DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

May 5, 1998
Approval: 5/12/98

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 97/82

10:00 a.m., August 18, 1997

Contents

Attendance . . . . Page 1

1. Bangladesh—1997 Article IV Consultation . . . . Page 3

Decisions Taken Since Previous Board Meeting

2. Office Space—Phase III—Cost of Constructing Alternate Cafeteria Smoking Room . . . . Page 35
3. Approval of Minutes . . . . Page 35
4. Executive Board Travel . . . . Page 35
5. Travel by Managing Director . . . . Page 35
6. Travel by Acting Managing Director . . . . Page 36

Executive Board Attendance

A.D. Ouattara, Acting Chairman

Executive Directors	Alternate Executive Directors
A.A. Al-Tuwaijri	
	N.R.F. Blancher, Temporary
	C.K. Duenwald, Temporary
B. Esdar	W.-D. Donecker
	J.N. Santos, Temporary
	T. Berrihun, Temporary
	W.K. Gruber, Temporary
	A.L. Coronel, Temporary
	S. Zádor, Temporary
	S. D. Melese d'Hospital, Temporary
A. Mirakhor	
	B.M. Lvin, Temporary
	J. Shields
A.S. Shaalan	
M.R. Sivaraman	
	H.B. Disanayaka
	K.M. Heinonen, Temporary
	C.M. Gonzalez, Temporary
	J.L. Pascual, Temporary
	J.P. Leijdekker, Temporary
	T.-M. Kudiwu, Temporary
	H. Ono
	H.W. Cocker, Temporary
	Huang X., Temporary
	O. Otazú, Temporary

R.H. Munzberg, Secretary
S.W. Tenney, Assistant

Also Present

IBRD: N. Ramachandran, South Asia Regional Office. Asia and Pacific Department: H. Neiss, Director; D.J. Goldsbrough, M.R. Kelly, K.M. Meesook, L.E. Molho. Fiscal Affairs Department: J. Ha. Policy Development and Review Department: D. Burton, K.H. Kang, S.S. Rizavi. Secretary's Department: P. Gotur. Advisors to Executive Directors: M.A. Ahmed, M.H. Elhage, G.M. Iradian. Assistants to Executive Directors: W.F. Abdelati, C. Austin, J.G. Borpujari, M. Carlens, D.A.A. Daco, R.J. Heinbuecher, L. Palei, R.P. Watal.

1. BANGLADESH—1997 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1997 Article IV consultation with Bangladesh (SM/97/194, 7/22/97; and Sup. 1, 8/15/97). They also had before them a background paper on recent economic developments in Bangladesh (SM/97/88, 3/27/97) and a statistical appendix (SM/97/195, 7/24/97).

The staff representative from the Asia and Pacific Department said that the staff had recently been notified that the Bank of Bangladesh had depreciated the exchange rate by a further 1 percent, effective August 18, 1997. That adjustment, in combination with the 1 percent depreciation that had taken place on July 1, 1997, should have helped moderate the real effective exchange rate appreciation recorded since end-June 1996.

Mr. Sivaraman made the following statement:

> It is customary to commence a statement by complimenting the staff for their unbiased and fair observations on the performance and management of a country's economy. I cannot, unfortunately, do so unequivocally in this case as my authorities have expressed their reservations and surprise on the comments that have been made by the staff on the performance of Bangladesh. For a country, which has passed through several crises, its performance on the economic front measured by the normal economic parameters of economic growth, inflation and fiscal deficit can be called impressive.
>
> An appraisal of economic performance in the context of an Article IV surveillance exercise is meant to be a consultative and cooperative exercise. Such an exercise, I presume, should be conducted on a common denominator of shared confidence between the staff and the authorities and also based on facts that are not subject to dispute. Only interpretations arising from this basis could justify the conclusions, and legitimize the policy advice that is intended to be conveyed to a member of this organization. My authorities feel that acknowledged deficiencies in the system have either been unduly exaggerated or wherever there has been creditable performance, it has been explained away as fortuitous thereby belittling the efforts of the government.
>
> In June 1996, Bangladesh witnessed the reestablishment of a democratically elected government which in a short period evolved a consensual political environment and continues to remain committed to economic development and reform. This has been reflected in significantly higher growth of GDP during the fiscal year 1996/97. In fact the economy saw the highest growth rate of its GDP (5.7 percent) in the last seven years surpassing the target of 5.5 percent for the year 1996/97 according to the preliminary estimates of the Bangladesh Bureau of Statistics. The inflation rate for the same period has been contained below 4 percent on an annual basis and the external current account deficit was reduced from 4.7 percent of GDP in 1995/96 to 2.9 percent of the GDP in 1996/97. The fiscal deficit fell from 5.3 percent in 1995/96 to below 5 percent, according to the staff, and the export growth rate was 13.8 percent in FY 1996/97. These are encouraging developments and cannot be ascribed totally to exogenous factors.

The authorities are deeply committed to the implementation of strong measures to foster macroeconomic stabilization and will continue to address key structural problems to get on to a higher and more equitable economic growth path. The government's performance since the last Article IV consultation has resulted in a substantial increase in confidence by all operative economic agents.

In spite of this, the staff report seeks to create a contrary impression that everything is wrong in Bangladesh. The observations on governance and corruption unfortunately are obiter dicta and not in accordance with the guidance note on the role of the Fund in governance issues. The authorities did not receive from the staff, during the consultations, any specific complaint of corruption which has macroeconomic implications since the present government has been in office. I am sure that Directors would appreciate that sweeping generalizations could also lead to adverse consequences and this could impede rather than help the process of reform. At the same time, the Directors should remain reassured that the authorities are determined to take immediate and appropriate action if specific governance related issues that have macroeconomic implications are brought to their notice.

The growth during 1996/97 has been attributed to the unusually good performance in the agricultural sector. But apart from agriculture, the industrial sector also has not been short on performance. This is borne out by figures given in the staff report at page 11. The growth in the agriculture sector has also been facilitated by increased budgetary allocations for agriculture by the government. The significant shortfall in fertilizer production and acute power shortage owing to gas supply problem are likely to be eliminated by early 1998 and consequently, growth in industrial and energy sectors would be accelerated in the near future.

Low inflation was not the result of only bumper crops, but nonfood prices also grew at a lower rate than food prices during this period. The estimates of Bangladesh Bureau of Statistics indicate that the overall price index in FY 1996/97 increased by 3.9 percent; food prices increased by 4.9 percent and nonfood prices increased by 2.5 percent.

The staff report contains a strong assertion that Bangladesh Bank is acting as a lender of the last resort of a banking system that is on "the verge of insolvency" and is in a "precarious financial position." The problems of the financial sector in Bangladesh and its weaknesses are known and acknowledged, but it is an exaggeration to say it is on the verge of insolvency. The problem of nonperforming assets is persisting, but the situation has not worsened. Recovery of loans has improved substantially following the various measures taken by Bangladesh Bank, especially after the setting up of the Task Force for accelerating loan recovery. The recovery against overdue loans during the period January–June 1997 stood at Tk 24273.6 million while an amount of Tk 9908.9 million of overdue loans was rescheduled during the same period. Furthermore, the deposits in scheduled banks are protected by deposit insurance as well as high (20 percent) statutory reserves. The authorities have also issued bonds to the tune of Tk 5.6 billion for capitalization of the Nationalized Commercial Banks (NCBs). With the amendment of the Bank Companies Act 1991 which came into effect in March 1997 and the implementation of the Bankruptcy Act from August 1,1997, rigorous actions have been taken against defaulter Directors of different banks and other defaulters.

Recognizing the complexity of the problems of the financial sector, the government in consultation with the IDA has initiated a commercial bank reform project which would address inter alia, the issues of institution-building and more autonomy for the central bank, effective and impartial legal system and privatization of state-owned banks. Under the Bangladesh Bank Order, the central bank has the authority to pursue its monetary and exchange rate policies although there is a provision for the government to give direction to the Bank after consultations with the Governor in public interest. The authorities hope to strengthen the central bank further within the framework of the reform project which is proposed to be implemented with the assistance of the World Bank.

In view of these stringent measures, it is expected that the banking sector will witness progress in the next few months.

Doubts have been raised in the staff report about "fiscal transparency." The government has been vigorously pursuing the implementation of a U.K.-assisted project for budgetary reforms. Furthermore, all fiscal data are available to the staff on request. The intention of the authorities is to be very open and there has been no intention to make the system nontransparent to any institution to whom the authorities are accountable.

As regards the fiscal deficit in Bangladesh, it has to be viewed in a larger context of four commercial accounts (food, railway, post office and telephone) forming part of government account. Consequently, any increase in their stocks/assets is reflected as government deficit. The authorities agree that reform of the present accounting system is essential for accurate monitoring of the government deficit. Furthermore, the development of a secondary market for treasury securities will also be a precondition for restricting government's access to central bank credit. The government has already decided to promote the development of such a market.

While the government recognizes the need for reducing the borrowing from the central bank, the suggestion to reduce the overall budget deficit to about 3.5 percent of the GDP in 1997/98 appears unrealistic. The authorities feel that a target to keep the overall fiscal deficit to around 5 percent, and despite the decline of foreign aid, domestically financed fiscal deficit to 1.5 percent is more reasonable. Any attempt to reduce the fiscal deficit below this target will be only at the cost of expenditure in social sectors. The authorities are determined to restrain current expenditure including wage increase and the budgeted expenditure will be reviewed continuously to keep the deficit under control. A number of measures have been undertaken in the sphere of income tax and customs duties to moderate rates and broaden the base in the budget for 1997/98. The value-added tax has also been extended to cover a few more items. Government, for the first time in four years, have imposed new taxes to raise resources in their 1997/98 Budget.

