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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 87/159

10:00 a.m., November 23, 1987

M. Camdessus, Chairman
R. D. Erb, Acting Chairman

| Executive Directors | Alternate Executive Directors |
|---|---|
| A. Abdallah | A. G. A. Faria, Temporary |
| | Yang W., Temporary |
| | M. K. Bush |
| | D. C. Templeman, Temporary |
| | A. Rieffel, Temporary |
| | L. Hubloue, Temporary |
| | M. Hepp, Temporary |
| M. Finaish | S. K. Fayyad, Temporary |
| | B. Goos |
| J. E. Ismael | J. Reddy |
| | J. Hospedales |
| | C. Enoch |
| | D. McCormack |
| | W. N. Engert, Temporary |
| Mawakani Samba | D. Saha, Temporary |
| Y. A. Nimatallah | I. A. Al-Assaf |
| | V. J. Fernández, Temporary |
| | M. Fogelholm |
| | G. Pineau, Temporary |
| | V. Rousset, Temporary |
| G. A. Posthumus | |
| | C.-Y. Lim |
| | O. Kabbaj |
| | S. Rouai, Temporary |
| A. K. Sengupta | |
| | M. Sugita |
| | T. Morita, Temporary |
| S. Zecchini | |

L. Van Houtven, Secretary and Counsellor
J. K. Bungay, Assistant


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Also Present

IBRD: A. J. Clift, Asia Regional Office; G. A. Heim, Africa Regional Office. African Department: A. D. Ouattara, Counsellor and Director; E. A. Calamitsis, Deputy Director; S. E. Cronquist, R. E. Daumont, M. De Zamaroczy, A. Doizé, D. J. Donovan, P. H. Mathieu, S. M. Nsouli. Asian Department: H. Neiss, Deputy Director; K. A. Al-Eyd, B. Banerjee, K. Bartholdy, E. A. Milne. Central Banking Department: C.-J. Lindgren. Exchange and Trade Relations Department: E. Brau, J. H. Felman, S. Kanesa-Thasan. External Relations Department: V. R. Khanna, G. P. Newman. Fiscal Affairs Department: L. K. Doe. IMF Institute: O. B. Makalou; B. Amadu, Participant. Legal Department: H. Elizalde, P. L. Francotte, A. O. Liuksila. Treasurer's Department: F. G. Laske, Treasurer; D. Williams, Deputy Treasurer; A. G. Chandavarkar, D. Gupta, D. V. Pritchett, B. B. Zavoico. Bureau of Statistics: K. W. O'Connor. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: M. B. Chatah, A. Ouanes, I. Sliper, N. Toé, A. Vasudevan, K. Yao, J. E. Zeas. Assistants to Executive Directors: N. Adachi, H. S. Binay, R. Comotto, F. Di Mauro, S. Guribye, M. A. Hammoudi, C. L. Haynes, G. K. Hodges, A. Iljas, S. King, M. A. Kyhlberg, V. K. Malhotra, L. M. Piantini, G. Seyler, B. Tamami, R. Wenzel, I. Zaidi.

1. GENERAL ARRANGEMENTS TO BORROW (GAB) - SIXTH RENEWAL

The Executive Directors considered a staff paper on the renewal of the General Arrangements to Borrow (GAB) for a period of five years from December 26, 1988 (SM/87/241, 10/15/87).

Mr. Hospedales said that he could support the proposed decision to review the General Arrangements to Borrow for a further period of five years; however, he wished to express his regret and disappointment at not having been given an appropriate opportunity to comment on the extension. In the light of the fact that the Fund was the recipient of GAB resources, it might have been helpful to have the views of the Executive Board on whether possible modifications were required, in line with the important proposals made recently by the Group of Twenty-Four. He believed that such a discussion should have been scheduled before the extension had been recommended to the Deputies of the Group of Ten.

Mr. Lim stated that he could support the proposal to renew the General Arrangements to Borrow without modifications. He agreed that the GAB had served to strengthen the Fund's capacity to respond to potential systemic difficulties. As the staff had noted, many of the uncertainties existing when the General Arrangements had previously been renewed were still present, and thus the GAB would continue to act as an important financial backstop for the Fund. The maintenance of a financially strong Fund was in the interest of everyone. With that in mind, he believed that it was important for the Fund to secure an early and substantial increase in quotas under the Ninth General Review of Quotas. He also believed that the Fund should rely principally on quota-based resources rather than on borrowed resources.

Mr. Sengupta said that he agreed with the proposed decision. However, he had been gravely disappointed by the way in which the issue had been handled. As Mr. Hospedales had pointed out, it was understood that the participants in the GAB were the Group of Ten, but nonparticipants, including members of the Group of Twenty-Four, did have views on the Arrangements. In the recent report of the Group of Twenty-Four, attention had been drawn to ways in which the GAB could be activated and used to complement the Fund's resources for use in contingency situations. A discussion of the G-24 proposals would have been helpful, particularly since the Fund was trying to safeguard and bolster the international monetary system. He had expected the staff to prepare a study on the proposals in the report of the Group of Twenty-Four for consideration by the Executive Board, prior to the discussions with the Group of Ten. Yet in SM/87/241, the staff had reported that it had reviewed the texts of the provisions in Decision No. 7337-(83/37), adopted February 24, 1983, and found that no modifications were needed at present. It had been indicated to the Deputies of the Group of Ten at their meeting on September 9, 1987--and reported to the Executive Board on September 11, 1987--that renewal of the General Arrangements to Borrow would be desirable for a further period of five years. Subsequently, the GAB participants had endorsed renewal of the arrangements without modifications for that additional five-year period. His question was whether the staff had indicated to the Deputies of the Group of Ten in September 1987 that a considerable number of members of the Fund considered that some modifications to the GAB might be desirable, or had simply communicated the message that the staff did not suggest any modification in the provisions of the General Arrangements.

Mr. Saha commented that he shared the views expressed by the previous speakers. He supported the proposed decision.

Mr. Goos stated his support for the proposed decision. However, he was puzzled about the criticism that had been directed at the procedure described in SM/87/241. Perhaps he was not fully aware of all the details, but the staff certainly would not have had a mandate to approach the GAB participants to request any modifications to the Arrangements. The staff had acted appropriately in proposing renewal of the General Arrangements. If the Executive Board had discussed the issue before the meeting of the Deputies of the Group of Ten in September, the staff could have informed the Deputies of the outcome, if any modifications had found support in the Board. However, no such discussion had been requested, and in the circumstances, it seemed too late to be criticizing the procedures.

Mr. Faria noted that his chair shared the misgivings expressed by Mr. Hospedales and Mr. Sengupta about the procedure adopted by the staff in a matter within the purview of the Board.

As indicated by the staff, the revised GAB had not been activated owing to the restrictive conditions required for its activation, Mr. Faria recalled. Since the General Arrangements to Borrow could be activated only in response to emerging strains in the international monetary system, developing countries, in particular the smaller ones, which individually did not pose any threat to the system, were unlikely to benefit from its activation. The balance of payments problems of those countries were serious and significant in their own right, and required substantial financing. For those countries the Ninth General Review of Quotas was a critical exercise. In that regard, it was noteworthy that the Group of Twenty-Four had recommended that the GAB should be improved further and its resources made available, not only when there might be a threat to the international monetary system but also when the success of Fund programs was endangered by resource constraint. Finally, he supported the proposed decision.

Mr. Engert stated his support for the proposed decision.

Mr. Nimatallah remarked that the procedure followed by the staff on the occasion of the present as well as previous reviews had been appropriate. If Directors had views on the future of the General Arrangements to Borrow, they should express them, and the Board could then decide whether or not it concurred with those views.

Mr. Sengupta commented that Decision No. 7337-(83/37) stated clearly that in considering the renewal of the decision for the following five-year period, the Fund and the participants should review the functioning of the decision, including the provisions of paragraph 21. As the staff had indicated, in the absence of activations of the revised General Arrangements to Borrow, the Fund had not gained any experience with the actual functioning of the provisions of that decision, but did not obviate the need for a review.

Mr. Templeman said that he could support the proposed decision. He also concurred with some of the comments made by Mr. Goos. It seemed that there had been no consensus in the Board to recommend further study of the GAB. Members of the Board had not been precluded from bringing the question to the agenda at any point between the time that the report of the Group of Twenty-Four had been issued and the current meeting. Moreover, the participants in the GAB were certainly aware of the report of the Group of Twenty-Four, and if they had been interested in pursuing the issues raised, they could have done so in the period since the issuance of the report. In any case, a discussion of the report of the Group of Twenty-Four was to be included in the Board's schedule in the future.

The Chairman said that he took full responsibility for the procedure that had been followed with respect to the sixth renewal of the General Arrangements to Borrow. At the same time, he recognized that some members of the Board might have considered it appropriate to proceed in a different fashion. Nevertheless, it was useful to recall a few points. First, the report of the Group of Twenty-Four had been circulated officially in mid-July, and it had not been possible to schedule an Executive Board discussion on proposed changes in the GAB before the meeting of the Deputies of the Group of Ten on September 9. Second, the previous revisions to the General Arrangements had occurred in the context of the Eighth General Review of Quotas. While some members of the Board had expressed regret at the trade-off between the quota increase and the increase in the General Arrangements to Borrow--a regret that he had shared--the establishment of some relationship between the two increases was understandable. The Ninth General Review of Quotas was under way, and thus the provisions of the GAB might well be raised in that context again. Third, the changes proposed in the report of the Group of Twenty-Four could be discussed by the Board irrespective of the proposed decision to renew the GAB, which of legal necessity had to be taken before December 24, 1987. He was convinced, and he believed that Executive Directors for the Group of Ten countries would concur with him, that the current decision did not preclude future discussions, when appropriate, on possible amendments and improvements to the General Arrangements to Borrow. His personal view was that an instrument that had not been used for a long time should indeed be reconsidered or re-evaluated, although not necessarily changed.

Mr. Nimatallah agreed that the renewal procedure should be completed on schedule. The broader question of the role of the GAB could then be taken up separately, as it had been in the past, if the circumstances called for a review.

He supported the proposed decision, Mr. Nimatallah noted. His authorities had not yet come to a decision with regard to the associated agreement with Saudi Arabia; their decision would have to be made in the light of the general need of the system and the external position of Saudi Arabia, as well as the attitude of the Fund on certain issues such as quotas and the compensatory financing facility.

The Chairman replied that he recalled very well that the contribution of Saudi Arabia to the GAB in 1983 had been considered a new gesture of cooperation by Saudi Arabia to help reinforce the international monetary system. The Saudi Arabian contribution had been much appreciated, and he was sure that Saudi Arabia would continue acting in that same spirit, despite the changes in circumstances in the world and in Saudi Arabia.

Mr. Goos remarked that, like Mr. Nimatallah, he was sure that the Group of Ten maintained a flexible attitude and would be prepared to reconsider the decision on the GAB if the need arose.

The Executive Board took the following decision:

> Executive Board Decision No. 7337-(83/37), adopted February 24, 1983, effective December 26, 1983, on the General Arrangements to Borrow, is hereby renewed for a period of five years from December 26, 1988.

Decision No. 8733-(87/159), adopted
November 23, 1987

The Deputy Managing Director then took the chair.

## 2. BANGLADESH - STRUCTURAL ADJUSTMENT FACILITY - SECOND ANNUAL ARRANGEMENT

The Executive Directors considered a staff paper on Bangladesh's request for a second annual arrangement under the structural adjustment arrangement approved on February 6, 1987 (EBS/87/227, 10/28/87; Cor. 1, 11/20/87; and Sup. 1, 11/20/87), together with a policy framework paper (EBD/87/276, 10/27/87). They also had before them a statement by the Managing Director, which 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 Executive Directors of the Bank and IDA in their November 17, 1987 discussion in Committee of the Whole of a paper entitled "Bangladesh - Policy Framework Paper, 1987/88-1989/90."

