NOT FOR PUBLIC USE

0404

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 87/23

10:00 a.m., February 6, 1987

M. Camdessus, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	E. T. El Kogali
	Jiang H.
	M. K. Bush
J. de Groote	H. G. Schneider
A. Donoso	
	T. Alhaimus
	M. B. Chatah, Temporary
G. Grosche	
	B. Goos
	J. Reddy
	J. Hospedales, Temporary
T. P. Lankester	M. Foot
	H. Fugmann
M. Massé	I. Puro, Temporary
	C. V. Santos
	Mawakani Samba
	I. A. Al-Assaf
	L. Filardo
H. Ploix	G. Pineau, Temporary
G. A. Posthumus	J. de Beaufort Wijnholds
C. R. Rye	
G. Salehkhou	
A. K. Sengupta	O. Kabbaj
K. Yamazaki	
S. Zecchini	M. Sugita
	N. Kyriazidis

L. Van Houtven, Secretary
L. Collier, Assistant

Also Present

IBRD: F. T. Temple, South Asia Regional Office. Asian Department: H. Neiss, Deputy Director; K. A. Al-Eyd, B. Banerjee, E. Gurgen, R. Heller, A. Tilakaratna, D. Villanueva. Exchange and Trade Relations Department: M. Guitián, Deputy Director; J. T. Boorman, J. H. Felman. Fiscal Affairs Department: H. R. De Zoysa. IMF Institute: O. B. Makalou. Legal Department: F. P. Gianviti, Director; P. L. Francotte, R. H. Munzberg. Research Department: L. Alexander, N. M. Kaibni, R. Pownall. Treasurer's Department: T. Leddy, Deputy Treasurer; D. Williams, Deputy Treasurer; J. E. Blalock, D. H. Brown, D. Gupta, R. B. Hicks, B. E. Keuppens, D. V. Pritchett. Western Hemisphere Department: G. Yadav. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: P. E. Archibong, A. Bertuch-Samuels, S. M. Hassan, G. D. Hodgson, R. Morales, A. Ouanes, I. Sliper, N. Toé, A. Vasudevan, K. Yao. Assistants to Executive Directors: M. Arif, A. R. Abdullatif, A. Muhammad, F. Di Mauro, W. N. Engert, S. K. Fayyad, G. K. Hodges, L. Hubloue, O. Isleifsson, A. R. Ismael, S. King, V. K. Malhotra, T. Morita, R. Msadek, C. Noriega, B. Tamami, H. van der Burg, E. L. Walker, Yang W.

1. INCOME POSITION - BURDEN SHARING - RATE OF CHARGE AND RATE OF REMUNERATION - ADJUSTMENT FOR QUARTER ENDED JANUARY 31, 1987

The Executive Directors considered a staff paper setting forth possible courses of action on the adjustment of the rate of charge and the rate of remuneration with respect to deferred charges for the quarter ended January 31, 1987 (EBS/87/16, Sup. 1, 2/4/87).

The Deputy Treasurer stated that the amount of deferred income that was not covered by the automatic adjustment in the rate of charge and the rate of remuneration had been reduced to SDR 1.55 million from SDR 1.9 million. The reduction had come about because the rate of charge on purchases under the enlarged access policy had recently been finalized; an accrued rate had been used at the time of the staff paper's issuance.

Mr. Posthumus said that although the staff had presented options to resolve the small problem before the Board, he wished to suggest a technical alternative. He understood that deferred charges up to SDR 65 million could be covered by a symmetrical decrease in the rate of remuneration and increase in the rate of charge; the remainder--SDR 1.55 million--would be considered forgone income by the Fund. An alternative would be to treat the amount of SDR 1.55 million as deferred income in the upcoming fourth quarter--ending April 30, 1987. The rates of charge and remuneration would then be adjusted with respect to that amount for that quarter.

The Director of the Legal Department remarked that Mr. Posthumus's proposal could be adopted by the Board; it would require a 70 percent majority of the total voting power. However, no retroactive reduction could be applied to the rate of remuneration nor any retroactive increase to the rate of charge. Since a short period had already elapsed in the fourth quarter, the proposal, if approved by the Board, should take effect from the date of the decision.

Mr. Foot commented that had his chair known the outcome of the Board's decision agreed at EBM/86/188 (11/26/86) to adjust the rate of charge and the rate of remuneration on a quarterly, rather than semiannual, basis, it would have preferred to stay with a six-monthly basis. The issue of burden sharing was complex, and the small amount--SDR 1.55 million--did not warrant an extensive review of the subject. The basic policy seemed to be working well, and he continued to support it. Moreover, the Fund's net income position for the year would apparently be satisfactory. The present case was a minor technicality and should be treated in that spirit. The Board's decision should not be viewed as a precedent if the Fund ever faced large arrears that threatened to reduce the remuneration coefficient below 85 percent or net income below the target for the year.

Ms. Bush said that she also believed that the necessity for the review had arisen because of the Board decision to adjust the rates of charge and remuneration on a quarterly basis. It was unfortunate that

the present discussion had to take place, considering the small amount involved and the intensive deliberations that had determined the burden-sharing decision. The appropriate course of action, consistent with the understandings reached previously by the Board on burden sharing, would be to cover the SDR 1.55 million of deferred charges through a modest increase in the rate of charge. Some element of asymmetry had been included in the decision on burden sharing, which specified an 85 percent floor for the rate of remuneration but placed no limitation on the rate of charge. The staff had stated that in the absence of Board approval of either of the two options presented in the paper, charges would be increased under the decision on burden sharing to generate the income necessary to cover the deferred charges.

Mr. Sengupta observed that while the decision stated that if the remuneration coefficient fell below 85 percent, a review should take place, it did not specify the outcome. However, as the amount involved was modest, he would not want to prolong the discussion.

Mr. Rye commented that the matter was complex, but two points should be kept in mind. First, the decision adopted that day, although necessary, should not set a precedent that the Board might later wish to reconsider. Second, the small amount reflected more a technicality than a fundamental breakdown of the operation of the decision. He could therefore go along with the staff's proposal, especially as the Fund's income position was better than projected. He was attracted by the suggestion put forward by Mr. Posthumus, however, and he would be willing to go along with it if it received broad support.

Mr. Yamazaki said that he endorsed the views expressed by Ms. Bush and Mr. Foot.

Mr. Grosche remarked that he considered the problem a purely technical one stemming from the Board's decision to adjust the rates on a quarterly basis. The Board should therefore deal with the modest amount in a flexible and low-key fashion without creating a precedent. Another reason for flexibility was the Fund's projected excess net income for the financial year (FY) 1987, part of which could be used to make up the temporary loss of income or additional charges. He would have preferred to postpone a decision until the final outcome for FY 1987 was known. However, for technical reasons he could support the staff proposal, although he could also go along with Mr. Posthumus's suggestion if it gained the broad support of the Board.

Mrs. Ploix noted that the Fund's financial prospects were satisfactory. Moreover, the decision on burden sharing, reached after difficult discussions, should be maintained and there should be no departure from the agreed principle of symmetry. As the problem was minor and technical, she concurred with the positions stated by Mr. Grosche and Mr. Rye of supporting either the staff proposal or Mr. Posthumus's alternative.

Mr. Fugmann said that he also could accept the proposals of the staff or Mr. Posthumus. He would prefer Mr. Posthumus's proposal if it would attract the support of Ms. Bush and Mr. Foot.

Mrs. Filardo made the following statement:

> The recent Fund decision on the process of burden sharing may be regarded as one of the most important accomplishments in the negotiations between debtor and creditor countries. This process is based on the principle of symmetry, and the high priority that this chair attaches to that principle prompts us to endorse the decision proposed by the staff for a limited symmetrical adjustment of the rate of charge and the rate of remuneration for the quarter ended January 31, 1987.
>
> Although the principles embodied in burden sharing highlight the spirit of collaboration between countries, we are only beginning to learn how to apply them in practice. Therefore, we should analyze the problems resulting from the schemes we have devised and study other alternatives, so long as they preserve the principle of symmetry. The issue being discussed arises because of unforeseen consequences of the decision to provide for quarterly, instead of semiannual, adjustments of the rates of charge and remuneration. Because the increased volatility in the rates is at odds with previous agreements, the present discussion could be considered a technical review of the procedure.
>
> The proposal by Mr. Posthumus may solve the problem, and it would adhere to the principle of symmetry; therefore, we can support it. The amount of deferred income does not warrant broaching the subject of burden sharing again. The solution suggested by Mr. Posthumus could be adopted, with the clear understanding that it poses no precedent.
>
> In sum, I endorse the staff proposal, but I am willing to support any other alternative that would gather the consensus of the Board and preserve the principle of symmetry.

Mr. Zecchini observed that it would not be advisable to initiate a debate on all aspects of the burden-sharing decision. The present discussion, which was taking place because of the procedure adopted by the Board, could not be confined to one or two issues, as the decision on burden sharing had struck a delicate balance in order to reach a compromise between very divergent positions. The problem facing the Executive Board stemmed from the recent change to a quarterly basis in the adjustment procedures. Perhaps the amount of deferred charges in the next quarter would leave more room for the application of the decision without violating its basic principle of symmetry; if the situation should prove

otherwise, a discussion on all aspects of the decision would seem mandatory. In light of those considerations, he believed that the solution proposed by Mr. Posthumus was the most appropriate.

Mr. Massé commented that the present discussion should not lead to a review of the principles of burden sharing, notably that of symmetrical treatment. One solution to the present problem was to ignore the modest amount involved, but he did not favor placing the Fund in a position to forgo income. He therefore supported Mr. Posthumus's proposal to shift the amount to the fourth quarter when the rates of charge and remuneration could be adjusted accordingly. A discussion of the basic principles of the decision should occur only if a significant amount were involved.

Mr. Donoso said that he agreed with the staff analysis and the suggested course of action for the adjustment of the rates of charge and remuneration for the quarter ended January 31, 1987. The proposed decision preserved the principle of symmetry embodied in the burden-sharing decision adopted in 1986 while it did not affect significantly the Fund's financial position. The existing gap between the level of deferred income and the amounts that could be financed by adjustments in both the rate of charge and the rate of remuneration, without reducing the remuneration coefficient below the 85 percent floor, was small and should not prevent the Fund from achieving its annual net income target, as suggested by the current projections for that variable.

In addition, it was unlikely that the situation would arise again, unless a further aggravation of the overdue payments situation should occur, Mr. Donoso noted. The increase in the rate of remuneration to a level equivalent to 100 percent of the SDR rate of interest would provide more room, if needed, for downward adjustments in connection with the financing of the amounts of deferred income that might be required.

In sum, Mr. Donoso concluded, the proposed decision had the merits of adhering to the principles of burden sharing as well as being practical and easy to implement, and he could support it.

Mr. de Groote commented that the proposal put forward by Mr. Posthumus was attractive because it did not entail a general review of the underlying principles of the burden-sharing decision. Moreover, the amount under consideration was modest, and the Fund's income position was favorable. He therefore strongly supported the proposal.

