Reforming the Financial Sector

by Ahmed Kamal Khan Chowdhury

Time has come for the banks to set aside funds against the possibility that a substantial portion of the overdue loan may ultimately remain uncollected.

The reform programme is termed as "Financial Sector Reform Programme" (FSRP)which was introduced during the financial year 1989-90 and still being followed by the Democratic Government. It is understood that the Reform Programme was undertaken at the suggestion of World Bank and IMF to facilitate their continuous cooperation in our development efforts.

EVEN though Bangladesh is a labour surplus economy, the output remained limited by a shortage of capital. Mobilisation of domestic resources may allow the necessary capital formation that generate additional further stream of income. Mobilisation of domestic resources along with mobilisation of external resources require policy that will facilitate the process of capital accumulation. Process of capital formation involve these essential steps : An increase in the volume of saving, so that resources can be released for investment purpose; Channeling of saving through a finance and credit mechanism so that investable funds can be collected from a wide range of different sources and claimed by investors; The act of investment itself, by which the resources are used for increasing the capital stock.

Bangladesh too have undertaken a reform programme in the financial sector with the objective to ensure a more effective role of the Banking System in the country's development efforts and mobilisation of resources. The reform programme is termed as "Financial Sector Reform Programme" (FSRP) which was introduced during the financial year 1989-90 and still being followed by the Democratic Government. It is understood that the Reform Programme was undertaken at the suggestions of World Bank and IMF to facilitate their continuous cooperation in our development efforts. The objectives are to be achieved through the following policies : Introduction of flexible interest rate policy and providing incentives and subsidy for lending to priority sectors; Monetary management through flexible and indirect instruments. Restructuring of capital and establishment of appropriate accounting principles for banks and financial institutions; Establishment of efficient loan recovery procedure; Improvement in capital market.

Flexible Interest Rate

The FSRP sought to improve the allocative efficiency of bank's resources by introducing flexible interest rate policy and thereby gradually removing the distortions in the existing interest rate. Accordingly Bangladesh Bank has instituted a new interest rate policy for all scheduled banks. The overall objectives of the interest rate policies are :

To introduce flexibility into lending and deposit rates, permitting individual banks to establish their own rates within limits set by the monetary authorities;

To replace the existing refinance facility with a single Rediscount Window. Bank rate will be adjusted by Bangladesh Bank from time to time to control the volume of rediscounting in order to implement the Central Bank's monetary policy;

To make explicit the subsidies for lending to priority sectors by funding these by the Government.

With the initiation of this set of reform the monetary authorities intended to encourage the commercial banks to take full responsibility for their lending and for reaching their profitability targets. For directed lending to priority sectors the subsidy paid by the Goyernment is meant to cover the differences between shadow interest rate and the allowed interest rate.

The new interest rate policy has been able to bring down the existing interest on long term deposit from the interest rate range of 12% — 14.25% to 11% — 12.75%. Commercial banks have successfully taken advantage of the flexibility of the rate of interest and reduced their cost of fund by lowering the interest on deposit rates. But the commercial banks lending rates continued to remain on higher side and fixed at the maximum point of ceiling allowed by the monetary authorities. However, Government allowed interest subsidy for financing in the priority sector below shadow price. The reason for fixing the lending rates at a higher level inspite of reduction in deposit rate is due to the increase in Loan Loss Reserve (LLR) requirement as per the FSRP. The above Loan Loss Reserve requirement has significantly raised the shadow interest rate which the monetary authorities ignored or could not perceive at the time of formulation of FSRP. Therefore the banks are reluctant to invest in new capital financing and private investments have not gathered momentum. In addition FSRP has introduced strict security criteria which have reduced the investment propensity of the potential private investors.