It is stated that budget estimates for FY 1997/98 are unrealistic because sufficient provision has not been made for quasifiscal deficits estimated at 30 percent of GDP. About 85 percent of this debt is owed to the government and the balance is due to commercial banks. In the circumstances, if part of the debt is assumed by the government, public debt would not increase by 15 percentage points as suggested in Box I of the report. Furthermore, debts of state-owned enterprises and recapitalization requirement of banks overlap. The experience of financial sector reforms in Bangladesh suggests that such recapitalization is not always fruitful. The government is ready to take appropriate action for assuming debt liabilities within the framework of a phased program of reforms. Furthermore, the government has already decided to review the administered prices of natural gas, fertilizer and petroleum products. Those revisions will significantly strengthen the financial position of major state-owned enterprises.

The government of Bangladesh recognizes the need for a proactive and flexible management of exchange rate and there has been eight upward adjustments in the exchange rate based on the Real Effective Exchange Rate (REER) since June 1996. The authorities hope that with an improvement in the reserve position, there will be a gradual shift toward a more flexible exchange rate.

Bangladesh has been one of the pioneers of trade reforms in the South Asian region. The maximum tariff rate has been reduced from 350 percent in 1991/92 to 42.5 percent in 1997/98 whereas actual import-weighted average tariff is now about 17 percent. Furthermore, about 60 percent QRs have been eliminated. (Box 3, page 30 of the report gives a cross country comparison of trade regimes. It refers to 63 percent of the tariff lines in neighboring India being subject to QRs. This is factually incorrect and the figure is less than 25 percent).

There are, however, three constraints to further trade liberalization in Bangladesh. First, balance of payments constraint has to be taken into account in further trade liberalization. Secondly, customs duties continue to be a significant source of revenue and a sudden reduction in duty will affect revenue. Thirdly, the government is legally required to consider the recommendations of the Tariff Commission on tariff anomalies. Despite these constraints, the government is determined to carry forward further trade reforms in tandem with the stabilization of the reserves and the needed reforms in tax structure.

Privatization of state-owned enterprises continues to be the cornerstone of government's reform program. The government has already completed a protracted dialogue with labor unions of jute and textile sectors. Measures are already under way to close down a few loss-making enterprises. With the streamlining of privatization procedures, significant progress in this area is expected in the current year.

While the promotion of a market based economy is likely to contribute to higher income inequality, income distribution in Bangladesh is still more egalitarian than most of the countries in this region. Annexure II of the staff report itself indicates that the share of top 20 percent in total income in Bangladesh is the lowest among twelve countries reported in the table. Bangladesh started from a very low level of social development. Nevertheless, notable progress has been made in infant mortality, safe drinking water supply and educational enrolment and the deceleration in population growth. Recent data indicate further improvement in some areas. For example, the preliminary estimates of the Household Expenditure Survey in 1995/96 indicate that the percentage of hardcore poverty has declined from about 28 percent in 1991/92 to about 23.8 percent in 1995/96. Life expectancy has increased from 55 in 1985 to 59.5 in 1996. The authorities recognize that much remains to be done in the area of social development. However, the recent achievements in the face of heavy odds should not be altogether ignored.

The government of Bangladesh has a realistic vision for growth and reforms. In the medium term, the government proposes to (i) consolidate and initiate further reforms in the banking sector in the light of the recommendations of the Commercial Bank Reforms Project, Banking Reforms Committee and Law Reforms Commission; (ii) follow a more proactive exchange rate policy; (iii) raise taxes in line with the experience of the previous programs in Bangladesh supported by the Structural Adjustment Facility and Enhanced Structural Adjustment Facility (ESAF); (iv) encourage private investment specially in infrastructure; (v) restrain current expenditure and continuously prune the ADP so that overall deficit remains at a sustainable level; (vi) close down loss-making state-owned enterprises in a phased manner and accelerate privatization and reform the system of administered prices; and (vii) take appropriate measure for the establishment of market-based, transparent and well-governed economy. The government would welcome support of the development partners for a realistic reform program which could be implemented with the broad support of the people.

In conclusion, I wish to reiterate that the government of Bangladesh are determined to carry forward reforms in all areas of economic management. We must recognize that there is a trade-off between the pace of reforms and the potential for social unrest especially in a country which has now a stable government working with all concerned on a consensual basis. Therefore, any judgment of the performance of the government of a country must be viewed in its sociopolitical environment. Bangladesh's performance seen in this light has been above average during the last year and the authorities are making all endeavors to attain a higher equitable growth path. I would urge the Board to encourage and support their efforts with their valuable advice.

Mr. Shields made the following statement:

I firmly support the staff assessment. The message for the Bangladeshi authorities is clear: seize the opportunity, now, to take action on a wide range of policy measures and to address the serious governance issues; or face continuing steady decline and persistent poverty.

Bangladesh successfully maintained macroeconomic stability in the early 1990s, but there followed two years of slippage, reflected in rapid growth in credit to the government and declining official reserves, which threatens to constrain private sector prospects. GDP growth has held up well over the past year, and inflation remains respectable by international standards. But this has been due more to luck—favorable weather conditions—than to design. There is a risk that agricultural growth will fall back, and overall growth fall short of target, unless prospects for industrial recovery can be enhanced.

I agree with the staff assessment that short-term adjustment is necessary to restore and maintain macroeconomic stability. A more proactive response by the authorities would help lay a more solid basis for low-inflation growth. This calls for more prudent fiscal and monetary stances: even if current policies prove to be just sustainable, the costs to the economy in foregone growth and poverty reduction are likely to be significant. But the risks to the balance of payments position, due to unfavorable or more normal weather conditions, or because of problems with the EU over Generalized System of Preference privileges and frozen foods, suggest that the consequences may be more acute.

I very much welcome the authorities' desire to target the poor through its budget. But the programmes announced are likely to be limited in coverage, and careful attention will need to be paid to design to ensure they reach the intended beneficiaries. The staff analysis shows that much of the budgetary expenditure is both highly regressive and detrimental to economic efficiency. Addressing these issues, as proposed in paragraph 37, would permit a much more broad-based attack on poverty.

In my view there is substantial scope to prune some items of expenditure without harming growth prospects. The authorities should aim in particular to cut unproductive expenditures such as Annual Development Program projects of poor quality; much of the quasifiscal expenditure (well presented in the staff report); poorly targeted subsidies; and defense—it is difficult to see the case for a large (8 percent) increase in the latter. Revenue performance over the past year has been poor, which points to the need for action here too, both to improve collection and broaden the tax base. The 1997 Budget was disappointing in these areas.

The staff paper raises concerns about corruption and vested interests. These are familiar issues, and difficult ones, the negative impact of which is evident in terms of low levels of foreign direct investment and a low ratio of revenue relative to GDP. Better governance, allied with greater fiscal transparency, as recommended in the staff paper, is much needed.

Privatization, financial sector reform and trade liberalization are rightly highlighted as critical issues. The authorities' intentions are welcome; but we have heard all of this before. Too often the story has been that "gradualism" translates into "inaction." The time for tough decisions and strong action is now. The target to privatize 82 state-owned enterprises this year, and complete the program by 2000, is bold: but in stark contrast to actual progress in recent years. It will be important for the newly appointed Chairman of the Privatization Board to be given authority to act, and the support of the authorities. The state-owned enterprises are a major drain on the budget which must be corrected. In the banking sector, the authorities must set out a clear policy and move quickly to implementation, with planned support from the World Bank. Similarly on trade reform, the authorities need to set out a timetable of action to provide guidance to the private sector.

All of the above comments point to the need for a revised budget that will provide the basis for a stronger macroeconomic framework. A credible program of adjustment and structural reform should pave the way for Fund support under an ESAF arrangement. This is the immediate task ahead.

Mr. Shaalan made the following statement:

Bangladesh's overall economic performance in 1996/97 remained broadly favorable. The economy continued to grow by close to 6 percent without major signs of inflationary pressures, both the external current account and fiscal deficits narrowed from the level of previous years, and the prospects for foreign direct investment appear to have improved. To sustain and increase the growth prospects of the economy the macro situation as well as key structural reforms need to be strengthened. Notwithstanding this, I was rather surprised at the tone of the opening statement of Section IV of the staff report. The report could have benefited from a more balanced approach rather than one that casts an unduly pessimistic shadow on performance and possibly on prospects. On this score we share many of the concerns expressed in Mr. Sivaraman's statement. In particular, I would note that the generalizations on corruption and mismanagement are not substantiated and, equally seriously, I understand from Mr. Sivaraman's statement, were not discussed with the authorities. Much more caution by the staff in addressing these sensitive issues is called for. On a different point, the staff notes that the budget estimates for 1997/98 are not realistic because of the noninclusion of certain quasi deficits. There appears to be a significant divergence of views between Mr. Sivaraman and the staff on the extent of these quasi-deficits. I would appreciate staff views.

The main economic challenge facing the authorities is to map out and rigorously implement a reform program that is realistically and sufficiently strong to place the country firmly on a higher growth path in order to break out of the circle of poverty. This would require first and foremost strengthening the macroeconomic balances and the creation of an environment that provides incentives to private sector initiative and investment. As indicated in the staff report, like other countries in the region at a similar stage of development, many of the structural weaknesses that impede the attainment of a higher growth rate need to be more adequately addressed. In particular, more attention needs to be accorded to the development of human resources. It is noteworthy that the secondary school enrollment rate in Bangladesh showed no significant improvement during the past 15 years, and remained the lowest among the Asian economies, this is almost half the rate in Vietnam which has a similar per capita income. Additionally, addressing the problems of the financial system, reforming public sector enterprises, as well as a more determined effort at privatization, should be accorded high priority if the economy is to reach its potential.