Mr. Al-Assaf observed that the problem that had arisen in the third quarter seemed to be due, among other factors, to the Board's earlier decision to place the burden-sharing calculations on a quarterly basis. On the occasion of that discussion, he had indicated that the probability of reaching the remuneration coefficient floor would be increased by the shift to a quarterly basis.

A decision to use a portion of the projected income surplus would amount to creating an additional purpose for that surplus, namely, covering deferred charges, Mr. Al-Assaf stated, he preferred not to adopt a decision at the present stage.

The problem faced at the present was not likely to recur in the final quarter of the financial year, Mr. Al-Assaf remarked. However, steps should be taken to reduce substantially the prospects of its recurrence. He therefore suggested a procedure whereby the Sudanese authorities, who apparently intended to mobilize some $50 million to reduce their overdue obligations, could apply forthcoming payments to new interest obligations. In that way, Sudan would avoid accumulating further deferred charges and reduce the probability of the burden-sharing formula reaching its limits. He suggested in essence that payments be assigned on a last-in first-out, rather than a first-in first-out, basis. Such a procedure could help to ensure that the present problem did not recur and could be applied to other countries in arrears.

Mr. El Kogali made the following statement:

In considering the possible courses of action on the adjustment of the rate of charge and the rate of remuneration for the quarter ended January 31, 1987, I am inclined to view the second option proposed by the staff as realistic and more likely to accord with the Board's earlier decision on the matter. This option, which preserves the symmetrical adjustment of both the rate of charge and the rate of remuneration while maintaining the agreed 85 percent floor for the remuneration coefficient, seems not only equitable but more appropriate to address the problem. Although the first option could produce both a rate of charge and a rate of remuneration that would fully compensate for deferred charges, I am not sure that the resultant reduction in the remuneration coefficient below 85 percent, which would reduce remuneration below the level specified in the decision on the principles of burden sharing, would be acceptable.

Admittedly, our preferred option would, according to the staff, reduce the Fund's net income below what it would otherwise have been. But this should not pose a problem at this time, given the Fund's projected net income for FY 1987 of SDR 120 million--SDR 36 million more than the target amount of SDR 84.2 million for the year. Indeed, this fairly robust net income position, among other things, justifies our preferred course of action.

Equity should also apply to the distribution of the proceeds of the settlement of deferred income between the recipients of remuneration--creditors--and the countries paying charges--debtors. In this connection, I find some merit in the recommendation that

the distribution of such proceeds should be based on an approach similar to that embodied in the decision on the principles of burden sharing.

I look forward to the time when all members will remain current with the Fund, and thus spare the Board this difficult exercise. I suppport the proposed decision, although the suggestion put forward by Mr. Posthumus is interesting.

Mr. Jiang said that he could go along with the proposed decision; it took into account the favorable income outlook for the remainder of the financial year and the expressed wish to maintain a relatively stable rate of charge on the use of the Fund's ordinary resources. The staff's proposal was the most practical decision that could be taken in the present circumstances.

Mr. Mawakani stated that he shared the views put forward by Mrs. Ploix and could go along with her proposal. There should be no departure from the basic principles of symmetry and simultaneity underlying the decision on burden sharing.

Mr. Hospedales commented that in the light of the modest amount involved and the complexity of the burden-sharing arrangements decided after lengthy and delicate negotiations, the staff's proposal seemed an appropriate solution to the problem. He could support the proposed decision, especially because of the relatively favorable financial position of the Fund and the desirability of maintaining relative stability in the rate of charge.

Mr. Kabbaj remarked that for the reasons outlined by almost all previous speakers, he could go along with either the proposed decision or Mr. Posthumus's proposal.

Mr. Alhaimus said that he too could support either the draft decision or the suggestion made by Mr. Posthumus.

Mr. Reddy remarked that his first preference was to ignore the SDR 1.55 million that could not be recovered through adjustments to the rates of charge and remuneration. His second preference was the proposal put forward by Mr. Posthumus.

Mr. Donoso said that he also could go along with Mr. Posthumus's proposal.

Ms. Bush recalled that a few Directors with a fair percentage of the voting power had suggested that the rate of charge should be increased to generate an amount equivalent to that part of the charges deferred during the quarter that was not covered by the reduction in remuneration expenses. She considered that the rate of charge should be raised to cover the

Fund's income position. While Mr. Posthumus's suggestion had received support, she found some aspects of it disturbing. If coverage of the deferred charges were postponed to the fourth quarter, the Fund's income position would not be covered in the third quarter, whereas the intention of the burden-sharing agreement was to fully cover deferred charges as they occurred, notwithstanding any increase in reserves. While in the present case the amount was modest, it was impossible to predict the magnitude of any future similar situation, and if a sizable amount were involved, the attractiveness of shifting it to a later quarter would be questionable. The decision taken that day should not establish a precedent. Because of her strong concern that the principles of the burden-sharing agreement be respected, she suggested a slight variation of Mr. Posthumus's proposal: to increase the rate of charge for the third quarter to cover the Fund's position, but to agree that the amount paid by the debtors through the rate of charge would be redistributed to them at the end of the fourth quarter when the Fund's excess net income had materialized. In that way, the Fund's position would be covered and the debtors would benefit from a retroactive decrease in the rate of charge.

The Deputy Treasurer stated that present data indicated that the Fund would have excess net income for the year as a whole of about SDR 36 million. Net income could be reduced by two occurrences: a very sharp rise in the SDR interest rate and a large reserve tranche drawing--neither of which could be forecast. However, the staff felt reasonably sure about the outcome because the maximum amount of deferred income for the fourth quarter was expected to be somewhat less than SDR 45 million. Therefore Ms. Bush's proposal could be accommodated.

There was, however, a technical complication, the Deputy Treasurer remarked. The Fund's net income in excess of the reserve target had been forecast at about SDR 36 million and was attributable basically to the substantial fall in the SDR interest rate and to the discharge of deferred charges that had been incurred before May 1, 1986. The Board had not decided how that payment with respect to income deferred before May 1, 1986--amounting to about SDR 23 million--would be distributed because it did not fall under the burden-sharing decision. No agreement had been reached on that point, partly because several Executive Directors had considered that, as the rate of charge had risen in FY 1986, the income should go to those who had paid the increased charges; others had felt a strengthening of the Fund's reserve position was warranted.

Another aspect was the payment in the third quarter of amounts that had been deferred in the first half of FY 1987, the Deputy Treasurer continued. According to the principles of the burden-sharing decision, that income would be distributed to those members who had paid additional charges or had received reduced remuneration. If, according to Ms. Bush's proposal, SDR 1.55 million were paid in the present quarter in the form of higher charges, it would subsequently be reflected in a reduction of the rate of charge for those who had paid the increased rate of charge for that quarter. The issue was one of redistributing the excess income for

the last quarter of the year--income which derived, however, from sources which the Executive Board had not agreed to use to lower charges or raise reserves.

The Chairman noted that speakers in general had been concerned that the complex subject of burden sharing not be reopened. They had also expressed a strong desire not to create a precedent in dealing with the modest amount under consideration or to deviate from the principles of the decision of burden sharing. However, it was necessary to find a solution supported by 70 percent of the voting power of the Board.

Mr. Foot said that, of the options presented, he continued to prefer the staff proposal. Like Ms. Bush, he was concerned about the conceptual aspect of Mr. Posthumus's proposal in the sense that the Fund's third quarter income position was not covered. However, he could support his proposal if it was made clear that it would not be considered a precedent if in future a similar problem arose but consisting of a significant amount. In addition, some reassurance was provided by the favorable outlook for the Fund's excess net income.

The proposal put forward by Ms. Bush seemed to reflect the spirit of burden sharing in a pragmatic way, Mr. Foot observed. The debtors would receive in the fourth quarter what they had paid in the third quarter.

Mr. Grosche said that he could go along with the proposals put forward by both the staff and Mr. Posthumus, although he had a slight preference for the staff proposal for some of the reasons mentioned by Mr. Foot. He considered the third and fourth quarters as one unit, and he was reassured by the fact that the excess income for the total fiscal year would cover the problem faced in the third quarter.

Mr. Posthumus observed that he had put forward a technical proposal because he preferred not to follow the staff's option at the cost of the Fund's income position. The alternative he had suggested should not in any way be considered a precedent. While he would prefer not to endorse the staff proposal, he was ready to support the majority decision.

Ms. Bush remarked that Mr. Posthumus's proposal would apparently cover deferred charges in the fourth quarter. She asked the staff to explain whether its proposal would also do so.

The Deputy Treasurer said that under both proposals, the Fund's net income for the fourth quarter would fall. Under the staff proposal, the deferred income would be covered formally whereas under Mr. Posthumus's proposal it would be covered de facto. One important difference arose, however; if the Board followed the staff's proposal, the Fund's net income for the third quarter would be formally reduced and the resulting adjustment of charges and remuneration would be made on a lower net income taking the year as a whole. Under Mr. Posthumus's proposal, the amount of deferred income for the fourth quarter plus the SDR 1.55 million deferred from the third quarter would be covered by an increase in the rate of

charge and a reduction in remuneration in the fourth quarter that would be within the 85 percent remuneration coefficient limit. The amount of adjustment with respect to charges and remuneration for the fourth quarter under Mr. Posthumus's proposal would be larger than under the staff proposal.

Mr. Yamazaki said that he supported the views of Ms. Bush; however, of the proposals put forward, he could go along with the one suggested by the staff.

Ms. Bush observed that she hoped that the Board would reach a decision that could, as much as possible, protect the Fund's income position. In the light of the staff's explanation, she could go along with Mr. Posthumus's proposal.

Mr. Zecchini considered that because the present problem was the result of the Board's decision to place burden-sharing calculations on a quarterly basis, he could endorse Mr. Posthumus's proposal.

Mr. Foot commented that the principle of symmetry in burden sharing was a good concept, but there was a difference between the spirit of the principle and practice that was unduly punctilious. A pragmatic approach could achieve the same benefits. He could go along with Mr. Posthumus's proposal.

Mr. Grosche, Mr. Sengupta, Mr. Yamazaki, and Mr. Al-Assaf said that they supported Mr. Posthumus's proposal.

The Chairman indicated that Mr. Posthumus's proposal had received the necessary support .

The Executive Board then took the following decision:

1. The Executive Board has reviewed the operation of Decision No. 8348-(86/122), adopted July 25, 1986 (as amended), in accordance with Section V, paragraph 2(f) of that decision.

2. The adjustment in the rate of charge for the quarter ended January 31, 1987 will be limited so as to generate an amount equal to the amount generated through the reduction in remuneration for that quarter to cover deferred charges. The resulting shortfall will be deemed deferred income in the quarter ending April 30, 1987; the rate of charge and the rate of remuneration will be adjusted with respect to this amount, for the period from February 7, 1987 to the end of the quarter.

3. Whenever charges that became deferred are settled, distributions under Section V, paragraphs 4(b) and (c) of Decision No. 8348-(86/122) (as amended) shall be made in the

proportion that the adjustment payments with respect to deferred income for that period had to the amount of deferred charges for the same period.

