INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 90/128

10:00 a.m., August 10, 1990

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
M. Al-Jasser	Z. Iqbal, Temporary
G. K. Arora	
C. S. Clark	C. M. Towe, Temporary
Dai Q.	
	S. B. Creane, Temporary
	J. Prader
	L. B. Monyake
	M. J. Shaffrey, Temporary
	M. Hepp, Temporary
	G. García, Temporary
	B. Bossone, Temporary
M. Finaish	
	I. H. Thorláksson
M. R. Ghasimi	
	K.-H. Kleine, Temporary
	T. Sirivedhin
	L. I. Jácome, Temporary
	J.-L. Menda, Temporary
Mawakani Samba	
D. Peretz	P. Wright
G. A. Posthumus	G. P. J. Hogeweg
K. Yamazaki	K. Ichikawa, Temporary

L. Van Houtven, Secretary and Counsellor
M. Primorac, Assistant

Also Present

IBRD: P. Suriyaarachchi, Asia Department; R. H. S. Fennell, P. Hamidian-Rad, Africa Department. African Department: M. Touré, Counsellor and Director; E. L. Bornemann, Deputy Director; E. A. Calamitsis, Deputy Director; H. R. De Zoysa, H. Hino, R. H. van Til. Asian Department: P. R. Narvekar, Director; C. M. Browne, P. Gotur. Exchange and Trade Relations Department: T. Leddy, Deputy Director; D. Dwor-Frecaut, M. Edo, G. R. Kincaid. External Relations Department: H. P. Puentes. Fiscal Affairs Department: R. Hemming, D. P. Hewitt, J. R. Modi. Legal Department: H. Elizalde, P. L. Francotte, R. B. Leckow, A. O. Liuksila. Treasurer's Department: G. Laske, Treasurer; W. J. Byrne, W. L. Coats, Jr., J. C. Corr, S. J. Fennell, P. S. Ross, G. Wittich. Advisors to Executive Directors: M. A. Ahmed, M. B. Chatah, M. Eran, J. M. Jones, B. S. Newman, P. Péterfalvy, F. A. Quirós, A. Raza. Assistants to Executive Directors: T. S. Allouba, T. Berrihun, C. Björklund, Chen M., B. A. Christiansen, H. E. Codrington, E. C. Demaestri, A. Y. El Mahdi, S. K. Fayyad, A. Fernandez, B. R. Fuleihan, M. A. Hammoudi, A. Hashim, K. Ishikura, A. Iljas, M. E. F. Jones, M. Nakagawa, J. K. Orleans-Lindsay, S. Rouai, D. Sparkes, C. M. Towe, Wang J.

1. BULGARIA - MEMBERSHIP - COMMITTEE

The Executive Directors considered the proposal by the Chairman to establish an ad hoc committee to consider the application of Bulgaria for membership in the Fund.

The Executive Board took the following decision:

The Executive Board, under Rule D-1, decides to establish a committee to proceed with the formal investigation, to obtain all relevant information, and to discuss with the Government of Bulgaria any matters relating to its application for membership in the Fund. The Committee shall consist of Mr. Yamazaki, Chairman; Mr. Dai, Mr. El Kogali, Mr. Evans, Mr. Feldman, Mr. Filosa, Mr. Peretz, and Mr. Posthumus. (EBD/90/241, 8/10/90)

Adopted August 10, 1990

2. NAMIBIA - MEMBERSHIP - COMMITTEE

The Executive Directors considered the proposal by the Chairman to establish an ad hoc committee to consider the application of Namibia for membership in the Fund.

The Executive Board took the following decision:

The Executive Board, under Rule D-1, decides to establish a committee to proceed with the formal investigation, to obtain all relevant information, and to discuss with the Government of Namibia any matters relating to its application for membership in the Fund. The Committee shall consist of Mr. Ismael, Chairman; Mr. Clark, Mr. El Kogali, Mr. Finaish, Mr. Fogelholm, Mr. Mawakani, and Mr. Peretz. (EBD/90/241, 8/10/90)

Adopted August 10, 1990

3. SWITZERLAND - MEMBERSHIP - COMMITTEE

The Executive Directors considered the proposal by the Chairman to establish an ad hoc committee to consider the application of Switzerland for membership in the Fund.

The Executive Board took the following decision:

The Executive Board, under Rule D-1, decides to establish a committee to proceed with the formal investigation, to obtain all relevant information, and to discuss with the Government of

Switzerland any matters relating to its application for membership in the Fund. The Committee shall consist of Mr. Clark, Chairman; Mr. Al-Jasser, Mr. Arora, Mr. Dawson, Mr. Evans, Mrs. Filardo, Mr. Finaish, Mr. Ghasimi, Mr. Grosche, Mr. Landau, Mr. Mawakani, Mr. Posthumus, and Mr. Yamazaki. (EBD/90/241, 8/10/90)

Adopted August 10, 1990

4. BANGLADESH - 1990 ARTICLE IV CONSULTATION; AND ENHANCED STRUCTURAL ADJUSTMENT ARRANGEMENT

The Executive Directors considered the staff report for the 1990 Article IV consultation with Bangladesh and Bangladesh's request for arrangements under the enhanced structural adjustment facility (EBS/90/132, 7/17/90; and Sup. 1, 8/6/90). They also had before them a background paper on recent economic developments in Bangladesh (SM/90/144, 7/19/90), a policy framework paper for the period 1990/91-1992/93 (EBD/90/145, 5/11/90), and a statement by the Managing Director.

The Managing Director's statement read as follows:

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 Committee of the Whole of the Executive Directors of the Bank and IDA in their meeting on June 5, 1990:

The Committee recognized that in implementing the policies outlined in the previous policy framework paper for fiscal years 1989-91, the Government's task of managing the economy had been complicated considerably by the devastating floods of 1988. The Committee, however, expressed concern that during the past year, in spite of strong recovery in the real economy, weaknesses had developed in fiscal management, monetary and credit policies, and the balance of payments, including a rapid drawdown in foreign reserves. The Committee expressed the hope that sound and more vigorous economic policies would support sustained growth in the coming period and welcomed the strong collaboration between the Bank and the IMF in assisting the Government in preparing this policy framework paper.

Many speakers stressed the need to restore financial stability as a prerequisite for sustained growth. They noted the actions already taken by the Government since February, particularly the control of recurrent expenditures, the introduction of new revenue measures, restraints on credit expansion, and the recent adjustments in the exchange rate. They urged the

Government to maintain these efforts by preparing a realistic budget for 1990/91, continuing a flexible exchange rate policy, and maintaining prudent monetary and credit policies.

Improvements in public resource management were identified as a key area for future policy reforms. Several speakers stressed the need to increase public investment, provide additional resources for the social sectors and for operations and maintenance, control the growth of less essential current expenditures, including the inefficient subsidies, and introduce measures to improve project and commodity aid utilization. Noting that several large projects such as the Jamuna Bridge and the flood control program were being planned by the Government, it was emphasized that there was an urgent need to review the investment program to ensure that high priority investments were sustained. It was suggested that a timetable for prioritization of public expenditures was necessary.

Greater efforts to mobilize domestic resources are needed through sound public pricing and cost recovery policies, the introduction of direct tax reforms, including reductions in tax exemptions, the implementation of value-added tax during 1990/91, and improved tax administration.

The good performance of the agricultural sector was singled out as an example where pragmatic policy reforms led to a significant increase in growth. The Government was urged to support recent achievements by expanding the liberalization of agricultural inputs, strengthening support services, improving the management of foodgrain imports and procurement policies, and the integration of food aid into development programs.

In order to increase private sector investment, the Government was encouraged to streamline investment sanctioning procedures, liberalize import controls, rationalize and reduce tariff levels, and pursue an active exchange rate policy. Actions should also be taken to improve the efficiency of the public enterprises, particularly in the jute sector, and privatize such enterprises in appropriate cases.

The Committee noted the close link between sound macroeconomic policies and the success of the recent reforms in the financial sector and urged their prompt implementation.

The Committee encouraged the Government to give high priority to poverty alleviation and the involvement of women in development programs. Actions to improve human resource development through strengthened educational programs were noted, and the Government

was urged to expand targeted poverty programs, and to involve the NGOs (nongovernmental organizations) more effectively in providing support for development.

The Government's successful efforts in expanding family planning and maternal and child health care services were noted, and continued strong support for population programs was recommended.

Recent natural disasters emphasize the vulnerability of Bangladesh to environmental problems. The Committee commended the Government on the recent flood control action plan and urged that high priority be given to its implementation.

The Committee noted that there would be a continued need for substantial levels of concessional assistance to Bangladesh in the context of a sound economic policy framework and welcomed the forthcoming review of policy implementation under the Action Program. In view of the serious concerns expressed at the last CG meeting, the Government was urged to energetically follow the implementation of the Action Program and to continue working closely with the donor community to ensure the prompt utilization of available resources.

Mr. Arora made the following statement:

My authorities are highly appreciative of the staff report for the 1990 consultation. The report presents an in-depth and objective analysis of the economic situation in Bangladesh. My authorities also value the policy recommendations made by the staff to overcome the manifold problems facing the country today. As we are in broad agreement with the staff appraisal of the current economic situation and with the staff's medium-term perception and policy framework, I would confine myself to highlighting some of the developments and issues involved.

As the Board is aware, Bangladesh had a three-year structural adjustment facility arrangement that ended in 1988-89. The country has made significant gains; there have also been slippages in implementation. On the credit side, measures were initiated to revamp the exchange and trade system. Quantitative targets set under the arrangement were met. Tangible progress was made in several crucial areas--fiscal deficit was reduced; domestic credit expansion was curbed; higher realizations from exports and remittances helped lower current account deficit; external commercial borrowing was contained; and official reserves were built up. Investment sanctioning procedures were greatly simplified and controls on private investment eased. It is worth noting that the improvement in external position was recorded despite the

fact that some marginal improvement during in-between years notwithstanding, the terms of trade during the last year of the arrangement were markedly unfavorable as compared with the position in 1984-85. Export growth was also affected by supply constraints caused by floods and quota restrictions on garments. Credit goes to the helpful exchange rate policy. On the debit side, the authorities could not embark on the agreed program of tax reforms. There were slippages in import liberalization; these were offset subsequently. More important, the GDP growth was much below target. Without minimizing the role of policy slippages, the problem may, in large part, be attributed to adverse weather conditions and devastating floods.

The Bangladesh economy was--and continues to remain--largely dependent on weather conditions. It suffered heavily on this count during the last two program years. However, the weather turned favorable during 1989-90. Aided by policy measures taken--the staff has highlighted the increased role of private sector in the distribution of imports, agriculture, and in tandem other sectors, are estimated to have recorded healthy increase during 1989-90. However, given the structural problems of the economy, the authorities are genuinely concerned about the low--and declining--level of savings and investment in the economy. Investment has remained low despite increasingly greater market orientation of the economy and clearer guidelines for foreign investment. The authorities are also deeply concerned about the low level of savings, public as well as private--the latter despite positive real rates of interest. As indicated by the staff, a number of measures have already been taken to step up the rate of public savings. Thus, in addition to fiscal measures, the authorities have already effected large increases in electricity and natural gas prices, and in railway, ferry, and domestic air fares. The courage and boldness shown by the authorities in undertaking such measures deserves to be noted in the context of socioeconomic strains and stresses confronting the society. As regards private savings, banks have already been given the freedom to set their own interest rates on deposits within the range specified by the Bangladesh Bank; interest rates have thus become much more market oriented than before.

On the external front, the authorities generally followed liberal import and flexible exchange rate policies. These paid dividends as reflected in healthy growth of exports. During a short period of seven months to June 1989 the authorities held the taka value unchanged, which, in view of the relative rise in domestic prices, meant an effective appreciation in its real value. However, as this had an adverse effect on the balance payments, the authorities have since resumed the policy of gradual adjustment in the external value of the taka. As a result, the

volume of exports is projected to have increased considerably, with a beneficial impact on the current account balance.

The authorities are conscious of the seriousness of the problems facing the country and are keenly aware that policy deficiencies and slippages in implementation can only worsen the situation. They also realize that there is no easy route to growth and development. They have already opted for bold policy decisions with a view to taking the country to a sustainable and higher growth path. They contemplate wide-ranging reform of the tax structure with a view to making it more elastic and responsive to changes in the economy. Initial steps in this regard have already been taken. While the changes effected in income tax are expected to reduce evasion and promote investment, the proposed introduction of a value-added tax from January 1, 1991 will rationalize sales tax and excise duties and broaden the tax base. On the expenditure side, the authorities are committed to reducing food, fertilizers, and export subsidies, and to economizing on expenditures on staff and establishment. Thus, prices of rationed articles have recently been revised by between 5 to 16 percent. The public distribution system is also being reoriented to rely primarily on domestic procurement and to give more emphasis to targeted programs serving the poor while maintaining adequate price incentives to producers.

The authorities also propose further to revamp and restructure public enterprises and to strengthen their finances through more flexible pricing policies and measures to improve cost control and performance evaluation. The purpose is to improve their financial performance, enhance their operational efficiency, and enable them to be more self-reliant in financing their investment requirements.

In the area of monetary policy, the authorities are keeping the growth of broad money and domestic credit in check with a view to keeping inflation under control. Further, they plan to limit expansion of net credit to the Government and also to the rest of the public sector so as to ensure adequate domestic financial resources for the expanding private sector. The monetary and supervisory control of the Bangladesh Bank is being strengthened through issue of its own security for use in open market operations. The financial sector reforms aim at improving the efficiency of intermediation through adoption of more flexible and market-oriented methods of monetary management.

The authorities are firmly committed to a more open and transparent trade and exchange rate system. Mention has already been made of the active exchange rate policy aimed at maintaining competitiveness of export industries. The authorities intend to

continue following this policy. As regards the trade system, the authorities have already substantially reduced the number of categories of goods subject to quantitative restrictions/bans with a view to promoting exports, encouraging private sector investment, and generating efficiency and competition in domestic production. The authorities intend to accelerate the pace of import liberalization, and to rationalize the tariff structure.

My authorities have committed themselves to implementing a strong adjustment program covering the period 1990-91 to 1992-93. The main features of the program have been set out in the PFP issued with EBD/90/145 of May 11, 1990. The macroeconomic objectives for the three-year period are to sustain average annual real GDP growth of nearly 5 percent, reduce the inflation rate to 6 percent by the final year of the program, and make steady progress toward a viable external position. Investment is programmed to rise to 14 percent of GDP by 1992-93, compared with about 11 percent in 1989-90. Appropriate fiscal, monetary, exchange rate, and structural policies will be deployed to realize these objectives.

Initial steps have already been taken in this regard, in particular with respect to raising the rate of public and private savings and boosting the rate of private investment. The budget for 1990-91 should be viewed as a landmark in the evolution of sound macroeconomic policies in Bangladesh. The task however is truly gigantic and my authorities need substantial support from the international community. We would, therefore, urge Board approval of the requested arrangements under the enhanced structural adjustment facility and would simultaneously ask the donor community to substantially increase the flow of concessional finance to Bangladesh. My authorities have demonstrated the political will to implement a strong adjustment program based on sound policies. Sustained international support should underpin a brave domestic effort.

Extending his remarks, Mr. Arora indicated that at the last meeting of the aid group for Bangladesh early in 1990, an action program for policy reforms in fiscal 1991 had been formulated. That program covered financial stabilization; improvements in public expenditure management, in domestic resource mobilization, and in the industrial sector; maintenance of sound agricultural policies; and procedural improvements. He was happy to report to the Board that Bangladesh had taken decisive actions in all those categories in accordance with the action program.

Mr. Finaish made the following statement:

Bangladesh's economic performance under the structural adjustment facility program, despite the disruption caused by adverse weather, has been reasonably satisfactory. Although there were some slippages in program implementation and the momentum of structural reform was slower than desirable, domestic imbalances were reduced, exchange and trade liberalization was initiated, and inflation performance was broadly in line with the program target.