Regarding public finances, we concur with the view that the projected stance of fiscal policy for 1997/98 needs to be strengthened to support macroeconomic stability. While efforts are needed on both sides of the revenue/expenditure equation, raising revenues should be accorded more weight given the very low revenue/GDP ratio—at about 11 percent and the lowest among Asian economies. In this connection, we join the staff in calling for action to remove, or at least reduce substantially, the remaining tax exemptions and zero-rating from the value-added tax and customs duties. Policy should also be directed at aligning fertilizer prices with international prices, restoring real domestic petroleum prices to their levels of 1991/92, and adjusting natural gas and electricity prices with prices to be charged by the new private producers. We are fully aware that action on these various fronts is delicate and sensitive and we hope that the authorities can address these issues without social unrest. It would be also important that the authorities resist any pressures to increase spending to accommodate expenditures associated with restructuring of public enterprises and the banking system. The emphasis should be on enhancing public savings. Reliance on growth of private savings as a substitute for public sector savings is not likely to prove effective in the short run. A firmer fiscal stance will also make it possible for interest rates to decline as appropriate, thereby not only easing adjustment efforts of the financial sector but also enhancing the country's growth potential.

As the authorities move to strengthen public finances, monetary policy will be able to play a more effective role in stabilizing in a sustained fashion the Bangladesh economy, together with an improvement in the financial intermediation process. As noted by the staff, the effectiveness of monetary policy would also be enhanced by decisive reforms including: a revamping of the role of the central bank; prompt action to resolve the problems of the banking system; and establishment of firm legal limits on government access to central bank credit, if these do not exist. We are told by Mr. Sivaraman that such limits do exist. Staff comments would be appreciated.

Further fiscal adjustment would need to be accompanied by faster progress in financial sector reform. While steps to enhance bank regulation and supervision and strengthen the legal system are welcome, they are yet to reduce the incidence of nonperforming loans. More decisive action to rehabilitate the banking system is important to ensure the efficient flow of saving and investment and ease the constraints on monetary policy. In this regard, a firmer treatment of problem banks would be necessary to prevent an escalation of the costs to the budget. We also encourage the authorities to restrict connected lending, and improve the efficiency and competition of the banking system through restructuring and privatization. Private ownership and management of commercial banks, and entry of reputable foreign banks should also be encouraged to foster competition.

As for the state-owned enterprises, it was rather surprising that none of the 64 enterprises slated to be privatized in 1996/97 have been transferred to the private sector, we are encouraged by Mr. Sivaraman's assertion that the process of privatization will soon be accelerated and intact as the staff supplements indicate that a significant beginning has been made. Strong political commitment will be essential to speed the process of privatization. The nationalized commercial banks should be given clear instructions to avoid lending to loss-making state-owned enterprises. The enterprises that are likely to remain in the public sector must be given more managerial autonomy to operate under commercial criteria and accountability.

In conclusion, a sustained implementation of a stronger program of reforms both at the macro and structural levels would enable the authorities to set the economy on a path of sustainable high growth with low inflation. We wish the Bangladesh authorities every success.

Mr. Ono made the following statement:

I welcome the fact that in 1996/97 the Bangladesh economy retained its good standing, favorable growth rate and inflation performance, and reduction in the external deficit. However, looking ahead, I have some concerns regarding the resurgence of inflationary pressures, the continuing decline in reserves, and the widening of the current account deficit, all of which would cut short the recent economic expansion.

Needless to say, the immediate policy priorities for the Bangladesh authorities should be to increase investments, then to achieve higher sustainable growth so as to decrease the significant number of poor. According to an analysis by some economists, more than 7 percent economic growth is necessary in order to reduce poverty in Bangladesh. If this is the case, the average growth rate of 4–5 percent over the last several years is far from being satisfactory. To secure economic growth, the authorities must provide a tighter fiscal and monetary policy as well as a more flexible exchange rate policy, while at the same time pressing ahead with structural reform efforts.

Since I concur with the staff's view on the policy direction that the authorities should take, I would like to emphasize some of the points that I consider most important.

First, on fiscal policy, I agree with the staff's assessment that there is further room for reducing fiscal deficit by broadening the tax base, raising tax exemption limits and stricter prioritizing of ADP spending. Regarding subduing inflationary pressures, high public wage increases on the order of 10–15 percent is a matter of concern, given that the current inflation rate remains at only about the 4 percent level. The authorities should carefully watch the wage movement. In addition, I strongly support the staff's recommendation to establish firm legal limits on government access to central bank credit.

Second, the privatization of public sector enterprises is particularly important for two reasons: to mitigate the fiscal burden and to promote private investment.

It is disappointing that the progress in privatization has been slow because of enormous political pressures. Although there is strong resistance from vested interest groups, I would like to encourage the authorities to make a concerted effort at preparing a concrete and ambitious timetable for privatization with a view to achieving the invigoration of private activity and the promotion of capital inflow. To this end, I think it is worthwhile considering the staff's proposal to give the "Privatization Board" more power in order to overcome the opposition by interested groups.

Third, restructuring the banking sector is also a top priority policy agenda item. I am pleased to see recent improvements in related laws and regulations. I join the staff in encouraging the authorities to act more decisively in order to restore and maintain the stability of the banking system.

Finally, I hope that the authorities will take further steps toward reducing the role of the inefficient public sector and revitalizing private activity, with the goal being to achieve sustainable high growth and a reduction in poverty.

Mr. Mirakhor made the following statement:

As Mr. Sivaraman notes in his statement, in many important respects, recent economic performance in Bangladesh has been positive. Growth has been robust, with the economy expanding by the fastest rate in the past seven years; inflation has been subdued and in line with official forecasts, and the fiscal deficit for 1996/97 was less than projected. In the external sector, the favorable performance of exports and workers' remittances has helped lower the external current account deficit to about 3 percent of GDP and, despite a slowdown in aid flows, the fall in gross foreign exchange reserves witnessed in the previous two years appears to have slowed. These are noteworthy accomplishments against the background of difficult political and social conditions. Nonetheless, challenges facing the country are formidable.

The economy's recent good performance is narrowly based and rests on fragile foundations; in particular, growth and investment in the large-scale manufacturing sector appears to have slowed sharply and there are indications of resource pressures and growing imbalances in other sectors: government borrowing from the banking system remains high; there has been a deterioration in the finances of the public enterprises; and the banking system remains in difficulty. The stance of macroeconomic policies in 1997/98 seems to be less cautious than warranted by circumstances and could pose a threat to the hard-earned gains on inflation and risk exerting renewed pressure on the external accounts. More troubling is the slow pace of implementation of crucial growth-enhancing structural reforms that are key to a breakthrough in terms of higher growth, faster employment creation, and poverty alleviation.
Mr. Sivaraman is correct to point out the trade off between the pace of reforms

and social stability; the greatest economic challenge facing Bangladesh is to forge a social consensus, strong enough to allow the implementation of a vigorous program that will lift the economy onto a durably higher growth and investment equilibrium.

Turning to the present policy stance, the budget for 1997/98 contains important initiatives; steps have been taken to raise revenue by broadening the tax net and expanding its base. However, it seems that much of the benefit of these efforts will be mitigated by higher spending, notably on public sector wages. As a consequence, the fiscal outturn projected for 1997/98 is expected to be less favorable than that obtained in the previous year and fiscal policy would tend to impart a strong stimulus to aggregate demand at a time when the balance of considerations would suggest a more cautious approach. Moreover, as the staff paper notes, the spillover of the wage increase to the public enterprises will lead to further state-owned enterprises losses and require larger outlays on subsidies and transfers, in the absence of commensurate adjustments in administered prices and concrete steps to accelerate the pace of structural reforms. In short, there is the risk that the overall public sector deficit could widen quite sharply, with all its attendant adverse consequences for financial stability, inflation and the external current account.

With the public sector deficit on an expansionary course, monetary policy will be hard pressed to rein in demand pressures, hold down inflation, and keep the economy on a stable path. The staff paper calls for a significant tightening of monetary policy in order to safeguard the authorities' inflation and external sector objectives. It is difficult to see how this monetary tightening can be effected without crowding out of the private sector in the absence of a substantially reinforced fiscal stance and lower domestic government borrowing.

The authorities are aware of the potentially adverse consequences of the recent appreciation of the exchange rate. While at present there is little indication that the exchange rate has hindered the performance of exports, it is clear that competitiveness indicators will warrant close monitoring.

The task of macroeconomic stabilization will have to be reinforced by high-quality structural reforms. It is encouraging to note in Mr. Sivaraman's important statement that the government is actively consulting with IDA on a commercial bank reform project which aims at building a more effective legal system, evolving a plan for privatizing state owned banks, and, most importantly, granting more autonomy to the Bangladesh Bank. These consultations are both timely and appropriate and hold the promise of restoring the stability and soundness of the financial system. On the question of nonperforming loans, commendable steps have been taken by the authorities recently to enforce loan contracts and pursue defaulters, and we urge them to move forcefully in this area.

In general, the authorities have moved in the right direction in a number of difficult areas and have sought to correct the slippages that have occurred from the significant achievements of the early 1990s, but more needs to be done. The present stance of policies, on balance, runs the risk of straining the economy's productive potential and of pushing it on a path of faster inflation and declining reserves. In that event, the government's growth and investment objectives and its efforts to build confidence amongst domestic and foreign investors could be undermined. Clearly, this is an outcome that Bangladesh can ill afford. The authorities should be encouraged to implement a stronger, and realistically ambitious program of stabilization and growth-promoting structural reforms, possibly in the context of a multiyear arrangement with the Fund, that will help build the foundations for higher rates of economic growth and poverty alleviation, and foster an environment of financial stability. Needless to say, it will be imperative that in the design of a program, due prominence is given to a well-formulated and adequately financed social safety net to help mitigate the short-term costs of adjustment and adequately protect the most vulnerable segments of the population.

We wish the Bangladesh authorities all success.

Mr. Al-Tuwaijri made the following statement:

The Bangladesh economy has performed reasonably well. Last year, growth continued to accelerate, inflation fell further, and both fiscal and external payments positions improved. As Mr. Sivaraman's very helpful statement points out, this favorable outcome reflected not only good weather but also good policies. The staff report could thus be more upbeat than it is on the economy's recent developments and prospects.

That being said, let me stress that a speed up of the adjustment and reform effort is critical for a strong and sustained recovery. It is therefore encouraging that the authorities and the staff broadly agree on the necessary action. The challenge now is to implement the agreed policies without delay.

