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Full Float of Taka: Is Bangladesh Ready for It?

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The Centre for Policy Dialogue (CPD)*, established in 1993, is an innovative initiative to promote an ongoing process of dialogue between the principal partners in the decision-making and implementing process. The dialogues are designed to address important policy issues and to seek constructive solutions to these problems. The Centre has already organised a series of such major dialogues at local, regional and national levels. These dialogues have brought together ministers, opposition frontbenchers, MPs, business leaders, NGOs, donors, professionals and other functional groups in civil society within a non-confrontational environment to promote focused discussions. The expectation of the CPD is to create a national policy consciousness where members of civil society will be made aware of critical policy issues affecting their lives and will come together in support of particular policy agendas which they feel are conducive to the well being of the country. The CPD has also organised a number of South Asian bilateral and regional dialogues as well as some international dialogues.*

In support of the dialogue process the Centre is engaged in research programmes which are both serviced by and are intended to serve as inputs for particular dialogues organised by the Centre throughout the year. Some of the major research programmes of CPD include ***The Independent Review of Bangladesh's Development (IRBD), Governance and Development, Population and Sustainable Development, Trade Policy Analysis and Multilateral Trading System, Corporate Responsibility, Governance, Regional Cooperation for Infrastructure Development and Leadership Programme for the Youth****. The CPD also carries out periodic public perception surveys on policy issues and developmental concerns.*

As part of CPD's publication activities, a CPD Dialogue Report series is brought out in order to widely disseminate the summary of the discussions organised by the Centre. The present report contains the highlights of a dialogue organised by CPD held at **CIRDAP Auditorium, Dhaka** *on* **January 02, 2003** *on the theme of* ***Full Float of Taka: Is Bangladesh Ready for It?****.*

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Dialogue Report on

Full Float of Taka: Is Bangladesh Ready for It?

The Dialogue

The Centre for Policy Dialogue (CPD) organized a dialogue titled, *"Full Float of Taka: Is Bangladesh Ready For It?"* on January 2, 2003 at the CIRDAP Auditorium, Dhaka. The dialogue marked the presence of a good number of participants from varied professional groups including academia, NGOs, donor agencies, politics, bureaucracy and members of the civil society [see Annexure]. Professor Rehman Sobhan, Chairman of CPD, presided over the dialogue, while Mr M Saifur Rahman, MP, Hon'ble Minister for Finance and Planning and Dr Fakhruddin Ahmed, Governor of the Bangladesh Bank were present as Chief Guest and Special Guest respectively.

Dr Mirza Azizul Islam, CPD Fellow and former Director, UNESCAP Bangkok was the keynote speaker. The keynote presentation was titled *"Exchange Rate Policy of Bangladesh – Not Floating Does Not Mean Sinking"*.

The Keynote Address

The event began with the presentation of the keynote address by Dr Mirza Azizul Islam. He pointed out that according to media reports Bangladesh is under intense pressure by the International Monetary Fund (IMF) to change its prevailing exchange rate regime to one in which the nominal exchange rate will be determined primarily, if not solely, by the market forces of demand for and supply of foreign currency. There are also indications that the Government is willing to comply once the foreign exchange reserves situation improves. In light of this, he sought to examine if there exists any strong justification to carry out the change that the IMF has been apparently insisting upon.

Dr Islam began by explaining the concept and calculation of the real effective exchange rate (REER) and pointing out the REER should approximate the equilibrium exchange rate. He pointed out that Bangladesh pursues an active exchange rate policy at present and this activism is reflected in the frequency of nominal exchange rate changes announced by the Central Bank.

He then moved on to the criteria used to judge whether a country is suitably developed to carry out the implementation of a pegged exchange rate regime. He pointed out six such characteristics: (i) the low degree of involvement with international capital markets, (ii) the high share of trade with the counrty/countries to which the currency is pegged, (iii) the similarity of shocks the country faces to those felt by the country/countries to which the exchange rate is pegged, (iv) the attractiveness of exchange rate based stabilization to a country, (v) the willingness of a country to give up its monetary policy independence and largely follow the monetary policy of the partner country; and (vi) the availability of high international reserves. Dr Islam pointed out that Bangladesh met most of these criteria and that seemed to suggest that some sort of a pegged exchange rate regime may be the preferred option for Bangladesh.