1. The Committee fully endorsed the program which has been prepared by the Government of Bangladesh for the next three years. While congratulating the Government of Bangladesh on the successful implementation of the first year of the program agreed upon last year, and acknowledging the comprehensiveness of the program for the next three years, a number of concerns were raised by the Committee members:

a. Resource mobilization will need to be intensified over the medium term, despite the short-term problems created by the floods. Such efforts will be needed to support appropriate levels of public expenditures, including operations and maintenance expenditures, and to generate counterpart funds for improved project implementation.

b. Although the Committee recognized the efforts made thus far to improve credit recoveries, it also pointed to the need for a sustained effort to ensure continued financial discipline. However, the Government needs to be aware of the short-term trade-offs between accelerated credit recovery and having to safeguard agricultural production in the coming months; the Government needs to work toward a balanced medium-term solution.

c. The Committee noted the large unutilized pipeline of project aid. While government efforts to improve project implementation in recent years are recognized, the Committee feels that further efforts are required to accelerate aid disbursements.

d. The Committee stressed the importance of increasing agricultural productivity and the need to examine the role of food aid with a view to preventing disincentives to agricultural growth.

e. The Committee stressed the importance of protecting the poorer groups from the impact of the adjustment program, particularly when these groups are already suffering from the impact of devastating floods. The Committee noted that the Government is committed to assisting the poorer segments of the population through generating increased employment opportunities in both the agricultural and manufacturing sectors and by better targeting of public sector programs, particularly in the areas of food distribution and social sectors. The Committee endorsed the Government's efforts to design and support programs which will directly address the needs of the poor; and encouraged the Government to work cooperatively with nongovernmental organizations and donors to develop programs and policies to accelerate the process of poverty alleviation.

f. Several members of the Committee stated that in view of the severity of the recent floods and the difficult development problems faced by Bangladesh, there was a need for flexibility in the interpretation of the various targets set in the policy framework paper.

2. The members of the Committee expressed the need for continued external support for the efforts of the Government to pursue its adjustment program. The Committee noted the impact of the floods on the implementation of the program, the additional constraints which it imposed on the Government, and stated that these developments underscored the need for special targeted assistance to Bangladesh.

Mr. Sengupta made the following statement:

Bangladesh adopted a medium-term program in 1986/87 (July-June) and availed itself of Fund assistance for the first year of the three-year arrangement under the structural adjustment facility. The program sought to raise real per capita income, reduce the rate of inflation, and make significant progress toward achieving a sustainable external payments position. The program has been extended by one more year and revised in the light of the developments in 1986/87 and in more recent months of the current year. The broad objectives and the development strategy of the program, however, remain unchanged.

Economic performance during 1986/87 was satisfactory. Real GDP grew at 4.5 percent, which was higher than the previous year but slightly lower than the program target of 4.8 percent. The external current account deficit as a percentage of GDP was brought down from 7.1 percent of the previous year to 5.6 percent in 1986-87, compared with the program target of 6.6 percent. This was mainly the effect of high growth of nontraditional exports and workers' remittances, reflecting the impact of government policies. The average rate of inflation was contained at 10.4 percent, despite the delays in the arrival of foodgrain imports that contributed to a sharp increase in the prices of food items. The overall budget deficit, however, widened to 8.2 percent of GDP, exceeding the program level by 1.0 percentage point. This outturn was mainly a reflection of lower collections of trade-related taxes, a decline in nontax revenue, and an increase in expenditures beyond the program levels. The rise in capital expenditures was due principally to an acceleration in the construction of a urea fertilizer factory. The bulk of the budget deficit was financed from external sources. However, the share of net domestic bank financing also increased, primarily because of the reclassification of credit to the private sector after the Government assumed one third of the interest remission cost under the agricultural loan recovery program. Nevertheless, there was a significant achievement compared with the program targets in respect of the expansion of total domestic credit and specifically of bank credit to the public sector as a whole. Broad money expansion was in line with the program.

The authorities initiated wide-ranging structural measures during 1986/87 in the fields of industrial and trade policy as well as in the financial system. Industrial policy was liberalized, investment regulations were relaxed, and the number of sectors exempt from the sanctioning requirements more than doubled. Trade reforms increased access to imports of raw materials and intermediate products. Significant progress was made toward the unification of the exchange system. The scope for the secondary exchange market was enlarged. The gap between the official and secondary exchange rates was reduced from 9.5 percent at end-June 1986 to 6.5 percent at end-June 1987 through a depreciation of the official rate. The exchange rate management was flexible, with the taka depreciating by 2.3 percent against the U.S. dollar, and the real effective exchange rate being maintained below the reference level. In respect of the financial system, strong loan recovery actions, especially in relation to agricultural loans, were initiated, as a result of which total recoveries exceed the benchmark level. A customs duty on imports of crude oil was imposed for the first time in the 1986/87 budget, the subsidy for fertilizer was completely eliminated, and generalized food subsidies were reduced further.

The authorities intend to build on the structural reform measures initiated last year during the first annual arrangement. Early this year, however, there was a serious setback in the economic situation caused by repeated floods, the worst in 70 years. Crops of about three million acres were totally destroyed, and infrastructure suffered extensive damage. Real GDP growth is projected to slow down to 1.3 percent, against the 4.5 percent achieved in the previous year. The average rate of inflation is expected to rise to about 13 percent, reflecting mainly an increase in the prices of foodgrains and other essential items and transportation bottlenecks, as well as adjustments in administered prices. Flood-related damage will constrain export growth, while crop losses will necessitate large foodgrain imports. As a result, the external current account deficit is expected to widen to 7.7 perecent of GDP. Gross reserves will decline to the equivalent of 2.8 months of merchandise imports from the estimated 3.3 months during 1986/87.

Despite the setbacks, the authorities remain committed to sustaining the structural adjustment efforts during the second annual arrangement. The structural measures that have already been taken and that are being envisaged are detailed in the staff papers.

With respect to trade liberalization, the number of items in the restricted and negative lists has been slashed by about one fifth from the end-1986/87 level. By 1989/90, industrial inputs are expected to be freely importable. For the current year, the global limits on industrial firms' imports of restricted goods and subceilings on raw materials, spare parts, and packing accessories have been doubled. To rationalize the tariff system, the maximum import tariff rate on final goods in the textile, steel and engineering, chemical and electronics sectors was reduced from over 200 percent to 125 percent. The reductions in tariff rates in the chemical and electronics sectors were originally scheduled for 1988/89 but have been brought forward to the current year. With minor exceptions, maximum customs duty rates have been set at 20 percent for raw materials, 75 percent for intermediate goods, and 100 percent for final products. Sales taxes were reduced to three rates. The authorities intend gradually to extend duty-free status to all exporters and to all inputs used in the manufacture of exports.

Trade liberalization efforts are being supported by a flexible exchange rate policy. Even though the inflation rate is expected to be higher in the current year, the authorities will not allow a real effective appreciation of the taka relative to the agreed reference level. They intend to reduce the gap between the official and secondary exchange rates, from 6.5 percent in 1986/87 to not more than 5 percent, by end-December 1987. The scope of the secondary market is being expanded. For the first time, aid imports will be transacted at the secondary rate.

The Government will limit external borrowing on commercial terms. However, this year commercial food credits of about $45 million will be needed to meet the larger requirements for public distribution and the maintenance of reasonable stocks of foodgrains. The debt service ratio is projected to decline from 27.6 percent in 1986/87 to 22.7 percent of current receipts in 1987/88, and stabilize at about 20 percent over the medium term.

The fiscal effort envisaged in 1987/88 is enormous, considering the economic circumstances of Bangladesh. In the current budget, a number of new and bold revenue measures have been taken. When it was felt that expenditures would be high on account of the damage caused by floods, the authorities took emergency revenue measures in September. The additional revenue receipts from all these efforts in 1987/88 are expected to yield 0.9 percent of GDP, which is remarkable, considering the deceleration in GDP to 1.3 percent and the revenue-eroding impact of trade and financial sector reforms in 1987/88. Total revenue as a percentage of GDP, in spite of these considerable tax efforts, is expected to remain at 9.1 percent, which is lower than originally targeted. My authorities believe that it is necessary to expand the tax base and undertake a reform of the tax structure. They are firmly committed to such a reform, beginning with the 1988/89 budget. The reform program will aim at increasing the revenue/GDP ratio to at least 9.5 percent in 1988/89 and ensuring a steady rise in it thereafter. Total expenditure is expected to be only 17 percent of GDP in 1987/88--against 17.3 percent in the previous year--even though the authorities have to accommodate the bulk of flood-related spending. The overall budget deficit is expected to fall in 1987/88 to 7.9 percent of GDP, as against 8.2 percent in 1986/87.

To improve the efficiency of the nonfinancial public enterprises, the authorities recently have made a number of adjustments in prices and tariffs, including those for natural gas, electricity, and sugar; the Government is currently preparing guidelines to allow the enterprises greater autonomy in setting prices. A Performance Contracting Process for strengthening coordination between selected enterprises and suppliers and customers is being implemented. Financial control is being tightened for public sector jute mills. The authorities also intend to privatize partially several units in the steel, sugar, and chemical corporations by selling shares to the public.

To facilitate the achievement of macroeconomic objectives, broad money expansion during 1987/88 is projected to increase by only 16.5 percent. The increases in domestic credit and in credit to the public sector are to be contained at 14.8 percent and 8.2 percent, respectively. Even though the economic circumstances have been worsened by the flood, the agricultural loan recovery program will be sustained. The industrial loan recovery program too will continue uninterrupted.

The authorities plan to initiate a thorough reform of the financial system. To sterilize part of the excess liquidity, Bangladesh Bank increased the cash reserve and statutory liquid assets requirements and intends to limit loan refinancing. Bangladesh Bank will also sell treasury bills from its own portfolio to the commercial banks. Key interest rates will be maintained at positive levels in real terms. To develop new instruments and strengthen the operational framework for monetary intervention, Bangladesh Bank will initiate a study in early 1988 with Fund assistance. The program to rehabilitate development finance institutions will be intensified, and will include measures such as increasing provisions for bad debts, recapitalization, and strengthening supervision and accounting systems.

In conclusion, I would point out that the structural adjustment efforts that are being undertaken in Bangladesh, in the current difficult situation created by the unprecedented floods, are extraordinarily courageous in view of the decline in the already very low level of per capita income. These efforts need to be supported not only by adequate and timely financial flows from abroad but also by a measure of international understanding.

Mr. Ismael made the following statement:

I welcome the wide-ranging structural reform introduced by the authorities in 1986/87 under a structural adjustment arrangement. It is encouraging to note that most structural measures envisaged in the policy framework paper for the first annual arrangement have been implemented. I believe that these measures--which focused on trade and industrial liberalization, domestic resource mobilization, and financial institution improvements--have strengthened the stabilization program adopted in 1985/86 under a two-year stand-by arrangement.

I am pleased that economic growth in 1986/87 is expected to be higher than in the previous year, despite the sluggishness of agricultural production. I also welcome the much stronger than anticipated outturn of the balance of payments, owing to the strong improvement in nontraditional exports and higher workers' remittances. It is very encouraging to note that the firm recovery in industrial production and significant improvement in nontraditional exports were the major factors behind the improved performance in economic growth and external balance. However, I regret that the rate of inflation and fiscal performance did not meet expectations. While the higher rate of inflation was caused by delays in the arrival of foodgrain imports, the overshooting of the budget deficit was attributable to both a shortfall in revenue and higher expenditures.

The economy continues to be vulnerable to external shocks, and the recent devastating floods have adversely affected economic prospects for the current fiscal year. In view of this regrettable natural disaster, I can support the modification of program targets for the second annual arrangement as envisaged in the revised policy framework paper. I concur with the authorities' view that the deviation from the original targets is temporary, and I hope that they will be able to return in the next fiscal year to the medium-term adjustment path outlined in the original policy framework paper.

I agree with the staff that a major challenge now facing the authorities is to sustain the adjustment efforts initiated in 1986/87. Even before the floods, fiscal performance was below expectations, despite various measures introduced by the authorities; therefore, I welcome the strong efforts by the authorities to prevent the fiscal stance from becoming unduly expansionary in the current fiscal year--for example, by reorienting capital spending. In this context, I agree with the staff that the authorities will need to implement tax reform measures vigorously in 1988/89 to ensure the success of the medium-term adjustment program. For this purpose, the review of tax policy and administration should be completed in the current fiscal year.

In conclusion, I am confident that despite difficult circumstances, the authorities will continue their efforts to implement the various policy measures outlined in the policy framework paper. Therefore, I support the proposed decision.

Mr. Goos made the following statement:

I have little to add to the staff appraisal, which accurately describes the performance under the first year of the structural adjustment arrangement--including the encouraging liberalization in trade and industrial policies and flexibility in the management of the exchange rate--and the major policy areas that warrant particular attention. Moreover, the policies agreed under the updated policy framework paper and the second annual arrangement are basically appropriate. I am particularly pleased to note that the authorities are committed to correcting the unfortunate setbacks in adjustment resulting from the recent devastating floods.