Rediscount facilities and discount rate also could not play an effective role in inducing investment. Commercial banks are now faced with excess liquidity due to lack in investment activities for reasons already discussed. Excess liquidity have forced the commercial banks to do away with costly deposits and borrowing under rediscount facilities. The recent reduction in discount rate and liquidity requirement have not shown any real effect till writing of this article. Monetary authorities also cannot rely on subsidy very much as the Reform Programme is designed to establish market rate of interest. Alternative policy seems to be further reduction in deposit rate and lending rate.

Monetary Management Flexible and Indirect Instrument

In order to introduce more flexibility in monetary management and facilitate effective open market operation, monetary authorities introduced a bill titled "91 days Bangladesh Bank Bill". Since the availability of treasury bill depends on fiscal policy of the Government, the introduction of Bangladesh Bank bill with flexible interest rate is intended to provide of financial instruments to banks, financial institution and other individuals firms etc. The bill is issued at a discount and the rate of discount is determined through auction. The bill is transferable and repaid at maturity. The first auction of the bill took place in December 1990 so it is very early to comment about the working of this instrument. But till writing of this article the bill did not attract the commercial banks. The bill is regarded as less liquid and rate of discount is less attractive interms of other investment opportunity available in the financial markets like call loan, deposit with other banks and debentures financing (where debentures is an approved securities).

Restructuring Capital and Appropriate Accounting Principles

One of the objective of FSRP was putting the banking system on a sound financial footing and strengthing Bangladesh Bank regulation and supervision of bank. For the first time a clear procedure for classification of loans and advances has been given and the step is particularly appreciable considering the present overdue loan situation in Bangladesh.

For the purpose of loan classification the eligible securities are: Goods with ready market that are physically held in the control of the bank in its godown; Gold/gold ornaments physically held by the bank; Fixed and other deposit (except Bearer Certificate of Deposit) on where lien is marked; Government bonds or certificates held by the bank; Guarantee/counter guarantees given directly and formally by either the Government of Bangladesh or the Bangladesh Bank. A guarantee by any other is not on eligible security.

Efficient Loan Recovery

The objective of FSRP is also to improve the loan recovery position of the banks through establishment of efficient loan recovery procedure and enactment of new legislation. Nothing significant has been achieved in this sphere of reform programme. With the establishment of Financial Loan Courts Act and publication of defaulters list a momentum was created for the recovery of loans but both the monetary authorities and the scheduled banks failed to take any benefit out of this situation due to lengthy procedure of legislation. In order to accelerate the pace of recovery, monetary authorities recently issued guidance to all scheduled banks (except foreign banks) to partly waive the interest of the overdue loans if the defaulting borrowers are willing to pay the balance outstanding loan within stipulated time period. At first this may seem to be welcoming but quickly the scheduled banks would realise the cost of the interest waiver and avoid the same. Recovery position cannot be improved without changing the existing laws. Law should be so enacted so that the banks can quickly fall on the securities if the borrower failed to repay.

Apart from the deficiencies already discussed, it is again too simple to depend on the financial reform alone for domestic resources mobilisation.

A national awakening is also required and the society should be prepared to work more and accept sacrifices in the short run in order to have real growth in the long run.

Cola Wars Go Global

Led by industry giant Coca-cola, the marketing of soft drinks abroad has reached record proportions as companies vie for the top spot in an increasingly global market.

"Already, 80 per cent of our operating income comes from outside the United States, and that proportion is absolutely destined to go higher," said Roberto Goizueta, Coke's chief executive, in a newspaper recently, "We are increasingly global because 95 per cent of the world's consumers are outside this country," he added. "It's that simple."

Goizueta predicts that the year 2000, the consumption of Coke worldwide will double to a billion servings per day, led by European consumers.

Europeans now consume the most Coke products, on an average of three and one-half cans per week, according to figures quoted by the US-based Fortune magazine. Germans consume an average two cans of Coke per week while the French consume one-half can per week.

But soft-drink executives are optimistic that the continued internationalisation of the industry combined with an aggressive marketing strategy will create more and more consumers worldwide.

While the United States leads the world in soft-drink consumption, last year it accounted for only one-third of case sales and about 20 per cent of operating profits, according to company reports.

