taking into consideration the determination of the authorities to pursue their reform efforts, we have no difficulty in supporting the proposed decision.

Mr. Lee said that he strongly supported the analysis and policy advice in the staff report. During the three years under the ESAF arrangement, Bangladesh had made substantial improvements in macroeconomic stability despite difficult circumstances, but progress in structural reform had been much slower than planned. As a result, economic growth remained slower than desired. The current challenge was to build on gains made in recent years in order to achieve a higher growth objective, which would bring about a substantial reduction in poverty over the medium term. In that regard, he was pleased that under the 1993/94 program the authorities would continue to consolidate macroeconomic stability and undertake further structural adjustment. However, as the staff report clearly indicated, the structural reforms under the program, even if implemented as planned, would not be sufficient to attain the higher medium-term growth that the authorities were aiming for. Consequently, the authorities should accelerate structural reform in key areas, particularly the financial sector and the public enterprises. The authorities should develop as a matter of urgency a comprehensive medium-term program of accelerated structural reforms, possibly in consultation with the Fund and the World Bank. A comprehensive reform program should contain the key elements suggested in the staff report, which focused on reducing the role of the public sector in the economy and on improving the environment for private sector activity.

Mr. Abbott made the following statement:

As other speakers have emphasized, Bangladesh has had a very consistent track record over the course of its recently concluded three-year ESAF arrangement. Macroeconomic stabilization has been handled with remarkable steadiness and skill. The stabilization results have been exemplary in terms of price stability, balance of payments adjustment, reserve accumulation, and steady, moderate growth.

What has been missing has been any evidence of emerging economic vitality that might trigger the faster rates of growth that would begin to move Bangladesh away from disheartening levels of poverty. The preconditions for such a takeoff have been firmly established, but the takeoff is not emerging spontaneously. A stable macroeconomic environment has been established without accompanying structural and supply-side reforms that would help lift the economy out of its lethargic, if steady, pace of activity.

I would like to comment on just two specific areas where more vigorous policy action is clearly indicated: financial sector reform and public enterprise sector reform.

For a country of 111 million people, the financial choices available in Bangladesh are highly circumscribed. There are only a small number of banks, and these are highly concentrated in the hands of state-owned banks. There is little in the way of capital markets. Worse, the banking system, as it exists, is fundamentally unsound. About 50 percent of bank assets are effectively nonperforming.

Allowing this system to fester is highly detrimental to the efforts of Bangladesh to break out to a higher growth trajectory. The prevailing gradualist approach of trying to allow banks to recapitalize themselves through retained earnings creates a series of vicious circles that frustrates much-needed adjustments. Excessive spreads mean private initiative is handicapped, as borrowing is only justified if projects can meet an overly demanding rate of return. High borrowing rates in the open market encourage the authorities to perpetuate a system of directed preferential bank lending to sectors with political patronage, particularly agriculture and public sector enterprises. The policy preference accorded these sectors discourages prompt payment. Public ownership of the banks discourages vigorous collection and tolerates weak management. Low returns to savers discourage savings.

Comprehensive banking system restructuring is needed on an urgent basis. This should involve cleaning up bank balance sheets in such a way that new banking activity is undertaken on a stand-alone commercial basis, rather than forcing new borrowers to carry old defaulters. Some variation of a "good bank/bad bank" system is needed. Capital infusion with restructuring will be ineffective. Greater competition is essential. New entrants should be actively encouraged. This should go ahead immediately and should not be contingent upon restructuring state banks. Privatization of state banks should be pushed aggressively. It may be difficult to put these banks in a position to be sold. These banks are more likely to be shaped up if they are subject to greater competition.

Hand in hand with banking reform, there should be a prompt elimination of the preferential access to credit that now prevails. We fully agree that public sector enterprise reform will need to be part of this process, as nonperforming credits to public sector entities are a significant part of the financial problem of the banking sector. But banking reform should not wait until all the dimensions of reforming public enterprises can be knitted together. Experience shows that such structural policies take a very long time to be implemented in Bangladesh. Too easy access to credit is one of the props holding up a poorly functioning public enterprise sector. If reform and greater competition undermine the structure of this system, this should be exploited as part of the strategy of accelerating growth.