Dr Islam then went on to highlight some of the criteria that a country must meet to be suitable for the floating exchange rate system proposed by the IMF. These include: (i) a credible alternative nominal anchor indicator (such as inflation targeting) for the conduct of monetary as well as fiscal policies (as the exchange rate fails to provide such an anchor), (ii) an independent central bank that can constrain the Government from financing deficits through the commercial banks and other ways that may have inflationary consequences, (iii) a group of highly competent professionals who can predetermine an appropriate target rate of inflation; (iv) a deep and competitive foreign exchange market, (v) a well regulated, well-supervised and financially sound banking system, and (vi) high international reserves. Dr Islam pointed out that the ex-ante requirements for the adoption of a floating exchange rate are not satisfied in Bangladesh.

Dr Islam then turned his attention to other countries in the region and their relative performance with their respective exchange rate regimes. He laid out evidence that showed that these countries experienced greater volatility in exchange rates under a floating rate regime. The attendant uncertainty caused by the volatility is likely to adversely affect the overall trade and investment climate which is already afflicted by many unfavourable elements in Bangladesh. He also pointed out that the experiences of other countries also show that a floating regime does not eliminate the need for intervention in foreign exchange markets. Given the size of the market in Bangladesh, the need for intervention may be even greater as the authorities cannot remain silent spectators when the exchange rate gyrates wildly.

Concluding his presentation, Dr Islam stated that the present exchange rate regime in Bangladesh has been serving the country quite well. No major misalignment with the equilibrium exchange rate has occurred and the real effective exchange rate has not been allowed to appreciate. There has been satisfactory performance in terms of certain key macroeconomic indicators such as export growth, current account deficit, inflation and remittances from non-resident Bangladeshis. Given this, he concluded Bangladesh should not move to a floating exchange rate system.

The Discussion

After the conclusion of Dr Islam’s presentation, Professor Rehman Sobhan initiated the discussion. He thanked Dr Islam for his succinct presentation, and then opened the floor for discussion by raising issues related to Bangladesh’s current economic and political situation.

Preconditions for Floating Rates and Bangladesh’s Current Situation

Mr M. Syeduzzaman, former Minister for Finance, was the first person to express his views on the topic at hand. He began by saying that the present system definitely had some positives that were noteworthy and in the present world there was no unique exchange rate system that a country should follow. As countries developed and became more mature, it has been observed and expected that they do slowly begin to move toward a more floating form of an exchange rate. He argued that it is incorrect to assume or argue that the fixed exchange rate system present in Bangladesh currently should be in place forever. It should be the aim of Bangladesh and its Government to move slowly toward a freer form of exchange rate. However, he felt that there were certain socio-economic conditions in Bangladesh at present that needed to be remedied. He highlighted the serious budget imbalances and the lack of adequate foreign exchange reserves in the country. Without addressing these two areas, he felt that Bangladesh should not move to a floating exchange rate regime. Mr Syeduzzaman also felt that in the early 1990s Bangladesh missed an opportunity to move from a fixed exchange rate system to a floating one. At that time, the current account deficit had improved and Bangladesh had a very strong reserve of foreign exchange (approx. $3.4 Bn). However, since then the fiscal balance has been damaged and foreign exchange reserves have fallen, and the country is still recovering from that. He felt that once these problems have been remedied, Bangladesh should make a conscious effort to move toward a more floating exchange rate regime. He pointed out that in today's world, all prices were fluid and it made no sense for the exchange rate, which was another price, to be sticky.

Mr Syeduzzaman concluded by stating that Bangladesh's true competitive nature is not correctly reflected in its exchange rate. For example, Sri Lanka has an exchange rate of 93 per US dollar, while Bangladesh's is still in the 60s. This would seem to imply that Bangladesh is more efficient than Sri Lanka, when in reality that is not the case. He also pointed out that Bangladesh's currency was overvalued vis-à-vis the other SAARC countries and in many ways, this can explain the trade imbalance Bangladesh has with India.