This experience, by highlighting the vulnerability of the economy to exogenous shocks, reinforces the need for the authorities to adhere strictly to a sustained path of adjustment, as the staff rightly stresses. It was therefore with considerable concern that I noted the slippage in the 1986/87 targets for the inflation rate and the government budget deficit, including in particular the shortfall that occurred in public savings. These slippages will complicate the adjustment task in the face of the increased resource constraint resulting from the floods. At the same time, the slippages could also give rise to questions about the authorities' policy intentions, especially if one considers the pronounced rise in current expenditures that occurred despite the better than expected outcome in food operations. Similar questions are prompted by the stop-and-go pattern of monetary policy this year, with a relaxation in January and a tightening in October.

A sustained and predictable course of adjustment is also called for in structural reforms. I note that the export performance benefit for blue leather that was introduced only last year was removed again, in July 1987; I am afraid that such on-and-off signals are not conducive to strengthening the confidence of investors and exporters. In this context, I also recall the authorities' plan to address the price and supply instability in the jute sector, on the basis of a World Bank study that has been available since mid-1986. Having failed to find in the report any reference to that plan, I wonder whether Mr. Sengupta or the staff could enlighten us on its current status.

I commend the authorities on their quite successful loan recovery efforts, which are essential for the restoration of financial discipline. At the same time, however, I am somewhat concerned that these efforts could be undermined by the authorities' decision to reschedule certain agricultural loans falling due between the end of 1986 and December 1987. To be sure, loan recovery has been rendered more difficult by the recent floods; nonetheless, I wonder whether the refinancing of the loans in question, perhaps even on relatively easy terms, might not have been more advisable than an explicit rescheduling.

In concluding, I should stress that I am impressed with the authorities' continued commitment to adjustment, which has been confirmed explicitly by Mr. Sengupta. Despite the progress achieved thus far, much remains to be done. In view of the examples that I have mentioned, it appears that the authorities should monitor closely their adjustment policies with a view to avoiding further program deviations and potentially conflicting signals about their medium-term intentions. With these remarks I support the proposed decision.

Mr. Enoch made the following statement:

Last February (EBM/87/23, 2/6/87), when the Board reviewed Bangladesh's performance under the stand-by arrangement and considered its request for a structural adjustment arrangement, the staff reported that the performance under the stand-by arrangement had been broadly satisfactory; as we review performance under the first annual structural adjustment arrangement, it too seems to have been broadly satisfactory. The balance of payments, in particular, has performed well and growth was close to target, although there were some slippages on the policy and inflation fronts. The authorities' success in generally maintaining the thrust of their adjustment efforts for several years now, especially given the appallingly difficult conditions that they have faced, is impressive. I am particularly struck by the better than expected performance of nontraditional exports and by the strength of workers' remittances, and I regard these outcomes as clear examples of what can be achieved by the adoption of structural reforms and more appropriate exchange rates.

The outlook for this year, of course, has been overshadowed by the recent floods. In general, the authorities seem to have reacted commendably to these terrible events and have thus helped to reduce the overall impact. The authorities' stated commitment to maintain their earlier medium-term plans is welcome, and, as Mr. Sengupta suggests, very courageous in the present conditions.

As we broadly endorse the staff appraisal, I would like to highlight a few areas that deserve particular emphasis. The overall message at this stage must be that the authorities need to maintain their efforts if they are to regain the adjustment path they initially set out for themselves, which is an extremely important objective. One central problem that continues to face the authorities is the fiscal deficit and the persistent difficulties in improving revenue performance. Even before the floods it was clear that revenue receipts had not lived up to expectations, and I would echo Mr. Goos's concerns on this matter. Further efforts are clearly essential as soon as circumstances permit to undertake the tax reforms necessary to improve the elasticity of the revenue system.

More generally, the authorities clearly recognize the importance of continuing to liberalize the economy to promote greater private sector activity. Ensuring that the exchange rate continues to remain competitive will have an important role here. I am encouraged to see that the authorities are committed to maintaining a narrow differential between the official and secondary markets, and I also note their commitment, made at the time of the approval of the structural adjustment arrangement, to unify the markets before the end of the arrangement. We are also glad to see that the authorities are making further progress in tariff reforms. One effect of the proposed changes will be to give small firms a more competitive market from which to purchase supplies. This effect should bring considerable advantages both in terms of increasing output and reducing inflationary pressures. Moreover, the general emphasis on rationalizing effective rates of protection is surely right.

In addition to appropriate demand-management policies, structural reforms also have a central role to play in promoting stronger growth. In this connection, I note in particular the need to strengthen the financial system and the importance of continuing the general process of deregulation. We have stressed on several past occasions that we attach importance to improving the operation of the financial system, including an increase in the loan recovery rate. It is thus very encouraging to see that the authorities are making good progress in this area. They need to continue and to intensify their efforts.

I am glad to see that the authorities have relaxed the investment policy guidelines, and that self-financed projects are now permitted without approval in a large number of sectors. A more detailed description of developments might have been useful here. Perhaps we might have more detail on these policies at the time of the next Article IV consultation.

I have one final comment to make on a more general policy issue. As this chair has made clear on several occasions in the

past, we believe that wherever possible program years should coincide closely with arrangement years. We discussed this issue in some detail both in the context of the initial approval of Bangladesh's structural adjustment arrangement, and again at the time of our overall review of the structural adjustment facility. For this annual arrangement, the gap is about four months, down from seven months last year. While we quite understand the difficulties the staff has faced in this particular case, we hope that every effort will be made to reduce gaps between programs and arrangement schedules, to three months at the very maximum, and to less time wherever possible.

In sum, the authorities have continued to make progress in the past year and have demonstrated again their commitment to adjustment even in the face of very difficult circumstances. As a result the economy remains sound, and a good base seems to exist for continued growth. If the objectives of the medium term are achieved, the debt service ratio, for instance, is poised to fall dramatically, and the country should become increasingly less dependent on the fortunes of its traditional exports. The authorities have set an example that many others would do well to follow. I support the proposed decision.

Mr. Finaish made the following statement:

The authorities should be commended for the generally successful results thus far in the program under the structural adjustment arrangement. In the first year of the program, wide-ranging structural measures were introduced to liberalize industrial and trade policy, strengthen the financial system by increasing loan recoveries, and enhance domestic resource mobilization by widening the tax base and improving cost recovery. The effective implementation of these policies has consolidated the gains that were achieved in the previous stand-by arrangement, and we look forward to further progress in the next two years of the arrangement.

The authorities face major challenges in the second year of the program because the recent devastating floods caused crop losses and damage to infrastructure, resulting in lower growth, a higher rate of inflation, and a weaker external position. Although the targets of the second annual program under the structural adjustment arrangement were modified, the authorities see this deviation as being temporary and are determined to persevere with their adjustment efforts. It appears that the original target to increase revenue to 10 percent of GDP in the current fiscal year will not be feasible, owing mostly to the revenue losses emerging from the rationalization of the tariff structure and financial sector reforms. We are in agreement with the view expressed by several members of the World Bank

As we broadly endorse the staff appraisal, I would like to highlight a few areas that deserve particular emphasis. The overall message at this stage must be that the authorities need to maintain their efforts if they are to regain the adjustment path they initially set out for themselves, which is an extremely important objective. One central problem that continues to face the authorities is the fiscal deficit and the persistent difficulties in improving revenue performance. Even before the floods it was clear that revenue receipts had not lived up to expectations, and I would echo Mr. Goos's concerns on this matter. Further efforts are clearly essential as soon as circumstances permit to undertake the tax reforms necessary to improve the elasticity of the revenue system.

More generally, the authorities clearly recognize the importance of continuing to liberalize the economy to promote greater private sector activity. Ensuring that the exchange rate continues to remain competitive will have an important role here. I am encouraged to see that the authorities are committed to maintaining a narrow differential between the official and secondary markets, and I also note their commitment, made at the time of the approval of the structural adjustment arrangement, to unify the markets before the end of the arrangement. We are also glad to see that the authorities are making further progress in tariff reforms. One effect of the proposed changes will be to give small firms a more competitive market from which to purchase supplies. This effect should bring considerable advantages both in terms of increasing output and reducing inflationary pressures. Moreover, the general emphasis on rationalizing effective rates of protection is surely right.

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In sum, the authorities have continued to make progress in the past year and have demonstrated again their commitment to adjustment even in the face of very difficult circumstances. As a result the economy remains sound, and a good base seems to exist for continued growth. If the objectives of the medium term are achieved, the debt service ratio, for instance, is poised to fall dramatically, and the country should become increasingly less dependent on the fortunes of its traditional exports. The authorities have set an example that many others would do well to follow. I support the proposed decision.

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Committee of the Whole, which reviewed the policy framework paper: that given the severity of the floods and the difficult development problems faced by Bangladesh, flexibility is needed in the interpretation of the various targets set in the policy framework paper. As noted by Mr. Sengupta, the fiscal effort envisaged in 1987/88 is enormous, considering the economic circumstances in which Bangladesh is now placed. We agree with the view, expressed by the authorities in their memorandum of economic and financial policies, that a significant and lasting increase in the revenue ratio will be possible only after an expansion of the tax base and a thorough reform of the tax structure. The authorities are also making commendable efforts to reorient all categories of expenditure to accommodate rehabilitation needs in the wake of the floods.

With regard to the social implications of the structural adjustment arrangement, we are encouraged that certain reform measures included in the program--such as tax reform, elimination of generalized subsidies, and loan recovery provisions--will mainly affect the wealthier segments of the society and are expected to narrow income inequalities. However, the policy framework paper notes that in the initial stages of program implementation, the reduction in food subsidies, increases in some administered prices, and the agricultural loan recovery program will adversely affect the poor. The authorities will need to monitor these developments closely and should stand ready to take action if necessary to avoid too large a share of the adjustment burden being borne by the poor segments of the population. We are glad that efforts are being intensified in 1987/88 to offset the erosion in rural incomes caused by declining foodgrain and jute production and rising food prices.

As to the balance of payments, welcome progress has been made in narrowing the spread between the official and secondary exchange rates. Also welcome is the ambitious program to liberalize the trade system and provide adequate incentives for exports. The expansion of exports is essential to strengthen the balance of payments, and it would be highly beneficial for Bangladesh to diversify its exports, because the medium-term prospects for jute--Bangladesh's main traditional export--are not favorable. According to the policy framework paper, a key constraint on export diversification is the inadequate export financing system. It is encouraging to learn that during the program period, the authorities will improve the arrangements for export financing by expanding the Export Credit Guarantee Scheme and the rediscounting mechanism for export loans. We hope that the Government's plan to create a foreign exchange revolving fund to finance import requirements of exporters will receive the support of the World Bank. It is also important that Bangladesh's trading partners open up their markets for its exports.

The medium-term scenario prepared by the staff shows considerable improvements in a number of areas. The average annual growth rate of real GDP is projected at 5 percent, allowing a significant increase in per capita income. There is a steady increase expected in public sector savings as well as in investment, particularly in export-oriented industries. Particularly welcome is the significant increase projected for nontraditional exports. The external debt is projected to rise, but most of it will be on concessional terms, and the debt service ratio will fall gradually. It is to be emphasized, however, that these favorable projections depend importantly on open export markets and concessional external assistance, and the international community should be willing to support the commendable adjustment efforts of the Bangladesh authorities.

To conclude, we support the proposed decision.

Mr. Faria made the following statement:

The staff paper and Mr. Sengupta's statement confirm both the determination of the authorities and their success in initiating and sustaining a process of structural transformation of the economy, despite the influence exerted by adverse factors beyond their control. The performance of the economy during the first year of the structural adjustment arrangement has been commendable. Apart from the fiscal deficit, all macroeconomic targets were comfortably attained, while wide-ranging structural, trade, and financial measures were initiated. Moreover, an unanticipated revenue shortfall from trade taxes, rather than expenditure overruns, was essentially responsible for the resulting nonattainment of the overall budget deficit and domestic bank borrowing targets.