Mr. J. E. Ismael made the following statement:

Bangladesh's overall macroeconomic performance over the past year has indeed been commendable. It is within this context of achievement that I can support the authorities' view and the staff's appraisal that the present level of the exchange rate is broadly appropriate and that the nominal exchange rate stability pursued so far has had no adverse effect on Bangladesh's international competitiveness. Under these circumstances, further improvement of competitiveness should not, in my opinion, be pursued through depreciating the taka but, rather, through stepping up deregulation and other structural policies aimed at improving efficiency.

There is indeed an urgent need for increased structural reform to facilitate a higher growth rate, which so far has remained elusive. Moreover, potential sources of financing a higher growth rate are available and so far untapped, as attested to by the fact that the ratio of revenue to GDP is only 11.6 percent, which is a rather low level. At the same time, an increase in this ratio would help to reduce the projected 1993/94 budget deficit of 6.3 percent of GDP.

In concluding, like a few other Directors, I also wonder why Bangladesh has opted to have its 1993/94 program monitored under the enhanced surveillance procedure. Why is Bangladesh not offered a fourth-year arrangement under the ESAF? The fact that a program is still needed for 1993/94 shows that the structural reform efforts under way during the past three years are still incomplete, and the strong external position achieved as a result should not preclude the attainment of a fourth-year ESAF arrangement or an alternative use of Fund resources, as rightly pointed out by Mr. Mirakhor. Under the circumstances in which Bangladesh finds itself, there is no need to have what is known in commercial bank jargon as a "clean-up" period of one year before resumption of any use of Fund resources.

With these comments, I support the proposed decision.

Mr. Moss made the following statement:

Bangladesh continues to display the same economic picture as during previous Board discussions on Bangladesh: an exemplary macroeconomic performance combined with a lagging structural reform effort, which results in a suboptimal growth picture. This suboptimal performance is particularly unfortunate given the pervasiveness of poverty and of so-called extreme poverty in the country. Only by accelerating growth can employment be significantly increased and more public funds be made available to meet the health and education needs of the population. Obviously, a key role will have to be played by the World Bank to assist the country over the coming years so that it will be in a position to realize the high-growth scenario laid out in the staff report. The role of the Fund will necessarily be more limited, especially now that the country no longer has an obvious balance of payments need and enhanced surveillance is replacing program reviews.

It is worth underlining, however, that many of the structural reform measures have a direct bearing on the country's macroeconomic performance. The staff report has clearly spelled out the prime areas for structural reform: the financial sector, the private enterprise sector, fiscal reform, and trade policy reform. Let me just address two of these areas that directly relate to the country's saving/investment balance.

First and foremost, as several speakers have underlined, without financial sector reform, the following developments will no doubt occur: interest rates are bound to remain high in real terms, because of the risk premium incorporated in the holding of deposits with a not too sound banking sector; the interest rate spread will also stay high, or even go up further, in order to maintain the profitability of banks at its currently already low level; good creditors will be penalized by having to pay excessive borrowing rates to compensate banks for the quasi-fiscal burdens imposed on them by the Government; and the Government itself will continue to avoid financial intermediation by satisfying its reduced borrowing needs directly with the public. The authorities perceive a wait-and-see attitude by private investors, attributable to risk-averse behavior, but perhaps private investors are only displaying a rational wait-and-wait attitude for a long overdue overhaul of the financial sector. This assessment of the relationship between high real interest rates and low investment differs somewhat from the one offered by Mr. Mirakhor, but I agree with him that more light should be shed on the issue. In any event, I have two minor questions in this regard.