However, by early this year, a number of difficulties emerged that manifested themselves in increased price pressures, a weakened balance of payments, and an associated loss of reserves. In response to this challenge, the authorities took immediate steps to restore financial stability. The success of this stabilization effort, and a strong budget for 1990-91, led the way to the proposed enhanced structural adjustment arrangement. The measures that have been taken subsequently, which are described in the staff supplement, mean that Bangladesh has now fulfilled all the commitments that were made to the Fund in connection with the 1990-91 program. These actions bear testimony to the authorities' commitment to the process of economic and financial reform.

The authorities' medium-term adjustment program represents a wide-ranging and bold effort by Bangladesh to achieve higher growth, foster a more vibrant private sector, address basic human needs, and strengthen its balance of payments position. The program rightly underscores the need to maintain financial stability and low inflation, and strong structural policies in the areas of public resource mobilization and trade, industrial, and financial liberalization. The special emphasis on human resource development and poverty alleviation is appropriate. The program will require, and I believe deserves, the continued support of the donor community. Given the authorities' demonstrable commitment to take difficult decisions needed to put their reform program back on track and to persevere with their reform effort, I strongly support Bangladesh's request for enhanced structural adjustment facility resources. These resources, in combination with other external flows, will give confidence to the authorities that their structural reform program can proceed smoothly.

Beyond these remarks, I would like to make a few observations on selected aspects of the program. First, on the overall strategy being pursued, I note the importance that has been given to raising the level of investment in the economy. Of course, no one would disagree that this is an appropriate goal given the need to strengthen infrastructure and support private investment. However, one wonders whether more attention should not have been given in the program, at least initially, to raising the

utilization of the existing capital stock and supporting this with measures to rehabilitate and maintain it. Such "capital stretching" innovations would have brought about quicker and more certain results and could have important implications for short term import management policies. Of course, over the longer term, the balance of emphasis would eventually have to shift to new investment. Perhaps the staff would care to comment on the relative balance in the program between fuller utilization of installed capacity and the creation of new capital.

Second, it appears that the authorities have expressed some reservation at the fast pace of import liberalization being proposed although the evidence regarding trends in the imports of liberalized items is inconclusive. While the level of foreign exchange reserves may appear to be adequate, they do not, in my view, provide a sufficient cushion against contingent risks; indeed, the level of reserves in terms of import cover is actually expected to be lower during, and following, the enhanced structural adjustment facility program compared with, say, 1987-88. This also raises a further important question of why access in the case of Bangladesh has been limited to only 90 percent of quota--the lowest access level so far under the enhanced structural adjustment facility, if I am not mistaken. Moreover, too rapid a pace of liberalization, especially in respect of those goods that compete with actual or potential domestic production, could deter private enterprise investment at a time when the Government is anxious to foster a more dynamic private sector. For these reasons, while I certainly support the objectives of the import liberalization program, I would urge due caution regarding the speed at which the program is implemented.

Third, the export target growth rate appears to be somewhat ambitious but well worth aiming for. A fast pace of progress toward strengthening the export base is clearly required if Bangladesh is to eventually reduce its dependence on external aid. But the very sizable gains in market shares implied by the export projections in the face of quota restrictions that Bangladesh faces--or is likely to face once market shares rise quickly--suggest that success in this area would be crucially dependent on continued access to industrial country markets. While diversification and a move toward higher value-added items is a possible way of circumventing markets that are quota constrained, experience shows that this takes time; clearly Bangladesh will need open and growing markets if its drive for balance of payments viability is to be assured. The staff's sensitivity analysis demonstrates how a weaker outcome for exports would seriously affect growth prospects.

Fourth, an important objective of the Government's reform program is stimulating new employment opportunities as a means of alleviating poverty. Yet, despite the central role that employment creation must play in agriculture and export-oriented industry, I did not find any discussion in the staff paper on the issue. I would be grateful if staff could elaborate on this subject and, in particular, on how it expects employment growth to evolve over the medium term.

Finally, Bangladesh's large aid pipeline and weak absorptive capacity has been a matter of some concern and was commented upon by a number of Directors last year. To be sure, there is scope for improving aid utilization procedures in Bangladesh and the recent government-donor consultations should help in this regard. However, since project aid accounts for the bulk of the aid pipeline and the projected increase in disbursements, this places a limit on how quickly or sharply disbursements can be increased and sustained even under the best of circumstances. A concomitant effort by the donor community to reduce the complexity of donor-determined restrictions and administrative procedures both for project and for import support would also be welcome. But by far the best way to increase aid disbursements would be to shift the composition of aid toward more quick-disbursing forms of assistance, with the necessary safeguards to ensure productive use of resources. This would provide support to the balance of payments and the adjustment program in a quick and timely way. It would also generate local counterpart funds, which are in short supply, and thereby protect the development program from recurrent shortfalls and ensure that the external assistance that is being made available to Bangladesh is in a form that is easy to utilize.

Mr. Yamazaki made the following statement:

Bangladesh is one of the poorest member countries, and its growth prospects are hampered by the population explosion, which has resulted in an extremely high population density, and by repeated flooding. When the authorities initiated the medium-term structural adjustment program under the structural adjustment facility, the Board encouraged the authorities to address the country's low domestic savings and investment by reducing the financial imbalances. At the same time, the importance of structural adjustment in order to enhance the efficiency of resource allocation was stressed. During the three-year structural adjustment arrangement, domestic imbalances were reduced through prudent fiscal and monetary policies, and exchange and trade liberalization was initiated.

However, performance during 1989/90 was disappointing, as there emerged substantial policy slippages in the fiscal and monetary area. As a result, the authorities lost part of the gains they had achieved earlier under the structural adjustment arrangement, including the external competitiveness of the economy. Since the staff report elaborates on the situation at that time, I will not go into it here; however, it should be stressed that the adjustment objectives cannot be achieved unless national savings are enhanced through tight financial policies. Elimination of structural impediments, on both the domestic and external fronts, is also needed in order to activate private investment. It is unfortunate that structural reform was also delayed in 1989/90 as a result of the weakening of the public finances.

It is heartening to note, however, that the authorities demonstrated their commitment to structural adjustment by adopting a number of additional measures in the first half of this year. The short-term stabilization measures constitute an important part of the prior action required of a request for an enhanced structural adjustment arrangement. While it is disappointing that the additional measures fell short of fully restoring the original program targets, they will help to regain the momentum for sustainable growth in the economy. In particular, it is encouraging that domestic financial stabilization, along with the devaluation of the taka, is expected to reverse the deterioration of the external balances. On the other hand, I am particularly concerned about the increase of the public dissavings, and more vigorous fiscal adjustment is needed in both the central government budget and the parastatals.

I welcome the adoption of a renewed medium-term adjustment program, as indicated in the policy framework paper. However, I note with some concern that the envisaged pace of financial adjustment is relatively slow. For example, the target for fiscal deficit reduction is no more than 2.5 percent of GDP during the enhanced structural adjustment arrangement period. While it is true that the inflow of concessional assistance and aid resources is mitigating the balance of payments problem, and a financial gap is not likely to emerge immediately, much faster adjustment is needed in order to address the poverty issue.

In order to achieve substantial progress in the area of poverty, national savings and investment should be further encouraged, and key importance should be attached to the enhancement of public savings. In retrospect, it is clear that the gradual approach has not been successful, as it only prolonged the poverty situation. The poverty-oriented program should be strengthened and subsidization and public assistance should be focused on particular social needs. At the same time, rationalization should be

introduced in the general pricing and subsidy policies. To this end, I hope that the authorities will strengthen public finance by accelerating the structural reforms and encouraging private sector response. Parastatal reform should be expedited during the program period.

Another issue is external adjustment. While strong growth seems to be an overriding objective for Bangladesh, sustainability of growth, in the context of both domestic and external development, is the necessary precondition in any case. The staff is right to emphasize the need to stimulate export-oriented industry and reduce the dependence on official transfers. However, the export subsidies currently provided to this end are adding a fiscal burden; ultimately, the competitiveness of industry should be enhanced by establishing a sound macroeconomic framework, not by direct subsidization. In this regard, there appears to be plenty of room to accelerate import liberalization. Similarly, while the flexible exchange rate policy is welcome, any exchange rate action should be underpinned by tight domestic financial policies. In this connection, I am somewhat doubtful about the staff's suggestion on page 20 for further exchange rate adjustment. While the March devaluation seems to be justified as a correction of distortion, further nominal rate adjustment without financial tightening will only harm the stability of the economy.

In view of the poverty situation, the authorities' commitment to the objective of food self-sufficiency is understandable. However, unless competitiveness is attained in agricultural production, the pursuit of this objective may result in inefficient resource allocation. I would appreciate hearing the staff's comments on the competitiveness of the agricultural sector.

Turning to the 1990/91 program, I welcome the authorities' commitment to the tax reform and current expenditure retrenchment. While the revenue enhancement effect of the tax reform was not large in the first year, this reform, which is aiming at broadening the tax base, will establish a more elastic tax structure and could encourage private sector activity. On the expenditure side, I agree with the staff that high prioritization is needed on both current and development expenditure in order to effectively address the poverty issue. However, a more important fiscal objective, which also applies to monetary policy, is to maintain the momentum of financial adjustment, following the short-term adjustment measures during the first half of the year. Unless tight fiscal and monetary policy is maintained, the exchange rate devaluation that was implemented earlier this year will only produce price pressures in the course of the enhanced structural adjustment program.

On structural policy, it is somewhat disappointing that parastatal reform, in particular the rehabilitation of the jute and the industrial corporations, has been relatively slow. Like the staff, I urge the authorities to accelerate this reform. In addition, I would encourage the staff and authorities to prepare a more concrete time frame for parastatal reform.

I also encourage the authorities to expedite import liberalization and exchange rate unification. These are important targets for the establishment of export-oriented growth.

The authorities face the formidable task of reorienting the economy toward stronger and more sustainable growth. They should move away from the previous gradual approach, and pay special attention to structural reform. I remain concerned about the slowness of adjustment on every front. Nevertheless, I support the authorities' request for the enhanced structural adjustment arrangement, on the understanding that adjustment should be further enhanced in the subsequent annual programs.

I support the proposed decisions.

Mr. Ghasimi made the following statement:

I welcome this review of recent economic and financial developments in Bangladesh and would like to take this opportunity to commend the authorities for their courageous efforts and their commitment to economic reforms, which are reflected in their decision to pursue the medium-term structural adjustment under an enhanced structural adjustment arrangement. Since I generally agree with the thrust of the staff analysis and appraisal, I will concentrate my remarks on a few areas of particular interest.

During the past ten years, Bangladesh has been supporting its adjustment programs by a close collaboration with, and continuous financial support from, the Fund. The structural adjustment facility arrangement covering the period 1986/89 is the latest manifestation of this close association. The main objectives of this arrangement were to increase real per capita income with a view to alleviate poverty, to reduce the rate of inflation, and to move toward a viable external position.

The overall results achieved during the structural adjustment arrangement period were indeed encouraging. As a result of the implementation of the wide-ranging structural reforms and macroeconomic policies contained in the original policy framework paper, the authorities were able to reduce domestic imbalance, achieve the program's objectives in the areas of inflation and

external position, and liberalize the exchange and trade regimes. Also on the positive side, I note the prudent management of external debt, the consolidation on external reserves, and the authorities' commendable policy of discharging their financial obligations in a timely manner.

On the other hand, the much needed growth objective of the program was not realized as adverse weather conditions, including devastating floods in the second and third program years, disrupted agricultural production in particular and the management of the economy in general. These developments, combined with a loosening of the momentum of structural reforms and some slippages in policy implementation, resulted in a buildup of weaknesses in the fiscal and monetary areas and a rapid erosion of external reserves in 1989/90.

In these conditions, it is most welcome that the authorities reacted rapidly and convincingly in early 1990 to stabilize the economy and to set out the basis for the continuation of the adjustment program in the years ahead within the framework of an enhanced structural adjustment arrangement. I support the general thrust of the policy framework paper and, in particular, the macroeconomic objectives of fostering growth and alleviating poverty, further reducing inflation, and consolidating the external position. I also welcome the comprehensiveness of the reforms envisaged, including the introduction of a value-added tax (VAT) system, the move toward a more market-oriented monetary management in the context of the reform of the financial sector, and the increased emphasis on public enterprise rehabilitation and public expenditure rationalization. The implementation of these measures will undoubtedly consolidate public and private savings, which remain relatively low.

Promotion of efficiency and competitiveness will be crucial in enhancing diversification of production and of the export base so as to alleviate the country's vulnerability to external shocks and heavy dependence on external aid. The recent identification of four nontraditional export categories of toys, luggage and fashion goods, electronic items, and leather goods as priority export sectors are definitely steps in the right direction in the authorities' export diversification efforts. To this end, further exchange and trade liberalization will be very supportive. The authorities are not only adhering to this policy, as it appears from the most recent measures implemented, but are also prepared to accelerate the pace of import liberalization and tariff reduction in the second and third years of the enhanced structural adjustment arrangement. However, as is the case for many developing countries, the success of this strategy in Bangladesh will depend largely on improved access to markets in industrial

countries, particularly for those sectors where developing countries are gaining substantial comparative advantage, such as textiles and clothing. Needless to say, easier access to these markets constitutes the most efficient and sustainable way to expand commercial flows to Bangladesh.

The promotion of labor-intensive activities in Bangladesh is also appropriate given the scarcity of natural resources and in view of the urgent need to generate additional employment opportunities and alleviate poverty. Equally important is the emphasis given on environmental issues, particularly in view of the frequent natural disasters affecting the country.

Finally, it appears that even after the completion of the proposed enhanced structural adjustment arrangement, large fiscal and current account deficits will remain. In this regard, I encourage the authorities to persevere in their adjustment efforts and to strengthen them where feasible. I also call on the international financial community to continue providing the country with appropriate and highly concessional financial assistance.

I support the proposed arrangement and decisions.

Mr. Thorláksson made the following statement:

I welcome the proposed enhanced structural adjustment arrangement for Bangladesh. The authorities' renewed efforts to undertake a comprehensive adjustment program deserve financial support from the Fund.

Performance under the previous structural adjustment arrangement was mixed. Overall, the authorities conducted a prudent macroeconomic policy. However, the fiscal and financial reforms were disappointing, and contributed less to structural adjustment than desirable. In light of this, it is encouraging that the authorities intend to implement economic policies along the lines of the policy framework paper. Nevertheless, I find that policies in some areas are characterized by a higher than desirable degree of gradualism. In particular, I would like to see stronger fiscal adjustment in the years ahead and more momentum in structural reforms. Furthermore, Bangladesh will be highly dependent on concessional foreign aid, which it is optimistically assumed will increase greatly over the program period.

A major concern is the impact that the continued low rate of investment and the insufficient rate of savings, in particular public savings, will have on Bangladesh's efforts to achieve sustained growth. The authorities state that they are disappointed

by the hesitancy in the private sector's response to the deregulation and other measures that have been undertaken. I would add that the sluggish response from the private sector and the fact that the weak fiscal situation constrains the level of public investments are clear signs to the authorities that a more courageous approach is needed in the areas of both macroeconomic and structural policies.

In commenting on the various policies under the program, I will begin with the public finances. The strengthening of fiscal policy in March of this year is indeed welcome. However, the medium-term projections suggest that the authorities will have to pursue firm fiscal policies in order to keep the economy on a sustained growth path and to make substantial progress in poverty alleviation. Clearly, discipline in the budget policy is a key element of the program.

Revenues are projected to increase under the program by only 1.5 percent of GDP, which includes 0.5 percent of GDP during the next fiscal year. I welcome the introduction of the tax measures; however, I fully agree with the staff that revenue efforts need to be further intensified in order to raise the very low tax/GDP ratio in subsequent years. In addition, market-oriented reforms and price policies should be initiated to reverse the decline in profits in the public enterprise sector that has occurred over the last few years and to increase significantly resource mobilization.

Current expenditures are expected to decline by 0.2 percent of GDP during 1990/91, and overall by 1 percent during the program period. I particularly welcome the reduction in subsidies and the intention to service the poorest segments of the population in a more targeted manner. An area of particular concern is the continuing cash subsidies to the jute sector, where I find the efforts less ambitious than the precarious budget situation dictates. In order for the authorities to mobilize sufficient domestic funds for high priority development projects, firm expenditure control and a more ambitious approach to the phasing-out of all subsidies have to be adopted.