Decision No. 8515-(87/23), adopted
February 6, 1987

2. BANGLADESH - 1986 ARTICLE IV CONSULTATION; REVIEW UNDER STAND-BY ARRANGEMENT; STRUCTURAL ADJUSTMENT ARRANGEMENT; AND PURCHASE TRANSACTION - COMPENSATORY FINANCING FACILITY

The Executive Directors considered the staff report for the 1986 Article IV consultation with Bangladesh, the second review under the stand-by arrangement, and a request for a structural adjustment arrangement in an amount equivalent to SDR 135.125 million (EBS/87/7, 1/15/87; Cor. 1, 2/5/87; and Sup. 1, 2/5/87), together with a request for a purchase under the compensatory financing facility (EBS/87/8, 1/16/87; and Sup. 1, 2/5/87). They also had before them a background paper on recent economic developments in Bangladesh (SM/87/26, 1/30/87).

The Chairman made the following statement:

There follows for the information of Executive Directors the text of a memorandum that I have received from the President of the World Bank to serve as the basis for my statement on the matter to the Board. This text summarizes the main points covered by the Executive Directors of the Bank and IDA in their January 29, 1987 discussion in Committee of the Whole of a paper entitled "Bangladesh - Policy Framework Paper (July 1986-June 1989.)"

1. The Executive Directors of the Bank and IDA discussed, in a meeting of the Committee of the Whole, the paper entitled "Bangladesh - Policy Framework Paper, July 1986-June 1989."

2. Speakers complimented the Government of Bangladesh on an excellent document describing an ambitious and generally satisfactory policy framework. The considerable progress already made was also commended. It was recognized that Bangladesh is one of the poorest countries, with high population density and continued high population growth. Its capacity for domestic resource mobilization is, therefore, limited. It was noted that further efforts were, however, necessary. Staff pointed out that tax reform was under discussion but that progress was likely to be slow. Doubts were also expressed about the feasibility of the growth rate, which is well above achievements in recent years. Attaining a higher annual growth would require the effective implementation of the program.

3. Speakers stressed the importance of several measures in the program. It was suggested that the unification of the exchange rate should be completed expeditiously. The initial improvement in the reduction of arrears in both agriculture and industry was welcomed but considerably more progress would be essential if the financial sector is to remain viable.

4. There were also questions about the realism of aid flows. In particular, increased disbursements of project aid might be difficult in view of continued weaknesses in public administration. However, it was noted that a number of measures had already been taken and that project disbursements had increased. Nonetheless there was no doubt that in the long term, prospects for improved absorptive capacity and higher overall growth will require increased emphasis on human resource development programs.

5. A number of speakers emphasized the long-term nature of Bangladesh's development problem and the need to focus on human resource development and poverty alleviation. In addition, concern was expressed that some of the measures included in the adjustment program might be detrimental to the very poor. Staff explained that an incidence analysis had been undertaken in as much detail as was possible, given the lack of data. Results suggest that there is unlikely to be a net negative impact on the lower-income groups. However, it is clear that policies to promote growth and efficiency must be complemented by targeted programs to assist the most vulnerable and by increased efforts in education and training and in primary health. IDA was deeply involved in assisting the Government in these areas and would continue to be so. Shifts in educational priorities are already being discussed, encouraging an emphasis on basic education and improving education administration. Poverty alleviation remains the core of Bangladesh development strategy. This is clearly a very long-term objective requiring continued efforts in human resource development as well as measures to improve the efficiency of resource mobilization and use.

The staff representative from the Asian Department reported that the authorities had informed the staff that they intended to unify the exchange markets; the unification process would be pursued gradually in order to minimize any possible adverse impact on workers' remittances and on utilization of tied aid. The authorities had requested the staff to study the subject and to examine the operational modalities of the unified exchange rate system.

Mr. Sengupta made the following statement:

My Bangladesh authorities are highly appreciative of the staff's excellent assessment and analysis of economic developments in Bangladesh, and of the cooperative atmosphere in which

the discussions took place over the structural aspects of adjustment when Bangladesh made a request for arrangements under the structural adjustment facility (EBS/87/7). They also thank the staff for endorsing the request for use of resources under the compensatory financing facility (EBS/87/8).

Bangladesh, as Directors are aware, is currently implementing an adjustment program under a 19-month stand-by arrangement with the Fund in the amount of SDR 180 million, of which SDR 132 million has been utilized. The main objectives of the adjustment program are to reduce internal and external imbalances and to moderate the inflation rate while maintaining a satisfactory rate of economic growth.

Macroeconomic performance during 1985/86 was satisfactory. Real GDP is estimated to have increased by 3.9 percent, slightly less than the program target of 4.1 percent, reflecting a decline in the production of textiles and stagnation in foodgrain production. The inflation performance was better: the rate decelerated to 9.8 percent, compared with the program target of 12 percent, owing to a moderation of domestic demand helped by a slower increase in import prices. The budget deficit at 7.3 percent of GDP was in accordance with the program target, with lower than programmed expenditure offsetting the fall in total government revenue. Monetary developments were also broadly in accordance with the program, except in the area of loan recovery. Net domestic asset expansion was lower than the program level in absolute terms. However, broad money expanded by 17.1 percent, slightly higher than the program target of 15.9 percent, mainly owing to a stronger than expected balance of payments outcome. Interest rates remained positive in real terms. The lower external current account deficit--6.9 percent of GDP compared with the target of 7.3 percent--was rendered possible by a decline in food imports and the increase in workers' remittances responding to the depreciation of the taka. These two developments alone had more than offset the drop in export earnings caused mainly by a steep fall in the prices of raw jute. The official exchange rate of the taka vis-à-vis the U.S. dollar was adjusted frequently, in small steps, resulting in a 20 percent depreciation in the nominal effective rate and in a 12 percent depreciation in real effective terms.

The 1986/87 program was designed to consolidate the gains of 1985/86. The program included measures that ultimately formed part of the first annual phase of the proposed structural adjustment arrangement. Its objectives are to achieve a higher real GDP growth of 4.8 percent while reducing the inflation rate to 8.5 percent. The current account deficit was set at 6.6 percent of GDP, while the overall budget deficit was to be contained at 7.2 percent of GDP. It is envisaged that most of the budget deficit would be financed from external sources. The expansion in net domestic assets of the banking system was to be limited to 15.0 percent.

The present economic situation of Bangladesh is adversely affected by depressed domestic prices for the major cash crop--raw jute--and by the external environment, as reflected in lower export prices for raw jute, jute goods, and tea. The average industrial production index during the first five months of 1986/87 recorded a noticeable increase compared with the average during the corresponding period of the previous year, especially in food, textile, and petroleum industries. Domestic production of cement also increased sharply during the five months of the current year. The prospect of growth in the agricultural sector, on the other hand, seemed to have weakened mainly owing to the substantial fall in both production and prices of raw jute. The overall growth rate is therefore expected to be slightly below the target. Prices have increased by 6.08 percent during July-December 1986, compared with 5.06 percent of the corresponding period last year, with pressure mainly concentrated in September and October 1986 because of heavy rainfall that damaged agricultural crops. However, prices started falling from the latter part of November 1986 and it is expected that the inflation rate would come down in the coming months. The annual rate of inflation during 1986-87 may, however, remain slightly above that of the previous year.

Workers' remittances will be much higher than programmed, but export growth will be lower than expected, owing to continued weakness of jute and tea prices. Mainly owing to inadequate resources for imports in the first half of the current year and to the fall in prices of international commodities, imports will be lower than expected in value terms. The Government has taken steps in the last two weeks to increase imports, particularly of industrial raw materials and essential consumer goods. The current account deficit may not differ from the programmed target in terms of GDP. With the likely shortfall in commodity aid, the overall balance of payments will most likely show only a small surplus of $12 million. However, considering the expected use of Fund resources under the structural adjustment and compensatory financing facilities, gross international reserves are likely to be higher than programmed. The authorities also made further progress toward the unification of the exchange markets. In November 1986, the official exchange rate was depreciated by 1.6 percent vis-à-vis the U.S. dollar. In July 1986, the scope of the secondary exchange market was enlarged substantially, raising the share of both export and import transactions. The overall budget deficit is expected to fall short of the program target by 0.1 percentage point, with reductions in expenditure, especially in the food account, exceeding the shortfall in total revenue. The fall in total revenue is partly due to reduced tax revenue which in turn originated from the lower level of imports and partly due to the shortfall in nontax revenue reflecting the poor performance of the jute industry, largely because of a fall in international prices of jute goods and of the textile sector, resulting from a lower offtake due to reduced demand. The Government is

undertaking various measures to improve the performance of these public enterprises. Measures to raise tax collections are being implemented and the total subsidy for food will be further reduced in the current year. While the elimination of food subsidies can be a valid objective, it can be pursued only by indicative targets without a rigid time frame. According to my authorities, the situation should be watched carefully every year, taking into account the levels of production and import availability. The rate of broad money expansion is expected to decelerate to 15 percent, against the program target of 15.7 percent, owing to smaller increases in net foreign assets and in net domestic assets of the banking system than envisaged.

The policy measures being undertaken in 1986/87 also contained those that formed part of the first annual program under the proposed structural adjustment arrangement. These cover a broad spectrum and I propose to focus on a few areas--fiscal, financial, jute goods, trade, and exchange rates.

It has been recognized that modest government revenue in relation to GDP, high dependence on trade-related taxes, deterioration in the financial position of nonfinancial public enterprises, and administrative deficiencies in tax collection are the major issues in the field of public finance. A comprehensive review of the tax policy is already under way. As already indicated, measures to counter tax evasion and further reductions in subsidies will be undertaken in the current fiscal year. Policies to rehabilitate public enterprises, including measures to reduce excessive lags in settlement of accounts due, are being formulated in consultation with the World Bank and with UNDP assistance. Under the three-year structural adjustment facility program, public enterprise profitability will be enhanced through the adoption of appropriate pricing policies and increased operational efficiency. The authorities also intend to privatize public enterprises on a selective basis and to sell government-owned shares in others to the public.

In the jute sector, the Government will discontinue its price support for raw jute in 1986/87. But the actual purchases so far by the Bangladesh Jute Corporation have exceeded the annual target because the private jute traders have remained inactive. The lower international prices for jute and jute goods and sluggish export demand also accounted for losses. Rationalization of the capacity of jute mills, which is a way out of the problem, has to be undertaken carefully, considering its impact on employment and the consequential socioeconomic implications during the period of transition. The Government is currently reviewing the World Bank study on the jute sector, which is intended to reduce the price and supply instability in the sector.