Mr Saifur Rahman, MP, Minister of Finance and Planning, in his introductory remarks, agreed with the conclusions of Dr Islam's keynote presentation and said that the points made in the presentation accurately reflect Bangladesh's economic conditions. Bangladesh does not have either the banking infrastructure or the foreign exchange reserves to sustain a floating exchange rate. He was quick to point out that he was not close-minded about the topic and believed Bangladesh may eventually move to a float, but only when the underlying conditions and situation was right. Right now, however, he did not see any reason to make a switch. “I do not have any rigid stance but the current exchange rate policy is serving us better at least for the time being.” Referring to the weaknesses of the country’s financial markets, the Minister said that “The depth and strength of our money markets do not suggest that we should opt for a policy which we cannot handle and would create problems for us.” The Finance Minister mentioned that the international agencies counselled Bangladesh to opt for free float of the exchange rate but that there were many factors that have to be looked at before opting for free exchange rate regimes. Even the social considerations needed to be examined in greater detail and must improve before he would consider the possibility of changing exchange rate regimes.

Former secretary, Dr Mashiur Rahman disagreed with the keynote speaker and said that the question that Bangladesh needs to ask is not whether the current system is adequate but whether we can do better under a new system. He argued that the empirical evidence was not conclusive that a floating rate was bad. In the case for India, who opened up its economy in the 1990s under a weak government with a socialist economic legacy, still followed a policy of economic and particularly exchange rate reform. In the last year, the Rupee has only depreciated by 1%. He argued that India is an example of a carefully managed float that was successful and that Bangladesh should take steps to do the same. He agreed that the period following a float would be very volatile, but he also argued that such volatility is a function of that fact that the taka is inefficiently priced at present and would be a natural correction on its part. He agreed that Bangladesh did have institutional weaknesses, but that these barriers were not insurmountable. Institutions do not develop in greenhouses, and waiting till we have the right institutions in place and then opting for a change is an unrealistic goal. Rather the institutions would develop as the float occurred as they would be forced to develop. In conclusion he argued that the switch to a new system would hurt traders and people who had high sunk costs in their investment projects. It is the responsibility of the Bangladesh government to ensure that such people are adequately taken care of.

Dr Zaidi Sattar of the World Bank, pointed out that the issue at hand was a very complex one. If economics is a science, he argued, and all prices are flexible, then the exchange rate is but another price, and there is no reason it should be fixed when everything else is market driven. He also emphasized the nuances present – the exchange rate is not a pegged system nor is it a fully floatable one. None of the South and South East Asian countries has a fully floating currency. After the adoption of the floating regime, all the countries had a fair amount of volatility. He pointed out that the measures of volatility presented in the keynote paper are perhaps a little simplistic. A more important question is whether all the countries who accepted the floating system are regretting whether they moved to a floating system or not.

Trade Deficit with India

The gaping trade deficit with India was a point brought up by many of the speakers and Rehman Sobhan then turned the discussion to focus on Bangladesh's trade deficit with India. He pointed out that most of it is not financed through the Bangladesh Bank.

Former BB Governor, Dr Farashuddin Ahmed said that the volatility and risk associated with the full float of the exchange rate may have a negative impact on the inward remittances. He also mentioned that the Sri Lankan currency witnessed around 35-40 percent depreciation in a short period when it opted for a market-based exchange rate. He suggested some changes in the present exchange rate regime and inclusion of the currencies of trade competitors in the current basket. This has been a major reason for the relative appreciation of the Bangladeshi taka relative to the India rupee (as India is not in that basket). He stated that to address the deficit with India, this is a point that needs to be considered.

Dr Abu Ahmed, Professor of Dhaka University, pointed out that the floating exchange rate has been abandoned by some countries around the world. Their decisions for abandonment need to be researched more. He also pointed out that upto 1995 India's currency was totally fixed. He argued that devaluation is difficult without a trade bloc and that simply depreciating the Bangladeshi currency would not solve our trade problems with India.