The projected increase this year in the fiscal deficit and domestic bank financing is therefore a concern. Indeed, the staff notes risks that the outcome may be worse because of likely slippages in implementation and shortfalls in receipts from State Owned Enterprises. Clearly, early action is essential. On the revenue side, steps to bolster the low revenue-to-GDP ratio and rationalize state owned enterprise prices are priorities. Containment of public sector wage increases, downsizing of the civil service, and prioritization of public investments are also crucial.

The fiscal restraint has to be accompanied by an appropriate tightening of monetary policy. In that regard, I share the staff's priority for limits on domestic bank financing of the budget, curtailment of long-term central bank lending to commercial banks, and transfer of the funding of specialized credit banks from the central bank to the budget. The authorities' intent to develop a secondary market for treasury securities is welcome.

The slide in external reserves and the widening divergence of official and parallel market exchange rates underscore the importance of a more proactive external policy stance. I am therefore encouraged by the authorities' readiness for greater exchange rate flexibility and development of an efficient interbank foreign exchange market. It is also important that these steps be complemented by a speed up of trade liberalization, including especially further reduction of tariffs and an early end to all quantitative restrictions. Avoidance of nonconcessional borrowings and attraction of foreign direct investments are clearly priorities.

On the structural policy front, speedy reform of the financial system, the public enterprises, and the economy's legal and regulatory framework is crucial. Here, the authorities' commitment to the IDA-supported Commercial Bank Reforms Project is reassuring. The challenge now is to deepen and extend the steps already taken to tighten bank supervision. I share particularly the staff's priority for weeding out nonperforming loans and banks. It is also essential that the privatization effort be stepped up to make up for the past slippages that have already led to lapsing this year of a World Bank credit. Implementation of an efficient rule-based legal and regulatory environment is crucial in that regard.

With these remarks, I wish the authorities success in meeting the difficult challenges ahead.

Mrs. Coronel made the following statement:

We thank the staff and Mr. Sivaraman for raising important questions. We feel that the staff should clarify a number of these questions.

Output and inflation performance in 1996 was favorable. Was it exclusively the result of beneficial exogenous factors or also the consequence of an improvement in confidence by economic agents?

Is the situation of the banking system close to insolvency, or are the actions being taken likely to bear fruit?

Were the observations on governance and corruption appropriately discussed with the authorities?

Having said this, we should add that the authorities' commitment to the implementation of strong measures to foster macroeconomic stabilization and structural reform, as indicated by Mr. Sivaraman, particularly in the areas of privatization, trade liberalization, and financial sector reorganization, deserves support and commendation. These actions should help the country build the necessary credibility to strengthen revenue, and achieve the rates of growth it needs to reduce poverty and improve the social indicators.

The risks to the balance of payments position should be carefully evaluated. Being a vulnerable economy, a more comfortable level of international reserves would help Bangladesh face—with lower costs— any adverse developments in the external sector.

Along these lines, we would encourage the authorities to strengthen their efforts toward short-term adjustment and create the necessary conditions for sustainable growth. We wish them the best in their endeavors.

Mr. Huang made the following statement:

In assessing Bangladesh's economic performance, although there are many unsatisfactory aspects, the authorities are still commended for their progress in achieving a relatively high growth and low inflation, and reducing the fiscal deficit, especially when its huge population pressures and unfavorable geographic conditions are taken into account. However, the economic situation is vulnerable, and the authorities face longer-term daunting challenges in achieving a sustained high economic growth and reducing poverty. We are encouraged by the authorities' firm commitment to macroeconomic stabilization and structural reforms.

I would like to make some brief comments.

The immediate challenge facing the authorities, as the staff and other speakers have rightly pointed out, is to maintain a stable macroeconomic environment, which calls for perseverance with prudent fiscal and monetary policies. We see that the priority task should be to gradually promote the independence of the central bank, with prompt actions taken to achieve its operational independence as the first step.

Over the medium term, more rapid growth and poverty reduction on a sustainable basis require significant increases in national saving which has been persistently low. Apart from efforts to foster conditions for private saving, the authorities are urged to take stringent measures to increase public saving, including measures to arrest excessive government borrowing from the central bank and boost the extremely low level of budgetary revenues.

In addition, accelerated efforts should be made to restructure the state-owned enterprises sector.

Finally, we concur with Mr. Sivaraman that there is a trade-off between the pace of reforms and the potential for social instability. It is essential to ensure that any reform initiative be implemented with broad public support. The authorities are encouraged to make every effort to advance reforms within their sociopolitical capacity.

With these remarks, we wish the authorities every success.

Mr. Santos made the following statement:

Reasonable economic growth, low inflation, and small macroeconomic imbalances have characterized the economy of Bangladesh in recent years. We commend the authorities for these achievements. However, there has been a lack of decisive progress in key structural reforms, namely, in the banking system and the state-owned enterprise sector, which may lead to a loosening of the policy stance, rising inflation, and widening domestic and external imbalances. As the risks of the present situation are highlighted in the staff report, we would like to stress only two issues.

First, we fear that the precarious financial position of the banking system will place a large drain on public finances, even because the authorities have expressed a firm commitment to ensure the safety of banks. A more equitable burden sharing among the stakeholders should be pursued, while providing some safety net for small depositors, for instance by assuring full convertibility of deposits up to a certain amount. The weak banking system places a considerable burden on monetary policy, hampering its proper management and requiring a significant amount of support by the central bank. The situation is serious enough to warrant a bolder strategy in order to ensure a more efficient flow of savings and investment and to contain the costs of recapitalizing the banking system.

Second, a more decisive approach toward privatization is called for, particularly in view of the weak position of many state-owned enterprises and banks, which place a considerable burden on public resources, the central bank, and on the conduct of economic policy in general. A higher share of privately supplied goods and services would certainly reduce the scope for economic mismanagement.

In this respect, we are concerned that the lack of adjustment of administered prices is hurting the financial position of public suppliers of these goods and, in general, is sending the wrong signals to economic agents. A bolder privatization strategy should help contain the quasi-fiscal deficit and promote efficiency and growth in the long run.

Mr. Leijdekker made the following statement:

I would like to raise only two issues related to the staff report and to governance issues. From the current discussion, these two issues seem to be somewhat contentious.

First, the staff report is clearly critical. I can understand Mr. Sivaraman's reaction to it. However, the staff report should be seen in the light of the Fund's efforts to provide more transparent and more frank assessments. The staff report should also been seen in the light of the efforts aimed at increasing selectivity in surveillance. In the context of ongoing discussions on improving surveillance, the Fund clearly concluded that, for every country, the staff should focus on problem areas. In the case of Bangladesh, the staff report makes clear that the macroeconomic performance, as measured by inflation or growth, is not so much the problem as the deep-rooted structural rigidities in the economy. Therefore, the staff report has correctly focused on the structural issues, even though that focus makes for, perhaps, a more negative assessment.

Some staff reports have come further along in this process than others. It is against that background, that I read the staff report for the current discussion. The Asia and Pacific Department is clearly at the fore in our efforts to improve surveillance, although similar movements toward greater selectively can be noted in staff reports prepared by other departments. It would be unfortunate if the Board were to discourage the staff from moving forward in that direction at the present stage. In light of the long-standing cooperative relations between Bangladesh and my authorities, this chair would describe the staff report for the current discussion as critical, but fair.

Second, the staff report clearly describes the ways in which governance issues affect macroeconomic performance in Bangladesh. The current governance structure in Bangladesh provides ample room for catering to vested interests, such as through the widespread exemptions in the tax system, the lack of autonomy of the Bangladesh Bank, the lack of discipline among nationalized commercial banks, and the continued support and privileges that are extended to state-owned enterprises. The staff report makes sound arguments pointing to possible areas where there is scope for mismanagement in the Bangladesh economy. In cases where there are such concerns, they should not be glossed over by the staff; they should be clearly addressed.

It is important to note, however, that this is one area where the authorities clearly recognize that there are concerns. As the staff report indicates, the authorities are taking actions to address governance issues, especially in the financial sector. For example, the authorities are aware of the need to put into place the Bankruptcy Act, strengthen the judicial system, and increase the power of the Securities and Exchange Commission. These actions are very welcome, but we should encourage the authorities to move further in this direction, and not react by pretending there is no problem.

Mr. Mirakhor said that he had not received the impression that Mr. Sivaraman's statement was intended to muzzle the staff or in any way suggest that that governance issues should not be addressed in staff reports. Indeed, the Board had agreed on previous occasions that such issues should be addressed in the context of Fund surveillance. On the contrary, Mr. Sivaraman had raised two very critical issues, namely, whether the governance issues cited in the staff report had been substantiated on the basis of objective evidence and whether those issues had been raised in discussions with the authorities. Those important issues clearly warranted careful consideration.

Mr. Shaalan stated that he fully agreed with Mr. Mirakhor.

Mr. Leijdekker commented that he agreed with Mr. Mirakhor that the staff should substantiate suspected governance issues. However, it was important to bear in mind that the Fund was not a police agent. Its main focus should be on the structural weaknesses in the economy and on specific areas where there was too much scope for rent-seeking behavior or corruption. In cases where such weaknesses existed, it would be important for the staff to clearly point them out.

Mr. Shields said that he agreed with Mr. Leijdekker. It there were specific issues related to governance that had not been raised in discussions with the authorities, that would be a cause for concern. However, the staff report seemed to focus on problems in the Bangladesh economy that were well known. In that respect, the examples provided by the staff in terms of areas where governance concerns might be having an impact on macroeconomic developments—such as in the tax system, where there were numerous exemptions; the privatization process, which was subject to vested interests; and the public sector, where there were clear inefficiencies—had been discussed on other occasions and in forums other than the Fund.