Even more commendable is the authorities' determination to persist with their commitment to structural adjustment during the forthcoming second year of the program, particularly in the face of the worst floods in almost a century, with their adverse consequences for macroeconomic and financial performance. It would have been useful to have in the staff paper some tabular indication of how the original program targets for 1987/88 were scaled down from the previous levels. Particularly noteworthy are the ambitious reform of the industrial and trade system, the greater use of indirect instruments of monetary control, and the flexible management of exchange rate policies. Because the overall performance of the public sector will remain critical to the success of the program, especially in view of rehabilitation-induced pressures on the expenditure side of the budget, we would agree with the staff that the authorities should move vigorously to increase their tax effort and to achieve further expenditure economies, in particular by increasing the efficiency of public enterprises through market-based pricing of their sales.

I have one question relating to the medium-term scenario concerning the remarkable increase of nontraditional exports in U.S. dollar terms. This increase has significant implications for the reserve position and the debt service ratio, among other things, no doubt reflecting appropriate exchange rate policies. While I recognize that a prospective 21 percent growth rate is decidedly more conservative than the earlier 41 percent rate--although the latter was from a lower base--in absolute terms the more than doubling between 1986/87 and 1987/88 still implies a larger increase. Could the staff provide some background for these forecasts, such as the nature of such exports, in particular textiles and shrimp, and the markets to which they are exported.

In conclusion, we agree fully with the staff that the revised medium-term program represents a realistic scaling down of the original objectives to reflect the difficult circumstances confronting the Bangladesh authorities.

Mr. Kabbaj made the following statement:

At the outset I wish to support the request by Bangladesh for a second annual arrangement under the structural adjustment arrangement, and the proposed decision. I generally agree with the thrust of the staff appraisal. Apart from some slight slippages in the financial area, the policy benchmarks established for the first annual arrangement were met and the objectives were achieved. The overall economic and financial performance of Bangladesh in 1986/87 was largely satisfactory; real GDP growth is estimated to be close to the targeted level; current and overall balance of payments positions were improved more than envisaged in the program; and the rate of inflation, while exceeding the program target, was kept close to the previous year's rate, at about 10 percent.

The authorities should be commended for the successful implementation of wide-ranging policy reforms initiated in accordance with the original policy framework paper, and aimed at increasing real per capita income, attaining a viable external position, and reducing the rate of inflation. The significant progress achieved in the first year through the implementation of appropriate structural measures, as outlined by Mr. Sengupta, laid the basis to help the authorities pursue their economic and financial program in the years ahead as outlined in the updated policy framework paper.

Notwithstanding those improvements already achieved, the economy is still vulnerable to external shocks. The recent monsoon-induced floods, which brought about extensive losses in crops and livestock, as well as damaging infrastructure in the affected areas, are expected to have a large negative impact on Bangladesh's economic and financial performance, domestically and externally, in 1987/88. Real GDP is projected to fall sharply to 1.3 percent and the rate of inflation is estimated to increase to 13 percent. The current account deficit is projected to widen to 7.7 percent of GDP, owing mainly to the predicted slowdown in exports--particularly of shrimp and jute--and to the inevitable large increase in foodgrain imports. The overall balance, however, is projected to record a small surplus because of the anticipated increase in foreign aid disbursement, which is being made available to offset partly the flood-induced current account deterioration. The modifications to the original policy framework paper targets should have been more in line with those developments resulting from the unfortunate floods. I, therefore, share the views expressed by several members of the Committee of the Whole in the World Bank, namely, that there is a need for flexibility in the interpretation of the various targets set in the policy framework paper.

The authorities are also encouraged to continue implementing structural measures while pursuing cautious fiscal, monetary, and external debt policies, in order to facilitate a return to the original path of adjustment in the third year of the program. Having said that, while I welcome the authorities' intention to minimize commercial borrowing, it is discouraging to note that they have been forced to finance about $45 million in additional foodgrain imports with nonconcessional loans. Taking into account the improved world food security and further availability of food aid, I wonder whether the Fund or donor countries could help Bangladesh to finance its additional foodgrain imports with concessional loans.

Mr. Posthumus commented that Bangladesh's performance in the first year of its comprehensive structural adjustment program had been commendable, and the program warranted continued support by the Fund. However, it was disappointing that in 1986/87, notwithstanding good growth performance and a surprisingly good export growth of 30 percent, the fiscal position had not improved, and price increases had been higher than estimated. The central government operations showed that current expenditure was lower than total internal revenue. If one assumed that the annual development program consisted of investments, then government savings were positive. Nevertheless, internal revenue was quite low, and current expenditure seemed low in comparison with the need for public sector activities. Accordingly, it was urgent to increase the mobilization of domestic resources, not necessarily to decrease the budget deficit, but to increase current expenditure wherever necessary.

According to Mr. Sengupta's statement, the recent floods in Bangladesh had caused extensive production losses and damage to the infrastructure, Mr. Posthumus continued. The major part of that shock might be invisible in the statistics, in that it was carried by the population and not recorded in the figures. Of course, the estimates for 1987/88 showed a large reduction of expected growth, and the increase of consumption showed unfavorable results as well. Nonetheless, foodgrain revenues, as well as the budgetary expenditures and gross investment outlays, were not estimated to change greatly. Those estimates, together with the expectations of much slower export growth and much higher import growth in 1987/88 than in the preceding year, made him wonder whether the estimates were not too optimistic. There was a distinct possibility that the fiscal outcome would deteriorate, particularly in the sphere of internal revenue. However, he concurred with the staff appraisal and supported the proposed decision.

Mr. Fernândez made the following statement:

> We congratulate the authorities for the adequate implementation of the policies in the first year of the program supported under the structural adjustment arrangement. We are also glad to see that most of the program's objectives have been achieved. We regret very much the disastrous economic consequences of the recent floods, the worst in seventy years. The authorities are fully justified in making the temporary changes in targets for the current fiscal year to take into account the developments of 1986/87 and the impact of the floods. The authorities should be commended for their intentions of returning to the original path of adjustment in the third year of the program. Given these considerations, we support the proposed decision.
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> Both the staff paper and Mr. Sengupta's statement clearly explain why economic performance under the first year of the structural arrangement can be viewed as broadly satisfactory. Two key policies have been of major help in achieving such results: the persistent control of broad money expansion, and maintenance of flexible exchange rate management. If monetary policy keeps key monetary aggregates under control, a higher than expected rise in prices because of flood-related price increases and adjustments in administered prices is not a matter of first concern to us.
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> We are, however, more worried about fiscal slippages caused in part by shortfalls in tax and nontax revenues. A number of measures to widen the tax base have been agreed upon. We welcome this development in structural policies as well as the further reduction of price subsidies. We also support the target of making the industrial sector more competitive through the liberalization of industrial and trade policies. We welcome the reductions in tariffs, although we would point out that a reduction of tariffs on inputs alone will not mean that the industrial

sector will become more exposed to international competition. Without adequate reduction in nominal protection on final goods, lower input tariffs mean higher effective protection. Therefore, a more uniform rate of effective protection among industries may not be a desirable target if this uniformity is not achieved at lower levels of effective or real protection. Staff comment on the nature of this trade and tariff reform would be helpful. In particular I would like to know whether reductions already made in nominal protection have led to lower effective protection of final goods.

We also welcome the progress made toward exchange rate unification by the reduction of the gap between official and secondary exchange rates, as well as the enlargement of the secondary exchange market, from approximately one half to about two thirds of exports and imports.

The increase in loan recoveries in order to strengthen the financial system was also a positive step, although much more remains to be done.

With respect to the second annual arrangement under the structural adjustment facility, we find the authorities' modification of targets for the current fiscal year justified. The new proposed targets imply a general worsening in the key economic indicators, primarily because of the floods. However, under these unfavorable circumstances, the authorities should be encouraged to maintain a nonaccommodating monetary policy, a flexible exchange rate, and to avoid a further widening of the overall budget deficit, mainly through an effort to keep revenue collection as programmed.

Other welcome intentions of the authorities are to continue both a prudent external debt policy implementation and a credit policy aimed at providing the private sector with adequate financing.

Finally, most of the structural measures already initiated should be implemented vigorously, particularly in the financial sector, by a strengthening of the financial and credit institutions, and in the public enterprises, by an increase in their autonomy, and by the enhancement of performance evaluation tests.

Mr. Pineau remarked that in the face of strongly adverse external conditions, such as severe flooding and declining export prices, Bangladesh had been able to post some quite encouraging results. Economic activity remained strong, the major macroeconomic variables had not deviated significantly from the projected path, and some major structural reforms were well under way. However, several weaknesses, notably in the tax and exchange systems, had already been obvious when the Executive

Board had approved Bangladesh's request for a three-year arrangement under the structural adjustment facility (EBM/87/23, 2/6/87), but they had not been tackled fully since then. Whereas loan recovery procedures and the financial system as a whole were being rationalized, progress in improving tax collection had been disappointingly slow. The present low level of public revenues should be corrected to enhance the effectiveness of fiscal policy. A broadening of the tax base and a restructuring of the tax rates should therefore rank high on the authorities' agenda for the second annual program.

All the important steps taken by the authorities to liberalize the trade system and to open up the import regime were greatly welcomed, Mr. Pineau stated. Those steps should prove decisive in fostering a diversification of exports away from the traditional jute industry. The same approach should also prevail for the exchange rate policy. That policy was conducted at present in a flexible manner, and the spread between the two markets had been reduced recently. Nevertheless, as a further step, the authorities should carry through their intention to unify the exchange system as conditions permitted.

Ms. Bush made the following statement:

> Efforts to raise income and achieve balance of payments viability, which are very important in Bangladesh, have had mixed results in the past. However, we believe that the policy framework process and the authorities' commitment will help to ensure that policy reforms and financing by external sources are mutually reinforcing and produce more tangible and satisfactory results in the coming years.
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> Looking back over the past year, we see a welcome pickup in the pace of reform. The authorities are to be commended, for example, for advancing the scheduled tariff reductions in the chemical and electronic sectors. The growth in nontraditional exports also continues to be impressive. We agree with Mr. Sengupta that this reflects the impact of government policies, and we would underscore the progress made in restoring credit discipline, especially in raising the rate of loan recovery in the agricultural sector. By contrast, progress in improving domestic resource mobilization has been slow and the pattern of supply of credit to the economy remains a major constraint on growth.
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> With regard to the updated policy framework paper, we are encouraged that the authorities have decided to retain the medium-term objectives of the initial paper despite the setbacks related to flooding and jute prices earlier this year. Generally, we find that the policy framework paper is comprehensive, but it could be more concrete and specific with regard to the objectives to be attained. In particular, the policy framework paper notes that per capita foodgrain production has declined since 1984/85,

which is a matter of paramount concern; we would have liked to see specific objectives for raising agricultural production. We would welcome the views of the World Bank staff representative on whether the measures outlined in the policy framework paper can be expected to achieve the 3.5-4.0 percent annual growth in foodgrain production needed to raise per capita consumption and ensure food security. In addition, we would be interested in knowing when the comprehensive review of foodgrain production will be completed.

The parastatal sector also needs greater definition of the policy measures. Areas of weakness are identified, but timetables for taking and completing action would help to ensure the success of this effort.

We have similar concerns about the exchange rate policy, which is an active one compared with the policies of some countries that face equally difficult balance of payments pressures. The authorities are committed to unifying the foreign exchange markets at the earliest opportunity. Given the use of Fund resources and the potential for a third annual arrangement under the structural adjustment arrangement, we think that unification should be a priority. We would appreciate comments from the staff on whether this is expected to occur sooner rather than later. In this connection we think that an active exchange rate policy would reduce the need for a larger and presumably more costly export credit guarantee scheme.

Another matter of concern is that to our knowledge, the policy framework paper has not yet assumed a significant role in guiding the consultative group process for Bangladesh, or in directing World Bank lending. My authorities believe that their bilateral support, as well as that of other bilateral donors, will stand a better chance of being used properly if the policy framework paper takes on a more central role in the consultative group meetings for Bangladesh.

I have four comments on the program for 1987/88. First, given the importance of controlling public expenditures, we are concerned about the increases in compensation already implemented. Second, the staff appraisal notes that the authorities will need to implement tax reform measures vigorously beginning with the 1988/89 budget. We view this as an area in which even earlier action is feasible and appropriate. Third, we support the staff's view that the pace of interest rate liberalization should be accelerated. Fourth, while there are some structural benchmarks for the year, we believe that in general, more emphasis should be given to structural benchmarks, including setting ones that have a greater degree of specificity and that also are more concrete with regard to timing.

We do hope that the authorities will give, as the latter comment implies, increased attention to the scope and pace of their adjustment efforts, giving particular emphasis to the structural area. Although we appreciate that some progress is being made, we believe that structural reform is important to achieve a sustained improvement in the external payments position and stronger growth of incomes in Bangladesh.