In the monetary and banking field, the increase in overdue loans has been a matter of concern. This increase has been caused by increased lending and low loan recovery. The liberal refinancing policies of the Bangladesh Bank contributed to the increase in lending while loan recovery problems have eroded the liquidity position of the state-owned banks. Recognizing the seriousness of the situation, the Government has recently put into effect a comprehensive loan recovery program. In respect of agricultural loans, the program aims at increasing collections during 1986/87 by at least 30 percent over the level realized in 1985/86. Banks have been asked to set up and pursue quarterly cash recovery goals. Accrued interest and penalties will be waived on all crop loans not exceeding TK 10,000 if the principal amount is repaid by end-February 1987. As of November 1986, crop loans have not been given to farmers not possessing valid passbooks. Bangladesh Bank will be establishing a new credit information system to prevent willful defaulters' from obtaining new loans. The Government has established a high-level committee, headed by the Cabinet Secretary, to coordinate and supervise the agricultural loan recovery program and to take policy decisions on agricultural credit reforms. The task force responsible for monitoring the implementation of the recommendations would serve as the technical arm of this committee. Regarding the industrial loans, the two development finance institutions (DFI) were given collection targets. The Government is also implementing measures such as denial of commercial bank credit and import licenses to defaulters on DFI loans and takeovers of defaulters' assets through special procedures. The loan recovery program will be an important element of the financial sector reforms envisaged as part of the program under the structural adjustment facility.

It is the intention of the authorities to rationalize the interest rate structure and make it flexible. The movement toward a market-oriented system, however, will have to be gradual. The role of the Bangladesh Bank will be strengthened. Indirect instruments of monetary control will be emphasized.

The authorities intend to develop export-oriented industries, follow flexible exchange rate policies, and reform the exchange, trade and industrial systems. In July 1986, the list of banned and restricted imports was considerably shortened. Official approval of new investment is no longer needed if the investment is self-financed. The sanctioning procedures in cases of investment financed by domestic borrowing have been streamlined. The limits to sanction loans to units, by banks and DFIs, have been doubled. Direct foreign investment, especially in export-oriented industries, is being encouraged.

The official exchange rate has been adjusted periodically since 1985. Bangladesh Bank has not intervened since the beginning of July 1985 in the secondary exchange market. In July 1986, the

scope of the secondary market was further expanded, by increasing the share of export transactions from about 53 percent to 73 percent of total exports and that of import transactions from about 28 percent to 42 percent of total imports. As indicated already, in November 1986 the differential between the official and secondary markets was narrowed from 9.2 percent to 7.5 percent through a depreciation of the taka. The authorities remain committed to exchange rate unification, in a gradual manner so as to avoid any unfavorable consequences for workers' remittances or the costs of aid-financed imports.

My authorities have built the structural adjustment facility program for 1986/87 on the measures being implemented under the current stand-by arrangement. The three-year program aims to raise annual real GDP growth to at least 5 percent on average, reduce the inflation rate to 7 percent by 1988/89, and stabilize the current account deficit and the central government budget deficit at about 7 percent of GDP. It is expected that the debt service ratio will be reduced to about 21 percent by 1988/89 from the level of 29 percent in 1985/86. The projections for current account deficits during the medium term depend on aid absorption from year to year and therefore should be treated as flexible. Nontraditional exports are expected to grow by 21 percent a year over the medium term. This is feasible, as there is considerable scope for exporting such items as frozen food, ready-made garments, and vegetables.

My Bangladesh authorities also ask for the Board approval of their request for the use of resources under the compensatory financing facility. As the Directors are aware, Bangladesh exports declined by 21 percent in 1985/86, mainly because of the weakness of the markets for raw jute and jute goods, which is beyond the control of Bangladesh. Support under the compensatory financing facility would help to raise gross international reserves to a level that would facilitate the liberalization program and help speed up the adjustment process.

Mr. Yamazaki made the following statement:

I am pleased to note that further progress has been made during 1985/86 and in the early months of 1986/87 toward attaining the objectives of the adjustment program supported by a stand-by arrangement. All the performance criteria through September 1986 were met, and economic performance in the first months of the fiscal year was broadly in line with the program.

At the same time, some recent developments highlighted the structural weakness of the economy, which could hamper the adjustment and development processes over the medium term. The shortfall in government revenue underscores the need to increase tax

revenue and improve the management of public enterprises. The export shortfall reflects the industrial structure's heavy reliance on jute and jute products. An alarming increase in of outstanding bank credit--was a major impediment to resource allocation nonperforming loans has revealed the fragility of management, accounting, and the legal framework of the financial system.

The staff identifies four major areas where structural improvement is called for, namely, mobilization of public sector resources, the jute sector, the financial system, and the liberalization of trade and industrial policies. I can endorse the staff appraisal and recommendations in these areas, and I am encouraged that, sharing these views, the authorities are embarking on a comprehensive structural adjustment reform to be supported by the structural adjustment facility. Nevertheless, I must underline the need for early implementation of structural measures that would provide continued support for the adjustment efforts under the existing stand-by arrangement.

First, on revenue-raising measures, while I welcome the authorities' intention to conduct a comprehensive review of tax policy and administration, this is an area where the need for reform has long been recognized, and early action based on the findings is most important. I also concur with the staff in stressing the importance of mobilizing resources in the short term which can be realized by improving tax collections and reviewing the system of subsidies.

Second, the inefficiency of the public enterprises is a subject that has been discussed repeatedly by the Executive Board, and I strongly hope that concrete steps will be taken to improve their efficiency on the basis of consultations with the World Bank and the UNDP. In this connection, reform of public pricing policies will have an important role to play.

Third, a sharp drop in the rate of loan recovery is a source of concern, posing a potentially serious threat to the whole financial system. Various factors worked together to cause this problem and, while the action program represents an important step in the right direction, comprehensive and far-reaching measures will be required to deal with the fundamental weakness in the financial system.

The interest rate structure is another important area where immediate attention and action are called for. Interest subsidies implied by lending rates lower than deposit rates are borne by lending institutions and undermine their financial positions. They are also harmful to the efforts to mobilize domestic resources.

Fourth, on industrial and trade policies, liberalization of the exchange and trade system and rationalization of the tariff structure need to be continued with a view to promoting industrialization and export diversification. The authorities should intensify their efforts toward unification of the dual exchange system and in this connection the presentation of a time schedule is worth consideration.

In concluding, while I note with satisfaction the progress made so far under the stand-by arrangement and can endorse the program to be supported by the structural adjustment facility, I see some scope for intensifying and accelerating structural reform measures, which would also be helpful in realizing the objectives of the stand-by arrangement. I can support the proposed decisions related to the review under the stand-by arrangement and to the structural adjustment facility. I can also endorse the decision with regard to the compensatory financing facility.

Mr. Lankester observed that the Bangladesh authorities had achieved a good track record in the recent past. They deserved praise for their efforts in tackling the formidable problems facing the country. Growth in 1985/86 had continued at about 4 percent; inflation had fallen somewhat; and, most important, a modest surplus in the overall balance of payments had been achieved, despite a sharp deterioration in the terms of trade. Those results were commendable, as was the good standing of the authorities with the Fund, which had been maintained despite adverse circumstances.

The authorities' success in meeting the objectives of the stand-by arrangement appeared to have continued in the current fiscal year, although the performance of the nonfinancial public enterprises had been weaker than expected, Mr. Lankester said. It was encouraging that the shortfall might be partially offset by improved tax receipts; that development would be particularly welcome as tax revenue was currently low by international standards.

The staff believed that development expenditure might be below projected levels while current expenditure was running higher than planned, Mr. Lankester continued. That imbalance gave cause for concern. The development spending shortfall seemed to be due partly to slower than expected aid disbursements, which in turn was partly attributable to a relatively low rate of aid utilization. In that connection, the main problem seemed to be weaknesses in public administration and inadequate provision for the necessary counterpart funds. Over the medium term, the staff had assumed that the volume of aid disbursements would grow by 7 percent a year. He hoped that that level could be achieved, but it would require great efforts by the international community and by the Bangladesh authorities in improving their ability to absorb external aid.

As to the proposed arrangement under the structural adjustment facility, the policy framework paper was excellent, Mr. Lankester commented. The drafters had shown a masterly grasp of the problems and prospects of Bangladesh.

In the monetary area, the poor rate of loan recovery continued to be a serious problem, Mr. Lankester remarked. It was disappointing that there had been some slippage in performance under the stand-by arrangement. The magnitude of the loans--those in arrears amounted to over 18 percent and to the development of the financial system. He welcomed the authorities' commitment to a number of additional measures aimed at tackling the problem, and he hoped that they would be able to implement them rapidly. The authorities seemed to recognize, however, that other measures were needed to improve the operation of the financial system and that the interest rate structure was "unduly complex and not very efficient." He welcomed the authorities' plans to undertake a thorough review of interest rate policy and to move toward a more market-based system. The authorities' renewed commitment to the unification of the exchange rate system within a timeframe covered by the structural adjustment program was welcome, Mr. Lankester noted. In light of the relatively small gap between the two rates, he hoped that the unification could be achieved as soon as possible.

He wondered whether there might not be a case for seeking a higher level of reserves during the life of the structural adjustment arrangement, Mr. Lankester said. Despite the recent relatively good balance of payments performance, reserves remained at about three months of imports. That level seemed low considering the country's vulnerability to natural disasters and other external shocks.

With respect to the proposed drawdown of funds, the staff had suggested that the Board amend the regulations governing the structural adjustment facility to effectively allow a country to receive a second disbursement less than one year after the first, Mr. Lankester remarked. In that way, Bangladesh would be allowed to commence its second annual program under the facility in July 1987. The forthcoming review of the structural adjustment facility would present an appropriate time to discuss that subject in detail. Nevertheless, he had considerable difficulty with the staff's proposal. While he appreciated that it was desirable that the facility's program cycle coincide with the authorities' budgetmaking cycle, he was troubled by the element of retroactivity that the staff's proposal contained: in effect, it was being proposed that endorsement of the program should be back-dated to July 1986. Although there was a case for some added flexibility in the facility's tranching to allow the programs to be aligned with a country's budgetary process, he was opposed to retroactivity. He asked the staff to clarify whether the adoption of the proposed decision was affected by that qualification. His impression was that the decision could be endorsed, and that the proposed disbursement under the first annual program could be made immediately following Board approval of the arrangement. Finally, he supported the proposed use of resources under the compensatory financing facility.

Mr. Al-Assaf made the following statement:

The recent good performance of the Bangladesh economy is encouraging. Internal and external imbalances have been considerably reduced and, more important, this was achieved while maintaining a relatively high rate of economic growth. I commend the authorities for this performance and welcome their request for a structural adjustment arrangement. Such a program will strengthen structural adjustment, maintain the momentum of growth, and help consolidate the gains achieved so far. As I am in broad agreement with the staff's assessment and conclusions, and with the main thrust of the policies to be undertaken under the structural adjustment arrangement, I would only like to emphasize three important areas where the authorities would need to be especially vigilant.

First, Bangladesh is one of the poorest countries, with high population pressures and an extremely limited capacity for domestic resource mobilization. Yet it is a country that must maintain growth just to keep its standard of living from deteriorating. There is room for improvement of performance in the fiscal area, particularly with respect to tax collection and subsidy rationalization. On the latter, I was surprised to note in the policy framework paper that the poorest segment of the population is not, in fact, the principal beneficiary of subsidies. This clearly calls for a targeting of subsidies--a measure that should improve the welfare of the most needy and could, at the same time, increase public sector savings. Another important potential source of enhanced overall domestic savings is public enterprises, where the authorities would need to redouble their efforts to reduce inefficiencies and improve profitability. Appropriate pricing policies and the introduction of more efficient management will be essential in restructuring these enterprises.