Those problems had an influence on investment, particularly foreign direct investment, Mr. Shields noted. Potential investors were clearly dissuaded from potential activities in Bangladesh, owing to the widespread perception of mismanagement or corruption. As the staff report indicated, there had been recent improvements in the situation with respect to foreign direct investment, but much more remained to be done. For example, an external assessment by Transparency International on perceptions of corruption had placed Bangladesh as the fourth worst performer in the world, after Niger, Pakistan, and Kenya. In the circumstances, there was clearly a need for the staff to point out areas where there were problems related to governance and to suggest possible improvements that could have a positive impact on future macroeconomic performance.

Mr. Shaalan recalled that a recent corruption perception index by Transparency International published in *The Financial Times* had not included Bangladesh among the worst cases.

Mr. Sivaraman said that he had been among the Directors that had strongly supported the Fund's rule in addressing governance issues related to macroeconomic management. However, like most other Directors, he had not indicated that the Fund should become involved in governance in general.

It should be noted that the statements contained in the staff report were very sweeping and general in nature, Mr. Sivaraman considered. For example, he wondered whether it could be seen as appropriate for an international institution, like the Fund, to describe a member country as having "a bloated, mismanaged public sector and a tortuous legal and regulatory system that undermined governance, bred corruption, and stifled entrepreneurial activity."

In a letter to the Prime Minister of Bangladesh, dated June 23, 1997, Mr. Sivaraman recalled, the Managing Director of the Fund had stated that: "In the 12 months since your government came to office, we have been impressed by the political consolidation that has taken place in Bangladesh and by your efforts to accelerate economic growth and reduce poverty." The new government of Bangladesh was struggling to restore stability in the country, and it was committed to strong reforms on numerous fronts. In the circumstances, he could understand the need for the staff to be critical in its assessment of recent developments and to point out areas for further improvement. However, it was not appropriate to condemn the new authorities by making sweeping, negative statements about governance in general.

Mr. Donecker noted that, on several previous occasions, the Board had encouraged the staff to be more outspoken about governance issues and to point out the main areas where such concerns stifled macroeconomic performance. From the current discussion, there seemed to be general agreement among Directors on the urgent need for prompt actions aimed at economic stabilization and structural reform.

Mr. Mirakhor commented that, while Transparency International dealt with perceptions of corruption, the Fund's role was to look beyond perceptions to the core issues pertaining to a country's economic prospects. He agreed with Mr. Donecker that it was important not to lose sight of the areas where urgent reforms were needed in Bangladesh. Indeed, his chair had been perplexed for some time by why the Bangladesh economy did not seem to be moving forward in the effort to achieve high-quality growth. The staff report seemed to suggest that the underlying problem was a need for structural reforms to change the "bloated, mismanaged public sector, tortuous legal system and regulatory system that undermined governance and bred corruption." If that was the case, the staff should have substantiated its assessment on the basis of objective evidence, and it should have pointed out the areas where action was needed directly to the authorities.

In many previous cases, the Fund staff had been able to point out to member country authorities in a constructive manner the areas where governance issues were a cause for concern, Mr. Mirakhor said. Indeed, it was only through such open discussions with country authorities, based on mutual cooperation and trust, that the Fund could be effective in helping deal with such problems. Any other approach would likely lead only to misunderstandings and confrontations, which would not help to improve policy making.

Mr. Sivaraman stated that there was no intention on the part of his chair to give rise to confrontations. His statement was merely intended to point out that, in making critical assessments of the way governments functioned, it was important to use language carefully and to put forward arguments in a constructive manner that would be palatable for country authorities.

Mr. Huang said that he fully agreed with the Mr. Sivaraman's comments on the appropriate use of language in staff reports.

The Acting Chairman commented that management generally did not correspond with member country authorities unless there were particular issues of concern. As there was always a need for the Fund to be vigilant about possible unauthorized disclosures of information, it tried to avoid the use of language that could be seen as damaging to member authorities or the Fund in its correspondence with individual countries.

At previous discussions, Executive Directors had agreed that the staff should be more transparent and more candid than in the past with respect to consultations and negotiations with member countries, the Acting Chairman noted. In the course of those discussions, Directors had observed that experience in previous cases involving governance issues showed that it was not necessarily in the authorities' best interest for the Fund staff to clearly point to specific instances of corruption or mismanagement. At the same time, they had said that the Fund, including the staff and the Executive Board, should make every effort to convey to country authorities its concerns about governance issues and the need to tackle those issues forcefully. The staff report currently under consideration represented an attempt on the part of the staff to respond to the Board's request by taking a very bold and forthright approach. Given the differences of view expressed by Directors on the staff report, there might be a need to further consider the Fund's role in governance issues.

Mr. Shaalan considered that there seemed to be general agreement among Directors on the substantive economic issues in Bangladesh. It was clear that too much scope existed for vested interests to take a leading role in the banking sector, the privatization program, and the public sector. However, it should be possible for the Fund to point out those areas of concern and firmly recommend measures to reduce the scope for mismanagement and corruption without using language that could be seen as insulting or inflammatory. As all members of the Fund were faced with some problems related to governance, it would not be appropriate to single out specific members for especially harsh treatment.

The Acting Chairman stated that Mr. Shaalan was correct to note that there were two matters at stake for the current discussion. Directors seemed to be in general agreement on the first, namely, the substantive issues to be addressed in the Bangladesh economy. However, Directors seemed to be divided on the second matter, namely, the approach the Fund should take in dealing with those issues.

Mr. Mirakhor considered that he could sympathize with those Directors who had suggested that it might not be appropriate to include in staff reports specific instances involving mismanagement or corruption or detailed evidence related to possible governance issues. However, Executive Directors ought to be given some foundation for the assessments contained in staff reports in order to come to conclusions about those issues. Like other members of the Board, his chair had been concerned for some time about the reasons Bangladesh had not been able to break away from the less than optimal performance of the past and place itself on a path of higher sustainable growth. In the present circumstances, the issue of language could divert attention away from the most important questions at stake, which related to structural elements of the Bangladesh economy.

Mr. Leijdekker commented that the two points raised by Mr. Mirakhor might not be fully consistent. On the one hand, Directors seemed to be calling on the staff to substantiate its assessments on governance issues, while, on the other hand, it wanted the staff to avoid using any language that might be seen as too harsh. For the staff to clearly support arguments related to governance issues, it would likely need to be fairly explicit in the language it used. However, the use of such language in itself seemed to create additional problems.

Mr. Duenwald made the following statement:

> I fully support the staff appraisal, and therefore only have a few brief comments to offer.
>
> It is clear that Bangladesh's economy has arrived at a critical juncture. A further delay in economic adjustment is likely to spell a widening in macroeconomic imbalances, a slowing in growth with an ensuing deepening of poverty and income inequality. Like Mr. Shields and other Directors, I therefore call on the authorities to adopt more prudent fiscal and monetary stances as part of a front-loaded adjustment effort.
>
> I would like to highlight two specific points. First, I share the staff's assessment of the adequacy of recent exchange rate policy and join them in calling for greater exchange rate flexibility within the context of tighter fiscal and monetary policies. The authorities' willingness to consider moving in this direction is encouraging.
>
> Second, I appreciate the staff's candid assessment of the governance issue in Bangladesh, in keeping with the guidelines regarding governance issues recently adopted by this Board. I would join Mr. Shields and Mr. Leijdekker, as well as the staff, in calling for better governance, including through an

improvement in management of public resources and the development of a transparent and stable economic and regulatory environment. Such improvements will support the authorities' adjustment effort and thus improve the economy's performance.

The staff representative from the Asia and Pacific Department said that the staff report was consistent with the guidance note on governance issues agreed by the Board. That guidance note distinguished between two types of cases. Specifically, it stated that the staff should bring to the attention of the Board any instances of corruption that might be linked to particular individuals if those instances were considered to have macroeconomic implications. That was not the case in Bangladesh. However, the guidance note also directed the staff to highlight any policies, institutions, or administrative systems that gave rise to rent-seeking behavior or corruption. The staff had made clear, both in the staff report currently under consideration and in its discussions with the authorities, that there were long-standing structural and institutional problems of that kind in Bangladesh.

As Mr. Shields had noted, Transparency International had cited Bangladesh as being fourth among countries suffering from problems of mismanagement and corruption, the staff representative noted. More recently, a UNDP report had cited governance and corruption as a major problem in Bangladesh, noting that if corruption were eliminated, investment in Bangladesh would likely increase by 4–5 percentage points of GDP. In addition, numerous World Bank reports, both published and unpublished, had dealt with issues related to governance in Bangladesh in detail. Those issues had also figured prominently in recent discussions between the Fund staff, the World Bank staff, and the Bangladesh authorities on a policy matrix that could be supported by an ESAF arrangement.

Governance problems were clearly at the root of the continued rigidities in the banking sector, the staff representative considered. The World Bank staff involved in a commercial bank restructuring technical assistance project in Bangladesh had focused on those problems. Moreover, in the context of the Article IV consultation discussions with the authorities, the Fund staff had conveyed its concerns about the overly cautious and slow approach a series of governments in Bangladesh had taken in dealing with large defaulters and the continued lack of accountability of bank managers.

In the area of tax administration, the Fund staff had held open discussions with the authorities on fraud and corruption in the income tax and customs departments, the staff representative continued. In recent requests for technical assistance, the Bangladesh authorities had asked the Fund staff to examine ways that might be used to reduce corruption within the tax system. Although the Fund had delivered technical assistance in that area, its recommendations had not yet been implemented. Nevertheless, Mr. Sivaraman was correct to indicate that the Bangladesh authorities were keenly aware that there were major problems to be overcome. For example, the Finance Minister of Bangladesh had cited many of those problems in his budget speeches for 1996 and 1997.

As to the possible macroeconomic impact of governance issues in Bangladesh, it was fairly clear that, unless adequately addressed, mismanagement and corruption could threaten the viability of the banking sector and could have a negative impact on investment and investor confidence, the staff representative went on. Similar problems within the tax system could not only threaten the fiscal policy stance, but also place a heavy burden on monetary policy. Ultimately, the problems related to governance would likely have a negative impact on the country's ability to maintain overall external viability.