Unlike the domestic market, Coke enjoys an almost unchallenged position abroad. In foreign markets, Coke outsells Pepsi, its closest rival in the United States, by a four-to-one margin. Coke already has a stronghold in the Asian and Latin American markets and has steadily increased its shares in the European Community.

Germany in particular has proved to be a gold mine for the company. Goizueta expects one billion dollars in retail sales in East Germany alone this year, and the company has increased investment throughout Eastern Europe.

Cola Wars Go Global

Industry analysts point out that such a high degree of globalisation is risky due to international currency fluctuations. With a sharp rise in the dollar, Coke's foreign earnings would not be worth much in the United States.

But Coke has gone ahead with its relentless internationalisation, using all manner of marketing and management methods. To penetrate difficult markets like Asia and Latin America, it has brought foreigners into top-level management in the Altanta head office.

It has gone into joint ventures with bottlers in countries like Britain and Taiwan. In others, like France, it has used 100 per cent-owned bottling operations.

As a result, the company has seen non-stop growth, its international profits going up to 80 per cent from 50 per cent in 1985. Over the last five years, Coke's earnings have grown at an annual rate of 19 per cent, reaching US $1.3 billion last year on sales of US $10.2 billion.

Helping its product become almost ubiquitous all over the globe is the company's marketing strategy, which offers high-profile celebrities and catchy advertisement jingles.

The company has also enjoyed marketing results from highly publicised promotions in the past, such as the donations of Coke to US troops in Saudi Arabia during the Gulf War last year and to East Germans crossing the border after the fall of the Berlin Wall in 1989.

Although it has been less successful abroad, Pepsi has matched Coke's mammoth US marketing campaigns with successful advertisements of its own, featuring celebrities like Madonna, Ray Charles and Tina Turner.

These fiercely contested 'Cola Wars' will soon continue at the international level as Pepsi vows to increase its investments abroad and seeks to challenge Coke's predominance in foreign markets.

— IPS

Barking Up The Wrong Tree

by John Sipper

Asian Development Bank study outlines new policy alternatives in the forestry sector through natural resource accounting.

IMPRESSIVE gains in income and other conventional statistics about economic performance become questionable when they are achieved at the expense of a country's physical environment. This increasingly common theme is given further support by economists at the Asian Development Bank.

In a study entitled "Barking Up the Wrong Tree," Bank economists, Remi Paris and Ivan Ruzicka examine the problem of tropical forest depletion — especially the role of government in arresting the process — and, in doing so, relate environmental deterioration to standard measures of economic performance such as GDP or GNP.

Should cutting down standing forests or repairing damage caused by air pollution be regarded as adding to a country's income as is done today? Or, should these be considered a form of depreciation of the productive base or a form of "defensive" expenditure? Alongside these questions, Paris and Ruzicka ask if we are not overestimating the capacity of any country to sustain growth.

The importance of correctly identifying sustainable income — a distinct from a one-time profit which can result from asset liquidation — is particularly important in the case of natural resources, according to the authors.

In tropical forestry it is crucial, for example, to distinguish between high financial profits that come from simple logging of the forest (amounting to a depreciation or even liquidation of these assets) and the far smaller, but ecologically sustainable profits that come from careful long-term forest management.

This is dramatically illustrated in the study. The study takes issue with the definition of profits generated by forest which can be claimed by the government (as owner) in the form of a tax without endangering the long-term productivity of the forest asset. In doing so, the authors closely examine the process of tropical forest depletion and identify the main culprits.

According to conventional wisdom, forest resources in tropical countries are being overexploited because they are made available to loggers too cheaply. And, sine logging is extremely profitable, the rate of extraction is excessively high. The solution, so the argument goes, is simply to raise forest charges. Or, better still, to auction off standing forest to the highest bidder to ensure that resources are properly priced and used.

By carefully defining and benefits associated with forest management throughout the entire gestation period of forests, the authors arrive at radically different conclusions about of excessive forest extraction and some possible remedies.