If the rate of inflation is to be curtailed and the rate of savings improved, fiscal policies need to be supported by monetary policies. In this regard, positive real interest rates throughout the economy will be critical. I concur with the staff that it is important for the authorities further to accumulate external reserves and to contain monetary expansion. In this context, it is crucial that the authorities meet the requirements for net

domestic bank credit to the public sector in order to make room for the expansion of bank credits to the private sector, within appropriate limits.

I endorse the central bank reforms, designed to improve the control of growth of bank credits, and I support provision of technical assistance in this area. I also support the recommendations regarding financial reform, and the encouragement of a further degree of market orientation in the banking sector. I note, however, that the authorities intend to maintain certain interest rate subsidies, and I would urge them to reconsider that.

Turning to exchange rate policy, I urge the authorities to unite the two exchange rates as soon as possible, since the rationale for maintaining the two rates does not match the possible gains in the effectiveness and confidence that would follow unification.

I am not fully convinced that an active exchange rate policy is the correct approach. To my mind, large movements in the exchange rate would not provide a desirable economic environment in a situation where efforts are being made to develop financial markets and stabilize prices to encourage investment and growth. I am not disputing the fact that Bangladesh needs a competitive exchange rate, but in light of the recent exchange rate adjustment, it seems that no further substantial changes in the nominal exchange rate are required. To sustain and further improve international competitiveness, the authorities should place emphasis on domestic adjustment rather than on major adjustments in the exchange rate. I do not believe that the supply problems in the export sector should primarily be countered by adjustments in the exchange rate. Instead, adequate structural policies, combined with fiscal and monetary policies aimed at mobilization of sufficient domestic and foreign resources for important investments, should be the trigger for expansion and broadening of the export sector.

I can endorse the proposed decisions.

Ms. Creane made the following statement:

Bangladesh comes to the Fund in a weakened economic condition, complicated by its economic policies of recent years. It is discouraging to consider that the principal message from the last Article IV discussion--on the importance and sources of investment growth--does not seem to have had much impact on policies in the intervening year. The program for consideration today does emphasize that higher investment will not fuel faster economic growth

without the tight financial policies combined with serious structural reform that have been lacking until now.

Turning to fiscal policy first, I would emphasize the importance of fully implementing the tax reform, mobilizing revenues, and keeping within current expenditures limits in the hopes that these steps will quickly correct for the previous lapses in fiscal structure reform. A greater emphasis on public enterprise reform is warranted, and the authorities are encouraged to move toward reform and, potentially, privatization of public enterprises and to reduce subsidies more rapidly than planned.

I agree with the staff observation that the state of the Bangladesh economy demands vigorous adjustment. Yet the targets for the full three-year program indicate a very small improvement in the budget deficit and only a containment of the current account deficit. Perhaps these are the most realistic outcomes, but the possibility of slippage raises some concern about the outturn in this case.

Further public investment in infrastructure will be a critical input to future growth. In this regard, a clarification of the proposed trade-off between higher public investment and more "efficient" investment would be appreciated. In any case, I am pleased that the public investment target was chosen as a benchmark. The goal of promoting foreign investment is a solid one, but I do not see a concrete policy put forward and wonder if the staff could elaborate further on this.

Foreign and domestic private investment will be stimulated by further trade, exchange rate, and financial market liberalization. I encourage the authorities to consider adopting a more flexible exchange rate policy as the most effective method of maintaining competitiveness, and fully deregulating remaining import and export controls as quickly as possible, including the import deposit requirement and the remaining restrictions on one fourth of all imports.

Thorough financial market development is important, including the introduction of market-determined interest rates. The absence of specific measures calls into question whether enough private saving would be stimulated to finance the private investment growth necessary for the program's targets. I agree with the steps planned to move toward more indirect monetary policy instruments, and believe that the introduction of government securities is an appropriate benchmark. Tight control over monetary aggregate growth--which should be facilitated by the programmed control on the fiscal side--and improvement of financial markets are essential to promoting further investment. For this reason, I

would appreciate staff discussion of the additional 1990/91 plans to liberalize the interest rate structure cited in the report. I strongly encourage the inclusion of further detailed steps toward improving the banking system in the enhanced structural adjustment program.

The uneven implementation of Bangladesh's structural adjustment program and lingering questions as to whether Bangladesh needs balance of payments financing also give me pause, but not enough to withhold support for this program. If the full range of fiscal, financial sector, exchange, and structural reforms are taken as programmed, the stage should be set for higher saving and investment and stronger, sustained growth. Therefore, I support the proposed decisions before us today.

The staff representative from the Asian Department noted that the action program proposed for Bangladesh at the aid group meetings in April had been fully implemented. Financial stabilization success had been achieved. The end-June targets had been met for the monetary aggregate, external debt, and reserve targets. The political commitment to structural reform had been strengthened.

While the enhanced structural adjustment arrangement timetable for structural reform might not be as precise as the staff would like in all areas, particularly given past slippages, there had been progress in firming up a timetable in a number of areas, the staff representative observed. The VAT would be introduced in 1990/91. A central bank security would be introduced by the end of calendar 1990, and monthly adjustments in interest rates were taking place, compared with six monthly adjustments in 1989. A timetable was being formulated in conjunction with various World Bank credits in the financial, energy, and industrial sectors. A staff visit would take place in October in connection with the special aid group meeting, and at the January review of the enhanced structural adjustment program the staff would attempt to secure firm timetables regarding reforms in a number of other areas.

The question of raising investment was crucial to improving the growth performance, the staff representative stressed. Considerable discussion had taken place over the past couple of years not only on the size of the investment program, but also on its quality. There had been extensive discussion on questions of capital utilization, operations and maintenance, and rehabilitation with the Fund and the World Bank. The Bank's public sector resource management credit, which was currently being negotiated, addressed these issues in detail. Already, allocations for operations and maintenance had been raised considerably in the current budget, notwithstanding the overall constraint on current expenditure growth. Other issues related to the quality of the investment program included the prioritization exercise, which was designed to remove low priority projects from the

investment program, currently being conducted in conjunction with the World Bank, and a change in the composition of public investment toward agriculture, rural development, water resources, and social sectors.

With regard to the degree of fiscal adjustment during the enhanced structural adjustment program, the staff representative said that there did not seem to be much scope for a further reduction in the budget deficit. The authorities had already made bold efforts to raise revenue during the period of the first year enhanced structural adjustment program, and had constrained current expenditure. Most of the deficit was being financed by concessional aid, and resource to bank credit was limited.

The main focus of further fiscal reform during the enhanced structural adjustment program period needed to be in the public enterprise sector, the staff representative agreed. The Government had recently announced increases in natural gas prices of 15 percent, and in electricity prices of up to 17 percent. The staff expected an increase in railway fares of about 15 percent to be announced shortly, and there would probably be some need for an adjustment in petroleum prices in the course of the year. Still, much action needed to be taken to strengthen the performance of the public enterprises. The World Bank was formulating concrete proposals in a number of areas. For example, the Bank had recently put forward comprehensive proposals for the jute sector involving the reduction of employment by about 30 percent, reductions in capacity, and restraint in wage cost increases--measures designed to ensure the financial viability of the jute enterprises over the next three to five years. It was in that context that the jute export subsidies would be reduced. The role that the exchange rate could play directly in reducing subsidies was limited in the short run. The staff would be working in the next few months to strengthen the monitoring system for the public enterprises.

With regard to poverty alleviation, over the longer term higher economic growth and low population growth were key to success, the staff representative indicated. In the short term, the scope for offsetting any adverse impact of adjustment measures was rather limited because of the budgetary situation and the very large numbers of poor people in Bangladesh. Nevertheless, the Government had been giving increasing attention to targeted programs for the very poor. There had been an increase in the food-for-work and vulnerable group development programs. Ration price increases had been limited to about 5 percent for sales to the poorer groups, compared with 16 percent for sales to the police, army, and other better-off urban groups. The current year's budget provided increase in allocations of more than 20 percent for education, health, and family planning. The Government was also encouraging a greater role for nongovernmental organizations in poverty alleviation, including the use of contracts for such services as immunization, family planning, and primary education.

With regard to export growth, the staff representative indicated that he did not feel that the medium-term projections were overly optimistic.

The base was small, and a volume growth of about 8 percent had been achieved in recent years. Wage costs were very low, with sufficient skilled labor available. Entrepreneurial skills had been developed in recent years, particularly as a result of experience in the garment sector. And after several adjustments in the past few months, the exchange rate seemed appropriate.

There seemed to be growing interest in foreign capital investment in the export sector, in particular through the relocation of industry from more expensive parts of Asia, the staff representative said. Import liberalization should help to play a role in strengthening the competitiveness of the export sector. Further steps in removal of quantitative restrictions were in prospect for the next two years, and the margin requirements were expected to be eliminated within the next few months. While further growth in garments might well be constrained by quotas in developed countries' markets, there seemed to be scope for diversification into other labor-intensive industries such as electronics, toys, and leather products. The employment consequences of success in those areas could be very large. In garments alone, probably about 200,000 people were currently employed, many of whom were poor women and children. The staff did not have good figures on employment overall, so he could not offer precise details on employment trends, but clearly the export sector was expected to play a large role in employment creation.

With regard to the Fund's financing role in the enhanced structural adjustment arrangement, the medium-term projections provided for increased donor support, the staff representative noted. The Fund was expected to provide only about 5 percent or 6 percent of the gross financing needs over the period of the program; its role was seen by the staff primarily as permitting the reforms to proceed smoothly, in particular in such areas as import liberalization, and to ensure that adequate reserves were available in view of the vulnerability of the economy to external shocks. Given the large availability of aid and the limited debt-service capacity, enhanced structural adjustment facility access had been limited to 90 percent with the agreement of the Bangladesh authorities, which would in fact result in a slight decline in Fund exposure over the period of the arrangement.

Mr. Arora stated that the authorities did consider the level of access under the arrangement to be low, particularly in view of the very bold decisions being taken by the authorities. He hoped that the Board would approve a higher level for the second-year program.

Directors had expressed concern over the slow pace of import liberalization, Mr. Arora noted. While there was no doubt that import liberalization would improve efficient allocation of resources, strengthen the export sector, and generally lead to modernization and increased efficiency, there were limits to what could be done over a short period of time. Some degree

of gradualism was necessary if the new practices were to become permanent policy. Drastic measures, on the other hand, ran the risk of being reversed.

Some Directors had supported the flexible exchange rate policy while others had questioned the value of such a policy in the Bangladesh context, Mr. Arora observed. He personally considered that there was a risk in putting too much burden on exchange rate policy. Even though Bangladesh rates of inflation were low in comparison with other countries facing adjustment problems, they had exceeded double digits many times. The role of fiscal and monetary policy was very important, and overly exclusive reliance on the exchange rate mechanism could speedily lead to distortions and, in particular, price pressures. Because of the policy slippages and price pressures in 1989 and 1990, correction had been necessary, but the authorities were conscious of the importance of fiscal policy. They had demonstrated their commitment to fiscal reform, despite substantial parliamentary criticism of the measures designed to increase revenues by 0.5 percent of GDP. Many of the tax measures had had to be withdrawn, but new tax measures had later been imposed that had effectively restored the target that the Government had set for itself in consultation with the Fund and the Bank. The Board could appreciate that in a country with an annual per capita income of about $180 there were serious problems in raising savings. The solution was efficient management of the parastatal organizations and efficient operation of the private sector in Bangladesh, to which the authorities were devoting attention.

Mr. Bossone made the following statement:

> The economy of Bangladesh is at a delicate crossroads. Significant progress has been achieved in the context of the recent Fund-assisted adjustment program, but major structural difficulties still require long-term and intensive policy efforts if the country is to step onto a self-propelling development path. In the meantime, a sustained and strong government commitment to policy reforms, as well as continued assistance from the international donor community, remain indispensable prerequisites for the completion of the needed economic adjustment.
>
> This chair appreciates the determination shown by the authorities during the past two years in trying seriously to address the complex problems facing the national economy; it is pleased to acknowledge the spirit of cooperation of Bangladesh toward the international donors' community; and it praises the country's excellent record of discharging obligations.
>
> In light of this and in view of the far-reaching economic program envisioned to be implemented in the country with the

assistance of the Fund and the Bank, I extend the support of this chair to the proposed three-year arrangement under the enhanced structural adjustment facility.

I am pleased to note that the program has a sound and comprehensive policy framework, where well-specified macroeconomic and microeconomic measures are coherently designed to address simultaneously the objectives of economic stabilization, higher domestic output growth, and poverty alleviation. My authorities welcome the major steps being undertaken to restore fiscal discipline and to mobilize public resources through tax reform, expenditure controls, and measures to strengthen the financial management of the public enterprises. This chair particularly supports the stronger emphasis that is being placed on the government development budget and on the prioritization of funding allocations to productive and social infrastructural investments; similarly, this chair is in favor of the prospective elimination of subsidies, the liberalization of trade and financial flows, and the efforts to raise national savings.

I would like, however, to make a few remarks on the Government's recent record of policy performance and to highlight some related important issues. Although considerable corrective steps have been taken by the authorities under the 1986/89 structural adjustment facility program, I am concerned that some important structural benchmarks--on budgetary revenue mobilization, financial reform, and the maintenance of external competitiveness--were not fully observed, to a great extent as a result of slippages in the pace of policy implementation. I am also concerned that while it is apparently in line with the established target, price inflation has remained high given the much lower than expected growth performance of the economy. Furthermore, public investments have progressively declined instead of rising as programmed, the economy's competitiveness remains weak, and the measures implemented by the Government so far have not been successful in stimulating the anticipated response from the local private sector.

I shall return shortly to some of these questions. But I would first stress the need for the continual surveillance by the Government and the assisting multilateral financial institutions over the timely implementation of the program-related policy changes, given the critical fragility of Bangladesh's economic situation. The large imbalances resulting from the reform implementation delays under the 1986/89 program; the structural weakness of the current account balance; and the continued heavy dependence on foreign concessional funds all point to the need to assign maximum priority to the accumulation of productive resources, especially in export and import-substituting activities.

The staff report describes the difficulties encountered by Bangladesh producers in attaining and preserving a sufficient degree of external competitiveness. As a result, real export growth has lagged considerably behind expectations, notwithstanding the frequent currency realignments conducted by the authorities. The graphs in Chart 3 of the staff report show that despite the gradual but steady depreciation of the taka vis-à-vis the U.S. dollar since 1988, the real effective exchange rate of the Bangladesh currency has been subjected to significant fluctuations, most probably owing to jumps in the rate of growth of prices. This would seem to suggest that inflation has been a more serious problem during the structural adjustment program period than the staff report is ready to concede. In fact, not enough information is provided by the report on the nature and causes of the problem in Bangladesh. I am concerned that the persistence of inflation and the lack of compensatory gains in factor productivity might tempt the Government to resort to further devaluations in order to secure temporary margins of competitiveness. In this respect, the position of the staff is not at all reassuring when it asserts on page 20 of the staff report that "...if the supply response in the export sector proved inadequate, the authorities would need to reconsider whether the exchange rate should be adjusted to further strengthen competitiveness...."

On several occasions this chair has agreed that currency realignments are indeed necessary when exchange rates are kept at unrealistic levels, but it has also argued that, once adjusted, the rate should be maintained stable, with a view to signaling the Government's commitment to preserve the domestic and external value of the currency. Competitiveness should then be governed by anti-inflationary policies and by supply-side measures aimed to reduce the production costs per unit of output. This chair, therefore, is not in favor of Bangladesh, or any other country, using a flexible exchange rate to restore competitive margins lost because of policy mismanagement.

I support the proposed decisions.

Mr. Menda made the following statement:

I welcome the conclusion of an enhanced structural adjustment arrangement between Bangladesh and the Fund, after a three-year structural adjustment arrangement, particularly in the context of last year's difficult economic situation. I agree with Mr. Arora that substantial progress has been made during the structural adjustment arrangement in several crucial areas. Mr. Arora acknowledges in his very candid statement that some aspects have been disappointing. In particular, GDP growth averaged only

3 percent against an objective of 5 percent and investment declined from 12 1/2 percent of GDP to 11 percent. The authorities' management of the economy has clearly been complicated by the floods of 1988, but Mr. Arora indicates that major delays in fiscal and financial reforms have also played a significant role in this outcome.