Mr. McCormack made the following statement:

We support Bangladesh's request for a second annual arrangement under the structural adjustment arrangement. We also agree with the staff recommendation that the second annual arrangement be approved at this time in order to narrow the gap between the program year and coverage of the proposed arrangement. Some concerns about the timing of program approval were expressed by this chair when the Board discussed the first annual arrangement under the structural adjustment facility, and we feel that acceleration of approval of the second year is the correct means of putting the structural arrangement with Bangladesh on a more normal track.

Some important progress has already been made in the structural adjustment efforts in Bangladesh. However, the country's development needs and external factors, such as the serious floods during the monsoon period, continue to present a formidable challenge. It is particularly regrettable that damage arising from the floods has already lowered growth projections for fiscal year 1987/88 to only about 1 percent. The constant threat to Bangladesh's development caused by the risk of flooding reinforces the need for a continuing strong program of structural adjustment policies. It is in this light that we welcome the measures planned for the second-year program under the structural adjustment arrangement, and hope that full implementation of the program can return Bangladesh to a higher growth path.

During previous discussions, we emphasized the need to strengthen the financial system, as well as to stabilize public sector finances. These areas continue to be of paramount importance. We welcome the authorities' plans to undertake a thorough reform of the financial system that will deal not only with the effectiveness of monetary policy, but also the efficiency of the financial enterprises. Imaginative policies to improve the rate of loan recovery must be an important part of efforts to strengthen the financial system, as should the Government's plans to recapitalize public institutions. Faster interest rate liberalization is also a priority. We hope to see significant progress in all these areas during the coming year.

With respect to fiscal policy, we share the staff's concern that revenues have not increased as expected. We endorse the staff view that the authorities need to implement tax reform measures vigorously, while maintaining careful control of expenditures. On the latter count, efforts to contain the government wage bill in the wake of the floods have been an important signal that the Government is serious about controlling the fiscal stance. Continuing efforts to make public enterprises financially accountable and improve their profitability would be a further sign of the seriousness of the Government's intentions.

With regard to other structural policies, we strongly support the efforts to liberalize the import regulation system and the foreign exchange system more generally. We endorse the authorities' intention to unify the exchange rate as soon as possible, since this will be a fundamental element in improving export incentives. The impressive recent growth in nontraditional exports, which now account for 40 percent of total export earnings, indicates the potential benefits that could accrue from such policy initiatives.

In sum, we support the proposed program, and urge the authorities to continue efforts on all fronts to make the Bangladesh economy more flexible, to open markets further, and to give greater room for private sector initiative.

Mr. Al-Assaf made the following statement:

The severe floods of September had a devastating effect on the agricultural production and on the infrastructure of Bangladesh. The extent of the setback clearly suggests the need for rehabilitation and restructuring. Mr. Sengupta has noted the magnitude of the flood-related damage, and how damage has marred the prospects for the second year of the structural adjustment program. Real GDP is now projected to slow markedly to 1.3 percent, the rate of inflation will rise to 13 percent, and the external current account deficit will widen considerably. This suggests the need for flexible interpretation of the program targets and an adaptation of the policy framework paper.

Notwithstanding these serious adverse developments, the performance under the first year of the structural adjustment program was broadly satisfactory. Structural measures in key areas have been introduced, and significant strides are being made in redressing structural impediments to growth and in liberalizing the economy. There is, however, a major weakness emerging in the implementation of the program, namely, the weaker than expected fiscal performance and the slow progress being made in rehabilitating public enterprises.

The fiscal outturn fell short of program expectations, and, as a result, the overall budget deficit widened to some 8.2 percent of GDP, exceeding the program level by 1 percentage point. The expansionary fiscal stance has contributed to the acceleration of the rate of inflation and the increase in domestic liquidity. The authorities quickly reacted by introducing a number of measures aimed at improving the fiscal performance. While the package of revenue measures announced in September will still fall short of redressing fully the fiscal slippages, it constitutes a considerable and commendable effort by the authorities under the circumstances.

The challenge now facing the authorities is how to maintain the pace of fiscal adjustment, and, in particular, how to increase government revenues in line with the program objectives in the coming years. I agree with the authorities that, given the present tax structure and in view of the revenue losses emerging from the rationalization of the tariff structure and financial sector reforms, it will not be feasible for government revenues to reach the originally targeted 10 percent of GDP in the current fiscal year. Nonetheless, I urge the authorities to begin a process of fiscal reform with the aim of widening significantly the tax base, perhaps along the lines suggested by the Fund and the World Bank.

To ensure the success of the medium-term adjustment program, determined action will also be needed to bring about a significant improvement in the performance of the public enterprises. I commend the authorities for having improved the cost recovery and operating efficiency of the nonfinancial public enterprises. In the context of Bangladesh, the adjustments in the tariffs charged by public enterprises are difficult and bold actions, and constitute a welcome, significant change in policy direction. The authorities have clearly signaled their intention to widen the domestic pace of revenues, and to emphasize efficient allocation of resources, which are two key objectives of the policy framework paper.

In conclusion, the setbacks, while necessitating an adjustment in policy and objectives, have demonstrated the authorities' firm commitment, in the face of adversities, to the objectives of the program supported by the structural adjustment facility. I support the proposed decision.

Mr. Yang said that he fully understood the extreme difficulties facing Bangladesh because of the devastating floods. Therefore, he appreciated the continuing commitment of the authorities to intensify their adjustment efforts. He supported the proposed decision.

Mr. Morita made the following statement:

I am also glad that the outcome of the first annual program under the structural adjustment arrangement is broadly in line with expectations, and that visible favorable results have emerged in some key areas. I note that important indicators such as the per capita growth of GDP, and gross investment and domestic savings as a proportion of GDP, are all estimated to exceed the programmed targets. Furthermore, there are also good signs in the external sector. The growth rate of nontraditional exports will double the programmed rate this year, and thus the current account deficit will be less than expected. These commendable results reflect the authorities' strong efforts.

Unfortunately, however, Bangladesh has just experienced a disastrous flood, which necessitates the modification of the program. Nonetheless, the authorities' intention is to put the program back on the medium-term adjustment path, as envisaged in the original policy framework paper, beginning in 1988/89. While I certainly welcome this intention, I would also point out that intensified efforts will be required to achieve the original objectives, now that the economic prospects are much less promising. Although some temporary modifications are suggested at this time, the authorities intend for the most part to continue the adjustment strategy that was initiated in the first annual program under the structural adjustment facility. Accordingly, I broadly support the second annual program, and emphasize the need for an early implementation of structural measures.

As for fiscal developments, I am disappointed to learn that government revenue was below the targeted level for the past fiscal year, and that the authorities have abandoned their objective of raising the ratio of revenue to GDP to 10.5 percent by the end of the program period. I welcome the additional revenue-raising measures taken this year; however, these measures are appropriate in timing, but insufficient in size and comprehensiveness. The current level of revenue, about 9 percent of GDP, is very low by international standards, and the need to raise this ratio has been stressed for quite some time. There is a serious need for the authorities to introduce the broader reform measures as soon as possible, and I look forward to observing their implementation at the time of the next discussion of Bangladesh.

The current inflation rate, on the high side, is a source of concern; the shortage of food caused by the floods is expected to raise that rate even higher. Under the circumstances, a tight monetary policy stance is called for, and excess liquidity should be reduced further. Moreover, it is also important to keep interest rates positive in real terms. Only market-based, realistic interest rates can attract workers' remittances from abroad or stimulate domestic savings. The tight monetary policy stance will not be inconsistent with the authorities' aim to reinforce private sector activities, if the financial sector reform is initiated and further efficiency is achieved through the liberalization measures and the establishment of firmer financial discipline. I welcome the authorities' commitment to a thorough reform of the financial system in the current fiscal year, and I hope that these measures will be implemented without delay.

With regard to the unification of the exchange rates, I am pleased that some progress is envisaged in narrowing the gap between the two rates, and that the scope of the secondary exchange market will be widened. I hope that this unification finally will be achieved at the earliest possible date. I support the proposed decision.

The staff representative from the Asian Department said that expenditures in the past year had been much higher than programmed, reflecting mainly a rise in development expenditures owing to the completion of major projects, which also explained the large rise in the flow of project aid for the same period. Despite the requirements for flood rehabilitation, total expenditures in the current fiscal year were expected to grow at a lower rate, and development expenditures would be low as well.

The revenue estimates for the current fiscal year had been based on projections of import levels and domestic taxes, especially income and excise taxes, the staff representative continued. Those estimates had been conservative and had taken into account the difficulties that had been experienced in realizing the revenue objectives. However, the recent strikes and political unrest were likely to have a negative impact on revenue, because transportation had been disrupted and production had been delayed. The staff expected to be able to assess the situation better during the Article IV consultations in January 1988, and it would then be clearer whether the revenue estimates had been realistic.

Special circumstances had led to a loosening of monetary policy in the first half of the past year and a tightening of it during the second half, the staff representative remarked. The Government's need to import large quantities of food after the floods had led to a large extension of credit beyond the usual requirements. In addition, the rescheduling of agricultural loans to enable farmers to replant would result inevitably in a larger extension of credit. Those special factors were not expected to be in existence during the second half of the fiscal year, and credit expansion was expected to be much less than it had been during the first half. In fact, credit expansion through the first quarter--through September 1987--had been below the indicative target under the program.

There were two aspects to the jute sector--the stabilization of domestic production and improving the performance of the jute mills, the staff representative indicated. Although the Government had considered the establishment of a buffer stock, that option was no longer under consideration because it was too costly, and it was also doubtful whether a buffer stock should be established for a commodity that was facing secular decline, because it would require the establishment of a minimum price. It had cost the Government a large sum of money during 1985/86 to maintain the price of jute at 200 taka per month. When the floor price had been removed, the price of jute had fallen. The Government was trying to approach the issue by announcing the procurement price before the planting season and by providing more information to farmers on the prospects for the requirements of the jute mills.

The Government had denationalized about 50 percent of existing capacity in the jute mills in the early part of the decade, the staff representative recalled. The authorities were currently taking other measures to improve the efficiency of the existing government-owned mills, including the adoption of cost accounting, encouraging the companies to improve their financial flows by holding lower stocks, especially raw jute stocks, and providing incentives through the banking system. However, progress in the jute mills sector was not expected to be rapid.

The authorities had opted for the rescheduling loans made to the farmers, the staff representative said, because they had considered that it would be more efficient administratively to postpone payments due and to reschedule them for the second half of the year than to become involved in the refinancing of those loans.

The assumptions underlying the export projections had been conservative, because the staff thought there might be difficulties in realizing more optimistic projections, the staff representative went on. The sources of growth potential were in readymade garments and frozen shrimp, because the Bangladeshi share of world trade in those areas was quite small and thus a large market was available. The problem was one of supply constraint rather than of limited demand, because the existing capacity for those industries in Bangladesh did permit an expansion. For example, in the case of shrimp, the yield per hectare was about one fifth the world average; with technical enhancement and innovation, that yield could be raised rapidly to meet the demand that existed. Another source of growth was processed leather. The Government had removed wet blue leather from the export performance benefit list in order to encourage a shift toward manufacturing leather rather than exporting raw leather.

The tariff reform had been intended basically to rationalize the tariff structure, the staff representative explained. There was an emphasis on reducing the effective protection for intermediate goods, but the high rates on final goods were being addressed as well. The tariff measures were intended to lower protection for final goods through a reduction of the restricted and banned lists and the reduction of quantitative restrictions, to be replaced by a rationalized tariff structure.

In 1986/87, the authorities had introduced a revised industrial policy, which had led to a relaxation of investment policies for the private sector, the staff representative commented. Under that policy, private sector investment was able to proceed in many sectors without any need of authorization by the Government, as long as the capital was provided by the investor; similarly, the authority of the development financing institutions and the commercial banks to approve investment loans had been expanded, such that the amount of capital that they could approve without referring to the Government had doubled. However, the response of private sector investors had not been vigorous because of other factors--including the lower demand for certain products within the economy, and the existing capacity in export-oriented industries in the Government. Moreover, the tight credit policy affected the level of private sector investment, and the development financing institutions had not been able to extend foreign exchange for private investment. Those difficulties were currently being tackled through the rationalization and rehabilitation of those institutions. Given the incentives being provided by the Government, private sector investment was expected to pick up during the current year and in the next year.