Second, special attention should be devoted to the financial system and financial discipline. In this respect, Chart 4 of EBS/87/7 was both interesting and disturbing; it shows that, over the recent past, the loan recovery rate has fallen substantially and is now 27 percent for agricultural loans. The rate for industrial loans is as low as 8 percent. It is essential that no effort be spared in reversing the trend of rapidly increasing overdue payments. As this chair has stressed on previous occasions, economic development and growth can only take place in the environment of a sound and stable financial system. As indicated by Mr. Sengupta, the authorities recognize the seriousness of the problem and are aware of its adverse effects on the efficiency of financial intermediation and on the conduct of monetary policy. The increased attention accorded to this issue and the authorities' intention to set up and pursue quarterly cash recovery goals are welcome.

Third, added emphasis should be placed on the expansion and diversification of exports. Given the limited domestic financial resources and the recent decline in aid and remittance flows, there is no question that it will be essential for Bangladesh to strengthen incentives and widen its export base. This is all the more important in view of the structural weakness and vulnerability of traditional jute exports.

In conclusion, the development process facing the Bangladesh economy will be long and difficult. But the recent considerable progress made by the authorities is both reassuring and commendable. I urge the authorities to stay the course and to maintain the momentum of growth, and I support the proposed decisions.

Mr. Alhaimus made the following statement:

Given the very low income level, limited resource base, and high population density of Bangladesh--all of which make economic management a particularly difficult task--the authorities should be commended for performing that task reasonably well. Their efforts are, however, constrained by the structural weaknesses of the economy, including heavy dependence on the jute sector. The performance of this sector, which generally contributes 60 percent of export earnings, is vulnerable to many natural and other factors, such as competition from oil-based synthetics whose prices have recently fallen with the decrease in international oil prices. The prices of raw jute exports fell by as much as 76 percent in the early part of this year compared with 1984/85. The pervasive destabilizing effects of such large fluctuations and the dilemma they pose for policymakers are easily visualized. I hope the authorities will be able to complete expeditiously the ongoing review of the World Bank's study of the jute sector and to take whatever measures are feasible to reduce the price and supply instability in this prime sector.

The authorities deserve commendation for their realistic policy stance in 1985/86, making it possible to satisfy the various performance criteria under the stand-by arrangement, which was not an easy task. We welcome in particular the reduction in the fiscal deficit as a percentage of GDP in line with the program target; the substantial deceleration in liquidity expansion; and the recent progress in loan recovery, although the backlog still remains heavy.

The outlook for 1986/87 indicates a number of potential weaknesses in the economy that will make increasing demands on the resourcefulness of the authorities.

First, in the external sector, the further weakness of the jute export market, as indicated by the data for the first quarter,

is expected to lead to lower export receipts and a larger current account deficit than planned.

Second, in public finance, the burden imposed by the losses incurred by nonfinancial public sector enterprises will be heavier than envisaged. The estimated budget deficit is expected to be slightly below the program target, partly due to an expected shortfall in planned development expenditure which Bangladesh can hardly afford at its present stage of development, with such a low level of per capita income.

Third, despite recent improvement, the low rate of loan recovery--due, among other things, to the floods of 1984/85 and the collapse of jute prices--continues to be a source of concern. In the case of agricultural loans, this rate is reported to have fallen further from 38 percent in 1984/85 to 27 percent in 1985/86, or almost half the target rate of 50 percent. Given the pivotal role of agriculture in the economy of Bangladesh, such defaults must be minimized if increased governmental assistance is to be channeled to this sector to improve cultivation practices and increase production.

The policy package initiated in the latter part of 1984/85 in the wake of the heavy floods has facilitated the successful implementation so far of the 19-month stand-by arrangement, which in turn provides a helpful setting for the program under the structural adjustment facility. During the recent past, the authorities' policy stance has been marked by firmness and flexibility, as indicated by frequent adjustments in the exchange rate, a substantial reduction in food subsidies, increasing privatization of public sector enterprises, and other structural reforms. It is encouraging to note that during the period of the structural adjustment arrangement they intend to continue to pursue the twin objectives of growth and adjustment and to undertake significant reforms in all areas, including taxation and exchange rate unification. Steady implementation of the program's policies should enable the authorities to achieve the ambitious program targets. The external environment will also be a crucial factor. For example, the 21 percent increase in nontraditional exports during ing the structural adjustment arrangement period will depend on adequate access to foreign markets. As the medium-term outlook for the balance of payments clearly shows, increased external assistance, on concessional terms, will also be crucial for the success of the growth-oriented adjustment strategy being followed by the authorities.

In conclusion, I support the proposed decisions. All the requirements for use of the compensatory financing facility have clearly been met. Moreover, I am in agreement with the staff on the question of timing and disbursements with regard to the structural adjustment arrangement

Mr. Massé said that the Bangladesh authorities' comprehensive adjustment efforts, including both demand management and structural adjustment aspects, were commendable. In view of the difficult situation facing the economy, he urged the authorities to implement carefully their policy intentions. He supported the proposed decisions and in general agreed with the staff's analysis and recommendations.

Several areas of policy required particularly expeditious pursuit or further clarification, Mr. Massé observed. For example, he attached great importance to the planned review of the tax system in cooperation with the Fund and World Bank staffs, and he urged early implementation of the expected tax reform. Similarly, he encouraged the authorities to adopt soon the recommendations of the World Bank concerning the reorganization of the jute sector.

Delinquent loans were one of the most pressing problems in Bangladesh, Mr. Massé noted. They threatened the conduct of monetary policy, impaired the efficiency of resource allocation, and seriously undermined financial intermediation. In addition, that condition eroded the credibility of both public and private institutions. He therefore welcomed the fact that loan recovery had been the subject of intense discussions and he commended the undertaking of a program to improve collection rates. He urged the authorities to make the effort needed to avoid slippages and to ensure the success of that program.

The financial sector in Bangladesh was complicated further and undermined by the particular structure of interest rates, with some clearly unintended and peculiar results, Mr. Massé continued. For example, interest rates were currently lowest for loans with the highest risk. In general, special care would have to be taken to increase the efficiency of instruments of monetary control, and the staff had made a number of suggestions in those areas. He welcomed the intentions of the authorities to rationalize the interest rate structure and to enhance the use of indirect instruments of monetary control. Greater efforts should be exercised in that field. The staff had summarized the policies and time frames for the structural adjustment effort, but he asked it to comment on the substantial progress currently envisaged in those areas.

The significant achievements in exchange rate and trade policy were welcome, Mr. Massé said, including the authorities' timetable for the unification of exchange markets.

With regard to the structural adjustment arrangement, he was aware of the problems--which could apply more widely than to the case of Bangladesh--that could be associated with discrepancies between the period of disbursement and the period of the program--or in some cases the budgetary planning period--Mr. Massé remarked. Similarly, a one-year cycle for the structural adjustment arrangement might not in all respects be optimal. However, he was concerned by the signals that could be given by an approach seen as providing disbursements outside the context of an approved arrangement. He could appreciate the need

for some flexibility in the amounts of disbursements over a given period, provided there was no endorsement in principle of retroactivity, but a fine line would have to be drawn in some cases. He looked forward to the forthcoming review of the structural adjustment facility when it would be appropriate to debate the present issue.

Mr. Pineau observed that the request for the use of resources under the compensatory financing facility met all the required provisions, and he could therefore support the proposed decision.

The quality of the policy framework paper offered an excellent example of the results of close collaboration between the World Bank and Fund staffs, Mr. Pineau observed. Any significant slippages in the course of the program would be deplorable. The modernization of the financial sector could prove instrumental in ensuring the success of the structural adjustment program. Stricter financial discipline should help to improve the loan recovery process, which currently hampered the mobilization of internal resources. Similarly, the tax base should be widened and redesigned in order to reduce excessive reliance on trade-based taxes and external assistance. More generally, the eradication of deep-seated structural weaknesses should involve appropriate institutional reform.

Bangladesh would remain heavily dependent on external assistance in the forseeable future, Mr. Pineau continued. The country should make every effort to speed up the use of committed but still undisbursed external funds in an efficient way so as to induce further commitments from the donor community.

With respect to the timing of the first annual arrangement under the structural adjustment facility, there was no overriding argument for the retroactive endorsement of a program initiated in July 1986, Mr. Pineau remarked. The time frame provided by the fiscal year was a relevant consideration but not an overwhelming constraint. However, if the Board agreed in the present case to introduce a long interval between the date of the program's approval and its actual start, it could create a dangerous precedent for all arrangements with the Fund. Although he was aware of the pressing financing needs of Bangladesh, consideration of the principles underlying the facility led him to stress the importance of setting February 1987 as the effective date of the structural adjustment arrangement for Bangladesh.

Mr. Salehkhou said that he was in general agreement with the staff appraisal, and he could support the proposed decisions. Notwithstanding the disastrous floods that had affected the economy in 1984, the economic and financial performance of Bangladesh in 1985/86 under the Fund-supported adjustment program had been largely satisfactory with an encouraging 4 percent rate of growth, a reduction in the rate of inflation to about 10 percent, a significant improvement in the balance of payments, and a slight decline in the governemnt budget deficit. In that regard, the authorities were to be commended for their commitment to the implementation of tight

monetary and fiscal policies and the pursuit of flexible exchange rate as envisaged under the current stand-by arrangement. All performance criteria under the current stand-by arrangement had been met and the objectives had been achieved. However, the economy had remained vulnerable, particularly to exogenous factors. Therefore, more effort should be directed at consolidating the gains already achieved in order to pave the way for sustainable growth with a viable external payments position.

The structural adjustment measures envisaged or implemented under the 1986/87 program were steps in the right direction, Mr. Salehkhou noted. Developments in the early months of the fiscal year suggested that, with the exception of the balance of payments, the program targets could be reached. Real GDP was expected to grow by 4.8 percent and the budget deficit was likely to decline to 7 percent of GDP, slightly below the program target. The external current account deficit was estimated to be higher than expected, both in absolute terms and relative to GDP, mainly reflecting lower than anticipated export receipts. The export shortfall had resulted largely from depressed and weakening international jute price--Bangladesh's main export item--during the remainder of the fiscal year. The cause of the export shortfall fully justified the country's request for a purchase of SDR 88.9 million under the compensatory financing facility. The shortfall in earnings had been entirely attributable to a drop of one third in average prices of raw jute goods from the levels experienced in the two preshortfall years. In addition, the authorities' record of cooperation with the Fund in efforts to find appropriate solutions to its balance of payments difficulties qualified Bangladesh for use of the facility.