Salman F. Rahman, Chairman of BEXIMCO, noted that a floating rate would be harmful to Bangladeshi business at this point of time. Bangladesh needs to improve itself internally before it considers external things. He also pointed out that Bangladesh, being an import based country cannot deal with a massive depreciation of the taka that would happen in a floating rate regime. He noted that Bangladesh should be aware of two things: *one*, it receives direct subsidies and *two*, in RMG industry, it has preferential access to the US markets till 2004, and hence should try and make itself more competitive after the MFA phase out. Hence internal competitiveness is essential for competing with India.

Intervention Capacity of the Bangladesh Bank

Participants raised numerous interesting queries. Questions were raised about the reserves and the fact that these reserves had gone up recently. What had been the source of the increase? Had these increases been driven by an increase in remittances or an increase in the assets? Would the bank be able to cope with speculative attacks?

Professor M Shamsul Huq, Vice Chancellor of City University, pointed out that there were 89 devaluations of the taka to date. He, however, argued that high reserves are not necessarily a great idea. He also said that more research needs to be done, preferably in a scenario analysis, on this subject and the consequences and ramifications of the adoption of the floating exchange rate.

Former Secretary, Dr Masihur Rahman suggested that Bangladesh should try to secure commitments from the donor countries that if Bangladesh should pursue a float, the donor countries will actually stand by Bangladesh and help it out in the event of a crisis. He argued that the benefits of the new regime cannot be adequately based on the exiting data presented in the keynote address.

Mr Syeduzzaman pointed out that we need to have adequate reserves to meet the current account deficit. He expressed his reservation regarding any conclusion on the issue and said that we should build up a technical base of foreign exchange and act accordingly.

Dr Fakhruddin Ahmed, Governor of the Bangladesh Bank, stated that the issue that was being discussed is a very complex one. He began by providing some key data on other South Asian countries - their foreign exchange reserves at the time of float. Pakistan and Sri Lanka had over $1bn and India had over $2.0bn. He argued that the volatility that follows a float is to be expected and all of the three countries had experienced some volatility, but now there currencies had stabilized. He pointed out that the adoption of a market based rate does not mean giving up intervention, and that interventions are not just limited to the foreign exchange market. He argued for the need for alternative studies, to show what would happen if the exchange rate was floated and whether it would lead to a better allocation of resources. Though Bangladesh has a pegged exchange rate, the market is operating in this country as the transactions in the inter-bank market is over $200MM. He pointed out that a major part of our import requirements are being met by this market. Regarding the issue of speculative attacks on the Bangladeshi currency, he pointed out that the Bangladeshi capital markets were closed and this would prove to be a major hindrance on any speculative attacks. He also mentioned that they were aware of the issue of capacity and reserves.

Concluding Remarks: *Dr Mirja Azizul Islam, Mr M Saifur Rahman, MP*

In his concluding remarks, Dr Islam thanked the audience for supporting his views and appreciated the constructive comments that had been facilitated in the dialogue. He specially liked the ideas of the private sector. He said that he disagreed with the notion of going to a float and then hoping for the institutions to develop.

The Finance Minister, in his concluding remarks stated that the economic realities prevent Bangladesh from moving to a floating system at this point in time. He pointed out that investment in this country would be severely hampered if we were to float the Taka – and investors would be reluctant to put their money in Bangladesh where the currency is floating around so much. He also pointed out the negative impacts on remittances, which would be severely hurt as a result of such a policy. He mentioned that Bangladesh was an import based economy and a depreciation of the Taka would make the costs of imports shoot up, and as a consequence cost of our exports would also go up, making Bangladesh uncompetitive in the global market. He pointed out the example of Argentina, and explained how the country that suffered after it had adopted floating exchange rate system. All the institutions in Bangladesh are too weak to deal with such a crisis. In addition, India never really devalued their currency, while Bangladesh has been continuously devaluing. He concluded by saying that he was open to the idea of a floating rate regime, but not at that particular moment in time.