First, I was somewhat surprised to learn that private depositors demand a higher risk premium for their savings in private banks than for those in the nationalized banks. After all, as pointed out in the background paper, lending by the nationalized banks has been subject to considerable political influence, leading to a far higher rate of nonperforming loans in this financial subsector. Are private agents really expecting a complete bailout in case of trouble in the nationalized banks, or are the higher rates offered by private banks less attributable to risk factors than to unfair competition by the nationalized banks? In this context, I note that the government-sponsored National Savings Schemes distort private savings behavior by offering a very high tax-free rate of return. My second question has to do with the need for recapitalization of the banking sector. The staff report leaves open the form of such recapitalization for the time being. But would the issuance of public bonds not be a preferred option for the case of the nationalized banks, perhaps in the framework of their privatization, given the relative scarcity of such paper and, hence, the impossibility of developing a well-functioning capital market in the country?

Besides the obvious need for financial sector reform, I would like to single out trade liberalization as a second area for action. Indeed, even though the country has been following a policy of phased trade liberalization over the past few years, the staff report notes that a number of quantitative restrictions remain in place and that tariffs are still well above those prevailing in internationally competitive developing countries. It is thus not all that surprising that diversification of export products has remained limited in Bangladesh and that ready-garment exports, for example, have to rely heavily on imported textiles as their input. In this context, I wonder whether the establishment this year of a second export processing zone, geared to high technology industries, is really an optimal policy response to the need for export diversification. Studies on export processing zones, including within the Fund, have come to show that such policies are likely to fail if they are regarded as a substitute for, rather than as a first phase of, a broad-based, outward-looking policy for the economy as a whole.

To my mind, it would have been preferable to have put more substance in paragraph 28 of the 1993/94 program of the authorities in order to strengthen their intention to accelerate trade reform, especially given the currently rather comfortable level of international reserves. Export-led growth, bringing along more foreign direct investment, may perhaps be the missing trigger to move the country onto a higher growth path. Could the staff outline how it sees an accelerated program of trade reform taking shape in the next two to three years? Within such a context of stepped-up structural reform in the trade area, Bangladesh would certainly deserve access to Fund financial assistance, given the country's vulnerability to external shocks.

With these remarks, I wish the Bangladesh authorities all the best in their enhanced efforts of structural reform within a context of macroeconomic stability.

Mr. Mohammed made the following statement:

Bangladesh has clearly been well served by the ESAF and by the associated macroeconomic and stabilization measures. Most of the standard indicators--the external accounts, foreign reserves, the overall government balance, and inflation--point to a success story, for which the authorities must be strongly commended.

The authorities should, however, heed the recent staff projections, which may dampen the positive record so far established. The deficits of both the current account and the overall government are expected to worsen in 1993/94, together with a rebound in inflation. Moreover, gross domestic investment remains too low, at less than 13 percent of GDP, and the economy continues to be critically dependent on the vagaries of weather and on foreign aid.

The staff is certainly right in stressing the need for more vigorous growth than has hitherto been the case, and in advocating that the authorities should stay the course of structural reform, particularly in privatization and in dealing with the problems of nonperforming loans and undercapitalization of banks. The authorities have already accomplished much in this domain, especially in the liberalization of their exchange system and the implementation of the public sector employee retrenchment program. Also, private savings have been steadily increasing in the past few years and, more important--and as Mr. Geethakrishnan informs us in his useful statement--the flow of investment to the rural sector is growing. These are promising developments that can be consolidated only by persistent macroeconomic stabilization and structural reform measures. I support the proposed decision.

The staff representative from the Southeast Asia Department said that a number of reforms were planned to accelerate and improve the implementation of spending under the Annual Development Program. It was the staff's understanding that those reforms included further streamlining of the project-approval process, greater training and dissemination of information on new procurement guidelines, further high-level involvement in tracking and managing problems as they arose, and greater emphasis on trying to ensure continuity in project management. In addition, although the rate at which land was acquired for such projects had increased recently, the staff would raise the issue again with the authorities and the World Bank to ensure that there would be no slippage in that critical part of the program.