To address the remaining structural weaknesses and to reduce the vulnerability of the Bangladesh economy to external shocks, the authorities had embarked on a medium-term adjustment program to be supported by a proposed three-year structural adjustment arrangement, Mr. Salehkhou continued. The program aimed at improving the allocation of resources, mobilizing domestic savings, enhancing the quality of development expenditures, increasing the effectiveness of monetary policy, strengthening the competitiveness of the export sector, and diversifying the export base. To achieve those objectives, implementation of the policies envisaged under the program would require significant contributions by donor countries and greater utilization of concessional assistance for the needed imports.

Given the authorities' strong commitment to the implementation of the program, medium-term prospects appeared promising so long as external factors such as weather conditions and aid inflows were favorable, Mr. Salehkhou remarked. Prospects for nontraditional exports under the export-oriented policies in the structural adjustment program were bright. The considerable increase in their shares in total export earnings from one third at present to over one half by 1991/92 would reduce the economy's heavy reliance on a single commodity. Moreover, the projected decline in the debt service ratio from 30 percent currently to 18 percent in 1991/92 was welcome.

Ms. Bush made the following statement:

The Bangladesh authorities have reconfirmed their commitment to their adjustment effort by undertaking the broad range of structural and macroeconomic adjustment measures outlined by the staff. From a medium-term perspective, the very gradual projected increase in the domestic savings rate and the continued high dependence on external aid indicate the scarcity of resources facing this low-income country. The authorities are striving to improve the utilization of those resources and to encourage more investment in labor-intensive sectors in order to promote sufficient growth in employment for the rapidly growing population. We support these goals as outlined in the structural adjustment program; but in some areas a faster pace of improvement could enhance the outlook by strengthening Bangladesh's productive potential.

Progress under the stand-by arrangement is in general satisfactory. Performance criteria and targets are being met, and we welcome, in particular, the stronger growth in reserves that is occurring. However, we note Mr. Lankester's concern that perhaps reserves are not growing at a fast enough rate; this is indicated to some extent by the fact that reserves in terms of import coverage are projected to decline somewhat. We therefore wonder whether faster growth of reserves might be feasible. Fiscal actions are gradually raising revenues, although some setbacks occurred this year. Expenditures are being rerouted to operations and maintenance so as to prolong the life of the existing capital stock. In addition, tax reform, emphasizing collections and de-emphasizing trade-related taxes, could be helpful in strengthening the revenue effort in the context of sustaining incentives to save and invest. In 1985/86, reductions in high marginal tax rates had taken place. Could the staff comment on the level of marginal tax rates now and on the effect that the tax rate reduction had on revenue generation? I understand that these reductions in tax rates had a positive effect on revenues. We encourage rapid finalization of the tax reform package and its prompt implementation. We welcome the inclusion of the fiscal deficit to GDP ratio as a benchmark in the structural adjustment arrangement.

One area of disappointing performance continues to be the nonfinancial public enterprises. A number of pricing measures were taken in 1986, but we wonder if additional actions are not needed to return these entities to financial viability while ensuring efficient utilization of their outputs. We will follow developments in this area closely over the course of the structural adjustment arrangement. We would also have welcomed more details on the privatization that is occurring; it is unclear from the staff papers to what extent the authorities have made progress in implementing measures to attain their

goals. In particular, the increased emphasis on foreign direct investment could perhaps facilitate the divestment of some commercially oriented entities.

Financial and monetary policies continue to raise concerns, particularly with regard to the low rate of loan recoveries in the agricultural and industrial sectors. The reasons for this poor performance have been described in the staff report, and new measures are being implemented as part of the structural adjustment arrangement. We had hoped to see better results by this time, following the emphasis placed on this matter for a number of years, although recent information indicates that end-December targets were met, which is encouraging. But problems in the financial sphere with regard to an appropriate spread between lending and deposit rates are continuing. Maintenance of positive real interest rates should remain a priority, but we wonder whether additional measures in the banking system are not needed to promote more efficient functioning; perhaps further action to reduce subsidized loans is necessary. Preferably, subsidies should be eliminated; however, if they must continue, they could perhaps be made more explicit through the budget, thereby relieving the distortions and problems of the banking system that are caused by subsidized loans. The tools of monetary policy are apparently continuing to detract from the flexible allocation of financial resources, and we strongly concur with the staff view that steps be taken to modernize the implementation of monetary policy. We would welcome more information on the specific measures included in the first-year structural adjustment arrangement.

The authorities have continued their generally appropriate management of the official exchange rate, although it appears that more frequent adjustments would be appropriate. The authorities are now committed to unification in the program, which seems unusually gradual in light of the distortions that arise from the implicit subsidization through the exchange rate of aid-financed imports. Furthermore, with the present fairly narrow spread between the two rates, we wonder why unification cannot take place in the near term.

Regarding the trade system, because of the great importance attached to employment generation, we urge prompt action to rationalize the tariff system so that effective rates of protection can be lowered and harmonized and growth in the traded goods sector encouraged. This action can mesh with the planned tax reform, whose aim is to reduce budgetary dependence on trade-related taxes by broadening the tax base. On a related matter, the authorities recognize that the further development of human capital in Bangladesh is important to their ongoing efforts, and we encourage progress toward this objective. In particular, the technical skills necessary for industrial development and the authorities' other goals must be developed.

Like Mr. Lankester, we are reluctant to endorse the staff proposal to consider this structural adjustment arrangement as applicable to the fiscal year that began in July 1986, thereby enabling the second-year structural adjustment arrangement to become effective this coming summer, less than half a year from now. This retroactive application of the formal structural adjustment arrangement to a fiscal year begun seven months earlier strikes us as creating a number of difficulties, especially in view of the phasing of the flow of resources into the Special Disbursement Account. We need not discuss these issues in detail today, in light of our upcoming review of the structural adjustment facility, but I consider it necessary to indicate at this time our reservations about this approach.

It is important to assess Bangladesh's ability to service its financial obligations to the Fund over the medium term. Balance of payments surpluses are projected, but reserves in terms of import coverage are projected to decline somewhat. Additional comments on the member's ability to repay would therefore be appreciated.

We support the request for a purchase under the compensatory financing facility. But we are somewhat concerned that there appears to be a structural change currently under way in the jute market, with synthetic substitutes drawing demand away from jute. This consideration supports significantly the goals expressed in the policy framework paper of promoting both more efficient agriculture and further industrialization, including export diversification. In view of these goals, we have some assurance that the authorities are initiating action with regard to this problem.

Mr. Goos commended the authorities for the successful implementation of the stand-by arrangement thus far and for the prospect that the current year's program targets would be largely met. That performance, including the impressive outlook for real growth, was all the more remarkable considering the serious difficulties affecting the jute sector, and it attested to the authorities' ongoing adjustment policies and their successful efforts to diversify economic activity.

Nevertheless, there remained several areas of concern that required further efforts, Mr. Goos continued. The most pressing problems were largely structural in nature, as they impeded domestic resource mobilization and their efficient employment. He therefore welcomed the authorities' request for a structural adjustment arrangement and their policy framework paper. In general, the policies envisaged under the structural adjustment program should go a long way toward easing the remaining constraints for investment and growth. In several important respects, however, the policy intentions of the authorities appeared to be less specific and binding than desirable, judging from the compilation of the policy measures in Table 1 attached to the policy framework paper, notably with respect to the necessary rationalization of the interest

rate structure, the introduction of indirect instruments of monetary control, and the strengthening of the role of the Central Bank. The only explicit policy commitment in that area--the maintenance of positive real interest rates--although of critical importance, would fail to produce the desired results in terms of domestic resource mobilization so long as the financial system remained subject to pervasive administrative controls and selective interference. It was worth recalling that the policy of official encouragement of lending to priority sectors had greatly contributed to the present problems of widespread nonperforming loans in the agricultural and industrial sectors.

More explicit commitments were also needed in the jute sector, Mr. Goos remarked. Whereas the authorities had committed themselves to restructure the jute mills, the program apparently did not specifically address the urgent problem of price and supply instability, despite the recommendations of the World Bank in mid-1986.

He had planned to express his disappointment that the authorities had been unable, despite repeated recommendations, to adopt a firm timetable for the unification of the exchange markets, Mr. Goos commented. He therefore welcomed the staff's announcement that the authorities had assured Fund management of their intention to unify the markets within the period of the structural adjustment program, although he shared the concern expressed by Ms. Bush that the authorities should not wait until the end of that period. He also commended the authorities for the substantial progress made recently in reducing the spreads between the official and the regulated rates, and in particular the substantial shift of export and import transactions through the secondary market.

The need to increase domestic savings, especially in the public sector, was self-evident, Mr. Goos stated. He therefore welcomed the intention to raise government revenue, although the planned increase in the revenue ratio of less than 1.5 percent over a three-year period was modest. In general, forceful implementation of all the measures contemplated should yield higher revenues than projected, and hence a lower fiscal deficit, which would be highly beneficial in the difficult domestic and external circumstances of the country. He stressed that point because he shared the doubts expressed by the World Bank staff about the realism of the aid flow projections, and in particular about the expected disbursements of project aid, in view of the existing administrative weaknesses and potential constraints with regard to the mobilization of the necessary counterpart funds. Because of those doubts, and considering the unavoidable uncertainties surrounding such projections, the authorities would be well advised to make every effort to outperform the program targets, notably those concerning the fiscal deficit and external imbalances. In that regard, he shared the concerns expressed by Mr. Lankester and Ms. Bush about the appropriateness of external reserve targets.

While he sympathized with the desire to have the program period of the structural adjustment arrangement and Bangladesh's fiscal year coincide, he had difficulty in endorsing a solution that provided for

retroactivity in setting the date for the beginning of the arrangement, Mr. Goos said. Accordingly, if it were agreed that the beginning of the second annual structural adjustment arrangement should coincide with the beginning of the following fiscal year, it would be appropriate to rephase disbursements in the second year so that all disbursements under the first and second arrangements together reflected the fact that the arrangements covered less than two years. However, those were merely preliminary reactions, and the Board would have to review experience with the structural adjustment facility in the near future; he asked the staff to consider those reservations in the paper to be prepared for that discussion.

Finally, all the relevant requirements for access to the compensatory financing facility had been met and, accordingly, he endorsed the proposed decision regarding the request for a purchase under the facility, Mr. Goos concluded.

Mr. Sliper made the following statement:

The structural adjustment program proposed by the Bangladesh Government is ambitious but well directed. Foreign exchange management, government revenue expansion, public enterprise reform, and loan collection and project management improvement are all areas where there are major weaknesses and where reforms will make a significant contribution to growth. We especially welcome the commitment of the authorities to improve tax collection with the aid of technical assistance from both the World Bank and the Fund. We also welcome the commitment, announced by the staff, to unify the exchange rate within the period of the structural adjustment program. Like a number of Directors, we hope that Bangladesh can bring about unification of the different rates within a short time rather than by the end of that period.

Last year we expressed some criticism of the collaborative efforts of the Bank and the Fund given the magnitude of the problems facing Bangladesh. This is clearly not the case this year, and the depth and breadth of the reforms owe much to the cooperation between the two institutions together with the resolve of the authorities. Some doubt remains as to the realism of the annual growth target of 5 percent a year, certainly when measured against the performance over the last few years. In view of the policy measures in the program, it would seem possible to achieve 5 percent growth at the end of the decade. However, to maintain this level for a sustained period seems a monumental task in light of the human capital constraint and the associated administrative difficulties present in Bangladesh.