With the exception of a few major ones, the public enterprises had been doing well financially, the staff representative observed. The principal problems had been concentrated in the jute sector and in the Power Development Board. The problems of the Power Development Board, and the energy sector in general, were being addressed under the proposed energy sector credit from the World Bank, and there had been a visible improvement in the financial position of the Power Development Board. The jute sector problems were also being addressed by the Government, whose measures were being supported by technical assistance from the World Bank and from other interested parties.

The authorities agreed with the staff that a unification of the exchange system was beneficial, and they intended to proceed as quickly as possible, the staff representative from the Asian Department concluded. The staff expected a move on exchange rate unification to take place during the course of the arrangement under the structural adjustment facility. The authorities had requested a study by the staff on the impact of that unification on the utilization of commodity aid and on flows of workers' remittances; the staff expected to send that study to the authorities before the end of 1987.

Mr. Sengupta said that additional comment was warranted on the authorities' fiscal efforts. The authorities were trying their best to improve their fiscal performance. That performance was already quite impressive in view of the tax structure of Bangladesh. The elasticity of the tax system had been about 0.7 until 1984/85. In 1986/87, the elasticity had risen to 0.9, and in 1987/88, real revenue was expected to grow by 1.7 percent, compared with real GDP growth of 1.3 percent. Accordingly, the shift in the trend of real revenue growth had been remarkable.

An examination of the revenue sources showed that in the past year, the major reductions had come from trade-related taxes--customs and sales--because of a fall in import demand, and because of a fall in the prices of some imported commodities, Mr. Sengupta continued. Clearly there was a need to change the tax structure, and the authorities were trying to work out a more rational tax system.

Finally, it was useful to note that during fiscal year 1987/88, real GDP was supposed to grow at 1.3 percent, and the additional revenue--not total revenue--was expected to be about 0.9 percent of GDP in real terms, Mr. Sengupta emphasized. Those figures indicated that a substantial effort was being made to capture a large part of the incremental GDP in terms of tax revenue. His authorities considered that effort to be the criterion by which one judged Bangladesh's efforts.

The Executive Board then took the following decision:

> 1. The Government of Bangladesh has requested the second annual arrangement under the structural adjustment facility.
>
> 2. The Fund has appraised the progress of Bangladesh in implementing the policies and reaching the objectives of the program supported by the first annual arrangement, and notes the updated policy framework paper (EBD/87/276).
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> 3. The Fund approves the arrangement set forth in EBS/87/227, Supplement 2.

Decision No. 8734-(87/159), adopted
November 23, 1987

## 3. NIGER - STRUCTURAL ADJUSTMENT FACILITY - SECOND ANNUAL ARRANGEMENT

The Executive Directors considered a staff paper on Niger's request for a second annual arrangement under the structural adjustment arrangement approved on November 1, 1986 (EBS/87/226, 10/27/87), together with an updated policy framework paper for 1988-90 (EBD/87/274, 10/26/87). They also had before them a statement by the Managing Director, which 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 Executive Directors of the Bank and IDA in their November 17, 1987 discussion in the Committee of the Whole of a paper entitled "Niger - Medium-Term Economic and Financial Policy Framework (1988-1990)."

The Executive Directors of the Bank and IDA discussed, in a meeting of the Committee of the Whole, the paper entitled "Niger - Medium-Term Economic and Financial Policy Framework (1988-1990)."

The Directors generally welcomed the three-year program set out in the policy framework paper. There was praise for the determination with which the Government of Niger is pursuing its structural adjustment program, in very difficult economic circumstances. Positive results were noted in reducing the fiscal and external deficits, as well as in improving the efficiency of public resource management and restructuring the public enterprise sector. It was noted that many of the details of the medium-term adjustment program had already been discussed by the Board in June 1987, when the Public Enterprise Sector Adjustment Credit was approved.

The Directors had four major concerns: (i) growth prospects; (ii) external debt and financing needs; (iii) the social impact; and (iv) domestic resource mobilization.

First, it was noted that, in spite of all the adjustment efforts undertaken by the Government, growth prospects did not appear very favorable over the near-term future. After an average rate of economic growth of 2.6 percent in 1987/89, real GDP growth would approach only 3 percent in the early 1990s, just barely above the rate of population growth. The outlook for uranium exports was relatively bleak, and the possibilities for alternative export products were few. Special efforts were needed, including basic agricultural research, to promote new agricultural crops with export potential and to address the threat of desertification. There was support for enhanced development of the private sector and for the strengthening of credit mechanisms serving that sector. The need for policies to address the population growth issue was also stressed.

The Directors' second concern was the need for debt relief and the availability of financing. The Directors underscored Niger's financing needs to achieve both enhanced growth and debt restructuring. In order to reduce the debt service ratio to acceptable levels, provide for adequate levels of recurrent cost financing, and achieve higher investment and growth rates than projected in the medium-term policy framework, substantial additional amounts of external financing would be required. The Directors expressed support for the World Bank's recent initiative to mobilize additional quick-disbursing concessionary resources and provide debt relief for debt-distressed African countries such as Niger.

The social costs of some adjustment policies were commented on, and support was expressed for the measures to expand employment opportunities over the longer term, especially in small and medium-sized enterprises. The importance of efforts to improve access to and quality of primary education and basic health care was also mentioned in this context.

The fourth concern was related to the improvements needed in the area of domestic resource mobilization. In view of the relatively low public revenue to GDP ratio in Niger, further efforts were needed to reform the tax system, increase cost recovery, and stimulate domestic resource mobilization. As to public expenditure, efforts should continue to improve services in essential areas such as human resource development, agricultural development, and maintenance of basic infrastructure.

The Directors encouraged the authorities to continue their disciplined economic management and to carry through the necessary adjustments in a timely manner. The performance of the external sector will have to be appropriately managed in order to achieve smooth and effective adjustment. Specific mention was also made of continued parastatal reform, further market and price liberalization, banking sector reforms, and careful public resource management.

Directors recognized that it would take time to achieve results and to obtain a supply side response, particularly from the private sector, which should be promoted to the maximum extent feasible. Clearly the economic and financial situation of Niger is very fragile. To sustain the effort at reform and achieve desirable results will require sustained support from the international community, as well as support of an extraordinary nature both in the form of concessionary assistance and generous debt relief on very concessional terms.

Mr. Mawakani made the following statement:

The Nigerien authorities' determined efforts to remove the structural impediments to sustained economic growth, and to progress toward viability of the country's external position were frustrated in 1987 by adverse exogenous developments, namely, the re-emergence of drought conditions and the unexpected sharp drop in prices and export volumes for uranium, Niger's main export commodity. As a result, the favorable outcome expected for 1987 at the time of the Article IV consultation and the midterm review of the stand-by arrangement in April 1987 will not materialize. Thus, real GDP is now estimated to decline by about 5 percent against a 2.7 percent increase previously expected; the rate of inflation, as measured by the GDP deflator, will be higher--7.1 percent, compared with 5.5. percent anticipated earlier--and the external current account position, including official grants, is expected to deteriorate instead of improving as originally envisaged.

In spite of such adverse developments, the resolute implementation of the financial and structural policies envisaged under the stand-by arrangement and the first annual arrangement under the structural adjustment facility enabled the authorities to comply with all the performance criteria set for end-June 1987 and to observe all the structural benchmarks except for two that pertain to studies on the reform of the civil service and on the agricultural credit system. On the basis of preliminary information, the end-September performance criteria are likely to be met.

The downturn in economic activity in 1987 and the reversal of the improvement in the external current account position have brought to light the vulnerability of the economy to exogenous factors and the fragility of the progress made over the past few years. This vulnerability underscores the need for a diversification of the productive and export capacity of the country away from uranium, as well as the implementation of a dynamic agricultural policy and the intensification of the Government's efforts to improve its fiscal position. Accordingly, the authorities have updated and extended, in close collaboration with the staffs of the Fund and the World Bank, their original medium-term policy framework paper to cover the period 1988-90. The objectives and strategies of the 1988-1990 policy framework and the policies to be implemented in the different sectors of the economy are spelled out in the policy framework paper.

Consistent with the thrust of the policies of the updated policy framework paper, a second-year program has been designed and the second annual arrangement under the structural adjustment facility is being requested to support its implementation. As described in the Memorandum on Economic and Financial Policies for 1988 (EBS/87/226, Appendix I), the 1987/88 program aims at achieving real GDP growth of 7.5 percent; reducing the rate of inflation, as measured by the GDP deflator, to 2.2. percent in 1988 from the 7.1 percent recorded in 1987; and containing the overall fiscal and external current account deficits, including grants, to 4.4 percent and 3.8 percent of GDP, respectively. To achieve these objectives, the authorities intend to implement structural policies affecting the public investment program, the public enterprise sector, the agricultural sector, and the pricing and marketing system. They intend also to pursue tight demand-management policies to support the structural policies.

The Government's main economic objectives over the medium term are, among others, to promote the development of an efficient private sector and to improve the fiscal position by strengthening the revenue performance and restructuring expenditures, with a view to reducing the share of the wage bill in total expenditure. On October 22, 1987, the Government adopted a program that will go a long way in meeting these two objectives. Indeed, this

"Program to Support Private Initiative and Job Creation" has been designed with the twin objectives of promoting private initiative and encouraging a voluntary departure of civil servants to help reduce the size of the civil service. Under the scheme, civil servants who wish to leave the service and create their own business can do so and receive a lump sum proportional to their seniority. To assist them in setting up their businesses, funds such as the Fund for the Support of Project Studies, the Supplementary Guarantee Fund, and the Intervention and Equity Participation Fund have been established. The scheme is also available to students graduating from universities. The initial reaction to it has been encouraging.

Private sector involvement in economic activity is to be enhanced through the liberalization of pricing and marketing policies. To this end, and following the actions taken under previous stand-by arrangements and the first annual arrangement under the structural adjustment facility, the authorities reduced further, effective October 28, 1987, the number of goods and services subject to prior authorization--homologation--from seven to five and abolished the restrictions on the number of traders allowed to import rice and cement. Effective October 29, 1987, the quantitative restrictions were replaced by higher taxes on rice imports and by the introduction of a tax on cement imports. Furthermore, the authorities have established a system of indicative prices for groundnuts and cowpeas and decided to let market forces determine the prices for these products.

With regard to the strengthening of the revenue performance, the authorities adopted on September 17, 1987 the 1987/88 budget, which included various revenue-raising measures that are expected to yield additional revenue amounting to CFAF 7.0 billion. These measures range from the appointment of special officers to verify the c.i.f. values of imported goods to the broadening of the tax base to cover a larger number of taxpayers in the informal sector. In addition, the Government is endeavoring to reduce the scope of tax exemptions and is requesting technical assistance from the Fund to that effect.

It should be also noted that the Government adopted in September 1987 the charter establishing the new water company, Société Nationale des Eaux, as contemplated in the second-year program.

Most of the above-mentioned measures are structural benchmarks established in the context of the second annual arrangement under the structural adjustment facility, and have been taken ahead of schedule.

The authorities have shown determination in the implementation of the structural and financial measures required to tackle the structural impediments to sustained, noninflationary growth and to restore internal and external financial balances. They remain committed to implementing such measures as necessary, but are concerned about the impact on the growth prospects of the economy of tighter financial policies that would be required to offset shortfalls in uranium exports. As Scenario III in the staff paper indicates, the impact of such developments would be detrimental to the growth prospects. Therefore, the authorities hope that donors and creditors will stand ready, as they have done in the past, to support adequately and on a timely basis Niger's adjustment efforts.

Mr. Rousset made the following statement:

The fall in Niger's real GDP in 1987 illustrates once more the vulnerability of this economy to exogenous factors and points out the need for diversification in its productive and export base. The policy framework paper takes into account this essential objective, and we fully support it. We also support the policies and measures to be implemented under this second arrangement under the structural adjustment facility. The staff report gives a very detailed and convincing presentation of this program.

We particularly encourage the authorities to make every effort to complete the study on a comprehensive rural development strategy as expeditiously as possible. In previous meetings many of my colleagues expressed their disappointment at the low medium-term growth rate forecast for Niger. We believe that this study can be an important contribution to the design of strategies aimed at achieving a faster growth rate and more diversified agriculture. The measures scheduled for 1987/88 to stimulate productivity, and the allocation of 36 percent of the public investment program to the rural sector, also go in the right direction. The setting up of a viable agricultural credit system will be another essential component of this policy.