All of the issues related to governance raised in the staff report for the current discussion had been included in the concluding statement of the recent staff mission to Bangladesh, the staff representative added. Individual areas of concern had been discussed in detail with the authorities in the context of a possible ESAF arrangement.

Although the language of the staff report currently under consideration might be more candid and forthright than that employed in other cases, it was similar to the language used by the minister of finance in recent budget speeches, the staff representative noted.

The staff report was not intended to imply that the authorities had been reluctant to provide data to the Fund, the staff representative said. Rather, it pointed out that, owing to the extensive quasifiscal operations, the available data were inadequate to allow accurate assessment of the fiscal policy stance. The box on fiscal transparency and sustainability included in the staff report was intended to describe the difficulties in that area. Indeed, the fact that there were such significant differences of view between the staff and the authorities on the likely costs of those operations served as an indication of the extent of that problem.

Data included in the box on fiscal transparency and sustainability had been used as a basis for the staff's estimates on the total debt outstanding of the state-owned enterprise sector, the staff representative stated. The data on the size and composition of the state-owned enterprises' debt as well as that on the outstanding amounts by creditor were neither comprehensive nor up to date. Therefore, the estimate on the amount of debt that would at some stage need to be assumed by the government was more likely an underestimate than an overestimate. Of the total, state-owned enterprise debt amounting to approximately 17 percent of GDP was short-term in nature. If the state-owned enterprises were sold to the private sector, the buyers would likely not be willing to take over that debt. While private sector investors might be willing to take over a part of privatized companies' long-term debts, amounting to about 13–14 percent of GDP, it was not clear whether the assets of the companies in question exceeded their liabilities. The staff estimates were subject to considerable uncertainties, but the aim at the present stage was not so much to provide totally accurate data on the size and composition of debt as to illustrate the order of magnitude of the problems the government would eventually have to face.

The staff would agree with Mr. Sivaraman that it was not always fruitful to recapitalize all financial institutions, the staff representative commented. In that respect, the staff did not intend to suggest that the government embark on efforts to immediately recapitalize all institutions. Rather, it would recommend that, in the context of a comprehensive reform effort, the authorities take measures to ensure that solvency problems would not reemerge in the future.

Again, the staff estimates on the likely recapitalization requirements were probably, if anything, overly conservative, the staff representative stated. The staff report relied on official estimates of the nonperforming loans and the undercapitalization of banks. Recent confidential studies by the World Bank undertaken in the context of a financial sector technical assistance project indicated that the problems of the banking sector were much worse than described by the staff report under consideration and that a very large percentage of the banking system was considered to be insolvent. Indeed, by international standards of loan classification, a much higher percentage of loans than indicated in the staff report would be seen as nonperforming, and the shortfall in capital would be greater than the official data suggested. Based on the official data, the budgetary costs of recapitalization were estimated to amount to about 5 percent of GDP, if comprehensive reforms were undertaken immediately; that amount could double if reforms were delayed significantly. The authorities had recently embarked on measures to speed up loan recovery. While those measures were clearly welcome, the staff did not have sufficient information at the present stage to assess their effectiveness.

There were no effective limits on central bank credit to the government, the staff representative said. Central bank credit to the government could take a variety of forms, such as ways and means advances and holdings of treasury bills. Therefore, although there might be some limit on ways and means advances, there was no effective limit on overall central bank credit to the government. That was especially true, given that the Bangladesh Bank took up any treasury bills that were not taken up by the banking system to finance the government deficit. The staff had discussed that matter in detail with the authorities in the context of the recent Article IV consultation discussions. It would also be taken up in the technical assistance provided by the World Bank. The staff had indicated to the authorities that the Fund would be ready to play a role in examining the functions of the Bangladesh Bank and in placing effective limits on credit to the government.

Favorable weather conditions and increased agricultural output had clearly played an important role in recent economic performance both in helping to keep average rates of inflation low and in containing the decline in reserves, the staff representative noted. If investor confidence had picked up more over the past year, there would have been greater private sector demand for credit which, in turn, would likely have had an adverse affect on inflation and the balance of payments, given the amount of excess credit used by the government.

Mrs. Zádor made the following statement:

During the discussion of last year's Article IV consultation with Bangladesh, the Board was encouraged by the availability of new opportunities for the authorities to adopt, in 1996, much bolder policies than had been possible during the preceding years of political uncertainty. It seemed likely that the government would find, in the political consensus on reforms, a way of accelerating growth in order to escape the trap of persistent poverty.

Since independence, Bangladesh has made remarkable progress toward consolidating the economy. In the face of very difficult natural and political conditions, the authorities had virtually eliminated the chronic food shortages and gradually increased living standards. But not even the well directed efforts of the newly elected government have sufficed to halt the economic decline since 1995. In spite of last year's relatively low inflation and high output growth, the underlying macroeconomic situation has worsened.

The staff's medium-term baseline scenario gives a very disquieting picture of the outlook for economic development if the present policies remain unchanged. The staff points out—and I incline to share their view—that without a decisive change from the present expansionary macroeconomic stance and acceleration of a critical mass of reforms, Bangladesh is likely to continue its present path of shrinking reserves, rising inflation, slowing growth, and persistent poverty. It may seem a shocking paradox to speak of expansionary policies in a country where 28 percent of the population (more than 30 million people) lives below the lower poverty line. Nonetheless, the figures show that domestic demand has been growing faster than real GDP since 1995, mainly due to growing public consumption. Much bolder reforms and a track record of greater economic stability will be needed to restore investor confidence and mobilize the badly needed but shrinking external assistance.

The most important aspect of the structural reform effort is to wholly rethink the state's role in the economy. Macroeconomic ratios and financial indicators clearly show the public sector "crowding out" the private sector, diverting resources from investments in the nascent private sector to nonproductive uses. Public enterprises should be restructured as quickly as possible, and so should the closely related financial sector, including privatization of nationalized banks.

Indeed, the financial sector is paralyzed by the large direct and indirect government financing needs and by weak financial intermediation. And although the overall budget deficit of about 5 percent of GDP seems manageable, the extensive quasifiscal activities of the central bank make the underlying fiscal position much worse than it looks from the figures. Large losses in the banking sector are reflected in wide interest rate spreads that put the burden on private borrowers.

Also, even though the current account deficit fell from 4.7 percent of GDP in 1996 to 2.9 percent in 1997, Bangladesh's external position is vulnerable. Stagnant aid disbursements and shrinking inflows of private capital have not been able to finance the increasing trade deficit, causing the already low reserves to decline further.

At this point, it is necessary to address the question of the exchange rate system. Though the exchange rate of the taka is periodically adjusted, the system basically amounts to a fixed rate regime. The authorities firmly believe that this maintains the competitiveness of Bangladesh's exports. But given worrisome movements of several indicators (the slowing growth of export volume, decreases in nonagricultural output, declining reserves), the staff is probably correct that combining the proposed fiscal adjustment with a more flexible exchange rate system would better serve several objectives. Specifically it would help prevent further erosion of reserves, aid in the conduct of monetary policy, and obviate an increase in administrative controls over imports.

Mr. Blancher made the following statement:

I would first like to commend the Bangladeshi authorities for their efforts to maintain economic growth and curb inflation. Progress on privatization and most recent trends in foreign direct investment inflows are also encouraging outcomes. However, I agree with staff that there still is ample room for a better policy design.

Development between 1991 and 1994 indicate the potential gains that the economy can get from comprehensive and sustained reforms. Today, several risks of macroeconomic destabilization call for urgent action both on the policy mix and on the structural side. I agree with Mr Sivaraman that in many respects, the authorities do act in the right direction. But, I also think that to err on the side of caution, Bangladesh should now favor bolder action over ongoing gradualism.

Areas where urgent action is particularly needed are clearly identified. I will limit myself to comments on two of these. On monetary policy, as indicated by the staff, good inflation results are partly misleading. They mask the rapid expansion of government borrowing from the banking system, the impact of which on the monetary aggregates has only been offset by restrictive measures that proved detrimental to private investment. In addition, weaknesses in the financial sector contribute to the very low level of domestic savings. The country cannot be expected to improve significantly the resource allocation process with a banking sector characterized by its "default culture." I fully share the staff's views in this area.

Recommendations on the pace of trade reform should be nuanced. I agree with Mr Sivaraman that significant progress has been achieved over the recent years. In my view, further action should be conditioned to greater room for maneuver on the external front. The staff rightly underlines that the economic expansion could be cut short by balance of payments problems, particularly in view of (i) the already large trade deficit and (ii) the fact that Bangladesh's exports remain extremely fragile, i.e., concentrated in some limited and protected sectors. In this context, further tariff reductions could effectively prove risky if implemented too hastily. In a longer term perspective, however, they should not be unduly postponed, which would most likely lead to increase their eventual cost.

Mr. Pascual made the following statement:

At first glance Bangladesh seems to have achieved a good economic performance since the last Article IV consultation. However, the results from a deeper analysis of its economy are far from satisfactory. In this sense, I should congratulate the staff for the well-focused analysis and their very useful presentation. They raise the major points of concern while they address them by suggesting a well-thought-out set of measures. I entirely support this approach and the solutions suggested, so I would limit myself to underlining some issues just for emphasis.

The present situation in Bangladesh could be defined as a "vicious circle," which originated in a misconception about the role to be played by the public sector in the economy. This misconception has led the public sector to spread its influence well beyond its reasonable role to become a vehicle of specific interest and rent seeking. The excessive number of public personnel, the great number of loss-making enterprises, the mismanagement of public banks, the lack of clear and stringent budgetary procedures and the lack of autonomy of the central bank are some features that define the problem. Consequently, monetary policy cannot achieve proper targets, the exchange rate policy is far from appropriate, and trade policy—although some improvements have been made during the past years—is compelled to be more protectionist than should be the case without internal inefficiencies.

