

Taka Convertibility: Bane or Boon

Azizur Rahman: On behalf of the board of Media World Limited, sponsors of The Daily Star, it gives me great pleasure to welcome you all to this roundtable and thank you most sincerely for responding to our invitation.

It is superfluous on my part to say a few words on Taka convertibility since we will spend the next three hours on this issue. There is tremendous interest in the public mind, specially in the business community, about the implications of this vital move. Therefore, we hope that this roundtable will help in a modest way to answer the questions which now agitate the public mind.

Unfortunately, Mr. S M Ali, the Editor of The Daily Star, who was supposed to moderate the roundtable is down with an attack of virus. He sends his deep regrets for not being able to be present here with us. It will therefore be the task of Mr. Mahfuz Anam, the Executive Editor, to conduct this roundtable.

Mahfuz Anam: The beauty of a discussion like this is that nothing is lost through reporting. We are taping this whole session and then we will publish the transcript with minimum editing. Basically, what we are trying to do is to take expert opinion and share it with our readers. This is our way of serving our readers better and creating a more informed public in the process. Can I now ask his Excellency the Minister of Industries, Mr. Zahiruddin Khan, to start the discussion.

Zahiruddin Khan: Thank you, Mr Mahfuz Anam. I have some questions for Mr Venkitaramanan because certain areas of this convertibility are not clear. You know I am not a financial expert, so I'll begin with the questions.

What agitates my mind are the speculation aspects of the convertibility issue, because we have seen that when you have total convertibility, the currency is under pressure from speculators. We have seen this happen with the yen, we have seen this happen with the Deutsch Mark and the dollar has also gone through considerable speculation pressure. Even government's intervention doesn't seem to control it.

So what happens to currencies like the Bangladeshi Taka or the Indian Rupee or the Pakistani Rupee if speculators get into the game? We'll have to know what are the safeguards that can be built into the system so that the speculation of the currency does not take place because that would do much more harm than the good we expect from convertibility. This is one question.

We dare to go into convertibility because of our excellent macro-stability, but we have to do it carefully, with caution and careful handling because it does have certain risks which are unknown to us but may be known to international financiers.

I believe this is a part of the reform package so that there is fluidity in our currency market. In the sense that foreign investors would have more confidence in the Taka. It could also help in raising external credit, provide access to external credit market where syndication etc. can take place in the desired currency of the entrepreneur. So these are the benefits. But I again go back to my question how do we prevent speculators from getting into the game?

S. Venkitaramanan: The Hon'ble Minister has raised a very important point on convertibility. When we move over to deregulation and free market determination of the exchange rate, that is what we did in India, we otherwise call it convertibility. In that case we ensure that the forward positions which are allowed to be taken by dealers and banks will have to have an underlying trade transaction.

This means that if a dealer takes a position for example a hundred million dollars, for argument's sake, if he does not have an underlying trade, then that is illegal. The positions can be cancelled, and these can be reversed. But the net effect of underlyings behind each position means that unless they violate these rules, speculation is not easily possible.

Now this involves of course some bureaucratic overhead. There will have to be some reporting system. But in the initial stage, we felt in the Reserve Bank of India (RBI), that it was necessary to have this kind of

What did it really mean, that Taka will be convertible? Will we be able to transact in any currency as and when we chose? Will this facility be available only to importers and exporters? What about the general public, is there any benefit for them in this change over? Then there was talk about prices of things going up, and there being some inflationary impact on the market.

With all such talks going around, The Daily Star felt it its duty to clarify these issues for the valued readers. Thus the idea of a Roundtable on Taka Convertibility came about.

We brought together leading bankers, industry leaders, government officials and national and international financial experts. Led by the minister for industries, Zahiruddin Khan and the Deputy Governor of the Bangladesh Bank, the discussion touched on some of the vital issues confronting our economy, and how making Taka convertible will impact on it.

The participation of the former Governor of the Reserve Bank of India Mr. S. Venkitaramanan added a special dimension to our discussion as we were able to gain from the experience of India making its own currency convertible.

protection. This has put us in good stead. At the same time we liberated the forward market in foreign exchange from many of the earlier regulations.

The forward market had not allowed the earlier positions to be cancelled because if a person takes a position in foreign exchange, he should be able to go out of the forward cover at any time of his choosing after paying a charge. We also allow this. So I think this takes care of speculation.