With regard to the industrial and trade sectors, the progress already made in the liberalization of price and trade regulations has substantially improved the climate for private sector activities. However, this liberalization has not yet given rise to a recovery in investment. This lack of new industrial projects is indeed a matter of concern. Accordingly, the study under way identifies the necessary policies to create a favorable environment that would increase private sector activity, and competition is particularly important.

Clearly, the full impact of these studies and policies will take time to materialize. In the meantime, we encourage the authorities to pursue their efforts on the fiscal side in order to meet the target for the overall deficit. The taxation of the "informal sector" and the strengthening of duty collection on imported goods will be particularly important. I would be interested to know whether the staff could give us some more precise information on this "informal sector": its scope, importance, activities, and to what extent it can be both taxed and stimulated.

The authorities have shown their very strong commitment to past and present Fund programs by respecting all the performance criteria and benchmarks. We are confident that these efforts will continue in the same manner in the future. Niger's adjustment efforts deserve the wide support of donors and creditors who should stand ready, as Mr. Mawakani suggests, to increase their assistance not only for project financing, but also in the form of budgetary and balance of payments financing. Should Niger request a stand-by arrangement in the future, my authorities would fully support their request.

Mr. Goos said that he could support the staff appraisal and the proposed decision. It was regrettable that, notwithstanding the satisfactory implementation of the adjustment program and the vigorous pursuit of numerous reform measures, the authorities had missed important targets. That experience, and the concomitant deterioration of the outlook since the middle of the year, demonstrated once again the extreme fragility of the economic and financial situation. Inasmuch as that fragility reflected in large measure Niger's severe natural constraints, it was all the more important for the authorities to concentrate their efforts on the resolution of the widespread policy-related structural constraints. Against such a background, the country could ill afford the kinds of delays that had been reported in the implementation of the reforms of the civil service and the agricultural pricing, marketing, and credit systems. He therefore welcomed the strengthening of the adjustment effort that was envisaged in the policy framework paper and during the second annual arrangement under the structural adjustment facility.

While he had no difficulties with the agreed structural reform measures, it appeared that the demand-management component of the program was more complex, Mr. Goos continued. Of particular concern was the protracted widening in the fiscal deficit and its impact on the external current account. One had to acknowledge that higher public investment outlays in support of nontraditional activities and a restructuring of expenditures to that end might be more important at present than a forced reduction in the fiscal deficit. Such outlays appeared acceptable in view of the concessional financing of the investments and the continued austerity envisaged with regard to current fiscal expenditure. However, more needed to be done to strengthen fiscal revenue. That need had been stressed in the staff report and reflected in the recent, welcome fiscal efforts of the authorities, but the development in the revenue ratio--expected to stagnate at 10 percent until the end of 1991--would fall short of requirements, in particular because of the uncertainties surrounding the staff's projections.

Accordingly, he recommended aiming at a more ambitious fiscal adjustment through the introduction of additional revenue measures, Mr. Goos concluded. In that context, he wished to endorse explicitly the authorities' request for technical assistance from the Fund. At the same time, however, if the projections for external financial assistance failed to materialize, the authorities would have to seek further fiscal savings, including a reduction in the investment program. The authorities should refrain from meeting any shortfall in financial assistance through recourse to commercial financing or the rather expensive short-term resources provided under regular Fund arrangements; on that point, he was not in full agreement with Mr. Rousset.

Mr. Fayyad made the following statement:

> Despite the authorities' effective implementation of the 1987 adjustment program, a number of exogenous factors have combined to affect adversely the outcome for the year. Thus, compared with the targeted growth rate of 2.7 percent, real GDP is estimated to decline by 4.9 percent. Moreover, program targets for the rate of inflation and for the current account deficit were not attained. Notwithstanding this unfavorable outcome, most of the benchmarks envisaged within the framework of the first annual arrangement under the structural adjustment facility have been observed. Additionally, all but one of the performance criteria under the current stand-by arrangement were observed through end-June 1987, and the staff indicates that the authorities expect to meet all the performance criteria through end-September 1987.
>
> In view of the economic performance and developments in 1987, the authorities have updated and extended their original policy framework paper covering the period 1988-90, with a view to reducing the economy's dependence on uranium exports, avoiding delays in the adoption of a comprehensive strategy for the agricultural sector, improving the revenue performance, and analyzing recurrent expenditure requirements in order to determine the most efficient use of public resources. Accordingly, the measures envisaged in the paper are intended, among other things, to reinforce incentive policies, continue the reorientation of public investment, implement a more responsive agricultural policy, and broaden public enterprise reform.
>
> In the 1987/88 program, in support of which the second annual arrangement under the structural adjustment facility is being requested, the authorities propose to continue the adjustment

effort that they have been pursuing for the past few years, as indicated by Mr. Mawakani. The principal economic policy objectives of the program are attaining a real GDP growth rate of 7.5 percent, limiting the inflation rate to 2.2 percent, and containing the current account deficit to 3.8 percent of GDP. To achieve these objectives, the authorities intend to implement a wide range of structural policies that are complemented with cautious financial policies. We share the staff's view that the authorities' success in this endeavor depends not only on the effective implementation of the envisaged measures, but also, as the downturn in economic activity and the reversal of the improvement in the external position in 1987 amply illustrate, on the evolution of favorable external developments. While the authorities have been making commendable progress in the implementation of important reforms, the medium-term outlook for the economy remains difficult, and the growth prospects are uncertain. It is therefore important that the authorities persevere in their adjustment efforts and that these efforts continue to be supported by concessional external financial assistance. Finally, we support the proposed decision.

Mr. Rouai made the following statement:

Recent developments in Niger's economy indicate that while the program remains on track and almost all performance criteria and benchmarks have been observed, the emergence of exogenous factors in 1987 threatened economic growth, which is now expected to decline by 4.9 percent, compared with a programmed increase of 2.7 percent. As the staff report indicates, the sluggish world uranium market has led to a reduction in both export volume and earnings from Niger's key export commodity, and the late arrival of rains has resulted in a 30 percent decline in output of the agricultural sector, which accounts for 26 percent of GDP. The authorities are therefore to be commended for firmly implementing their adjustment program despite these adverse developments. In this respect, the emphasis placed by the authorities on the revised policy framework paper, on the further diversification of the production and export base, and on the acceleration of the adoption of a comprehensive reform for the agricultural sector is appropriate, and denotes their intention to reinforce the adjustment process.

Since we had the opportunity of assessing Niger's economy in July (EBM/87/104, 7/17/87), and since I am in broad agreement with the content of the staff paper, I will limit my comments. First, I am pleased to note the wide range of technical assistance provided by the Fund and especially by the World Bank. Such assistance covers almost all policy areas: public enterprises, agricultural sector, public investment, civil service, public expenditures as well as pricing and marketing. Given the importance of this assistance and its impact on the program, the authorities and the World Bank should strengthen their efforts to complete their studies so as to identify and implement rapidly the required reforms.

Second, external support on concessional terms remains critical, given the country's limited debt-servicing capacity. The need for such assistance is also highlighted by the fact that almost 94 percent of the three-year public investment program is to be financed by external borrowing and grants. Beyond the attainment of a viable external payments position and the achievement of a sustainable rate of economic growth, the remaining task of the authorities is to concentrate on increasing domestic savings, which remain relatively low. Thus, further measures to improve private initiatives and to strengthen resource mobilization by the banking system are still required so as to alleviate the heavy dependence on external financing. In this respect, we welcome the adoption of the Program to Support Private Initiative and Job Creation, as described by Mr. Mawakani.

Finally, it is worth noting that most of the contemplated measures have already been taken ahead of schedule. This firm implementation, along with the authorities' commitment to introduce additional measures, could however prove to be insufficient to tackle the difficult uncertainties underlined by the medium-term scenarios and to alleviate their direct impact on growth. Given the low per capita income, particular attention should be devoted to assessing the social impact of the adjustment program. I can support the proposed decision.

Mr. Al-Assaf made the following statement:

The staff paper indicates that the growth performance of the economy in 1987 fell short of initial expectations. The two causes responsible for the estimated 4.9 percent decline of GDP this year are clearly beyond the control of the authorities. A severe drought has accounted for the 30 percent decline in the output of the agricultural sector, and the fall in uranium prices has resulted in a deterioration in the terms of trade, thus aggravating Niger's balance of payments difficulties. The pursuit of the adjustment effort, under these circumstances, has understandably been more difficult than expected. Therefore, the authorities should be commended for having implemented the 1987 program with determination. It is particularly encouraging that most of the benchmarks of the first annual arrangement under the structural adjustment facility have been observed.

Looking ahead to the second year of the structural arrangement, I can support the proposed decision. As to the more specific aspects of the program for this second year, I would like to emphasize the following points. The pursuit of the structural policies embodied in the second year of the program will need to be supported by a continued implementation of the authorities' cautious financial policies. The containment of current expenditures, in this context, appears appropriate. However, the wage bill is expected to grow in 1988 at a rate slightly in excess of the average rate for all current expenditures. I would appreciate clarification from the staff on the allocation of the expected increase in the wage bill, and to what extent it reflects a net addition to the number of government employees. It is noteworthy that 1988 will be the sixth consecutive year during which no cost of living adjustment will have been granted. It is not clear to me that this aspect of remuneration policies for the civil service is sustainable over the longer term. I hope that the expected study on the civil service prepared in consultation with the World Bank will provide some guidance in this respect.

Turning to structural policies under the program, I welcome the broadening of the reform of the public enterprise sector. In view of the limited financial resources of the economy, greater efficiency in public resource management seems to be a step in the right direction. The new emphasis on performance, evidenced in the planned formulation of performance contracts for a large number of public enterprises, constitutes an encouraging development.

Finally, I welcome the efforts to expand production in the agricultural sector, with the active support of the World Bank. I have noted, however, that the question of the establishment of a satisfactory credit system to replace the existing agricultural credit agency, which has stopped all operations not related to the recovery of outstanding credit, is still unresolved. I wonder whether any further information is available on this point and, in particular, whether the task force working on the issue has any deadline in mind as to the establishment of a new credit agency.

Mr. Enoch made the following statement:

The authorities have made further important adjustment efforts in the past year, despite an unfavorable climatic and external environment. Although economic performance over the past year was disappointing, and the economy clearly remains vulnerable, the authorities have made continued progress toward restoring external viability. I can fully endorse the proposed decisions. I welcome the authorities' decision not to request a further stand-by arrangement. I continue to believe that concessional support is the most appropriate form of Fund assistance for poor, heavily indebted countries; accordingly, I endorse the comments of Mr. Goos.

I agree with the staff on the importance of maintaining cautious demand-management policies. This will require continued expenditure restraint as well as further revenue enhancement efforts. I too note that, despite the recruitment freeze and continued wage restraint, the wage bill rose 9 percent last year, partly as a result of wage drift. It is thus encouraging to see that the authorities have set a firm target for the growth in the wage bill and that they are now reviewing the operation of the civil service.

I was interested to see that only about one third of the public investment program has been allocated to the rural sector. I found this information on sectoral breakdown of the public investment program particularly interesting and worth repeating more generally. I also wondered whether this figure was not on the low side, given the importance of building up diversification in the agricultural sector; staff comments on this point would be welcome.

It is also clear that continued efforts will be needed on the revenue front. Revenue growth fell somewhat below target last year and only a modest rise is forecast for this year. While this partly reflects the fall in output, it also emphasizes the need for continued further progress in this area.

The footnote on page 2 of the staff paper indicates that significant revisions have recently been made to the GDP figures. It would have been interesting to have seen some greater detail in the staff paper on these changes, including possibly some discussion of their implications for policy, including the fiscal stance.

I note that the authorities have continued to make encouraging progress in price liberalization. This effort is important if the growth and diversification of the economy is to be promoted. I am encouraged to see that the authorities intend to make further progress in this area, and I hope that they will consider bringing forward their target for abolishing price controls on nonstrategic goods.

Mr. Rieffel made the following statement:

We are pleased with the determination with which Niger continues to implement sound macroeconomic policies and undertake needed structural reforms. Despite setbacks in the form of bad weather and unfavorable uranium prices, the authorities are to be commended for intensifying their efforts and for meeting all the performance criteria for 1987 under their stand-by arrangement. While their record in meeting the structural benchmarks for their first annual arrangement under the structural adjustment facility is not quite as good, it is still impressive. We commend the staff for providing an especially clear assessment of progress to date. We would like to see in all such reports on structural adjustment facility arrangements the kind of summary found in Tables 1 and 3 in the staff paper. We were also impressed by the forthright treatment of Niger's protracted balance of payments problems and the medium-term scenarios.