On public enterprises and privatization, the staff representative continued, although it was clear that privatization was not a panacea in the case of Bangladesh, there were clear efficiency gains from moving some industries from the public sector to the private sector. Indeed, the staff had tried to point out that unless some of the older industries were privatized, it was likely that the Government would be faced with widespread wage claims affecting all sectors of the economy regardless of their relative productivity. For that reason, the authorities were quite keen to move on privatization. By the same token, however, the problems of developing a fully efficient private sector should not be underestimated, such as the need to adopt and implement needed legal and labor reforms. The benefits provided to employees laid off in the retrenchment of public enterprises were fairly substantial, approaching \$5,000-\$6,000 per head in 1992, according to an estimate by the World Bank. The progress so far in 1993 on retrenchment had been quite favorable; there had certainly been no shortage of volunteers, for example, in the scaling down of the national railway.

The targeting of the reforms was clearly an issue, as the authorities could obviously not address all of the many needed structural reforms at once, the staff representative noted. The staff had tried to focus on the reform of the financial sector, public enterprises, the fiscal structure, and the trade regime, but there were clearly other areas that needed attention, which would probably be the emphasis of the multilateral development institutions.

One of the key areas of financial sector reform was the issue of competition, as was noted by Mr. Abbott, the staff representative recalled. With the staff's encouragement, the authorities were about to license a few more banks, including some with foreign participation, as one way of improving the functioning of the banking system. The overall strategy for financial sector reform needed to be addressed in the short run, however, and the staff was working with the World Bank and the Asian Development Bank toward that end. There were a number of problems with the private banks, some of them potentially quite serious, and the focus of the staff's technical assistance thus far had been on assessing the magnitude of the problems. In particular, the staff was working to raise the classification and capital adequacy standards for private banks as quickly as possible.

With respect to trade reform, the authorities had lowered the remaining quantitative restrictions on imports to a fairly low level during 1993, the staff representative commented. They planned to undertake a study to see how those restrictions could be reduced further. It was true that other countries in the region were publicly targeting a reduction in both the average level and the maximum level of tariffs, and the staff intended to pursue that matter in its discussions with the authorities.

The enhanced surveillance procedure had proved to be useful in 1993, and it was the authorities themselves who had favored the use of that mechanism to help monitor the consolidation of progress in the macroeconomic and structural areas, the staff representative from the Southeast Asia

Department stated. It was also true, however, that the staff viewed the policies for 1993/94 as a bridge to a much-needed accelerated program of reforms. As noted in the staff appraisal, there was a need for substantial preparation during the coming few months to lay the groundwork, provide technical assistance, and, equally important, obtain a consensus within and outside the Government for the far-reaching actions that could warrant Fund support in the future.

The staff representative from the Policy Development and Review Department remarked that, at the present juncture, the enhanced surveillance procedure seemed well suited to Bangladesh, after several years of strong macroeconomic performance under consecutive ESAF arrangements. The authorities were trying to garner a wider consensus on accelerating reforms. In the current period of transition, they favored a closer involvement with the Fund than would be provided by the Article IV consultation process alone. Among the instruments available, and given the staff's assessment of the comfortable balance of payments situation, the authorities had ultimately favored the enhanced surveillance procedure as a means of providing the needed confidence in policies during the transition.

Mr. Dorrington noted that although the Chairman's summing up of the most recent discussion on surveillance policy (EBM/93/15, 1/29/93) indicated that application of the procedures for enhanced surveillance would be approved by the Executive Board, no such decision had been proposed in the case of Bangladesh.

On a more general point, Mr. Dorrington continued, all speakers agreed that growth in Bangladesh had been disappointing, although there was clearly some difference of view, including among the staff, about the underlying reasons for the poor growth performance. Indeed, both the Board and the staff would admit to some ignorance in that regard. Therefore, he supported Mr. Mirakhor's point that it would be desirable to explore the issue in a Board seminar--or, preferably, in a staff seminar that would be open to the Board--in which all aspects of the problem could be exposed in an open and academic way.

The staff representative from the Policy Development and Review Department observed that a formal Board decision to approve the program being monitored under the procedures for enhanced surveillance was not necessary. The Board would endorse the use of those procedures. Such an endorsement would allow the Board to monitor the program, and in that way provide confidence in the forward movement of policies.