In the first half of 1989/90, further slippages were experienced in financial policies, and while growth was robust because of a good harvest, price pressures were rising, the balance of payments deteriorated, and there were large losses of external reserves. We are reassured by the bold measures taken by the authorities at the beginning of the year aimed at restoring short-term equilibrium. Today's discussion of the policy framework paper and of a three-year arrangement under the enhanced structural adjustment facility is the appropriate occasion to reaffirm the necessary orientation of economic policies. In order to achieve the medium-term objective of higher growth and investment, the authorities should focus on raising domestic savings and implementing forcefully the much needed structural reforms.

As regards fiscal policy, I agree that a more rigorous adjustment effort is now necessary. The budget deficit is projected to decline to 6 1/2 percent of GDP during the enhanced structural adjustment arrangement period through a contribution of revenue-enhancing measures and expenditure restraint. The lack of elasticity of revenues and the delays in the implementation of the tax reforms played a major role in last year's disappointing results. The objective of raising revenue by 1 1/2 percent of GDP in three years appears reasonable. It is also a much needed achievement given the fact that revenue only represents about 9 percent of GDP. The introduction of a VAT in 1991 with the technical assistance of the Fund will be a key element. The adoption of a single rate will facilitate the introduction of the tax. However, further efforts will be necessary to reduce the number of exemptions of the tax system and to improve tax administration and tax compliance.

The reduction of current expenditure (by 1 percent of GDP) is also a necessary step. We welcome the emphasis placed by the authorities on the control of current expenditure, in particular on wages and subsidies. The establishment of a high level committee to streamline the public investment program and concentrate the resources on the highest priority projects is a welcome initiative.

I have little to add to the staff's comments on monetary policy. A comprehensive financial reform program has been designed by the Fund and the Bank and a World Bank financial

sector loan has recently been adopted. These reforms will support the evolution of monetary policy toward more market-oriented mechanisms. Some useful measures have also been taken in order to help commercial bank debt recovery. Furthermore, recent modifications in its intervention mechanisms will strengthen the Central Bank's control over the growth of bank credit. All in all, these measures should contribute to allow for an adequate credit expansion and a progressive decline in the rate of inflation.

Turning to structural reforms, more rapid progress is expected in two important areas: public enterprises and trade liberalization. Many studies on public enterprises seem to have been realized or at least are on the way to completion. It is now time for the authorities to speed up the process of rationalization and to adopt more appropriate pricing policies. This is true in particular of the long overdue reform of the jute manufacturing sector.

As to trade liberalization, some progress has been achieved during the structural adjustment program in the reduction of quantitative restrictions. However, while about three quarters of all imports are now free of quantitative restrictions, the negative list still contains 354 categories out of a total of 1,239 categories. I therefore welcome the further steps taken in July and urge the authorities to continue in that direction.

Turning to the external sector, the emphasis put by the authorities on exchange rate stability coupled with tight financial policies is appropriate in order to reduce external imbalances as well as the rate of inflation. I would also urge the authorities to proceed expeditiously to exchange market unification.

As evidenced in the medium-term projections, Bangladesh will still need substantial support from the donor community. Such support will obviously depend on the authorities' commitment to the present path of adjustment. The authorities should also aim at improving their country's absorption capacity.

On the access level, I would welcome staff comment on why a level of 90 percent of quota, which is the lowest so far for an enhanced structural adjustment arrangement, has been chosen. I wonder in particular if this is consistent with our concern that enhanced structural adjustment arrangements be made more attractive as compared with structural adjustment arrangements. I would point out, for example, that previous access under the structural adjustment facility reached 70 percent of quota.

I agree with Mr. Arora that the measures already undertaken are bold and courageous. The emphasis on programs targeted to the poorest categories of the population is essential to the success of the program.

Mr. Shaffrey made the following statement:

The path toward strong sustainable economic growth and balance of payments viability for Bangladesh has been fraught with difficulties. The devastating effects of the floods in the second and third years of the recent structural adjustment program all but wiped out the creditable efforts of the authorities in the first year.

Nonetheless, at the end of that three-year period, the authorities were able to point to some positive developments. Domestic imbalances were reduced, exchange and trade liberalization initiated, and all quantitative third-year structural adjustment targets met, while the external position was stronger than had been envisaged. On the other hand, fiscal and financial sector reforms were delayed, growth objectives were not met, investment was weak, and poverty remained a fundamental concern.

This makes it all the more disappointing that, despite the formulation of measures for another structural adjustment arrangement, delays in implementation at a time of robust growth led to significant slippages in financial policies from the latter half of 1989, while the momentum of structural reform was lost. Budget revenue shortfalls, growth in current expenditure, and an expansionary monetary policy all contributed to price pressures, a deterioration of the balance of payments, and large losses of external reserves.

While the authorities' action in implementing a stabilization program from March 1990 consisting of fiscal, monetary, and exchange rate measures went some way toward redressing these slippages, it is regrettable that such action was not taken earlier.

The staff report does a very good job of critically examining and reporting on the fundamental problems facing Bangladesh, and I do not need to list them again here. However, I do wish to focus on the critical problem of a poor investment performance, at once the result of poor policies in the past and the stumbling block to future strong growth. Strong and faster sustained growth and poverty alleviation depend crucially on raising both public and private investment and national savings.

The problem of weak investment despite some reduction in domestic imbalances highlights the importance of ensuring that appropriate fiscal reform measures are taken in tandem with fiscal discipline. While a number of problems have hindered growth in the rate of investment, the fact that fiscal imbalances have been reduced despite budgetary revenue shortfalls and fast growth in current expenditure shows clearly that public investment has suffered. As a result, despite the fact that there is no shortage of foreign capital flows in the form of aid disbursements, a shortage of local counterpart funds and poor implementation capacity have depressed public investment activity. At the same time, subdued domestic demand and a small pool of national savings have held back private investment.

An increased rate of investment, both public and private, is fundamental to the attainment of stronger sustained economic growth and balance of payments viability. Strong public investment, with an emphasis on strengthening infrastructure and implementing flood control initiatives, can make an important contribution to increasing investment, while appropriately firm financial policies and moves on import liberalization should foster private investment. But it is equally fundamental that national savings, both public and private, be increased. As regards public savings, current expenditure clearly needs to be restrained, and revenue-raising measures implemented. Strict financial policies and positive real interest rates in the context of financial reforms, including interest rate liberalization, should ensure an increasing contribution from the private sector.

More generally, the pursuit of firm fiscal and financial policies combined with reforms in these areas, along with the general thrust of policies aimed at reducing inflation and liberalizing trade, should all contribute to greater investment and increased availability of domestic funds.

I can support the request for an enhanced structural arrangement for Bangladesh. The policy framework paper and the staff report were particularly useful in setting out the proposed policy direction over the next few years. The broad thrust of the proposed program is in the right direction and aims to address the fundamental problems faced by the authorities. However, I do have some doubts about whether the proposed program can realistically be achieved, and concerns over the implications of it not doing so.

Specifically, in regard to the 1990/91 program, I wonder whether the policies will be sufficient to achieve the progress in the balance of payments envisaged in the staff paper. The projected growth in export volumes set at about an average of

8 percent per annum appears ambitious and implies sizable gains in market shares for nontraditional goods. On the other side of the ledger, the staff notes the very real risk that in view of the envisaged investment effort, import requirements may also be higher than projected. Together, these considerations imply a high degree of sensitivity of the longer-term balance of payments projections to weaker outcomes for exports and private savings, with not particularly significant deviations from the program leading to unsustainable deficits. Similarly, I would agree with the staff that a projected growth of 5 percent annually in aid disbursements appears to be a little optimistic. While I concede some margin to the "pipeline" effects referred to by the authorities, I would be grateful to have the staff's views on whether it is persuaded by the merits of such pipeline effects argument.

The projected investment growth of 12 percent is fairly strong and will depend on appropriately tight financial policies being pursued by the authorities. I note that past experiences with revenue shortfalls and current expenditure overruns repeatedly prevented achievement of public investment targets in the past, and would caution the authorities to monitor developments in this area very closely.

However, the risks of revenue shortfalls will be reduced by the recent tax reform measures. Nonetheless, I urge the authorities to make a major effort to raise the low revenue/GDP ratio. Also, I note that although the increase in current expenditure is low compared with recent outcomes, it is still in excess of inflation. Given the need for public investment, I have some doubts that the restraint here goes far enough.

These actions by the authorities over the past few months and their most recent announcements provide evidence of a clear commitment by the authorities to the program. The measures already put in place go a significant way toward fulfilling the commitments under the 1990-91 economic program, I welcome in particular proposals to introduce a VAT and a central bank security.

On the recently announced revenue measures, while I have some doubts about this best being achieved through increased customs duties on crude oil, more practically I am concerned by the reference to the revenue forecasts and the ability of Bangladesh Petroleum Corporation to pay the higher customs duties depending on world prices not exceeding end-July 1990 levels. I would be curious to hear staff's comments on the implications of the recent developments in the world price of oil, including the authorities' scope to adjust retail prices and capacity to pay issues.

With respect to the ongoing import liberalization, I note the authorities' concerns regarding the weak reserve position, but I would tend to support both the staff's views on the causes of this and the authorities' own view of the importance of import liberalization to a number of their crucial objectives. I would like to hear staff's views on the extent to which the pace of import liberalization and tariff reduction could be quickened if the reserve shortfalls prove less than expected as a result of tightened financial policies.

Finally, I would welcome the staff's thoughts on when complete exchange market unification, planned for early in the program period, may in fact be expected to occur.

The only solution to poverty alleviation, the objective of medium-term policies in Bangladesh, lies in strong sustained economic growth, which must be supported by strong investment, both public and private. Thus, the importance of following strict financial policies, including stronger revenue and reduced current expenditure, cannot be overemphasized. In this regard, I am reassured by the authorities' determination and commitment toward reform and firm financial policies and their preparedness to act further if necessary in order to meet targets.

I support the proposed decisions.

Mr. Iqbal made the following statement:

The Bangladesh request for an arrangement under the enhanced structural adjustment facility should be viewed as a link in the continuous chain of growth-oriented adjustment that has been pursued by Bangladesh over the past several years. Significant progress has been made during the past 3-4 years under the structural adjustment facility in strengthening external accounts. However, economic growth has lagged, in part owing to exogenous factors, but also because of weaker financial policies. Consequently, progress toward poverty alleviation has been slowed. Therefore, the shift to the more rigorous disciplines of the enhanced structural adjustment facility is highly desirable. It goes without saying that the continued support of the donor community will be essential. On a more general plane, I should hope that more structural adjustment facility-eligible countries would expeditiously graduate to enhanced structural adjustment facility programs.

I broadly agree with the staff's appraisal and support the request for the enhanced structural adjustment arrangement. However, a number of issues relating to the content of the medium-term program and strength of the first annual arrangement need to be addressed.

Success of the medium-term program is predicated on a full implementation of structural reforms and macroeconomic corrections proposed in the policy framework paper. Such reforms are time consuming, and the planned strong fiscal effort will require difficult political decisions. Even then, the durability of external viability will remain tenuous. Therefore, the authorities should give serious consideration to further strengthening the policy contents of the medium-term program, so as to curtail the budget and the external current account deficits at a pace faster than that envisaged hitherto. However, care will have to be taken to avoid weakening the growth process. Thus, there should be a stronger action on resource mobilization, raising revenues, and curtailing current expenditures.

In particular, Bangladesh needs further to strengthen its export-oriented growth strategy, so as to transform domestic savings into foreign exchange earnings. In this context, a number of uncertainties need to be addressed. For example, would adequate resources be available to undertake the planned import liberalization? In the absence of sufficient foreign resource mobilization, could the available foreign exchange be allocated more to the import of investment goods rather than to essential consumer goods, including food? Can sufficient structural changes be undertaken over the relatively limited period under the enhanced structural adjustment facility to strengthen the export base?

While Bangladesh probably has a comparative advantage in a number of labor-intensive products, so do many other countries in the region that are also concentrating on similar product lines. In these circumstances, Bangladesh can ill afford to allow its competitiveness weakened by inappropriate domestic policies. I would not call for a further exchange rate adjustment. However, it would be advisable to keep the exchange rate under constant review and seek an early market unification. At the same time, given the uncertainties with respect to market access, as stressed by other Directors, Bangladesh's efforts should be matched by a relaxation of trade restrictions abroad. Finally, the authorities must establish the conditions necessary to promote domestic investment and to attract foreign capital and entrepreneurship.

Incidentally, it is not clear how direct foreign investment would increase threefold during the enhanced structural adjustment period without substantive policy changes. While external debt

obligations seem to be manageable at present, the authorities will have to be careful about foreign borrowing on commercial terms.

Regarding the program for 1990/91, I find it by and large appropriate. The budget for 1990/91 is tight, and its full implementation should lay the foundation for medium-term reforms. While progress seems to have been made toward reforming the tax system, its full implementation is still in doubt. However, I wonder about the monitorability of the benchmark on the Annual Development Program during the program period. I endorse the decision to raise utility rates as a means for improving finances of state enterprises. However, a more fundamental correction is needed in this context. The adjustment of ration prices is appropriate and should help in weaning the economy off subsidies.

Turning to the monetary and credit program, there is logic in reducing the rate of domestic credit expansion, if the broad money target is exceeded. However, given the fact that the net domestic bank credit to the public sector is a performance criterion, this provision could lead to a crowding out of the private sector. Would it not have been better also to allow for a corresponding downward adjustment in the net domestic credit to the public sector? The program attaches considerable importance to financial sector reforms and liberalization of interest rates in rationalizing resource allocation and generation of private sector savings. However, the policy framework paper is rather cryptic about the contents of such reforms. Could the staff elaborate on this issue? Is the problem of nonperforming loans endemic, and if so, how can it be corrected in a short period?

Fund-supported programs with Bangladesh appear to have had some success in mobilizing policies for poverty alleviation without weakening adjustment and growth. Perhaps Bangladesh's experience can be reviewed in conjunction with other cases, if possible in a seminar format. Such an exercise could help in clarifying the apparent inconsistency of the twin objectives of poverty alleviation and adjustment.

Mr. Kleine noted that performance under the three-year structural adjustment arrangement had been mixed. Insufficient progress had been made toward the restructuring of the domestic economy. The adjustment process to date had not been convincingly cohesive, as evidenced in particular by the policy weaknesses during 1989-90. That was regrettable because an unsteady course of policy implementation was bound to affect the credibility of the adjustment process, and it certainly weakened the basis from which the enhanced structural adjustment arrangement would begin.

An enhanced structural adjustment program for Bangladesh should involve a substantial effort to strengthen the external payments position in a sustainable manner, Mr. Kleine considered. Given the high degree of gradualism envisaged in major policy areas, he failed to see how the country could really come closer to a viable balance of payments position under the program.

The proposed program was not without risk, Mr. Kleine observed. For example, the introduction of the VAT in 1991, though welcome, might prove to be more difficult to implement than was currently contemplated. It was also worrisome to note that the authorities, when facing public opposition, had withdrawn measures that had been introduced to strengthen tax revenue. In that context, he agreed with other speakers that more determined efforts to reform the public enterprises were needed.

Another area of concern was the continued high dependence on foreign assistance, and the implications that could have for the financing of the program, Mr. Kleine continued. Financing gaps were bound to arise, especially if the authorities did not live up to their policy commitments.

For those reasons, Mr. Kleine concluded, it was with some hesitation that he lent his support to the proposed enhanced structural adjustment arrangements. He appreciated the prior actions undertaken by the authorities, and he had taken into account the enormous difficulties that adverse weather conditions and devastating floods had for the authorities. Nevertheless, he hoped that the authorities would strive to strengthen the adjustment policies so as to create the basis for a favorable and swift response of external donors to the country's financing needs, and to achieve medium-term viability in the external accounts. He could support the staff appraisal and the proposed decisions.