Annexure

List of Participants
(in alphabetical order)

Professor Abu Ahmed	Department of Economics, University of Dhaka
Dr Fakhruddin Ahmed	Governor, Bangladesh Bank
Mr Shamim Ahmed	Director, Bangladesh Chamber of Industries
Mr Khondaker Mezbahuddin Ahmed	DCCI
Mr S M Al-Husainy	Former Chairman, PSC and Chairman, Swanirvar Bangladesh
Maj Gen A M S A Amin	Former Ambassador
Mr Md Manjurul Anwar	Senior Assistant Chief, Ministry of Finance
Mr A K Azad	President, Bangladesh Chamber of Industries
Mr Nurul Azim	UN Human Rights Media
H E Ms Lorraine M Barker	High Commissioner, Australian High Commission
Mr Cleaveland Charles	Chief Commercial Economic Officer, American Embassy
Dr Toufic Ahmad Choudhury	Professor and Director, Bangladesh Institute of Bank Management (BIBM)
Mr M Enamul Haq Choudhury	Managing Director, BRAC Bank
Dr Tawfiq-e-Elahi Chowdhury, BB	Former Secretary, Government of Bangladesh
Mr S A Chowdhury	Managing Director, Jamuna Bank Ltd
Mr Mainul Islam Chowdhury	Lecturer, BIBM
Dr Mohammed Farashuddin	Former Governor, Bangladesh Bank
Dr Williem Vander Geest	European Institute For Asian Studies and TRACE-BIDS
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Mr M. Ghaziul Haque	Chairman, Eastern Bank Ltd
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Mr M Ismail Hossain	Professor, Jahangirnagar University
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Professor Anwar Hossain	Director, Institute of Business Administration
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Mr Imtiyaz Hussain	Chairman, Imtiyaz Hussain & Co.
Mr M Shahidul Islam	Executive Vice President, Prime Bank Ltd
Professor Md Mainul Islam	Department of Management, Dhaka University
Dr Mirza Azizul Islam	Former Director, UN-ESCAP
Mr AFM Saiful Islam	Vice President, Southeast Bank
Mr Nurul Islam	President, Trade Union Kendro
Mr J K Kanjilal	Chief Executive Officer, State Bank of India

Dr M. Fouzul Kabir Khan	Executive Director and CEO Infrastructure Development Co. Ltd (IDCOL)
Mr Saiful Amin Khan	Director General (Far East), Ministry of Foreign Affairs
Mr M Hafizuddin Khan	Former Advisor, Caretaker Government of Bangladesh
Dr Omar Faruque Khan	Senior Development Advisor, CIDA
Mr M. F. Khan	Deputy Secretary, DCCI
Mr Mohammed Lakiotullah	Managing Director, EXIM Bank Ltd
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Mr M Moniruzzaman	Chief Executive, TCL
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Ms. Mary C. Ott	Deputy Mission Director, USAID
Mr Fazle Rabbi	Senior Information Officer, Ministry of Finance
Mr M Saifur Rahman, MP	Minister for Finance and Planning
Brig. General M Mofizur Rahman, psc, (Retd)	Executive Chairman, BEPZA
Dr Mir Obaidur Rahman	MDS, BPATC, Savar
Dr A K M Masihur Rahman	Former Secretary, Government of Bangladesh
Mr Salman F Rahman	Vice Chairman, BEXIMCO
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Mr M Zillur Rahman	Assistant Director, Bangladesh Bank
Mr Mohammad Ali Rumee	Deputy Governor, Bangladesh Bank
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Mr M K Mahmud Sattar	Managing Director And CEO, Eastern Bank Ltd
Dr Zaidi Sattar	Economist, The World Bank
Mr A K M Shamsuddoha	Managing Director, Dohatech New Media
Mr Ziaul Hassan Siddiqui	Executive Director, Bangladesh Bank
Mr M Syeduzzaman	Member, Board of Trustees, CPD
Professor Rahim B Talukder	IBA, Dhaka University
Dr Chowdhury A Zaman	Research Fellow, BIDS

List of Journalist Participants
(in alphabetical order)

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