Against this background, the staff's recipes are, although some debatable, mostly accurate. The medium-term outlook of the Bangladeshi economy demands a tremendous effort, both from the country itself and from foreign participants. Internally, the authorities should carry out a comprehensive and unequivocal U-turn. This should cover both economic policy and structural issues, and it should focus on establishing the conditions to enhance efficiency and growth. These are the only sound foundations that could ensure a sustainable path of growth from which all the population can obtain benefits. Externally, international institutions as well as individual countries have the moral responsibility to support the internal efforts to alleviate poverty. In this sense, and given the assumption that internal resources are not enough to guarantee the needed path of growth to alleviate poverty, the preliminary proposal for a future arrangement with the Fund could be the perfect catalytic element to attract foreign investment. However, once again, our responsibility compels us to require from the authorities a previous and clear commitment, shown by facts, to take steps on time and in the right direction.

In this sense, and taking advantage of the magnificent staff work, which could very well serve as guidelines, I would suggest to take prompt actions, as follows.

In fiscal policy, a complete review of the budgetary procedures so as to give to the budget its real dimension and to avoid undue slippages, especially in current expenditures.

A comprehensive reform of public service to streamline the personnel needs. This should help to reduce the overdimension and by doing so, could allow a more motivating wage policy.

A complete revision of public enterprises' activities to avoid unnecessary budgetary burdens and unacceptable interference in private sector activities. A completion of the first stages of the present privatization program is essential to gain momentum.

A clear definition and prioritization of development, health and education programs to maximize the social yields of the funds.

In monetary policy, the Bank of Bangladesh's autonomy to define targets and to carry out actions is urgently needed. A legal status to guarantee its independence is highly recommended. No privileged financing to the government or to other institutions should be granted.

A strengthening of the supervisory faculties of the Bank of Bangladesh, or other chosen agency is also essential.

Monetary policy should only be constrained by the exchange rate policy when internal economic conditions ensure the sustainability of the exchange rate and only during short periods of unjustified turbulences. In this case, unjustified turbulences mean big market movements not supported by fundamentals.

In exchange rate policy, a controlled flotation is advisable until internal conditions guarantee that the adoption of a peg will not erode competitiveness, widening the current account deficit and posing external constraints to growth. A free market-determined exchange rate system should be established as soon as possible.

In trade policy, the entire system of protection should be rationalized and new increases in tariffs should be avoided.

A comprehensive medium- to long-term program should be prepared to gradually liberalize the economy in parallel with the internal change of productive structures.

In financial markets, efforts should immediately be made to reorganize the banking system, to depurate and improve the management and to redefine the regulation to enhance competition. Combating loan fraud is a precondition.

The role of the SEC should be enhanced and independence should be given.

Interest rate controls should be eliminated as soon as possible and capital and money markets should be developed to facilitate the most efficient allocation of resources and to enhance savings and investment.

In health, important efforts should be made in collaboration with international institutions to alleviate current problems. A medium-term program could be the best solution to prioritize targets and to optimize results.

In education, measures should continue to reduce the illiteracy rate. Specific programs should be elaborated, considering precise targets in secondary studies to prepare people for future labor market needs.

To sum up, Bangladesh needs an important change in the orientation of its economic policy. A change that should be neither partial nor tentative. A change that establishes the necessary preconditions to reach, with the help of external aid, a sustainable path of growth, which is, in the end, the only way to truly alleviate the present situation of poverty. Otherwise, the imbalances will increase and the future will be uncertain. I am sure the authorities will see it that way. I wish them the best in these endeavors.

Mr. Melese-d'Hospital made the following statement:

> Many of the points I would like to make have been picked up by other speakers, in particular in Mr. Shields' statement, so I will just highlight a few key points.
>
> I would first like to thank the staff for a comprehensive and enlightening set of papers, which I believe, on balance, present a fair and unbiased assessment of the key policy challenges facing the authorities. Notwithstanding progress made in a number of areas, it remains apparent that the Bangladesh authorities have yet to fully grasp the urgent need for strong reforms to initiate a virtuous cycle of savings, investment, and growth capable of radically improving living standards.
>
> It has been estimated that Bangladesh will need to increase its investment ratio by 4 percent of GDP if it is to reach a 7 percent real GDP growth path to significantly address the problem of poverty. Yet the 1997/98 budget envisages no progress in this area, with measures to increase revenues more than offset by spending items, notably increases in public wages. Taken in conjunction with risks of slippages, including from a less-good agricultural performance, and in the context of the past two years' erosion of reserves, I would urge the authorities to consider additional measures to increase public savings on both the revenue and expenditure sides in the context of a revised budget.
>
> Issues of governance, corruption, and transparency will be crucial if Bangladesh is to increase its attractiveness to long-term foreign investment and to concessional finance. In this light, and in conjunction with comments made by other Directors, I found the staff's treatment of these issues to be on the mark. Progress in these areas takes on even greater importance in light of Bangladesh's weak starting position in the international competition for trade and investment, a fact which should be immediately apparent to the authorities.
>
> As noted in Mr. Shields' statement, privatization, financial sector reform, and trade liberalization have been correctly highlighted by the staff as high priorities. I would note in particular that the target to privatize 82 state-owned enterprises this year and to complete the program by the year 2000 is bold, but, as Mr. Shields pointed out, this is in stark contrast to actual progress in recent years. I would strongly urge the authorities to do more in these areas to move toward the potential 7 percent GDP growth path.

Mr. Donecker said that he could associate himself with the comments put forward by Mr. Shields, Mr. Ono, and Mr. Blancher for the current discussion. The more flexible stance taken with respect to the exchange rate policy and the adoption of internationally agreed capital and supervisory standards for the banking system was particularly welcome.

He generally supported the staff in its use of candid language in the staff report, Mr. Donecker stated. The staff was correct to provide an accurate assessment of structural weakness that needed to be corrected in its report. Moreover, from the current discussion, it seemed that Directors were in almost unanimous agreement on the structural problems in

Bangladesh and on the need to urgently tackle them in a forthright manner as well as to pursue progress toward economic adjustment. Having said that, however, he fully agreed with other Directors that it was important for the staff to discuss issues related to governance thoroughly with country authorities before preparing reports for Board consideration. He assumed that had been done in the case of Bangladesh. It was particularly important in cases, like Bangladesh, to safeguard the cooperative relations between the staff and country authorities.

Mr. Gruber made the following statement:

Let me start by thanking the staff for the comprehensive and clear-cut set of papers on the economic developments in Bangladesh which seem to us to be critical, but overall fair. We would like to encourage staff to continue to take a clear and frank position not only on its assessment of economic developments, but in particular also on policy recommendations. We agree in this respect with what has been said by Mr. Donecker (who asked staff to continue to talk with a clear and frank language, but at the same time underscored also the necessity of being open and fair toward the authorities, which means in this particular case, to confront them in advance with their observations on governance and corruption).

The relatively favorable growth, inflation and external performance of Bangladesh in 1996/97 is not able to conceal the fact that there persist important basic structural weaknesses which constantly put at risk macroeconomic stability and slow down growth significantly under its potential. We agree with the staff that strong measures are necessary to address key structural problems to get on to a higher and more equitable economic growth path and to break out of persistent poverty. The faster such reforms are addressed, the better.

Bangladesh's future depends on a speedy industrialization, which will have to take place in the main cities and their suburbs. It seems to be clear that Bangladesh can hardly support and bring above the poverty line an increasing population of already 120 million people in relying mainly on rural development and agricultural revolution. To perform such breakthrough, Bangladesh—which in many respects can be considered as a country in transition—needs to undergo wide ranging structural reforms in order to create a transparent and rules-based economic and institutional environment favorable to the development of private enterprises and to foreign investments.

This includes, first of all, that the government has to reduce its role in the economy by privatizing large entities in the areas of banking, energy, transport, telecommunications and production as well as by divesting its share holding in public limited companies. This would free resources for activities which cannot be handled by the private sector, notably the compensation and the retraining of laid off workers. We welcome in this respect the new impetus given to the privatization program by the appointment of a new Chairman of the Privatization Board. Given the still widespread opinion that the government should play a dominant role in the economy, it is important that the new policy is well explained to the population. It is also necessary that the new Chairman gets all the support he needs in order to overcome the opposition of vested interests.

Furthermore, it is urgently needed to streamline and increase the efficiency of the public sector. The civil service is overblown, over centralized, intermingled, inefficient and underpaid. This is, as it has also been mentioned by other speakers, a good breeding ground for corruption. Furthermore, as a result of insufficient civil services, the government, as well as international organizations and bilateral donors, have to resort to NGOs to replace the missing local authorities and to perform functions in education, health, family planning, poverty alleviation etc., which would normally belong to the public sector. The saying that "the state interferes in the economy where it shouldn't, while where it should, it does nothing" is especially valid also for Bangladesh. The civil service has to be decentralized, streamlined and a large part of the resulting savings used to increase the pay in the public sector.

As Mr. Shields, Mr. Mirakhor and other speakers mentioned—and as it also comes out from the staff report—Bangladesh stands at a junction and firm actions are now necessary to overcome persistent poverty. We hope that the authorities will be able to find the necessary social consensus to address these reforms as soon as possible and with the full commitment needed.

Mr. Berrihun noted that Bangladesh was one of the most densely populated countries, it was frequently adversely affected by the vagaries of nature, and poverty was widespread. Against that background, the progress achieved by Bangladesh over recent years was encouraging. He fully agreed with the views expressed by Mr. Sivaraman, Mr. Shaalan, and Mr. Mirakhor on the treatment of governance issues in the staff report for the current discussion.

Mr. Sivaraman thanked Directors for the sympathy they had expressed for the problems facing the Bangladesh authorities and for the valuable advice they had offered on the restructuring of the economy. He would convey Directors' comments for the current discussion to this Bangladesh authorities.

Bangladesh was a very young nation, Mr. Sivaraman noted. In the two-and-one-half decades of its existence as a sovereign country, it had been struggling to find its feet. It was only in the past year that it had established a stable government that was working on a consensual basis with the political opposition.