Mr. Monyake made the following statement:

> I welcome the addition of Bangladesh to the list of member countries benefiting from the enhanced structural adjustment facility. This case is another example of the useful role of the structural adjustment facility in supporting initial reform measures in low-income countries as a prelude to a more comprehensive and stronger effort to tackle deep-seated structural imbalances. The structural adjustment program has helped, despite the fact that not all of its objectives were achieved, to focus the authorities' attention on key areas where reform must be intensified: the tax effort, allocation of public expenditure, performance of public enterprises, and private sector participation in the economy, among others. The authorities have taken several prior actions in the context of the present program in the areas of revenue and expenditure reform, the exchange rate, and import liberalization that are consistent with the need to address those concerns. I would therefore encourage the donor community

to provide requisite and timely assistance to ensure that the program does not suffer because of inadequate financing.

I support Mr. Finaish on advising caution on the pace of adjustment, although the program targets seem reasonable. The staff and the authorities have attempted to set the economy on the right course without being too ambitious. Bangladesh is a poor country with more than half the population considered by the authorities to be below the poverty line. The level of illiteracy is also very high, and the country is susceptible to natural calamities. In the circumstances, we have to be more circumspect about the limitations of adjustment over the short to medium term.

The restrictions to Bangladesh's garment exports in industrial country markets once again draws attention to the dilemma that developing countries face in trying to pursue export-oriented growth strategies. The Fund must continue to discourage protectionism, especially in areas where developing countries could exploit their comparative advantage in order to diversify their economies.

I would welcome staff comment on why several donors have withheld aid commitments for 1990/91, pending a meeting in November to review progress in implementing the program, given that the authorities have taken a number of prior actions to demonstrate their commitment to the adjustment process. Would the delay have any material impact on the implementation of the program, given Bangladesh's high dependence on foreign aid?

Could the staff also outline their assumptions about the main sources of growth during the program period, which is expected to average 4.7 percent yearly? The terms of trade are not expected to change appreciably and the rate of investment is projected to increase by only 1 percent each year relative to GDP.

During the period of the structural adjustment program, there was a strong increase in private sector credit. However, it is also reported that domestic demand was subdued and investment was on the decline. I wonder, therefore, what was the driving force behind private sector credit.

I support the proposed decisions.

Mr. Prader noted that there were four major reasons for the vulnerability of Bangladesh's economy. First, although the physical demand and supply relations in the jute market should favor Bangladesh's ability to be its own price maker, other realities in the market limited the ability of that very poor country to act decisively. Second, generally unpredictable climatic

conditions and occasional natural disasters caused deviations in fiscal policy, hindering the management of the economy and defeating the investment decisions of the private sector. Third, the industrial countries' quotas on Bangladesh's exports, while definitely justified in the interest of those countries' own well-being, had been an obstacle to the expansion of Bangladesh's industry in the most competitive sectors. And fourth, administrative weaknesses had seriously impeded the collection of taxes, the targeting of subsidies to the poor, and the earmarking of resources for counterpart investment funding.

The staff representative had stated that the scope for reduction in the jute export subsidies was limited, Mr. Prader recalled. He found it difficult to understand why jute and jute goods should continue to be subsidized. Since Bangladesh exported almost all of the jute it produced, since the world jute market was dominated by Bangladesh jute, and given jute's demand elasticity and the market power of jute's importers, the benefits of Bangladesh's subsidy on jute goods went solely to the importers, who were end users. Could the staff comment on whether there were any other ways of stabilizing the price of jute and securing the income of small producers, such as, for example, establishing a jute fund based on contributions from donor countries.

Turning to the policy framework for 1990/91-1992/93 and the program for 1990, Mr. Prader said that he shared many of the staff's views concerning the structural objectives of the program. The World Bank's contribution to overcoming the major structural obstacles was extremely valuable. The medium-term success of the program would depend on the care given to phasing the structural reforms and on carefully devised pragmatic solutions for insulating the economy from the effects of the external factors to which Bangladesh had historically been vulnerable.

As expected, the 1990/91 program mainly aimed at minimizing the effects of recent fiscal slippages, Mr. Prader noted. Although some of the targets, such as increased national savings and reduction of fiscal and external imbalances, might seem ambitious, acceleration of the planned structural measures and continued Fund/Bank technical assistance should bring success within reach. The benefits of those measures would not be immediately visible, since they would be concentrated in the last quarter of the program year. It might be questioned whether such a time frame was appropriate for bringing out the anticipated results, or whether it would be strengthened by a greater reliance on short-term measures.

He did not consider the enhanced structural adjustment access to be too low, Mr. Prader remarked. One of the conditions for receiving enhanced structural adjustment facility resources was that the country have a very strong adjustment record, and there had been major slippages in Bangladesh's adjustment performance. It had been pointed out that there was not really a need for higher access because there were ample aid resources available to Bangladesh. But even if that were not the case, he did not consider it the

duty of the Fund to cover any financing gaps. All in all, Bangladesh would be served well with the proposed access, even if there were harsh conditions in the country.

Investment had been very low, Mr. Prader noted, and he would be interested in an analysis of why, despite increased market orientation, investment had not been forthcoming. Was investment low because foreign investors did not see any domestic market opportunities and exports would be the only reason for investment in the country? It seemed that quotas on industrial countries hampered investment by those countries in Bangladesh, which was a serious constraint on any program.

It seemed that the operation and effects of certain other factors he had cited at the beginning of his intervention were largely mediated by human error, and that in such a small, highly integrated world as the present one, they could be overcome through the investment of sufficient time, effort, and goodwill, Mr. Prader concluded. Ways and means of attaining that goal lay within the reach of normal human intelligence, where "normal" was defined as the minimum standard deviation. He shared the staff's appraisal and he supported the proposed decisions.

Mrs. Sirivedhin made the following statement:

> I shall limit my remarks to a few major policy measures that are crucial for Bangladesh to enhance savings and investment, thereby improving the prospects for higher and more sustainable growth over the medium and longer term. Before proceeding, I would like to emphasize that this objective can only be achieved if the authorities continue to attach a high priority to economic and financial stability. I am glad to note that they have recently undertaken the necessary measures to prevent slippages in the fiscal and monetary areas. These measures will certainly provide a more conducive environment for investment.
>
> Nevertheless, the investment to GDP ratio in Bangladesh has been very low and efforts to raise it so far have not been successful. Instead of increasing as programmed, the ratio has been declining in recent years. At the same time, there has been a lack of progress in promoting national savings, and public savings in particular. Indeed, the ratio of public savings to GDP has also been declining, and for 1989/90 it is even estimated to be negative. Therefore, the emphasis under the proposed enhanced structural adjustment on efforts to enhance investment and mobilize domestic resources is appropriate.
>
> I endorse the objective of the program to increase public savings through tax reforms and tighter control over expenditure. In this regard, the introduction of recent revenue measures, as outlined in the supplement of the staff report, is most welcome.

I am also encouraged by the planned introduction of a VAT at the beginning of next year; that will certainly contribute to broadening the tax base. In light of the less favorable performance in raising revenue in the past, it is important to accompany these measures by efforts to improve the tax administration.

On the expenditure side, I welcome recent adjustments in ration prices, which are expected to produce substantial savings in budgetary expenditures. I note that additional public savings are also expected from substantial adjustments in public utility prices, as well as from further improvements in the financial performance of public enterprises. Since these measures are likely to have an adverse impact on inflation and on the poorer groups of the population, the authorities need to monitor closely developments in these areas and stand ready to take the necessary measures.

As for private savings, deposit interest rates should continue to be kept positive in real terms, and I am encouraged in this regard by Mr. Arora's statement that banks are now free to set their own interest rates and that, as a result, interest rates have become much more market oriented than before.

In light of Bangladesh's very low per capita income, even the most extreme efforts are not likely to generate sufficient national savings to finance the necessary investment over the foreseeable future. The country will therefore continue to need substantial external financing. In this connection, I strongly support the authorities' request to the donor community to increase substantially their concessional assistance to Bangladesh. At the same time, like Mr. Finaish, I have concerns about the efficiency of aid disbursements and public investment.

I note that one major impediment in this area has been the lack of local cost financing. I therefore wonder whether there is not some scope to allocate a certain amount of concessional external financing to support counterpart financing, so that project aid disbursement could be expedited, thereby enhancing public investment. This, in turn, can be expected to stimulate private investment which, in most cases, depends on the availability as well as condition of infrastructures that are financed through public investment.

Efforts to promote private investment, including foreign investment, should be intensified, for example, through further improvement in investment licensing procedures, privatization of public enterprises, rationalization and reduction of tariff levels, and further liberalization of import controls. As for the latter, I welcome the recent removal of controls on 70 categories

of commodities, and I am also encouraged by the authorities' intention to accelerate the pace of import liberalization and tariff reduction.

I support the proposed decisions.

Mr. Wright remarked that actions taken by the authorities to come to grips with earlier macroeconomic slippages seemed to have taken hold. That, together with the low level of access proposed, meant that he could support the enhanced structural adjustment facility request, although he agreed with other speakers that the adjustment envisaged was relatively gradual.

The impact on public investment of a shortage of counterpart funds had been considerable, Mr. Wright commented. The intended response to that was to concentrate on projects with a high share of donor financing. But there was an urgent need to raise investment overall, and in order that donor flows be used to the fullest extent and the amount of investment forgone be minimized, it was of the utmost importance that domestic revenue be increased.

Import liberalization was a key measure in raising growth prospects, Mr. Wright stated. He welcomed the further removal of import restrictions as reported in the supplement to the staff report, but the subsequent imposition of high tariffs was disappointing and seemed to run counter to the tariff objectives specified in the policy framework paper. Mr. Arora's remarks on the pace of import liberalization were well taken, but he nevertheless urges the authorities to address that issue as soon as possible.

On the question of the exchange rate, Mr. Wright said that a strong export performance was, of course, of central importance to Bangladesh and he agreed that some flexibility in the exchange rate might be appropriate in helping to secure that. As always, however, that was subject to the important qualification that the main burden of maintaining Bangladesh's external competitiveness had to fall on domestic policy measures. Changes in the exchange rate might provide a useful buttress to structural and macroeconomic measures but should not, in any circumstances, be regarded as an alternative to them. There should be no presumption therefore that exchange rate changes should lead the drive to remain competitive. He had been encouraged by the staff's remarks in that context.

Mr. Dai made the following statement:

I congratulate the authorities for completing the 1986/87-1988/89 structural adjustment program. Looking at the actual program period as a whole and in particular during 1989, significant progress has been made in a number of areas, notwithstanding some slippages in the implementation of certain policy measures. It is evident that adjustment performance in the first two years

of the program was adversely affected by unfavorable weather conditions. However, preliminary results for 1989 appear encouraging, with real GDP estimated to be 5.5 percent--the highest since 1984, and exports and imports having increased by 16.6 percent and 6.2 percent, respectively. The external position was better than expected and, more important, there was a 6 percent increase in agricultural output. Aside from the weather factor, these developments can be attributed to the positive accumulated effects of the adjustment efforts supported by the structural adjustment facility. Compared with that under previous adjustment programs, this progress was not easily attained, and the authorities should be commended for their strenuous efforts and cooperation with the Fund.

In view of the program performance, it appears that the economic structure of Bangladesh is gradually changing. Before the adoption of the program, agriculture still accounted for more than 40 percent of GDP, while during the execution of the program, the share of agricultural output in GDP seemed to be declining. In the meantime, there has been a significant increase in the share of nonagricultural sectors, in particular, the striking increase in the service sector of close to 50 percent of GDP. This change is of particular importance to the economy as it will reduce its vulnerability to external shocks.

Important structural measures with respect to import liberalization, reduction of foodgrain subsidies, and exchange rate management have been carried out. Nonetheless, resource mobilization is still not satisfactory and gross domestic savings are still too low, which may in part be due to a lack of flexibility in interest rates and in the interest rate structure. Related to this is the low level of domestic investment. In this regard, we can understand the present dilemma confronting the authorities as they constrain credit and broad money growth in order to combat inflation at the same time that there is a lack of domestic savings to stimulate growth, especially public savings. Given the priority of financial stability in the present circumstances, one possible solution would be to focus efforts on increasing domestic savings and investment rather than relax control over credit and monetary expansion.

As far as the policy framework paper is concerned, I am in general agreement with the major objectives of the program. I believe the staff is correct in giving the highest priority to policies in the agricultural sector, which is still the most important source of growth in Bangladesh. I am impressed with the structural adjustment policies in this area, such as the increase in the share of agriculture in public development spending, ensuring price incentives for producers, improved research

and extension services, greater private sector distribution, and better rural infrastructure. Two factors are of primary importance in agricultural development in developing countries: the Government must adopt the correct policy to stimulate and protect farmers' incentives, and greater efforts must be made to promote scientific and technical innovations in agriculture. It seems that the authorities have been successful in this regard.

The population growth rate in Bangladesh over the past few years still seems relatively high despite the Government's successful efforts in expanding family planning. It will be a source of concern if agriculture is unable to keep pace with this growth and the authorities' objectives of food self-sufficiency and poverty alleviation are hampered.

Broad and comprehensive structural measures must be fully effected very soon; we therefore appreciate the continuity of the measures contained in the structural adjustment arrangement and the new measures built into the enhanced structural adjustment arrangement, which will strengthen the authorities' ability to sustain the momentum of growth. However, I wonder whether there should not be a clearer sequence of implementation in the comprehensive package of structural measures so that they could all be effectively implemented in proper order.

The implementation of the structural adjustment facility-supported program has well prepared the economy for the forthcoming enhanced structural adjustment arrangement, which, with the joint efforts of the authorities and of the Fund, will undoubtedly promote further adjustment and reforms. I therefore endorse the proposed decisions.

Mr. Hogeweg indicated that he supported the proposed decisions. The success of the program depended on the continuation of large concessional flows, and on the maintenance of tight financial policies. It was regrettable that the authorities seemed to have needed the evidence of alarming losses in foreign exchange to be convinced of that. He agreed with the staff that the main factor contributing to the growth of imports had been the expansionary financial policies and not the lifting of import restrictions in themselves.

He sympathized with the preference of the authorities for relative stability of the nominal exchange rate in order to provide a supportive environment for private sector trade and investment, Mr. Hogeweg said. The staff had warned that if the private sector response was insufficient, further strengthening of competitiveness through the exchange rate would have to be considered. It was of course difficult to judge what level of competitiveness would be sufficient. However, he was not sure whether

devaluation should be the answer, given that trade restrictions in Bangladesh's export markets were a factor in limiting the supply response. All that of course presupposed sufficiently tight domestic financial policies, on which the entire enhanced structural adjustment program hinged, including success in many of the structural areas. Nominal exchange rate stability might also be helpful in bringing such domestic discipline about. He hoped that concern on the competitive position would not prevent use of the exchange rate in that manner.

Mr. Yamazaki said, concerning the question of gradualism, that he appreciated Mr. Arora's comments and fully understood the political and economic difficulties of rapid implementation of financial adjustment in any field, including import liberalization. However, he would underscore the importance of rapid financial adjustment and rapid recovery of national savings and investment, in the case of Bangladesh as well as other enhanced structural adjustment facility countries.

The staff representative from the Asian Department noted that a number of Directors had pointed to the low level of private investment. The authorities and the staff had been concerned about the relatively modest response in the last few years to Bangladesh's move toward a more market-oriented economy. To some extent, it was probably the low rates of growth due to floods and other factors in the past few years that had discouraged investors, but clearly more steps needed to be taken to strengthen investor confidence. A number of measures implemented recently should certainly help: the improved quality of the public investment program to support the private sector; the role of the Board of Investments; and the encouragement of foreign investment through clearer guidelines. Vigorous implementation of the tax and financial reforms and the preservation of sound macroeconomic policies were crucial.

The authorities had been disappointed by the lack of progress in reducing inflation in recent years, and were placing increased emphasis on lowering the rate of inflation during the enhanced structural adjustment period, the staff representative indicated. An important element in that regard, in addition to financial policies, was the performance of the agricultural sector, in particular the availability of food supplies since food accounted for about 60 percent of the CPI. Production had recently responded in a very encouraging manner, in particular as a result of policy reforms including the liberalization of imports, improved irrigation equipment, and the increased role of the private sector in the distribution of fertilizers and other inputs. Further agricultural reforms were planned and should encourage further investment in the agricultural sector, which could be very competitive with the right incentives.