The Acting Chairman said that he intended to make a reference to the procedures for enhanced surveillance in his summing up of the discussion, which would have the effect of a formal Board decision.

Mr. Geethakrishnan recalled that several Directors had wondered why Bangladesh had opted for enhanced surveillance, perhaps implying that the authorities would not be implementing the necessary reforms with the same speed and vigor of the previous three years. He could assure the Board and management that it was the intention of his authorities to persevere with the reform process to the fullest extent. They had achieved a certain measure of success in fiscal and macroeconomic consolidation and in various economic and structural reforms, and they would persist with those efforts. Nevertheless, it was their perception, and that of the staff, that there would not be a balance of payments problem in the coming year. For that reason, the authorities had decided that, instead of seeking further financial assistance from the Fund at the present stage, they would request enhanced surveillance so that their reform efforts could be monitored externally.

On the lack of economic growth in Bangladesh, Mr. Geethakrishnan continued, the suggestion had been made, perhaps somewhat unfortunately, that the staff had been remiss in not concentrating on that problem during the previous three years. In his view, at the end of five or six years of adjustment and reform, the experience of the vast majority of countries assisted by the Fund had been broadly similar: successful macroeconomic stabilization, satisfactory implementation of structural reforms, but, invariably, very poor results for GDP growth and employment, the two most important economic indicators. More often than not, the rate of growth of GDP in those countries was in the range of 2.5-3 percent. In view of the fact that the population of many of those countries was growing by more than 2 percent, it was difficult to escape the conclusion that the per capita income of many countries assisted by the Fund was very close to its level at the outset of their respective Fund-supported programs. Similarly, in the absence of economic growth, the success in increasing productivity in those countries had inevitably led to a decline in employment opportunities. The consequent increase in youth unemployment created a number of problems for governments and contributed to the rise in fundamentalism.

In the case of the GDP growth rate, statistical methods existed with which to measure performance precisely, but no such precision was available to measure employment, Mr. Geethakrishnan remarked. On many occasions, he had raised the issue of employment in Board discussions on developing countries, but the response of the staff was often only to say that current data were unavailable or that the authorities were content with the employment situation, as had happened, for example, in recent discussions on Egypt and Viet Nam.

In general, by the time a country came to the Fund for support, it was already in serious financial difficulty, Mr. Geethakrishnan observed. Under those conditions, it was necessary for there to be some initial contraction in growth, thereby reducing employment. After three or four years of stabilization, however, it was reasonable for the Board to reflect on the extent to which growth and employment had been resumed and whether a policy change was necessary.

In the case of Bangladesh, the staff had held a special session during the Annual Meetings with the authorities, including the Finance Minister, on the question of how to increase growth and employment, Mr. Geethakrishnan remarked. Those discussions had not yielded any answers. Very often, growth was mistakenly equated with more resources, both external and internal. In the case of India, however, the savings ratio had consistently been in the range of 22-24 percent for two or three decades, but GDP growth had never been more than 3.5-4 percent. At the margin, the incremental capital output ratio (ICOR) in India was no less than 5 or 6, a luxury that India could not afford. The low ICOR in India was the result of both macroeconomic policy and inefficiency in implementation and administration. In many developing countries, including India, the application of a certain political philosophy had inhibited growth in several sectors, such as construction. Such decisions were largely political, however; with a stronger economic focus, it was possible that growth could be accelerated.

In his view, therefore, once a country had completed a period of adjustment--say, after about two or three years--the Board was duty bound to consider more carefully whether the appropriate policies were in place to boost growth and employment, Mr. Geethakrishnan said. Clearly, there would still be a need to continue with reform and macroeconomic consolidation, but it was also likely that additional measures would be required. In that regard, he was heartened that several Directors had raised the issue during the discussion, including the possibility of a seminar; he hoped that any such seminar would not be limited to Bangladesh, however, as the problem was common to a number of countries. He had already raised the issue with management separately, in the course of which his office had prepared extensive data that showed that most countries undergoing Fund-supported adjustment programs had been very successful, except in the areas of growth and employment.