The accounting method used in the study differs from the conventional method in two ways :

First, the authors stress that the cost of timber production does not begin and end with chainsaws. Several interventions are necessary to guarantee that a seedling (grown naturally or artificially) develops into a commercially valuable full grown tree. Silvicultural treatment and protection from human and natural depredation are examples. But these interventions cost money. They are an integral part of the cost producing timber and must be taken into account when measuring the profits that timber production bring.

Second, when estimating the benefits of forest management, more than just the value of the timber extracted should be included. In particular — and here the argument has important relevance to several countries in the Asia-Pacific region that were recently affected by natural disasters recognized as partly man-made and linked to deforestation — watershed maintenance and soil conservation services that forests provide to downstream areas must enter the calculation.

Once such benefits are included, it becomes clear that some forestry activities which — though highly profitable financially and tempting as targets for tax authorities — are socially destructive. In these cases, say the authors, they should be stopped altogether rather than merely discouraged through taxation.

Review of a simplified accounting exercise by the authors' tells the story. From their tabulation, it does not take a rocket scientist to see that the financial profitability of short-term logging operations (which forms the basis for the conventional prescription for increased taxation) can substantially differ from the social profitability of long-term, sustainable forest management.

They conclude that tropical forest resources are being over-exploited largely because they are being offered up to loggers on a short-term basis. This enables them to benefit from forest exploitation without having to incur the costs of managing and protecting the forest. Logging is extremely profitable but it is also unsustainable.

In the best case, the standard remedy of auctioning off timber resources on a short-term basis achieves little more than giving the government a share of these unsustainable profits. These unsustainable profits — in a more "sustainability-oriented" system of economic accounting — would be referred to as losses rather than profits, the authors remind.

In the worst case, this same auction approach would deny loggers wishing to manage forest resources on a long-term basis the funds to do so, and in this way actually fuels the process of forest degradation. This, the authors note, is tantamount to treating forests as "timber mines."

In other words, forest depletion largely results from inappropriate, short-term, forest leases which neither reward good forest managers nor punish bad ones. Taxing loggers may make unsustainable forestry less profitable but does not, in itself, create any incentive for responsible forest management. Those who have so vocally argued for increases in forest charges or auctioning of short-term forest leases have, in the opinion of the authors, been "barking up the wrong tree."

Having demonstrated the crucial importance of careful natural resource accounting in formulating policies, the authors are quick to warn against any mechanical application of their method and emphasize, instead, its illustrative intent. Drawing on Keynesian wisdom they remind that "it is better to be approximately right than precisely wrong."

The study is not merely a criticism of conventional policies. It is rather, in the view of the authors, "an outline of a better policy alternative." Sustainable allocation of forest resources, they stress, must begin with the recognition of wood production as dynamic process and aim at forcing loggers to become timber producers.

Such a policy would ensure competitive access to resources, provide strong incentives for leaseholders to maximize timber production and offer strong guarantees to governments that valuable resources will not be degraded and that penalties will be paid it they are.

This mechanism could also minimize the need for day-to-day enforcement of forestry regulations and maximize both the transparency of allocation decisions and the ability of the government to penalize violators. The instrument most likely to achieve all these objectives simultaneously, says the authors, would be a competitively-determined guarantee bond.

Such a bond could be deposited and invested for the life of the lease period and could be collected by the government if the leaseholder was found to be in violation of specific forestry regulations. The bond would provide, at once, a reward for abiding by forestry rules and the penalty of forfeiture for violating them.

Since the amount of the bond would be determined through open competitive bidding among interested parties, its amount would reflect the expectations of private bidders of the productivity of the area bidded for, the risks involved in undertaking to manage the given area for the duration of the lease and the possibility of arbitrary cancellation by the government.

This is a reversal of the more common situation in which the government bears all the risks of a leaseholder's mismanagement and the consequent losses caused by forest depletion and environmental degradation. "Like a house rental or car-hire deposit, the bond would be redeemable upon return of the item in question, undamaged, and would be transferable," the authors conclude.