Given the emphasis on tight financial policies and the adjustments of the exchange rate that had taken place in the past few months, the staff representative remarked, there did not seem to be any compelling reason for a major adjustment at the moment. The situation would, however, be kept

under review. Bangladesh had in recent years moved the exchange rate in a gradual manner to maintain competitiveness. The period in late 1988 and part of 1989, when the rate had been maintained against the U.S. dollar and had appreciated in real effective terms, had been somewhat unusual, and the appreciation that had taken place in that period had largely been corrected. Export performance in recent months had been quite encouraging.

Exchange rate unification was a commitment under the enhanced structural adjustment arrangement, the staff representative noted. The staff and the authorities had not yet arrived at a precise timetable for the remaining 2 percent of unification to be accomplished. The authorities had in recent months been conducting some studies to understand better how the market for remittances from the Middle East worked, and the staff expected to reach an agreement on unification when it was given the results of those studies at the time of the staff visit in October.

It had been suggested by Mr. Bossone that inflation might have been related to exchange rate policy in the past few years, the staff representative recalled. In fact, during the period in question, the exchange rate had been held constant, and inflation had increased domestically relative to inflation abroad, reaching about 14-15 percent at one point. There had been a large exchange rate adjustment in real effective terms before the structural adjustment arrangement period, but relatively little change since then.

The Acting Chairman noted that the exchange rate had not been leading adjustment, and in fact had only been adjusted when it became clear that there had been a sharp deterioration in the real effective exchange rate as a result of acceleration in the inflation rate.

Mr. Arora remarked that one major reason for the disappointing investment response by the private sector had been a relative inadequacy of public sector investment. However, he agreed with Mr. Prader that more analysis on the subject was necessary and that the record so far of foreign investment being guided by export opportunities available in the host country had not been very encouraging. From the point of view of both poverty alleviation and rapid growth, the stepping up of greater public investment in infrastructure was essential, both in the rural sector and the industrial sector. Even after import liberalization took place and even with very tight macroeconomic financial policies, it would be optimistic to expect a boom in foreign investment in Bangladesh. Therefore, the emphasis had to be on generating large domestic savings to finance a public sector investment program, with accommodating and supportive policies for both domestic and foreign private sector investment.

An interesting point had been raised by Mr. Dai regarding the fact that agriculture was supporting a preponderant part of the population with a declining share of GDP, and regarding the very striking growth of services sector, Mr. Arora recalled. He would welcome an in-depth staff analysis of

that pattern, which was certainly a very distorted pattern of development. The problem was resolved in the short run by expanding employment in the services sector, but without rapid and sustained growth of the agricultural and industrial commodity sectors, the pattern could not be maintained for any length of time. Part of the cause of the high inflation was most likely the rapid growth of the services sector, much of which was unproductive in terms of contributing to economic growth. The donor community also needed to examine how its aid was translated into consistent investment decisions.

The Acting Chairman made the following summing up:

Directors noted that under the three-year SAF, domestic imbalances were reduced. However, investment and growth targets were not met, progress in poverty alleviation was modest, and important fiscal and financial sector reforms were delayed. Last year, major weaknesses in financial policies emerged, leading to a rapid decline in official reserves, and the momentum of structural reform slowed further.

Directors welcomed the successful implementation of the financial stabilization program during March-June 1990. The budget had been strengthened by raising tax revenue and curbing current expenditure. In addition, net credit to the Government had been held within the agreed targets and private sector credit growth had been restrained. The value of the taka had been depreciated against the U.S. dollar to strengthen competitiveness, and gross official reserves had stabilized at the equivalent of nearly two months of imports.

Directors agreed that these actions had begun the process toward medium-term adjustment that could be supported by an ESAF arrangement. They endorsed the authorities' objectives for 1990/91-1992/93 of attaining higher growth and investment, reducing the rate of inflation, fostering a dynamic private sector, addressing basic human needs, and making substantial progress toward external viability. The success of this strategy would depend on the maintenance of financial stability, strong structural policies as described in the policy framework paper, and the continued assistance of the donor community.

A number of Directors believed that Bangladesh should strive to accelerate the pace of adjustment, in particular, through stronger revenue and expenditure efforts, in order to reduce the budget deficit at a faster pace than envisaged, to strengthen the overall national savings-investment performance, and to tackle the poverty issue more effectively. To that effect, Directors urged continued efforts to promote fiscal reform. The value-added tax should be introduced as scheduled. Further steps should be taken to reduce food, jute, and interest rate subsidies. Spending

should be redirected toward agriculture, water resources, human resource development, and population control. The prioritization of the Annual Development Program should be completed as soon as possible, to assure adequate financing for high priority projects and to reduce the number of lower priority projects, especially those financed primarily with local funds.

Directors attached particular importance to the reform of the public enterprises to enhance their operational efficiency and budgetary contribution. This should be achieved through more frequent price adjustment, closer monitoring of the finances of public enterprises, an enlarged privatization program, and the restructuring of jute and industrial enterprises.

Directors emphasized that the growth of credit to the public sector would need to remain restrained, in order to meet adequately the needs of the private sector. Prompt implementation of the financial sector reform would support moves toward a more market-oriented economy and broaden the range of financial instruments, and thus promote private savings.

Directors recognized that progress in poverty alleviation depended crucially on increasing employment and raising per capita income. While some scope existed for programs to help cushion the effects of certain adjustment policy measures on the most vulnerable groups, these programs needed to be targeted carefully, in view of the overall budget constraints and the need for strengthening of the fiscal adjustment.

Directors stated that continued exchange and trade liberalization was essential to promote efficiency and competitiveness in domestic production, and to achieve progress toward external viability. Directors noted that the recent exchange rate depreciation had strengthened competitiveness, particularly in light of the real effective appreciation of the exchange rate in the recent past. A number of Directors stressed the importance of supporting the exchange rate action with strong financial policies and structural reforms in order to attain the medium-term export targets, which implied steady gains in export market shares provided that Bangladesh enjoyed adequate access to markets. Accelerated removal of the remaining quantitative bans and restrictions on imports would be needed in the second- and third-year ESAF programs, in view of the cautious approach that had been adopted this year. If the supply response in the traded goods sector proved inadequate, the authorities would need to consider a further strengthening of adjustment policies.

Directors believed that if the reform effort remained strong, concessional external financing would be available on the scale

required to meet the program's objectives. External financing gaps were not foreseen during and beyond the ESAF period, but the need for quick-disbursing assistance was emphasized, while it was noted that Bangladesh would need to strengthen its aid absorptive capacity. Some Directors noted the high level of dependency of Bangladesh on foreign assistance, and underscored the need for a further acceleration of fiscal and monetary policy tightening, as well as for structural reforms.

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, Section 2(a), and in concluding the 1990 Article XIV consultation with Bangladesh, in the light of the 1990 Article IV consultation with Bangladesh conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. Bangladesh maintains restrictions on payments and transfers for current international transactions in accordance with Article XIV as described in SM/90/144, except that the restrictions on payments and transfers for current international transactions arising from the bilateral payments arrangement with a Fund member and from the limitation on the remittance of dividends by certain companies are subject to the approval of the Fund under Article VIII, Section 2(a). The Fund urges Bangladesh to eliminate the restrictive features of this bilateral payments arrangement and to remove the exchange restriction arising from the limitation on remittances of dividends as soon as possible. The Fund also encourages Bangladesh to administer the restrictions maintained under Article XIV in a liberal manner.

Decision No. 9518-(90/128), adopted
August 10, 1990

Enhanced Structural Adjustment Arrangement

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

2. The Fund notes the updated policy framework paper for Bangladesh set forth in EBD/90/145.

3. The Fund approves the arrangements set forth in EBS/90/132, Supplement 2.

Decision No. 9519-(90/128), adopted
August 10, 1990

5. SIERRA LEONE - OVERDUE FINANCIAL OBLIGATIONS - REVIEW FOLLOWING DECLARATION OF INELIGIBILITY

The Executive Directors considered a staff paper on the further review of Sierra Leone's overdue financial obligations to the Fund following the declaration of its ineligibility to use the general resources of the Fund effective April 25, 1988 (EBS/90/141, 8/3/90), together with a policy framework paper for Sierra Leone for 1990/91-1992/93 (EBD/90/218, 7/25/90).

The staff representative from the African Department indicated that the staff had received provisional information on the policy targets as of end-June. Total domestic credit had amounted to Le 11.3 billion as compared with the revised target of Le 11.7 million; claims on the Government, Le 8.4 billion as compared with the revised target of Le 8.5 million; claims on the private sector, Le 2.9 billion as compared with the revised target of Le 3.2 million; and broad money at end-June, Le 12 billion as compared with the revised target of 11.9 billion. The staff had also been informed by the Bank of Sierra Leone that the Bank had instructed the Federal Reserve Bank of New York to pay $250,000 to the Fund, although the Fund had not received that transfer to its account as yet, and that arrangements had been made for further payments to come very shortly.

The Acting 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 Committee of the Whole of the Executive Directors of the Bank and IDA in their meeting on August 7, 1990:

Directors commended the authorities of Sierra Leone on the steps the Government had taken to reform the economy. They mentioned in particular the measures to raise tax revenues and to tighten monetary policy, and the establishment of a market-determined exchange rate regime. Important actions also had been carried out to liberalize the marketing and pricing of rice and petroleum. Nevertheless, much remained to be done to address the

serious economic imbalances in the country. It was critical that the Government sustain the momentum for reform in order to restore public confidence.

Several Directors commented that the program could have been stronger in several areas. At the same time, some proposed actions such as the retrenchment of staff, increases in energy prices, and limiting defense spending could prove politically difficult to implement. Failure to tighten fiscal policy sufficiently would undermine the progress made so far and threaten the objectives of the program. In this regard, the reform of public enterprises is a priority.

Directors welcomed the recent deceleration in inflation and the restoration of positive interest rates. They noted that it would be necessary for the Government to reduce its borrowing requirements from the banking system in order to allow sufficient credit for the private sector. Reform of the financial sector needed to be a cornerstone of the program. Several speakers emphasized the importance of the proposed review of the sector and the design of reforms to improve financial intermediation.

Some Directors observed that the economic projections in the policy framework paper appeared optimistic and would be difficult to achieve. The expected switch in economic transactions from parallel to official markets would require the restoration of confidence in the economy. This will take time to achieve. Also important to bring about this change were the measures outlined in the paper to reform the structure of and collection of taxes, licensing, and marketing of gold and diamond trade in the country.

Directors expressed concern about the implementation capacity of the Government. They noted the proposed review of the civil service and urged the IMF, the World Bank, and other donors to be responsive to requests for technical assistance in this and other areas.

Several Directors noted the severe deterioration in social indicators which had taken place in Sierra Leone. They welcomed the Government's intention to adopt a comprehensive strategy to mitigate the social costs of adjustment. The implementation of projects to improve health and education services would be important and would need significant donor support. Adequacy of the social component was questioned. Directors welcomed the intention to develop an environmental action plan.

Directors commented that the financial requirements of the program were substantial. Debt relief would be particularly important. The amount of external payments arrears, including

to the IMF, the World Bank, and other multilateral institutions, as well as commercial creditors, was large in relation to available resources. The eventual settlement of these arrears was essential to the resumption of normal financial relations between Sierra Leone and its creditors. This could prove difficult. Success in these efforts would depend critically on the credibility of the Government in carrying out the reforms outlined in the policy framework paper according to the agreed timetable. Nevertheless, assuming that the Government persisted in the reform effort, they urged donors to provide adequate and timely support in order to help sustain the program. They also urged the Bank staff to follow closely the implementation of the measures in the program.

Mr. Monyake made the following statement:

I would like to express my authorities' deep appreciation for the diligent work performed by the staff and for their continued support. As a result of extensive discussions held in Freetown and Washington with the Fund and World Bank staffs, the authorities are now presenting the Board with a PFP for 1990/91-1992/93, containing a comprehensive set of macroeconomic and structural policies, that is to form the basis for a Fund-monitored program.

Since December of last year the Sierra Leonean authorities have come a long way in addressing their economic and financial difficulties and normalizing their relations with the Fund. The first phase of their efforts, represented in the package of policy measures adopted for the second half of the fiscal year 1989/90, aimed at stabilizing the economy and setting the stage for the medium-term program. In the fiscal area, a significant improvement in budgetary performance was realized, with the overall deficit being reduced by 2.5 percentage points relative to GDP, and government borrowing from the banking system falling by 18 percentage points relative to money stock, in January-June 1990 in comparison with the preceding six months. Monetary policy has been sharply tightened with interest rates being substantially raised so that deposit rates are positive in real terms. In addition to the continued focus on reducing liquidity in the economy and financing the Government deficit in a noninflationary manner, the commercial banking system has been boosted by the injection of large amounts of currency (leone).

Recognizing the need to overcome the credibility problem and skepticism of the business community and in an effort to attract transactions into official channels, the authorities undertook far-reaching reforms in the external sector. Accordingly, the leone was floated in April 1990 and import and export licences

were abolished. The Currency Control and Economic Sabotage Act, which was found to be restrictive of trade, especially in diamonds and gold, was repealed. Furthermore, and in support of liberalization measures, the authorities took another decisive step by privatizing procurement and distribution of petroleum and petroleum products. This is expected to ease the frequent shortages in petroleum.

Although the authorities realize that adjustment is necessarily a lengthy process and that the full benefits will only come as confidence is restored in the sustainability of these measures, they are encouraged by the positive signs being witnessed in the economy. In particular, the recent deceleration in the monthly rate of inflation will strengthen public support for the adjustment process, as the rapid erosion of purchasing power has been a major cause of the current hardships facing the Sierra Leonean people.

With the adoption of a medium-term economic recovery program, the authorities have embarked on the second phase of the adjustment process. The measures envisaged in the program are succinctly detailed in the Government's policy framework paper for 1990/91-1992/93, which was prepared in collaboration with the Fund and World Bank staff. The staff report reviewing the matter of Sierra Leone's overdue obligations also summarizes them well. I will therefore not repeat them here but will only attempt to highlight the main objectives and challenges facing the authorities in their implementation of the program. Taking into account the economic realities of Sierra Leone, the three-year adjustment plan aims at achieving an annual growth in real GDP from 2.5 percent in1989/90 to 4.2 percent in 1990/91 and to about 5 percent subsequently. The rate of inflation (end of period) is to be lowered from over 100 percent in 1989/90 to less than 30 percent in 1990/91 and to be reduced further to about 10 percent by 1992/93. Another major objective is the strengthening of Sierra Leone's external sector in order to enhance the country's capacity to service its foreign debt, and improve its relations with external creditors. As indicated in the PFP, a central theme of the program is the creation of an economic environment that allows the private sector to function efficiently and make maximum contribution to the national product.

The 1990/91 budget, which was planned within the context of the medium-term Economic Recovery Program, reflects the Government's commitment to the pursuit of tight financial policies and enforcing strict fiscal discipline by matching expenditure with actual revenue collected. To this end, an Expenditure Monitoring Committee set up within the Ministry of Finance is currently fully operational so that no expenditure contract is signed without

ensuring cost-effectiveness and availability of funds. In order to further contain the Government's wage bill, steps have been taken to address the problem of redundancy and that of remaining ghost and overaged workers. In addition, discussions aimed at reducing the rice subsidy to the military have been initiated. The expenditure portfolio also reflects the emphasis being placed on improving the economic and social infrastructure and human resource development as the basis for promoting self-sustaining growth. Efforts have been made to raise revenue, by broadening the tax base and improving tax administration. Moreover, ad hoc customs waivers have been discontinued. The combination of expenditure retrenchment and revenue raising is expected to reduce the deficit from 6.9 percent of GDP in 1989/90 to 4.5 percent of GDP in 1990/91.

The authorities would like to draw Directors' attention to unforeseen developments that are exerting an additional burden on the country's economy. First, the current political situation and civil strife in neighboring Liberia, with a large number of refugees streaming into Sierra Leone, is likely to pose a serious challenge. The cost of housing, feeding, and transporting about 100,000 refugees as well as costs associated with the proposed ECOWAS peace-keeping force, will necessitate urgent and unforeseen expenditures. Secondly, the refugee influx is expected to aggravate the already precarious food and fuel supplies. However, the authorities have reaffirmed their commitment to strict financial discipline.