With respect to Mr. Solheim's comments on the employment situation in Bangladesh, Mr. Geethakrishnan continued, it was true that the UNDP had made a categorical statement that in many developing countries the private sector was as inefficient as the public sector. Privatization per se did not increase employment. Indeed, he had personally experienced great difficulty as India's Finance Secretary in persuading others that, in the face of an already severe unemployment picture, further privatization was imperative. The answer to the privatization/employment dilemma lay not in slowing the pace of privatization but in freeing the economy for greater private sector participation, a view that many in the Fund and the Bank were reluctant to accept. The simplistic view, which was not correct, held that privatization resulted in a clean transfer of resources from the public sector to the private sector and, consequently, better utilization of such resources. In the absence of earlier measures to promote an efficient private sector, however, such privatization would only continue the inefficiencies and increase unemployment.

Finally, his authorities would be reassured to learn that several Directors had asked why Bangladesh had not requested further financial assistance from the Fund, Mr. Geethakrishnan commented. He understood the remarks of those Directors as an indication of their willingness to support such a request from Bangladesh. At present, his authorities did not see the need for such assistance, but if the circumstances should change during the course of the year, they would be encouraged by the degree of support that already existed for Fund support of their reform efforts.

The Acting Chairman observed that Mr. Geethakrishnan had reminded the Board that the issue of how to increase growth and employment had been raised in a number of other discussions, such as those on Egypt, Viet Nam, and, on an earlier occasion, Bangladesh. Mr. Geethakrishnan's request to management was being pursued through a multidepartmental effort under the leadership of the Research Department. In order to develop a general approach to the issue, the staff was examining the experience of a number of countries that had completed the stabilization process with reasonable success but that had not yet achieved the necessary level of growth to move the country out of poverty and onto a higher path of output and development. It was his expectation that the necessary work would be completed in 1994 and that a paper would be circulated to the Board, perhaps with a view to a Board discussion or seminar. However, it should also be recognized that Bangladesh, unlike many similarly placed countries, had accomplished a great deal in achieving macroeconomic stability. The relative success of that effort, and the need to move forward, was one of the reasons behind the request for use of the enhanced surveillance procedure in the case of Bangladesh.

Mr. Dorrington said that he was confident that the Fund staff was coordinating very closely with the staff of the World Bank on the research to which the Acting Chairman had referred.

The Acting Chairman made the following summing up:

> Executive Directors were in broad agreement with the staff appraisal. They commended the authorities for the substantial progress that Bangladesh had made under the ESAF arrangements in achieving macroeconomic stability in the face of very difficult circumstances. In particular, aided by the steady pursuit of prudent macroeconomic policies, inflation had been reduced to the lowest level in two decades, exports had risen strongly, and foreign exchange reserves had increased to record levels. However, progress in the structural sphere had been slower than planned, project implementation had remained persistently well below expectations, and domestic savings and investment had remained below target. As a result, the necessary conditions for a sustained upturn in economic activity had not been fully established. Growth had remained below levels that would permit a reduction in the pervasive incidence of poverty in Bangladesh. Directors observed that the challenge now was to build on what had been accomplished in order to lay the basis for an acceleration of growth and poverty alleviation over the medium term.

In light of the authorities' good track record under Fund arrangements and the desirability of continued close Fund involvement with Bangladesh, and to provide confidence to donors that sound macroeconomic policies are being pursued, Directors supported Bangladesh's request that its program for 1993/94 be monitored under the enhanced surveillance procedure until the next Article IV consultation. Directors were of the view that the program for 1993/94 would allow for a consolidation of the macroeconomic gains of earlier years and, with full implementation, progress in a range of important structural areas. A number of Directors questioned, however, whether the reforms already in place and those planned for this year would be sufficient to attain the higher medium-term growth path that the authorities have as their aim. Without a significant acceleration of reforms in key areas, constraints on sustained higher growth were likely to remain. In this context, the program for 1993/94 could be seen as providing a bridge to what should be a more ambitious medium-term program of structural reforms.