Tropical rain forests worldwide are being destroyed at an annual rate of 17 million hectares (42 million acres). This is one per cent of the total forested area of the planet each year. Loss of tropical forests (the rate of depletion has increased by 80 per cent in 10 years) results in the extinction of plants and animal species, waste of forest resources and encroachment of deserts in once fertile regions.

Logging in parts of the Asia-Pacific region continues unabated and large areas of forests have been converted to non-forestry uses.

Few, if any question, the urgency to formulate and put into action policies that remaining forests are managed sustainably.

The Asian Development Bank's focus on sustainability in the development efforts of its developing member countries in general is being accompanied by an increased commitment to improving the quality of the indicators of economic performance. An improved methodology of economic accounting can in turn serve important management and policy-formulation functions.

Destruction of forests: caused both by nature and man

Low-income families in NZ will benefit from 'credit cards'

by Derek Round

THE New Zealand government is considering issuing low-income families with plastic credit cards they can use to pay for health services and education. Instead of having to pay for services such as health costs on the spot card-holders would produce their card to the doctor or hospital. Some of the bill might then go to the government and some to the card-holder, depending on how much assistance they were eligible for. The amount of credit on the card would vary according to income and personal circumstances, with those better off having less state credit on their cards.

Officials advising the government on the possible introduction of such a card point out that credit cards for social service access have not been tried in other countries and they warn that implementation costs would be high. But they have told the government that credit cards would be the best way of directing or paying social assistance to those qualifying for it.

The possible introduction of welfare credit cards follows sweeping changes in Finance Minister Ruth Richardson's budget earlier this year which will force many New Zealanders to pay more for health services and education under "user pays" principles, seen by critics as an attack on the foundations of the welfare state which has traditionally looked after New Zealanders "from the cradle to the grave."

For the first time in decades New Zealanders will have to pay for hospital treatment and it will cost more to go to the doctor.

The government is introducing a plastic Kiwicard (named after New Zealand's unique flightless bird) which welfare beneficiaries and people on low incomes will have to produce to avoid having to pay higher medical bills and new hospital charges which come into effect next February. The credit card being considered would be an extension of the Kiwicard.

Plastic "Kiwicards" will be used to pay health care and education

Introduction of the Kiwicard has sparked off controversy, with critics claiming it is an invasion of personal privacy and a leading newspaper calling it "demeaning and divisive."

Some legislators fear the card will become a compulsory identification tag for everyone which would be linked into a wider information sharing system.

New Zealand does not have compulsory ID cards and there has always been strong opposition from civil liberties campaigners to their introduction.

One government member of Parliament who voted against the introduction of Kiwicards declared : "If we allow this card to come in, are we all prepared that in perhaps two, three or five years' time the card may have such a wide range of information on it that it could creep into every aspect of our privacy?" He described the card as a bureaucrat's dream with the capacity to carry thousands of bits of information about an individual. The cards will have a magnetic strip, an embossed number and a signature, but will not carry a photograph.

Social Welfare Minister Jenny Shipley has described opposition Labour Party criticism that the card is a "class card" as "utter garbage." She argues that he card and information sharing by government departments involved in its use is consistent with privacy legislation the government has just introduced. It says the privacy legislation is needed as part of its decision to share information between departments to combat welfare fraud. Until now it has been illegal for the Inland Revenue Department to give out information. Now it will be able to share it with the Social Welfare Department.

The new privacy legislation requires collection of personal information to be kept to the minimum necessary and it says information collection should be done with the consent and knowledge of the person concerned.

The Dominion newspaper said in an editorial that part of the disquiet over the Kiwicard stemmed from the realisation that it was also a "social sorting mechanism." "It cannot help but define the bearer as someone who, in the eyes of the government, has not quite made the grade and therefore requires the state's charity," it said.

— (Depthnews Asia).