A major constraint facing the Sierra Leonean authorities in the implementation of reforms is the country's limited institutional capacity. For instance, although every effort is being made to put in place an effective legal framework to facilitate new policy measures, the Law Officers Department is seriously bereft of adequate parliamentary counsels. The situation is similar in many of the key ministries. It is, therefore, imperative to ensure the provision of adequate technical assistance.

An important aspect of the Sierra Leonean medium-term program is the incorporation of measures to help cushion the impact of adjustment on the most vulnerable groups. Socially oriented programs, focusing on the provision of basic services and the rehabilitation of hospitals and schools as well as on helping those workers rendered unemployed by reforms in the civil service, are being formulated. To gain public support, without which no adjustment process can be sustained, it is important to ensure adequate financing for these programs.

Turning to the matter of Sierra Leone's overdue obligations to the Fund; as stated in the staff report, payments amounting to

SDR 0.8 million have been made since the last review. Although these represent only a fraction of obligations falling due to the Fund, they represent a considerable effort when taken in the context of the country's extremely difficult foreign exchange situation. The Sierra Leonean authorities note that although they have implemented courageous and far-reaching reforms, the slow and hesitant response to the adjustment process, both internally and externally, has meant that the tight foreign exchange situation has continued to constrain the Government's ability to make more substantial payments to the Fund. The authorities, however, reaffirm their commitment to fully collaborating with the Fund in solving their arrears problem and see a Fund-monitored or rights accumulation program as the only means to normalizing relations with the international financial community. They are confident that, with financial assistance in support of their adjustment efforts, they will be able initially to freeze the level of overdue obligations to the Fund at the level prevailing at the outset of the program and subsequently to reduce these arrears. In this connection, the importance of the timely establishment of a support group cannot be overemphasized.

In conclusion, I would like to reiterate my authorities' steadfast commitment to sustaining the current efforts at reforming the economy and their resolve to making the 1990s the "Decade of Sierra Leone's Economic Revival." Although they are cognizant of the fact that this will require belt tightening on their part, they are also keenly aware that the success of their efforts is critically dependent on timely and adequate external financial assistance on special terms. Finally, they assure Directors that they are prepared to take steps to reaffirm their commitment to economic adjustment.

Extending his remarks, Mr. Monyake stressed that a team of officials of the Sierra Leonean Government of was firmly committed to the program. He had visited Freetown the previous week and had met the President of Sierra Leone, who had assured him of his own and his cabinet's commitment to the program. The President had said that he saw no other salvation for his country but to go along with the program, which might be difficult in the short term but was necessary in the long term.

Paragraph 34 of the policy framework paper dealt with the fishing sector, which offered great potential for revenue, Mr. Monyake noted. The Government had entered into an agreement for the protection of the fishing area and also for the collection of revenue from whatever operators fished in those waters. It was hoped that the agreement would soon be operative. The authorities intended in the very near future to negotiate with the European

Communities on a fishing agreement, which they hoped would net the Government some much needed revenue.

On paragraph 35 of the policy framework paper, which referred to the diamond market, Mr. Monyake stated that the authorities had tried to create the necessary climate to attract investors. The authorities were currently negotiating with De Beers, for that company to become involved with the marketing and exploitation aspects of the industry.

He hoped that Directors would consider the papers presented to them in the light of the additional information presented by the staff and by the Acting Chairman.

Mr. Peretz made the following statement:

During the past six months, the authorities in Sierra Leone have taken a number of significant steps to tighten monetary and fiscal policy and liberalize the trade and exchange rate systems and as a result the economy is beginning to stabilize and this is indicated quite well by the provisional figures that Mr. Hino gave us at the beginning of the meeting. They deserve full credit for taking what have been difficult decisions. I warmly welcome the broad thrust of this policy framework paper, which will build on and extend the measures already taken. If implemented vigorously, the program would be a milestone in reversing years of decline and a good basis for realizing Sierra Leone's undoubted economic potential.

As I said at the World Bank's Committee of the Whole on August 7, the crucial test of this policy framework paper is whether it inspires sufficient confidence in those with a stake in Sierra Leone's future. Can it form the basis for a Fund-monitored program leading to the once and for all clearance of Sierra Leone's arrears to the international financial institutions? Does it give the donor community sufficient assurance that any future pledges of fresh aid will not be wasted? And, domestically, do the policies outlined in the policy framework paper represent a sufficiently clear break with the past to bring the pervasive parallel market back within official channels and so allow the authorities to re-establish fiscal and financial discipline?

I have discussed all these questions very carefully with both Bank and Fund staff; I have listened to the discussion at the World Bank on August 7; and I have listened carefully to what Mr. Monyake has had to say this morning, and I can say that I am reassured. Based on the projections contained in the paper,

inflation, the budget deficit, and the external position--though much improved--will still, in three years' time, be at the limits of sustainability. I am persuaded, however, that if the program is closely monitored and implemented vigorously, as I believe it will be, the projections are not only achievable but should be bettered. Indeed, in a way I am not sure that the projections are very credible. This is a country that will either get much better if it actually sticks to the action and proposals that have been taken or it will do worse if it slips back. The actual projections in the policy framework paper probably represent a rather unlikely outcome. Moreover, the fact that economic growth is forecast to be healthily positive, even in the very short term, suggests that there is scope for the adjustment program to be tightened further should events require it. We already have two events that were not foreseen when the policy framework paper was drawn up: the deteriorating situation in neighboring Liberia where the extra spending connected with the Sierra Leone contribution to the ECOWAS peace-keeping force will need to be contained within the existing budget, and the sharp rise in world oil prices which will affect the balance of payments. I very much hope that the authorities will not hesitate to take further action if this is required to keep the program on track.

I have four more detailed points. First, the short-term success of the program appears to depend crucially upon economic activity--in particular diamond exports--being channeled increasingly through the formal rather than the informal sector. I understand that the paper assumes that 75 percent of diamond trade will have returned to formal channels by the end of the program period. Is this likely to be achieved? Clearly a realistic official exchange rate, fair valuation of diamond exports, and low license fees are of central importance, but they may not be sufficient incentives in themselves. Ultimately what is important is traders' confidence in the authorities' policies: whether they are content to hold the proceeds of diamond sales in local currency, or whether they wish to get their money out of the country at all costs. This too points to the necessity for an ambitious adjustment program and a clear commitment to reform.

The return of the diamond trade to the formal sector is closely related to the health of the financial sector and this is the second area I would like to mention. Without diamond money--and without positive real rates of interest and an adequate supply of currency notes--the financial sector is likely to remain undeveloped, playing little or no role in allocating resources. The policy framework paper briefly refers, in a single paragraph, to the need to make the financial sector more competitive. I would go further and say that this ought to be a cornerstone of

structural reforms that the authorities are instituting. I would welcome a more specific account of the measures that the staff have in mind.

The third area where I have some questions is on the size of the proposed fiscal adjustment. In the policy framework paper, this depends heavily on new revenue raising, while recurrent expenditures show only a modest fall as a proportion of GDP, which is more than offset by a rise in capital spending. Is there scope for further cuts in public spending? In difficult times, expenditure decisions even in the most sensitive areas have to be reviewed and the authorities' willingness to ensure that the burden of adjustment is fairly shared will be an important test of their resolve. Stringent budgetary control will require the adoption of strict targets for expenditure, and not simply targets for the fiscal deficit as a whole.

Turning to revenue raising, I can certainly support the elimination of discretionary import duty exemptions and the extension of the sales tax. The question here is whether the revenue base could not be broadened in other ways as well that do not affect the consumer so directly. I understand that the authorities are trying to encourage foreign companies to resume mining and fishing operations in Sierra Leone, and I would hope that this might also benefit the budgetary position.

Above all, the success of a program of this nature will depend crucially on the authorities' ability to implement it. This will require the streamlining of the government machine and re-equipping of the civil service. Indeed, if a way could be found, I would like to see both these reflected in some way in the program's performance targets. The other important ingredient is technical assistance; I am sure that all the authorities' requests are well justified. But I would be interested to hear the staff's assessment of whether, nonetheless, the key institutions--in particular, the Central Bank and Ministry of Finance--will have the technical capacity to execute the program quickly and effectively.

As far as the paper on overdue obligations is concerned, I can support the proposed decision and the postponement of further remedial measures. I am however rather disturbed that the authorities have been unable to sustain the marked improvement in payments performance noted at the last review; since April they have met only 16 percent of obligations falling due. I would therefore suggest that a significant improvement in payments to the Fund is made a prior action to a Fund-monitored program.

In conclusion, let me repeat that I warmly welcome the authorities' determination to reverse the recent economic decline

and restore competent economic administration. Successful implementation will not be easy and will require considerable effort. The policy framework must be robust enough to improve confidence and allow for the risks to which the program will be subject. I very much hope that we have now reached a turning point and that when we next meet to discuss Sierra Leone we shall be considering a strategy to clear its arrears.

Mr. Menda noted that further substantial progress had been made by Sierra Leone toward normalizing its relations with the Fund. The adoption of a policy framework paper was certainly an important step in the process. He basically agreed with the staff that the measures taken since the beginning of the year, and the formulation of a medium-term framework for the implementation of economic policy, constituted a major turnaround after many years of mismanagement of the economy and government intervention, which had led to the expansion of the unofficial economy. It was important to remember that Sierra Leone benefited from abundant natural resources and favorable climatic conditions. The major challenge for the authorities would be to regain the confidence of economic agents through the implementation of adequate financial policies and structural reforms. The measures adopted so far, in particular concerning the exchange system, were in the right direction. However, it would take time to regain the confidence and streamline the activity of the unofficial economy.

On Sierra Leone's overdue financial obligations to the Fund, Mr. Menda noted that since the previous review, only SDR 0.8 million had been received, while additional obligations of SDR 4.3 million had become overdue, and the total amount of arrears at end-July had reached SDR 74.2 million, which represented 128 percent of quota. He would like to see more progress and a commitment on the part of the authorities to reduce that amount. At the least, a first step should consist of Sierra Leone remaining current on future obligations. He noted, however, that in fiscal year 1989/90, payments to the Fund had constituted about 80 percent of total debt-service payments made by Sierra Leone, which was encouraging since respect for the Fund's preferred creditor status was an important element by which to judge a country's degree of collaboration with the institution.

He welcomed the Acting Chairman's outline of the steps to be taken next in the case of Sierra Leone, Mr. Menda concluded, and he supported the proposed decision.

Mr. Prader made the following statement:

Today's sixth review of Sierra Leone's overdue financial obligations to the Fund appears to promise the prospect of normalization of Sierra Leone's relations with the Fund and with the international community at large. Since the last review of Sierra Leone's overdue obligations to the Fund, the stock of outstanding

overdues has again increased substantially. The amount of payments is so small by comparison with the additional obligations that become overdue that there can be no complacency concerning Sierra Leone's recent payments record. But I agree with the staff that Sierra Leone has given priority to the fulfillment of its financial obligations to the Fund, as nearly 80 percent of its total debt service payments during the fiscal year 1989/90 were to the Fund. Also, since December 1989, Sierra Leone has adopted a broad set of adjustment measures that are indicative of the country's improved cooperation with the Fund in the resolution of its overdues problem. For all those reasons, the proposed decision is entirely appropriate and I also endorse postponement of the proposal to apply remedial measures.

Sierra Leone has maintained the momentum of its increased cooperation with the Fund by presenting an economic and financial policy framework paper for the coming years. This marks a further important step along the painful path toward economic and financial rehabilitation, and we can endorse the broad outlines of the proposed policy framework paper. I should note here that the drastic deterioration in the quality of the civil service caused by past policies now represents a considerable obstacle to the full and rapid implementation of the economic program. Great care must therefore be taken to avoid overburdening the Administration with a whole range of structural measures. There is thus a need to prioritize these measures correctly and to define them more clearly and concisely in the policy matrix. The Government's aim of rebuilding its administrative capacity through recruitment and training is entirely correct; however, it is surprising that the review of the civil service is not expected to be completed until the end of 1991, so that the implementation of the review's conclusions cannot begin before fiscal year 1992/93. This scheduling does not reflect the correct priority, and ought be accelerated. Such an acceleration would also increase the appropriateness of the requested technical assistance outlined in Attachment 3 of the policy framework paper.

A most interesting feature of Sierra Leone's economic program is the exchange rate policy. Early in the year, the leone was depreciated sufficiently to restore the competitive position of the traded goods sector. Now the exchange rate is to be stabilized and the competitive position consolidated by reducing domestic inflation. In conditions of high inflation and poor fiscal discipline, this Board has often advocated using the exchange rate as a nominal anchor for re-establishing sound principles of economic management. Even though further small exchange rate adjustments will probably be needed during a transition period, the exchange rate anchor can be a credible policy device, but only when the internal adjustments are prompt and sufficiently

vigorous. From this standpoint, one may ask whether Sierra Leone's program is ambitious enough, since consumer price inflation is still projected between 15 and 45 percent during the next three fiscal years. I recognize that the programmed price adjustments, especially in the agriculture and public enterprise sectors, are intended to restore the producer price incentives and allow an adequate financial performance. But we must also take into account the sharp drop in recorded inflation over the last months: the May 1990 figure stood at 1 percent. A more pronounced deflationary process would be entirely appropriate, and I wonder whether the above projections are fully consistent with the latest experience and the price corrections that are in the pipeline.

A stronger adjustment effort would have been appropriate on the fiscal front as well. We must of course recognize that the civil service has suffered long neglect and will have to be rehabilitated before sufficient economic growth can be restored. Further global reductions of aggregate public expenditures will be difficult, making it even more important to restore sufficient public revenues. Every effort must be made to strengthen the fiscal correction; spending overruns such as occurred from April to June 1990 must be avoided.

The private savings trend, as set out in Table 4 of the staff paper, is also quite intriguing. It is projected that the ratio of private savings to GDP will continue to decline, becoming negative in 1991 and 1992. The staff might wish to comment on the underlying reasons for this forecast. The liberalization of the economy in general and the trade regime in particular work against higher savings. But re-establishing the financial viability of public enterprises, whose savings are included in the aggregate private savings figures, and returning real interest rates to positive levels, together with the prospective leveling off of inflation and stabilization of the exchange rate, should all have positive effects on the private sector's savings behavior.

In any case, a viable balance of payments outcome will require both private and public sector savings to increase. The financial sector reforms planned under the policy framework paper are therefore of great importance for restoring the traditional role of the banking system as a provider of financial intermediation and services to the public. We look forward to the Fund-assisted review of the financial sector, and to the quickest possible implementation of its conclusions.

The financing requirements of Sierra Leone's policy framework paper are quite impressive compared with the identified financing resources. The size of the financing gap is a further argument

for strictly applying the economic program and strengthening the fiscal adjustment, for only under such conditions will as yet unidentified financing resources be forthcoming. Some demonstration of the authorities' strong commitment to their economic program will be most helpful in encouraging additional resources. We should therefore regard our next review of Sierra Leone's overdue financial obligations as being connected with our consideration of the detailed economic program for 1990/91, rather than as simply marking the passage of four more months.

Mr. Ichikawa welcomed the adoption of important measures in the second half of fiscal year 1989/90, which were the first phase of adjustment as described by Mr. Monyake. It was particularly welcome that the tight financial stance had reduced the monthly inflation rate. Also, it was encouraging that the authorities had initiated a number of liberalization measures, most notably the adoption of a market-determined exchange rate policy, despite the difficulty of a shortage of foreign exchange.

However, he regretted that the lack of expenditure curtailment in response to the shortfall in revenue had led to deviations from the fiscal and monetary target, Mr. Ichikawa said. It was also disappointing that most of the proceeds from the sale of diamonds still went through the parallel market, which was also a source of concern in the context of the medium-term adjustment strategy.