We support Mr. Lankester's position and the qualification with regard to applying the structural adjustment arrangement retroactively. In general, we oppose the development of policy through individual cases; we would prefer that policies be

established on the basis of general principles and objectives. It would be inappropriate to prejudge the forthcoming review of the structural adjustment facility. My understanding of the practicalities of the present case is that February 6, 1987 will be inserted as the starting date for the structural adjustment arrangement and that it cannot be assumed that a further payment will be made in July 1987 or any other date within 12 months from February. Payment would depend on the outcome of the forthcoming discussion on the structural adjustment facility. I would welcome clarification on this point by the staff. With this understanding, we support the decisions relating to the review under the stand-by arrangement and the request for the structural adjustment arrangement.

With regard to the request for a purchase under the compensatory financing facility, the current case seems to satisfy all the relevant criteria. Bangladesh has cooperated with the Fund, there has been a significant shortfall in export receipts of both raw jute and goods produced from jute, and the shortfall is largely beyond the control of the member. We are especially encouraged that the adjustment program contains measures both to improve the efficiency of jute marketing and production and to expand nontraditional exports, thereby helping to widen the export base of the economy. There is scope for a difference of view about whether the shortfall in jute receipts is temporary in nature and the extent to which prices are likely to recover in the next two years. The wide swings in production volume will inevitably lead jute users to continue to look for synthetic substitutes, therefore some caution and pessimism must surround the medium-term outlook for jute.

The staff paper on recent experience with the compensatory financing facility (EBS/87/13, 1/26/87), especially the Fund record in projecting commodity prices, indicates that there has not been a significant bias in the staff projections. This record is commendable and, despite my qualifications, adds weight to supporting the present case. I endorse the proposed decision.

Mr. Puro said that in principle he welcomed the use of the structural adjustment facility and the macroeconomic objectives under the proposed arrangement. However, he had considerable difficulty in accepting the retroactivity of the structural adjustment arrangement. Moreover, in the present case, he would have found it useful if the staff could have arranged to have the first annual structural adjustment arrangement coincide with the fiscal year.

Mr. Donoso stated that he strongly supported the proposed decisions. The program supported by the present stand-by arrangement had been successfully implemented, and it illustrated the authorities' commitment to structural reform, which would lead to a significant recovery of the economy.

Mr. Hospedales observed that the protracted balance of payments difficulties in Bangladesh stemmed mainly from the economy's structural weaknesses. To reduce the country's vulnerability to external shocks and to improve the economy's resilience, Bangladesh had decided to sustain the adjustment process through the adoption of a medium-term program of action to be supported by a structural adjustment arrangement. He supported that request, including the timing and disbursements, and the request for a purchase under the compensatory financing facility, for which all criteria had been met. The authorities had demonstrated their sustained commitment to adjustment, as described by the staff and Mr. Sengupta, Mr. Hospedales noted. He was in general agreement with the staff appraisal, and, accordingly, could support the proposed decisions.

Mr. Yang commended the Bangladesh authorities for the satisfactory economic performance achieved during the previous year. He supported the proposed decisions. He was in broad agreement with the staff appraisal, and he welcomed the economic program and policy intentions outlined in the staff report.

Mr. El Kogali said that he supported the proposed decisions.

Mr. Reddy said that his chair viewed the authorities' adjustment efforts thus far as appropriate and he could support the proposed decisions.

The staff representative from the Asian Department explained that the decline in development expenditure had been due not so much to the low rate of foreign aid utilization as to the shortfall in commodity aid. In general, the financing of development expenditure was an important consideration in the long-term growth outlook. Current expenditure had increased mainly because of higher outlays on education and health services, which could be considered development expenditure, and project aid was forecast to rise faster than programmed. In any case, development expenditure in 1986/87 was projected to be 16 percent above the 1985/86 level.

The staff was justifiably optimistic about aid disbursements in the medium term, the staff representative continued. A project aid pipeline was estimated at about $4.7 billion, and the ability of the authorities to draw on that large pipeline of aid should be sufficient to allow for increased development spending, which, in turn, was expected to raise aid commitments. In addition, conditions for disbursements, especially by IDA and other aid donors, had been liberalized significantly, which would enable the authorities to absorb additional aid. The increased autonomy accorded project managers should help them to expedite project implementation, and it was hoped that the structural adjustment arrangement would play a catalytic role in attracting additional aid flows to Bangladesh.

Domestic resource mobilization, in particular, government revenue, must be viewed as a long-term process because of the difficulties of implementing a major reform of the tax system, the staff representative noted. A joint Fund-World Bank mission had visited Bangladesh in December 1986, and it was preparing an extensive report on long-term tax reforms.

Another Fund-Bank mission, planned for the spring of 1987, would focus on short-term bridging measures; with those short-term measures in place, government revenue should rise by 0.5 percent of GDP a year--a reasonable effort in the circumstances. The overall public sector revenue effort would be supported by the improvement in the public enterprises' financial position as a result of tax and pricing reforms, better management, increased autonomy in management decisions, and more efficient operations. The staff paper had provided for a significant increase in public sector savings, as indicated in the table attached to the policy framework paper.

The projected 5 percent annual growth of real GDP was somewhat ambitious and higher than the average achieved in recent years, the staff representative noted. However, assuming growth of the agricultural sector of about 2.9 percent a year, increased foreign aid together with the envisaged revitalization of industry and the private sector should contribute to growth prospects. To the extent that shortfalls in aid disbursement or project implementation would occur, the rate of economic growth would be lower, but given the assumptions in the medium-term scenario, the 5 percent growth rate was realistic.

Subsidies in Bangladesh were directed to food, the school system, the transportation system, and consumer goods produced by the public enterprises, the staff representative said. More subsidies accrued to urban dwellers than to the poorer segments of the population in the rural areas--the landless, women, and the very poor. The Government was striving to ensure that the reduction in subsidies under the adjustment program would not affect the very poor; in fact, tremendous efforts were being made to redirect subsidies to the needy through the work-for-food program, group feeding, and other services.

The long-term problems of the jute sector have been described in detail in a report prepared by the World Bank, the staff representative stated. The wide swings in the availability of raw jute supplies had led to variations in prices. The Government had been studying a stabilization policy for the supply of raw jute that could include buffer stocks. The organization and the financial burden of those stocks would perhaps be difficult for the authorities, although the Bangladesh Jute Corporation had been trying to build up jute stocks and to stabilize prices. Nevertheless, such stocks would entail additional large investments for storage facilities, purchases, and transportation, while maintaining a reasonable level of prices for producers. The World Bank estimated that the financial burden of a buffer stock system could amount to a 20 percent loss on jute operations. The question was under consideration by the Government.

When the policy framework paper had been discussed, the financial sector issues had been included, although a joint Fund-Bank mission to Bangladesh had been planned in November 1986 to address financial sector issues and reforms specifically, the staff representative recalled. Following that mission, the authorities had focused on financial policies, including rationalization of the interest rate structure, measures to improve the profitability and financial viability of banks, steps to

strengthen the role of the central bank and to develop the secondary money and capital markets, and the promotion of a greater role for market forces in the determination of interest rates and the allocation of domestic savings. Those policies would probably be supported by a financial sector credit from IDA. A follow-up mission would take place in the near future, and the policy framework paper had not been intended to pre-empt any precise recommendations, although the Memorandum on Economic and Financial Policies contained more details on financial sector issues.

The marginal tax rates on company profits in the 1985/86 budget had been reduced from 30 percent to 25 percent, apparently with a positive effect on revenue, the staff representative remarked. A tax amnesty for individuals had been granted, and it was also expected to yield a positive impact, as tax evaders would not have to declare the sources of their income but merely declare their income and pay the tax.

With regard to privatization measures, the industrial policy announced in July 1986 was extensive, the staff representative commented. The Government had opened more sectors to private investment, leaving only about seven essential areas, such as defense, to the public sector. In terms of actual privatization of government-owned corporations, progress had been slow, although the policy was to convert public sector corporations to limited public sector companies by offering up to 49 percent of their shares to the public. For example, it was envisaged that one bank would be sold during the coming year; two others had already been denationalized recently. In addition, the authorities were collaborating with IFC to sell some of the shares of the Bangladesh Chemical Corporation to the private sector. Although the process would be slow because of the time required to assess the companies' actual worth, the Government intended to proceed with the privatization effort in line with the policy initiated in 1983 whereby many jute mills and textile mills had been denationalized and privatized.

No foreign participation in or loans to Bangladesh companies existed, the staff representative pointed out. The Government had invited Bangladeshis working abroad to use their workers' remittances to subscribe foreign exchange in the shares of the local public corporations that they intended to denationalize. The free export processing zone was open to 100 percent foreign investment in export industries, such as garments. Government policy would continue in that direction.

As to subsidies through the banking system, the staffs of the Fund and the Bank had suggested to the authorities that the banking system should be allowed to operate as much as possible on a commercial basis and that subsidies to priority sectors should be identified and measured, and their impact on the economy should be assessed periodically, the staff representative continued. Those subsidies should be financed through the budget or special funds set up in the central bank, or by joint contributions by the commercial banks and the central bank. A bank loan should

be considered from a purely commercial perspective before its approval. He believed that the authorities would consider those recommendations seriously.

Rationalization of the tariff structure was being pursued, the staff representative said. Quantitative restrictions had been reduced substantially at the beginning of the fiscal year, and further progress was expected under an industrial sector credit that would be negotiated with the World Bank in February 1987. The reduction would be part of the liberalization process that was expected to take place within the period of the structural adjustment arrangement.

One section of the policy framework paper was devoted to the development of human resources, the staff representative remarked. The Third Five-Year Plan focused on the development of human resources, including the provision of better health care and education and a greater role for the private sector so as to create employment opportunities.

Some speakers had commented that reserves amounting to three months of imports were low, the staff representative recalled. While a higher level of reserves would be desirable, especially in the case of Bangladesh, three-month coverage showed good progress compared with the average over the past five years of only two months' coverage.

Bangladesh's record of repayment to the Fund had been quite good, the staff representative from the Asian Department noted. The staff's projections indicated that no difficulties should arise; the three-month reserve position took into account repurchases due to the Fund during the period. Of course, if balance of payments developments improved, especially with regard to the terms of trade or nontraditional exports, the situation could be further ameliorated. Some mechanical savings occurred in the case of Bangladesh to the extent that when aid flows fell, imports fell correspondingly; the authorities did not borrow commercially to finance their imports.

The Deputy Director of the Exchange and Trade Relations Department explained that the structural adjustment arrangement was not retroactive and would run for three years from the date of the Board decision. Directors had noted a seven-month discrepancy between the annual arrangement and the period of the policy program. The staff had also been concerned about that gap, because in all cases it sought to reach an appropriate degree of coincidence between program and arrangement periods. As Bangladesh had been implementing its policy program, the staff considered that acceptance of the unusual discrepancy would be preferable to the alternative of delaying the structural adjustment arrangement until the following fiscal year. There was no presumption, however, that the second annual drawing could be made at the beginning of 1987/88. The staff was proposing an arrangement that, following Board approval, would allow a first disbursement from the structural adjustment facility. Any further disbursements under the arrangement would have to be brought to the

Board for its approval. Directors' comments showed clearly that possible options in the present case would be best addressed in the context of the Board's forthcoming review of the structural adjustment facility.