The updated policy framework paper is a distinct improvement over the initial one, and we have relatively few comments. We welcome the priority being given to enlarging the role of the private sector. In this connection, we were pleased to learn from Mr. Mawakani about the Program to Support Private Initiative and Job Creation adopted in October, and about the important liberalization measures taken at the end of October. At the same time, while the policy framework paper indicates that price controls will be abolished for most goods and services by 1990, it mentions that they will remain for certain unspecified strategic goods and services. We believe it is important at this stage to identify specifically which goods and services will remain controlled, and we would appreciate some more information from the staff on this point. Furthermore, we would hope that controls on many of these strategic items would be eliminated under a program supported by the enhanced structural adjustment facility.

We would stress the importance of financial sector reform in facilitating more private sector activity. In the next policy framework paper, we hope to see a more concrete timetable for policy measures in this area.

I note the prominence given in the policy framework paper to population policy. Am I correct in assuming that efforts in this area would tend to raise health standards and thereby increase productivity in the agricultural sector?

Turning to the program for 1987/88, the objectives appear sound. We do agree, however, with the concerns expressed by Mr. Goos regarding fiscal policy, and share his view that Niger's decision not to seek Fund resources under a stand-by arrangement is a wise one.

We are pleased that the authorities took action at the beginning of the year to reduce the number of products subject to preset profit margins. We are puzzled, however, by the implication that no further steps in this direction will be taken during the course of the year. Would it not be feasible and appropriate to free another third of these products during the course of the year?

An impressive number of parastatal reform measures will be taken during the year, and yet we are not left with a clear impression of the pace of progress in this important sector. Perhaps the World Bank representative could provide some more information on this point. For example, by the end of the 1989/90 program year, will all the major reforms needed in this sector have been taken?

As for public expenditures, we would like to commend the authorities for their prudent approach to the size of the civil service and its compensation.

It is also worth noting that three of the five structural benchmarks for this year have already been achieved. While this is commendable evidence of the seriousness of the authorities, we wonder about the pace of progress during the remainder of the year. Benchmarks that can be met at an early date are welcome. We believe, however, that the length of the program period allows room for setting more ambitious benchmarks for the end of the program year.

The timetable of policy measures includes a substantial number of studies and reviews. We hope that these do not become excuses for delaying the action that is needed. In many cases, the direction of needed action is obvious before the study is completed, and early actions that anticipate the conclusions can make the adjustment process more manageable in later stages. For example, rather than waiting for the results of the review of tax exemptions and steps to improve the taxation of the informal and modern sectors, the authorities would be well advised to begin immediately to remove and reduce some exemptions and to take some modest first steps to tax the informal and modern sectors more effectively.

We have the impression that the staffs of the Fund and the Bank have been working especially closely in Niger, and the degree of collaboration is reflected in the quality of the updated policy framework paper and second annual program. There is also evidence in this case that bilateral donors are supporting reforms in a cooperative manner. We are pleased to support the proposed decision.

The staff representative from the African Department said that the Nigerien authorities divided GDP into two parts: that of the informal sector and that of the modern sector. The informal sector included commerce, transportation, handicrafts, and agriculture, and accounted for about 60 percent of GDP value added, whereas the modern sector encompassed mining, industry, public enterprises, and the Government, and accounted for 40 percent of GDP value added. The authorities had been attempting to stimulate private sector activity in the informal sector by means of price liberalization, a reduction in the scope of the public enterprise sector, the reduction in the budget deficit and concomitant provision of greater amounts of credit to the private sector, and, as Mr. Mawakani had indicated, the introduction of a specific program to support private sector initiative.

Considerable progress had been made in price liberalization, and at present only 39 goods remained subject to a flexible system of preset profit margins, the staff representative continued. The five goods still subject to price ceilings were petroleum, water, electricity, bread, and transportation. It was envisaged that toward the end of the three-year program period, all the goods subject to preset profit margins would have been liberalized, but it was possible that some of the five goods considered strategic would still be subject to price ceilings.

The diagnostic phase of the study on the rural development strategy had been completed in June 1987, and the authorities were working on additional studies that were expected to be completed by end-1988, the staff representative indicated. In the meantime, they were continuing to emphasize a number of policies designed to stimulate economic activity in the agricultural sector, and were allocating a high proportion of the public investment program to agricultural projects. Prices had been liberalized for groundnuts and cowpeas in the current year's program, and that liberalization, together with the reduction of subsidies for fertilizers, was expected to help reduce distortions in the agricultural sector.

The study on agricultural credit had been delayed because the authorities wished to put it on a proper footing and had been consulting with a number of major donors that were interested in assisting the authorities to establish such a system, the staff representative noted. Accordingly, a special task force, including a number of major donors, had been set up and had proposed terms of reference for a study that would lead to an agricultural credit system. Although the terms of reference were still being discussed by the donors and the authorities, both parties were aware of the need to move as expeditiously as possible.

In the context of two successive World Bank Structural Adjustment Loans, the authorities had made considerable progress in enhancing the autonomy and accountability of the public enterprise sector, expanding the process of rehabilitation of key public enterprises, rationalizing further the sector through the liquidation and privatization of a number of enterprises, and eliminating the cross-debts, the staff representative said. The completion of the financial restructuring of the sector was envisaged by 1989/90, in particular the elimination of all public cross-debts.

The budget deficit would increase in 1987/88, primarily because of a sharp rise in public sector investment under the three-year rolling public investment program that had been reviewed and considered appropriate by the World Bank, the staff representative continued. Since most of that program was financed externally, the Government would continue to reduce its net indebtedness to the banking system, thereby releasing resources to the private sector. Nonetheless, as a number of Directors had indicated, revenue in 1987/88 would suffer from two basic factors. First, the decline in economic activity resulting from the drought conditions experienced in the final quarter of 1987 would be reflected in the 1987/88 revenue. Second, there was a full-year effect of tax cuts that had been introduced in the previous year in an attempt to stimulate economic activity. The authorities had taken two major measures in the current program aiming at offsetting those adverse factors: the taxation of the informal sector, which was expected to yield about CFAF 3 billion, and improvements in the verification of customs valuation, which was expected to yield CFAF 2 billion. Those measures were estimated to mobilize additional revenue amounting to about 1 percent of GDP.

The authorities were limiting the growth in the wage bill to 4.9 percent by restricting hiring and making no cost of living adjustments, the staff representative went on. The authorities were concerned that no cost of living adjustment had been granted for five years in a row, but they were also aware of the need to continue with their austerity measures. The ongoing study on the civil service would provide a basis for reviewing the wage structure in Niger. The second phase of the study was being undertaken by a new group of consultants, and it was expected that the study would be completed late in 1988, after which the reforms of both the wage structure and the recruitment policies would be introduced.

When the authorities had reviewed the major measures that needed to be taken during the current program, including a number of benchmarks, they had decided that those actions should be included as early as possible in the implementation of the program in order to have the maximum impact during the year, the staff representative recalled. The fact that the authorities had already taken those actions was an indication of their determination in pursuing their adjustment policies. However, there were also benchmarks related to financial aspects and to the public enterprise sector that would have to be monitored during the current year.

As the staff report had indicated, the GDP numbers had been revised as part of an ongoing process of improving the GDP database for the country, the staff representative from the African Department explained. The Ministry of Planning had been working extensively to collect information to estimate as accurately as possible the levels of nominal and real GDP in Niger. Those revisions did not involve any fundamental changes in the economy as such, but rather, were the results of an improved database. Accordingly, those changes did not indicate any reassessment of policies.

The staff representative from the World Bank said that within the context of the recent public enterprise adjustment program that had been prepared in consultation with the World Bank, the authorities were continuing and intensifying their reforms of the public enterprise sector that had been initiated a few years earlier. Efforts were being intensified in four areas. First, institutional and legal reforms had been adopted at the governmental level and were currently being effected at the public enterprise level. Those measures aimed at providing more autonomy and more accountability to individual public enterprises by the adoption of new charters for the public enterprises and by the use of performance contracts to clarify the relationship between the Government and the public enterprises. A performance-based remuneration system for public enterprises was also being introduced.

A second area in which reforms were being intensified was the rehabilitation of key enterprises, the staff representative added. Those reforms were being undertaken with the support not only of the World Bank but also a number of bilateral donors. Rehabilitation programs were under way for individual enterprises such as the development bank, the public utility, and the telecommunications facilities.

The third area of emphasis was the rationalization of the sector through privatization and, if necessary, liquidation of certain enterprises, the staff representative continued. A number of privatizations had already taken place, including the artisan production in the leather industry, petroleum distribution, millet processing, the transit sector, and the paper industry. Moreover, privatization had taken place partially in a number of other sectors, so that the Government had sold a portion of its stock and private sector involvement had increased; enterprises in that category included tourism, textiles, insurance, transportation, and groundnut marketing. The Government aimed at shifting as many public enterprises as possible to the private sector, but a particularly difficult constraint was the identification of potential buyers that had access to adequate credit. The World Bank was providing technical assistance to the Government in that effort through a parallel project that had been approved in July 1987.

The fourth area of intensified efforts was the completion of the financial restructuring program, the staff representative went on. Under that program, outstanding debt arrears were being settled, but a number of measures were also being taken to prevent a recurrence of the cross-debts, in part through government measures to make adequate budgetary provisions for subsidies to public enterprises with a social vocation and to those that were providing goods and services, such as the public utilities. In addition, measures that were being taken by the individual public enterprises included strengthening their financial management and their auditing procedures. The World Bank was providing technical assistance for the financial restructuring program.

Although it was true that only one third of the public investment program was being devoted to the rural sector, that share of the program had increased considerably compared with rural investment of a few years earlier, the staff representative from the World Bank indicated. In the past, major emphasis had been placed on large infrastructural investments in the roads sector, but the Government's first priority was currently rural development. However, the pace at which that development could be accomplished was quite constrained. There was an absorptive capacity constraint within the Government itself; agricultural services were still quite weak, and the capacity of the Government to identify and implement projects in the agricultural sector was still limited. Moreover, the number of good investment opportunities that had been identified was also limited. The limited investment opportunities related more generally to the development constraints of Niger itself, including the poor soils, the harsh climate, and the absence of technological packages for projects such as rain-fed agriculture. In the past, the Government had attempted projects in large-scale irrigation, but those projects had not been successful, and the authorities were currently placing more emphasis on small-scale rural operations. Accordingly, the amount of investment resources that could be put into such operations was quite limited. The most important constraint was the lack of good investment opportunities, and thus the rural development strategy study had been undertaken, to identify new policies for the sector, but also to identify investment opportunities.

Mr. Mawakani recalled that the staff had stated rightly that the achievement of the objectives of Niger's 1987/88 economic and financial program depended not only on the effective implementation of the policies envisaged, but also on the return of normal weather conditions and on the sustained demand for uranium exports, which represented the main source of export revenue for the country. In the past few years the authorities of Niger had shown their ability to manage the economy, and they were committed to pursue those efforts with the same determination in order to attain the necessary adjustment. The authorities welcomed the international support for their adjustment efforts, and hoped that such support would continue.

The Executive Board then took the following decision:

1. The Government of Niger has requested the second annual arrangement under the structural adjustment facility.

2. The Fund has appraised the progress of Niger in implementing the policies and reaching the objectives of the program supported by the first annual arrangement, and notes the updated policy framework paper (EBD/87/274).

3. The Fund approves the arrangement set forth in EBS/87/226, Supplement 1.

Decision No. 8735-(87/159), adopted
November 23, 1987

## DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/87/158 (11/18/87) and EBM/87/159 (11/23/87).

### 4. MOROCCO - 1987 ARTICLE IV CONSULTATION - POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, as amended, the Executive Board agrees to extend the period for completing the 1987 Article IV consultation with Morocco to not later than December 7, 1987. (EBD/87/297, 11/17/87)

Decision No. 8736-(87/159), adopted
November 18, 1987

### 5. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 87/70 through 87/72 are approved. (EBD/87/293, 11/12/87)

Adopted November 18, 1987

### 6. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director and by an Advisor to Executive Director as set forth in EBAP/87/250 (11/17/87) and by an Assistant to Executive Director as set forth in EBAP/87/249 (11/17/87) is approved.

APPROVED: July 13, 1988

LEO VAN HOUTVEN
Secretary