He welcomed the adoption of the policy framework paper as an important first step toward cooperation with the Fund, Mr. Ichikawa indicated. However, he very much agreed with Mr. Peretz's and Mr. Prader's concerns about the lack of ambitiousness of the program and the overoptimism of the staff's projections. That being said, the most important task for the authorities for the time being was the timely and comprehensive implementation of the policies envisaged under the program in order to restore Sierra Leone's credibility.

In terms of credibility, Mr. Ichikawa attached particular importance to the resumption of current payments at an early stage. He was not at all happy with the authorities' payment record. He hoped that the authorities would further enhance their adjustment efforts and increase their payments to the Fund. He supported the proposed decision.

He wished to make brief preliminary remarks on the rights approach, Mr. Ichikawa said, although he was not yet in a position to commit his chair on that issue. One of the merits of applying the rights approach was to reduce substantially the program's financial requirements. However, if Sierra Leone was to request the application of the rights approach, it would have to rebuild its credibility in terms of both policy implementation and repayment record. The staff, even if it considered that the early application of the rights approach was appropriate, should refrain from making

optimistic assumptions on the disbursement of donor assistance. They should also be conservative in projecting the effects of policy measures, as there remained much uncertainty and downward risks in the program.

Mr. Kleine said that he was encouraged by the recent developments in Sierra Leone's case. The authorities were beginning to move in the right direction. He hoped that the 1990s would indeed become the "decade of Sierra Leone's economic revival." However, as previous speakers had already pointed out, the path ahead would be extremely rocky.

The economic projections in the policy framework paper appeared quite optimistic, Mr. Kleine considered. Sierra Leone's administrative capacity was extremely weak, and technical assistance was required to help the reform process unfold. The reform of the financial sector should become a more central element of the adjustment program in order to enhance that sector's operational efficiency and to allow it to play a proper role in providing financial intermediation.

He hoped that the forthcoming policy discussions between the staff and the authorities would help to provide a basis for a more fruitful cooperation with the Fund, Mr. Kleine concluded. He could support the proposed decision.

Mr. Bossone noted that in the past three months, the authorities had made efforts to return their economy to a stable course. The impression that one derived from the previous two reviews was that the Government was determined to reverse its record of policy failure and lack of economic discipline. Monetary and fiscal policies had remained tight since December 1989, price liberalization was being carried out, and inflation and output growth were showing significant progress. The budget had also shown substantial improvements, even though revenue had fallen somewhat short of expectations; expenditure had been higher than warranted; and government borrowing had exceeded the original target.

Further clear indications of the Government's new course of action were the repeal in mid-May of the Currency Control and Economic Sabotage Act, which had severely constrained diamond and gold trade; the introduction of the new exchange system under which current transactions were fully liberalized; and the deregulation of petroleum imports and prices, Mr. Bossone continued. If the authorities continued their efforts at stabilization and structural change and established sound market mechanisms in the economy, one could expect parallel transactions in foreign exchange eventually to dwindle under the new exchange system, since the prevailing rates in the informal and the official markets were currently similar. In addition, the implementation of the new system would provide incentives for efficient production in the official markets and would increase the availability of the foreign exchange needed for productive activities.

However, major structural impediments persisted, as shown by the low level of national saving and foreign exchange reserves, the unfavorable current account, and the heavy external debt, Mr. Bossone noted. To overcome such impediments not only required continued implementation of the established policy framework, but also demanded the active support of the international donor community. To that end, the Government should be fully aware of the importance of policy credibility when it came to winning the support of official donors.

An important sign of credibility and commitment would be a genuine attempt by the Government to increase its flow of arrears payments to the Fund, Mr. Bossone remarked. Unfortunately, the payments made by Sierra Leone since the previous review had not been sufficient to meet the obligations falling due in the meantime. However, it should be positively noted that, first, in fiscal year 1989/90 there had been an increase in the amount of repayments as a proportion of the obligations falling due, and second, during the same fiscal year, payments to the Fund had also significantly increased as a proportion of the total debt-service payments made by Sierra Leone during that period. The Government should capitalize on those improvements and commit itself to a prompt clearing of its financial obligations.

He considered that the Government was moving in the right direction toward cooperation with the Fund, and expected significant progress to result if the current policies were continued, Mr. Bossone concluded. However, he remained dissatisfied with the authorities' modest attempt to fulfill their financial obligations, although he perceived a slightly improved attitude in that respect. He could go along with the draft decision.

Mr. Dai endorsed the proposed decision. He welcomed the fact that, despite the very difficult economic and financial conditions in Sierra Leone, the authorities had resolutely taken bold steps to redress the country's economic problems, in close collaboration with the Fund staff. On the basis of improved policy performance, a policy framework paper had been formulated with the help of the staffs of the Bank and the Fund. The authorities' determination to adopt and implement a comprehensive adjustment program deserved international support. It was hoped that, with the continuous efforts of all parties concerned, a Fund-monitored program or the rights approach could be applied to Sierra Leone's case, and that arrears to the Fund could be fully settled at an early date.

With regard to the policy framework paper, he considered two points to be important to the success of the program, Mr. Dai said. First, the balance of payments prospect would depend largely upon the performance of exports. Exports were projected to grow at an annual rate of 18 percent, which seemed quite an ambitious target. He wondered whether the achievement of that target depended mainly upon diamond exports. How sustainable would such a growth rate be? Second, in projecting the balance of payments and

the financial gap, had the staff taken into account the unforseen political developments in the region and in other parts of the world? If not, their impact needed to be assessed.

Mr. Shaffrey made the following statement:

I can support the decision as drafted. Although there is no comfort to be found in the increasing level of arrears, I am persuaded by the staff assessment and Mr. Monyake's statement that the authorities are firmly committed to the adoption of appropriate economic policies that will allow them to settle their arrears. The broad set of economic adjustment measures undertaken since December 1989 has led to an improved policy performance in the first half of 1990, which stands in marked contrast to that of 1989. This is somewhat reassuring, as is the close collaboration between the authorities, the Fund, and the World Bank on the policy framework paper.

The measures adopted over the past six months, including the tightening of fiscal and monetary policies and some liberalization in the pricing and licensing areas and the introduction of a market-determined exchange rate system, have not only led to a considerably improved policy performance but also represent a strong attempt by the authorities to rebuild their credibility.

These measures reflect increasing recognition on the part of the authorities that restoration of credibility is central to enhancing the medium- to longer-term prospects for economic growth. The economic decline of the 1980s reflected several factors but, most important, a lack of financial discipline and consequent restrictive regulations that were nonetheless unsuccessful in correcting the situation. Soaring inflation, large domestic and external imbalances, and inability of the Government to deliver essential public services were not the only outcome, as confidence in the economy, most importantly that of the international financial community, was seriously undermined. This is the most serious obstacle to the resumption of strong economic growth that the authorities face.

The policy framework paper presented by the authorities is a comprehensive document that represents a substantial adjustment effort on the part of the authorities. A key issue is whether the program set out in the policy framework paper can be achieved. The program is a very strong one, and certainly not impossible to achieve, but it would be unrealistic not to recognize that there are considerable downside risks.

In his statement, Mr. Monyake made reference to some previously unforeseen circumstances that will make achieving the

policy framework paper's objectives more difficult. It is not inconceivable that there will be other external shocks with serious adverse consequences. In addition, one cannot discount the risk that progress by the authorities may be slower than envisaged.

Another worrying aspect is the projected external financing requirements, particularly for a country that is in the very early stages of rebuilding its credibility. Given that the success of the program depends critically on timely donor support, the staff's comments on the sources of this support are not reassuring. Even with all available financing and very optimistic projections on Paris Club rescheduling, apparent financing gaps remain. I am aware that arrears cases by their nature are high-risk strategies requiring large financing. However, if the program outlined turns out to be too ambitious, there is a possibility that Sierra Leone could end up worse off--although I take some comfort from Mr. Monyake's remarks at the start of this discussion on the authorities' commitment to their adjustment efforts.

Having said that, however, I see no other course for Sierra Leone than to pursue the program set out in the policy framework paper. If the authorities closely follow the policy framework paper and undertake the comprehensive structural reform and tight financial policies it contains, this will ensure a rebuilding of credibility. Consequently, I urge the authorities to ensure that there are no policy slippages and there is a timely implementation of the measures in the program.

Ms. Creane noted that the goals and depth of the economic measures proposed in Sierra Leone's program were encouraging. After a period of a stop-go approach to economic reform, the program and the actions already taken indicated that the authorities were firmly committed. She was somewhat uneasy about the ambitiousness of some of the targets, especially growth, although vigorous growth was necessary given the current economic situation. Full and timely implementation of the program would be critical. At the same time, Sierra Leone's continued poor payments performance was cause for concern.

Among the actions already taken in the past few months, Ms. Creane continued, several stood out as being of particular importance, including the liberalization of the exchange and trade regimes, the steps to tighten monetary policy, and the decline in domestic bank financing of the budget deficit. Similarly, in the context of the program, several policy decisions would have particular importance for macroeconomic adjustment. The proposed limits on government expenditures were welcome, although perhaps some of those steps might have been speeded up. Similarly, a greater emphasis on

the reduction of government transfers and subsidies to public enterprises earlier in the program would have a lasting beneficial effect on the budget. The decision to completely cut bank financing of the deficit would be critical in the effort to decelerate inflation. She would be keenly interested in the results of the financial sector review that would be completed with Fund assistance by December 1990. Development of the financial system was essential to implementation of monetary policy and increasing the savings rate.

While Sierra Leone's intentions to adopt appropriate economic measures seemed positive, she was disappointed with its payments performance, Ms. Creane remarked. Her chair had been disturbed in April when the SDR 4.6 million February payment was not followed by others, and it was more concerned now that only an additional SDR 0.8 million had been paid in the intervening period. As Sierra Leone had fallen further behind, she would appreciate any staff insight on the authorities' plans to resume payments.

She agreed to the proposed decision, Ms. Creane concluded.

The staff representative from the African Department said that the staff agreed with Mr. Peretz that financial sector reform should be a cornerstone of the structural adjustment effort. The authorities had already tightened liquidity and increased reserve requirements, thus forcing the banks to compete for deposits. They had also eliminated interest rate regulations, allowing banks to compete freely on lending. The lack of local and foreign currency was being corrected by the authorities, who had already injected Le 1.4 billion and had made arrangements for Le 5 billion more. They would also make arrangements for banks to obtain local currency from the Central Bank against live deposits. In addition, banks were now free to compete in foreign exchange markets.

There remained several structural problems in the financial sector, the staff representative continued. There were only seven banks in the country, each with only three or four branches that were almost all in one city in the mining area. The banking services were not available in most of the rural area. Another structural problem was that the business community, with its heavy concentration on diamond trade, appeared to attach a strong priority to anonymity. The authorities had embarked on a publicity campaign to educate the public of the merits of making transactions through the banking system. They were embarking on a program to expand rural banks and had already invited one foreign bank to participate. The authorities were trying to rehabilitate the postal bank of Sierra Leone. The staff planned to review the situation in a few months' time to try to identify further steps that could be taken, so that at the time of the 1991 Article IV consultation discussion, more concrete actions would be presented.

As for whether the authorities could make further cuts in public spending, the staff representative stated that much nonproductive spending was taking place. However, there was a serious need for rehabilitation of

government buildings and maintenance, so it was not clear whether in the aggregate there was room to make a substantial cut in public spending as a proportion of GDP. The World Bank was in the process of reviewing public sector expenditure, and the staff would have to return to the issue after that review was completed.

On Mr. Prader's question regarding the inflation targets, the staff representative remarked that looking at the annual averages, as presented in the staff paper, might be misleading. On a point to point basis, the inflation target for 1990/91 was on average about 2 percent per month. Taking into account the discretionary measures that had been taken on oil prices and the electricity tariffs, that inflation target was ambitious, and consistent with what had been achieved over the past few months.

The impact of recent developments in the Middle East and in Liberia had not been taken into account, the staff representative indicated, but the program's vulnerability to external shocks had been carefully examined. On the downside risk, the 30 percent increase in oil prices would add about $10 million dollars to the import bill. Also, prices of diamonds might decline as a result of the decision by the U.S.S.R. to release a large volume of diamonds. The possibility of a slower shift to the official system by diamond traders would also have to be taken into account. To provide a cushion against these downside risks, the program envisaged quite a significant increase in built-up reserves--$40 million over a three-year period. In addition, the program had not incorporated the rutile mining expansion project, which was expected to increase export earnings by as much as $40 million over a three-year period. In addition, there are other projects--such as the kimberlite diamond project and the fishing surveillance arrangements--that agreements offered additional potential for increased exports.

Mr. Monyake noted that Sierra Leone's infrastructure--social, fiscal, and economic--urgently required substantial rehabilitation, which would require significant concessional funding.

On the negotiations with the De Beers company, Mr. Monyake reassured Directors that company officials had been encouraged by the liberalization of the exchange system and had submitted a list of other issues that they wanted to discuss with the Government before they would move into the country.

Finally, he would ask Directors that when they looked at the statistics for Sierra Leone's economy, they keep in mind the actual numbers behind the percentages, Mr. Monyake said. The Sierra Leonean economy was very small, so that the impact on the economy of even a small shift in some of the ratios was significant.

The Executive Board then took the following decision:

1. The Fund has reviewed further the matter of Sierra Leone's continuing failure to fulfill its financial obligations to the Fund in the light of the facts and developments described in EBS/90/141 (8/3/90).

2. The Fund acknowledges the payments made by Sierra Leone since the last review, but regrets that these payments have remained modest. The Fund also deeply regrets the continuing failure of Sierra Leone to fulfill its financial obligations to the Fund, which is placing a financial burden upon other members and reducing Fund resources needed to help others, and the continued increase in the amount of Sierra Leone's overdue financial obligations to the Fund. The Fund urges Sierra Leone to make full and prompt settlement of the overdue financial obligations to the Fund, and stresses that settlement of these arrears should be given the highest priority.

3. The Fund welcomes the economic measures implemented recently by Sierra Leone, the preparation of the policy framework paper (EBD/90/218, 7/25/90), and the authorities' intention to work toward the adoption and implementation of a comprehensive set of macroeconomic and structural adjustment policies for 1990/91 that could lay the foundations for a program monitored by the Fund under the intensified collaborative approach. The Fund continues to cooperate with Sierra Leone in support of the authorities' efforts to implement a comprehensive adjustment program.

4. The Fund will review the matter of Sierra Leone's overdue financial obligations to the Fund again at the time of the Executive Board's consideration of Sierra Leone's program for 1990/91, or within four months from the date of this decision, whichever is earlier, in light of the actions taken by Sierra Leone in the meantime regarding settlement of its arrears to the Fund and implementation of a comprehensive adjustment program.

Decision No. 9520-(90/128), adopted
August 10, 1990

6. PANAMA - OVERDUE FINANCIAL OBLIGATIONS - REVIEW FOLLOWING DECLARATION OF INELIGIBILITY - POSTPONEMENT

Paragraph 4 of Executive Decision No. 944-(90/83), adopted May 30, 1990, shall be amended by substituting "on or not later than September 14, 1990" for "on or not later than August 30, 1990.

Decision No. 9521-(90/128), adopted
August 10, 1990

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/90/127 (8/8/90) and EBM/90/128 (8/10/90).

7. SVERIGES RIKSBANK - RELEASE OF INFORMATION

In a letter dated July 6, 1990, the Governor of the Sveriges Riksbank has indicated that the Riksbank is sponsoring a major study of Sweden's credit market and monetary policy in the period 1945-86 and has requested that the Fund would agree to a proposal to grant access by the researchers to Fund documents held in the archives of the Riksbank. Having taken note of the scope of the proposed study and of the guidelines outlined in the letter of the Governor of the Riksbank for use of Fund material in the archives of that institution for purposes of the study, the Fund accedes to the request by the Governor of the Riksbank.

Adopted August 8, 1990

8. GUYANA - TECHNICAL ASSISTANCE

In response to a request from the Guyanese authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/90/232 (8/7/90).

Adopted August 9, 1990

9. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director and by an Advisor to Executive Director as set forth in EBAP/90/214 (8/8/90) and by an Assistant to Executive Director as set forth in EBAP/90/216 (8/8/90) is approved.

APPROVED: August 6, 1991

JOSEPH W. LANG, JR.
Acting Secretary