Mr. Chatah wondered whether the present case was the first to include a timing gap and whether, if another case existed, the question of second-year disbursements was still awaiting review.

The Deputy Director of the Exchange and Trade Relations Department reported that the timing discrepancy in the present case was the longest in the Fund's experience. Slippages of up to three months could be considered normal because of the unlikelihood of establishing a policy program that would begin the same day that the Board adopted its decision. For that reason, a margin of flexibility was called for. In that context, the staff had noted the comments by a number of Directors at the present meeting to the effect that the seven-month lag in timing between the policy program and the arrangement was too large.

The Chairman remarked that the extent of retroactivity involved in the proposed approval of a program seven months after its start had given rise to the concerns expressed by some speakers. He assured Directors that the present case would not establish a precedent and that the issue would be discussed during the forthcoming review of the structural adjustment facility.

Mr. Sengupta remarked that two issues were involved: first, the period of the structural adjustment arrangement according to the effective date of the decision and the period of the program's implementation. Frequently in the case of stand-by arrangements, the program had started before it had actually been approved. In the present case, the Bangladesh program was being approved that day whereas it had been initiated seven months previously. Admittedly, the timing gap was exceptional.

The second issue was whether Bangladesh would receive a second disbursement during the current year, Mr. Sengupta continued. That point merited discussion because the Board had decided that disbursements under the structural adjustment facility should be made yearly. The question of whether the phasing of disbursements should be changed would be discussed during the forthcoming Board review of the facility. At present, once a program had been approved, the first tranche disbursement could take place. The second tranche could be disbursed according to the policies discussed and approved during the forthcoming review.

Mr. Massé said that he supported Mr. Sengupta's position. He could recall other cases with programs approved retroactively, and he believed that the timing in the present case should not prevent the first disbursement to Bangladesh. However, he joined other Directors in indicating concern about the length of the retroactive period. During the forthcoming review, the Board would discuss whether the second disbursement to Bangladesh could be made within the initial 12-month period.

The Deputy Director of the Exchange and Trade Relations Department commented that the phasing of drawings related to both the period of the program and the period of the arrangement. All Directors had supported Bangladesh's request and on that basis Bangladesh could receive the first disbursement under the arrangement. The issue that remained outstanding was the circumstances under which the second disbursement would be made available. In that connection, he assured Directors that it could not take place automatically at the beginning of the next fiscal year in July 1987 as the Board would not have had a chance to review performance under the first-year program under the structural adjustment arrangement. As he had noted earlier, issues related to the phasing of disbursements would be discussed in the paper under preparation for the forthcoming review of the structural adjustment facility.

Mr. Sengupta observed that programs to improve the loan recovery situation which was also a matter of concern to his authorities, had been described in the staff paper. His authorities were also conscious of the need for exchange rate unification. It was noteworthy that the difference between the official and free market exchange rates had narrowed substantially. However, Bangladesh's economy was dependent upon workers' remittances, and the authorities did not want to convey the impression that the incentives for those remittances would no longer exist. Although small, the incentives were effective and as a consequence affected the timeliness of the authorities' actions.

The economy was highly vulnerable to the external environment, Mr. Sengupta noted. Over the period 1982/83 and 1985/86, the export/GDP ratios had averaged about 5.6 percent while import/GDP ratios had moved between 18.5 percent and 15.2 percent, indicating their strong effect on the growth rate of the economy. The ability of Bangladesh to sustain that growth hinged on the availability of external assistance. Although Bangladesh was striving to increase its traditional exports of cotton and jute textiles, growth was limited. Nontraditional exports had grown by about 20 percent in 1985/86, reflecting the authorities' diversification efforts. However, historical limitations existed, and the authorities' ability to increase imports would depend upon the international community's assistance. For those reasons, the support of the Fund, the World Bank, and IDA was important.

The Managing Director made the following summing up:

> Executive Directors were in broad agreement with the views expressed in the staff report for the 1986 Article IV consultation with Bangladesh and the second review under the stand-by arrangement. They also supported Bangladesh's request for arrangements under the structural adjustment facility and for a purchase under the compensatory financing facility. Directors expressed satisfaction that economic performance under the authorities' adjustment program for the two-year period 1985/86-1986/87 has thus far been favorable and generally in line with the program objectives. Steady growth of GDP has been accompanied by a lower rate of inflation and a

reduction in the external current account deficit. However, Directors observed that the Bangladesh economy remains structurally weak and vulnerable to exogenous shocks.

Directors, therefore, welcomed the authorities' decision to sustain the adjustment process through the adoption of a medium-term adjustment program to be supported by a structural adjustment arrangement. They considered appropriate the 1986/87-1988/89 policy package, which includes significant measures aimed at generating substantial additional domestic savings, redressing problems facing the financial institutions, and enhancing the flexibility in exchange rate management while further liberalizing the trade and payments system.

The rate of domestic saving is low, reflecting mainly the inelastic tax system and the low profitability of key public enterprises, Directors observed. They therefore welcomed the authorities' intention to implement soon far-reaching tax reforms and to improve tax administration and collection procedures. It was also observed with concern that current budget outlays tended to exceed forecast levels while development spending tended to fall short of target levels; a strengthening of administrative mechanisms to improve the aid absorption capacity was thus called for. As regards public enterprises, Directors stressed that appropriate pricing policies, more autonomy in decision making, and measures to reduce costs will be essential to improve the financial position of this sector. In this connection, the jute industry drew particular attention. Directors noted that jute subsidies should be only temporary, and they encouraged the authorities, with the assistance of the World Bank, to focus on restructuring the operations of this vital sector with a view to reducing excess capacity and improving operational efficiency.

Directors expressed concern over the growing problem of overdue loans to domestic banks, which, given Bangladesh Bank's liberal refinancing policies, had led to the rapid growth of domestic credit in recent years and impaired the efficiency of both monetary policy and financial intermediation. In this regard Directors were pleased to note that measures to correct this fundamental weakness in the financial system are being implemented, and they encouraged the authorities to sustain their effort in order to achieve further progress in this area. On other aspects of monetary policy, Directors agreed that continuation of the present tight monetary and credit policies during the structural adjustment program period will be essential in order to further reduce the rate of inflation and strengthen the external position. Directors also endorsed the authorities' intention to rationalize the structure of interest rates and make it more responsive to market forces, and they urged the authorities to reduce the scope of subsidized lending and to place greater emphasis on indirect instruments of monetary control.

Directors commended the authorities on pursuing a flexible exchange rate policy and on their progress toward the unification of the exchange markets. The authorities' intention to further narrow the gap between the exchange rates and to complete the unification process at an appropriate level was welcomed by Directors. Several of them urged the authorities to take that step soon because it was in the best interest of Bangladesh. The authorities were also urged to continue reducing quantitative import restrictions and to further rationalize the tariff structure.

While noting that most of Bangladesh's external debt was highly concessional, Directors encouraged the authorities to continue the present cautious policy of strictly limiting commercial borrowing and at the same time to seek to strengthen the level of international reserves.

Finally, several Directors emphasized that the realization of Bangladesh's medium-term objectives would require not only firm resolve to implement fully the structural measures included in the structural adjustment program but also continued generous donor support.

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

The Executive Board then took the following decisions:

Decision Concluding Article XIV Consultation

1. The Fund takes this decision relating to Bangladesh's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1986 Article XIV consultation with Bangladesh, in the light of the 1986 Article IV consultation with Bangladesh conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Bangladesh maintains certain restrictions on payments and transfers for current international transactions and multiple currency practices as described in SM/87/26. The Fund welcomes the progress to date toward the simplification of the exchange system and the authorities' intention to eliminate the multiple currency practices arising from the dual exchange markets and margin requirements on import letters of credit, and encourages Bangladesh to take these actions as soon as possible. The Fund also encourages Bangladesh to eliminate the restrictive features of the bilateral payments arrangements with Fund members. In the meantime, the Fund grants approval for the maintenance by Bangladesh

of the multiple currency practices until March 31, 1988 or the completion of the next Article IV consultation with Bangladesh, whichever is earlier.

Decision No. 8516-(87/23), adopted
February 6, 1987

Review Under Stand-By Arrangement

1. Bangladesh has consulted with the Fund in accordance with paragraph 4(c) of the stand-by arrangement for Bangladesh (EBS/85/251, Sup. 1, 12/4/85) and paragraph 26 of the letter dated November 5, 1985 from the Advisor for Finance of Bangladesh, in order to assess performance under the program supported by the arrangement.

2. The letter dated January 5, 1987 from the Minister of Finance shall be attached to the stand-by arrangement and the letter dated November 5, 1985 as amended shall be read as supplemented and modified by the letter of January 5, 1987.

3. The Fund decides that the second review contemplated in paragraph 4(c) of the arrangement is completed.

Decision No. 8517-(87/23), adopted
February 6, 1987

Structural Adjustment Arrangement

1. The Government of Bangladesh has requested a three-year structural adjustment arrangement, and the first annual arrangement thereunder, under the structural adjustment facility.

2. The Fund approves the arrangements set forth in EBS/87/7, Supplement 3.

Decision No. 8518-(87/23), adopted
February 6, 1987

Purchase Transaction - Compensatory Financing Facility

1. The Fund has received a request from the Government of Bangladesh for a purchase equivalent to SDR 88.9 million under the Decision on Compensatory Financing of Export Fluctuations (Executive Board Decision No. 6224-(79/135), adopted August 2, 1979 as amended).

2. The Fund notes the representation of Bangladesh and approves the purchase in accordance with the request.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Decision No. 8519(87/23), adopted
February 6, 1987

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/87/22 (2/4/87) and EBM/87/23 (2/6/87).

3. JAMAICA - 1986 ARTICLE IV CONSULTATION - POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to extend the period for completing the 1986 Article IV consultation with Jamaica further to March 2, 1987. (EBD/87/34, 2/3/87)

Decision No. 8520-(87/23), adopted
February 5, 1987

4. SOLOMON ISLANDS - TECHNICAL ASSISTANCE

In response to a request from the authorities of the Solomon Islands for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/87/29 (1/30/87).

Adopted February 5, 1987

5. STAFF MEMBER - LEAVE WITHOUT PAY

The Executive Board approves the proposal set forth in EBAP/87/19 (2/2/87) concerning an extension of leave without pay for a staff member.

Adopted February 5, 1987

6. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 86/82 through 86/85 are approved. (EBD/87/30, 1/30/87)

Adopted February 5, 1987

7. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors and by an Advisor to Executive Director as set forth in EBAP/87/20 (2/4/87) is approved.

APPROVED: September 14, 1987

JOSEPH W. LANG, JR.
Acting Secretary