Given the improvement in the macroeconomic situation, as well as the quickening pace of reforms in other countries in the region, and Bangladesh's continued vulnerability to adverse external developments, Directors believed that the time was ripe for a determined effort to design and implement the strong and decisive program of reforms needed to put Bangladesh firmly on a higher growth path. The immediate priorities included a comprehensive reform of the financial system, restructuring and divestiture of public enterprises, further liberalization of the trade and exchange systems, and improvements in the fiscal structure. Strengthening the position of the banking sector was seen as crucial for supporting the medium-term growth strategy, with a particular emphasis on much improved regulation and supervision, capital adequacy, greater competition, and phasing out lending rate ceilings. Measures to encourage private sector activity, including much-needed legal and labor market reforms, were also seen as critical, as was the design of an appropriately targeted social safety net. Finally, Directors stressed the importance of adhering to the investment program targets under the Annual Development Program.

Directors observed that the design and implementation of such a program would require substantial technical preparation--including with regard to the prioritization of various measures--during the current program year. Such an effort would warrant the support of the international community, including through the provision of technical assistance. A number of Directors noted that the implementation of a sufficiently strong program could, in a situation of balance of payments need, merit support through further access to Fund resources.

Directors were of the opinion that recent exchange rate policy had served Bangladesh well, and that the present level of the exchange rate was broadly appropriate, although it would be important to keep it under continuous review. In particular, as inflation has been reduced to the level prevailing in partner countries over the past year, the authorities have been able to reap the benefits of nominal exchange rate stability without adverse effects on competitiveness. Directors welcomed the steps taken to liberalize the exchange system, including measures to develop the interbank foreign exchange market and the elimination of a number of restrictions on current international transactions. They encouraged the authorities to eliminate the remaining restrictions on payments and transfers for current international transactions, which are now few in number, by the end of June 1994 as scheduled, and thereafter to move rapidly to accept the obligations of Article VIII.

A midterm review of Bangladesh's economic policy program under enhanced surveillance will be completed not later than the end of March 1994. It is expected that the next Article IV consultation with Bangladesh will be held on the standard 12-month cycle.

The Executive Board took the following decision:

1. The Fund takes this decision relating to Bangladesh's exchange measures subject to Article VIII, Sections 2(a) and 3, and in concluding the 1993 Article XIV consultation with Bangladesh, in the light of the 1993 Article IV consultation with Bangladesh conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. Bangladesh's restrictions on payments and transfers for current international transactions are maintained in accordance with Article XIV as described in EBS/93/174, except that the restrictions arising from the two bilateral payments agreements are subject to the approval of the Fund under Article VIII, Section 2(a), and the multiple currency practices that arise from existing contracts entered into under the old forward cover scheme and the old nonresident foreign currency scheme are subject to approval under Article VIII, Section 3. The Fund urges Bangladesh to eliminate the remaining restrictions as soon as possible.

Decision No. 10517-(93/163), adopted
December 1, 1993

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/93/162 (11/29/93) and EBM/93/163 (12/1/93).

3. SDR DEPARTMENT - DESIGNATION PLAN FOR DECEMBER 1993-FEBRUARY 1994

The Executive Board approves the designation plan for the quarterly period beginning December 1, 1993 as set out in EBS/93/180.

Decision No. 10518-(93/163), adopted
December 1, 1993

4. OPERATIONAL BUDGET FOR DECEMBER 1993-FEBRUARY 1994

The Executive Board approves the list of members considered sufficiently strong as set out in EBS/93/179, page 2, footnote 1, and the operational budget for the quarterly period beginning December 1, 1993 as set out in EBS/93/179.

Decision No. 10519-(93/163), adopted
December 1, 1993

5. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 93/18, 93/98, 93/99, and 93/102 through 93/105 are approved.

6. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors and by Advisors to Executive Directors as set forth in EBAM/93/207 (11/24/93) and EBAM/93/209 (11/29/93) and by an Assistant to Executive Director as set forth in EBAM/93/208 (11/24/93) is approved.

APPROVED: March 14, 1994

LEO VAN HOUTVEN
Secretary