In recent speeches on the budget, the minister of finance had reassured the development partners and the people of Bangladesh of the governments' commitment to reform, Mr. Sivaraman said. He had also acknowledged that the severe political and social problems that needed to be overcome within Bangladesh required the active involvement of thousands of public sector employees, trade unions, and social groups in the implementation of reform policies. Against that background, the current government was fully committed to the implementation of policies that would serve the larger interests of the Bangladesh people.

It should be noted that the Bangladesh economy had grown over the past two-and-one-half decades, Mr. Sivaraman commented. In the early 1980s, Bangladesh had had a growth rate of about 3.3 percent a year; that rate had increased to about 4.7 percent in the mid-1990s, and it was currently expected to achieve a growth rate of nearly 5.6 percent in 1996/97. Exports had also increased over that period, from about 5.4 percent of GDP in the 1980s to about 12.2 percent in the 1990s, and exports were expected to reach about 13 percent of GDP in 1996/97. Its debt-service ratio had declined from 11.8 percent of GDP to about 9.8 percent, and its current account deficit remained fairly low at only about 3 percent of GDP. Although the rate of inflation was higher than optimal, it could be reduced over the period ahead.

As in other Asian countries, there were hundreds of state-owned enterprises in Bangladesh, Mr. Sivaraman said. Experience in many countries showed that, once state-owned enterprises became firmly entrenched in an economy, it was difficult to get rid of them, especially if the market economy was not yet operating at full efficiency. The Bangladesh authorities clearly recognized the need for privatization, and they were moving forward in selling off public sector enterprises. However, it was important to bear in mind that, in doing so, they would likely encounter severe differences with trade unions, which would tend to slow the privatization process.

The problems of the financial sector were well known, Mr. Sivaraman stated. In his recent speech on the budget, the minister of finance had pointed to the problems of mismanagement in the banking system, and he had given assurances that every effort would be made to safeguard the overall viability of the system. Toward that end, the authorities had introduced a number of new laws, as described in the staff report, and they were fully committed to making further progress toward reform in that area. Nevertheless, he would faithfully convey the concerns expressed by Directors for the current discussion on the dire need for urgent action to redress the problems of the financial sector to his authorities. He would also convey to his authorities the views of Directors on the need to place a statutory limit on government borrowing from the Bangladesh Bank.

The Bangladesh government was making efforts to open up the economy to private sector participation, Mr. Sivaraman noted. Significant strides had already been made in opening up the power sector and the gas sector to foreign investment. That would clearly add to the industrial potential of the country. The authorities were also opening up the telecommunications sector; licences had recently been granted for private sector interests to set up operations in that area. There was a growing interest in foreign direct investment in Bangladesh, as evidenced by the growing number of queries that were being made about opportunities in the country. In particular, foreign direct investors had made numerable expressions of interest in tapping the potential of the export-processing zones.

The Minister of Finance of Bangladesh had recently informed him that the exchange rate adjustment would proceed until an appropriate market-determined rate could be found, Mr. Sivaraman said. Petroleum prices were being revised in a manner that would eliminate the losses of the petroleum corporation. In addition, a committee was working on a determination of gas prices that would ensure that they would be market-determined in a way that provided needed assurances for private investors. Electricity prices had already been revised to bring them more into line with market forces.

The authorities were deeply concerned about the problem of poverty, Mr. Sivaraman commented. They were trying to cater to the needs of the disadvantaged, in particular the old and the homeless, through the establishment of an old-age pension scheme and a housing fund. However, the authorities faced severe resource constraints in those areas.

He wished to reassure members of the Board that his opening statement was not intended to dissuade the staff from being transparent and candid in its reports on developments in individual countries, Mr. Sivaraman stated. Rather, it was intended to highlight the need to take carefully into account political and social realities in formulating policy advice. It was much easier to offer theoretical solutions for common economic problems than it was to oversee the practical implementation of adjustment measures in the face of real-life social and political difficulties.

In cases like Bangladesh, the staff should not hesitate to provide critical assessments of recent developments or to recommend necessary corrective actions, Mr. Sivaraman considered. However, it would be counterproductive to do that in a way that might lead to their suppression not only from the press, but also within the government itself. In cases where rigorous adjustment was needed, it would be very important for the staff to use language that would be palatable for both the government and the people of the county concerned. The staff should use care to highlight the positive actions that had been taken in the past in order to encourage more progress in the future. It should also frame its policy recommendations in a way that would elicit cooperation from the government and help strengthen its hand in garnering widespread public support for reform. Such care in the use of language would be particularly important in cases where the measures needed for the long-term benefit of the country might require significant short-term sacrifices from the people.

The Acting Chairman made the following summing up:

> Executive Directors agreed with the thrust of the staff appraisal. While they welcomed last year's favorable output and inflation performance, they felt that Bangladesh should undertake significant further efforts to strengthen macroeconomic management, to accelerate structural reforms, and to achieve higher investment and growth necessary to reduce poverty. They saw risks to the macroeconomic outlook unless there was a decisive break from recent expansionary policies. Measures were also needed to restore investor confidence, which had been eroded by a lack of substantive progress in removing structural rigidities, especially in the banking system, public enterprises, and the trade system.
>
> Directors were of the view that the most immediate task was to maintain a stable macroeconomic environment and to reduce the vulnerability of the external position through a significant fiscal adjustment. Key to such an effort would be a front-loaded and sustained increase in public saving, which would arrest excessive government borrowing from the Bangladesh Bank. A few Directors expressed concern that the budget deficit relative to GDP would likely widen in 1997/98. They called for additional measures to achieve a significant reduction in the deficit ratio in order to enhance the effectiveness of monetary policy and, inter alia, allow for an adequate expansion of credit to the private sector.
>
> Directors recommended that efforts be stepped up to increase budgetary savings, and called for prompt increases in the prices of natural gas, petroleum products, fertilizers, and electricity. Noting Bangladesh's low tax ratio, Directors also stressed the need for measures to widen the tax base, together with bold reductions in tax exemptions and restraint on granting tax

holidays. Directors stressed the importance of containing increases in public wages. Directors also stressed that priority should be given to reducing unproductive expenditures, especially low-quality projects in the Annual Development Program, and to improving aid utilization in order to increase efficiency in resource use. Directors emphasized that, over the medium term, civil service reform and the elimination of the quasifiscal deficit would be necessary to make room for investment in infrastructure and the social sectors.

Directors stressed that fiscal consolidation must be supported by appropriate monetary and external sector policies. A tightening of domestic credit conditions, complemented by a more flexible exchange rate policy, would be essential to arrest the decline in reserves, protect external competitiveness, and contain inflation. The effectiveness of monetary policy would need to be strengthened by providing Bangladesh Bank with the autonomy and mandate to pursue monetary stability, with the responsibility for the funding of specialized credit institutions transferred to the budget. Some Directors also stressed the need for firm limits on government access to central bank credit. Directors noted the devaluation of the taka, and encouraged the authorities to consider establishing a more flexible exchange rate arrangement. Directors commended the authorities for prudent external debt management policy and encouraged continued avoidance of foreign borrowing on commercial terms, while promoting foreign direct investment and aid inflows through market-based reforms.

Directors urged the authorities to press ahead with structural reforms needed to foster private sector-led and outward-oriented investment and growth. In that connection, they noted the importance of unwinding inefficient public sector activities while taking steps to reform the administrative system and establish a rules-based legal and regulatory environment that would help improve economic governance. Those steps should include more transparent reporting of the budget and financial sector performance. Directors emphasized the immediate need to rehabilitate the banking system, including through restructuring and privatization, not only to ensure the efficient flow of saving and investment, but also to contain the cost of recapitalizing banks and ease the constraints on monetary policy. While Directors welcomed the ongoing progress to improve banking system laws and regulations, they urged the authorities to take concrete actions to improve the management of banks, enforce penalties on defaulters, and merge or close institutions that were not in a position to meet prudential standards.

Directors expressed disappointment about the slow progress in privatization in 1996/97, which was due in part to inadequate public support. While there were signs of renewed momentum of reform in the period ahead, Directors called for a strong political commitment to put privatization on a faster track, not least to reduce the drain on the budget and reiterate the government's commitment to market-based reform. To further promote economic efficiency and the export orientation of the economy, Directors urged the authorities to set out a timetable for an ambitious program of trade liberalization.

Directors considered reforms to establish a well-governed economy necessary not only to promote more rapid growth and poverty reduction, but also to alleviate income inequality. In order to ensure the redistributive goals of public policy, a strong adjustment program would need to be monitored through better economic statistics, in particular, improved fiscal data, in respect of its coverage, quality, and transparency.

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

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/97/81 (8/1/97) and EBM/97/82 (8/18/97).

2. OFFICE SPACE—PHASE III—COST OF CONSTRUCTING ALTERNATE CAFETERIA SMOKING ROOM

The smoking room that is currently under construction will be used as the cafeteria smoking room.

Adopted August 8, 1997

3. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 95/122, 96/87, 96/90, 96/94, 96/96, 96/99, 96/102, 96/103, 96/108, 96/109, 96/110, 96/112, 96/113, 96/114, 97/5, 97/8, and 97/14 are approved.

4. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAM/97/118, Supplement 1 (8/8/97), EBAM/97/124 (8/1/97), EBAM/97/126 (8/7/97), EBAM/97/127 (8/14/97), by an Advisor to Executive Director as set forth in EBAM/97/124 (8/1/97), and by Assistants to Executive Directors as set forth in EBAM/97/124 (8/1/97), EBAM/97/125 (8/5/97), and EBAM/97/127 (8/14/97) is approved.

5. TRAVEL BY MANAGING DIRECTOR

Travel by the Managing Director as set forth in EBAP/97/67, Supplement 1 (8/15/97) is approved.

6. TRAVEL BY ACTING MANAGING DIRECTOR

Travel by the Acting Managing Director as set forth in EBAP/97/81 (8/8/97) is approved.

APPROVAL: May 12, 1998

REINHARD H. MUNZBERG
Secretary