During the past two years of our experience, one and a half years or more have been very comfortable. There has been no speculation in this manner. But let me go to the question which you have raised about caution. I agree with you, cent per cent, that we should proceed with caution. But over caution might delay very necessary reforms. This is perhaps the right time for you to step into convertibility in the manner in which we have been talking, and I think on trade account if you go about it, it will increase the credibility of Bangladesh in the international market. That is the principal aim of the present deregulation moves in your agenda.

Mahfuz Anam: Sir, I'll try to represent my readers in this forum and attempt to think what sort of questions are going on in their minds. I'm not very clear, as to what's going to happen on October 1. What is going to make our lives different than it was on September 30?

Kamaluddin Ahmed: On October 1 our minister and governor and secretaries will not be here so I have an understanding that on that we will not be able to stick to the date. It may be the middle of October. Whatever the date is, the fact to be noted here is we are gradually doing it.

We dare to go for Taka convertibility because of our excellent macro-economic stability. This move will cause fluidity in the market and give foreign investors more confidence in the Taka.

We started almost two years back. Only recently we have made current account to be liberalised and we have also hastened the pace for doing these things. But that doesn't mean that when it will be declared on that day anything special is going to happen. What we have already done, will be summarised and clearly stated and then formal statement will be made that Taka is now convertible.

Mahfuz Anam: So we have a new information that it's not on the first but on the 15th. Who would like to take the floor next? Mr. Latifur Rahman?

Latifur Rahman: Well, I'm a little disappointed to hear that it's going to be postponed to the 15th or whatever the date because this date has been long talked about and I think the



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government should have taken adequate steps irrespective of whether X or Y or Z was available.

I think it's a bit symptomatic of relying on individuals rather

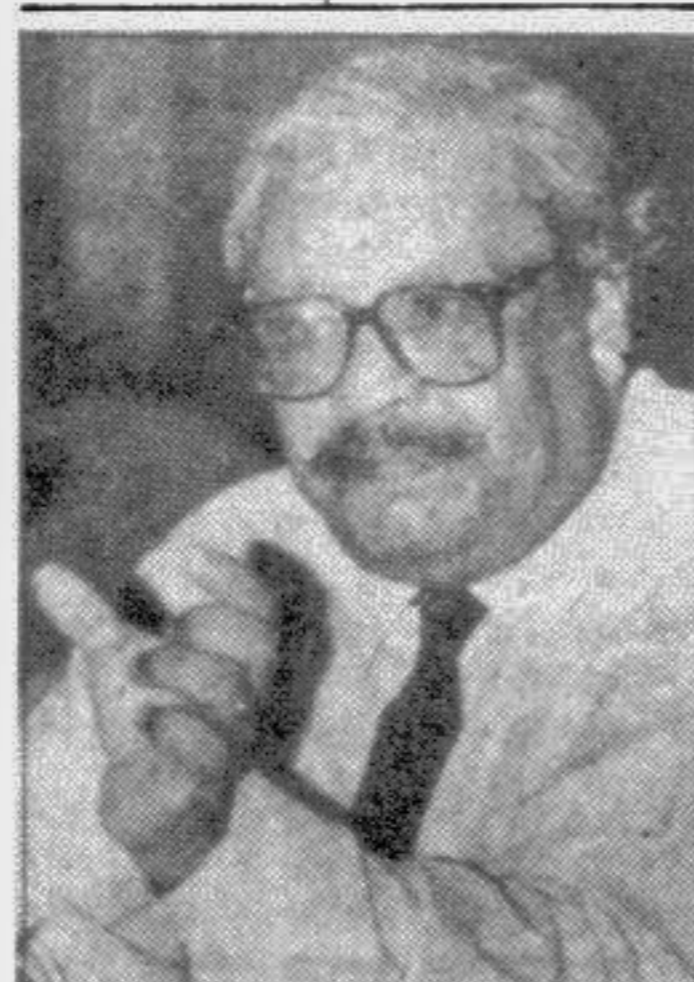


The Daily Star Round Table

than institutional framework that we go into a programme or we pull out of a programme or a step based on individuals. I don't want to say I'm being critical of the Bangladesh Bank as such, but just as a matter of principle I think if something meaningful is decided, that is what should be done.

One point I heard in the discussions we had earlier in the Metropolitan Chamber was about the lack of forward cover by the central bank. The central

J P Raynaud: I wish to say that this floating or convertible of Taka is a step in the right direction. But there are still too many rules and regulations and exchange controls to make it very unattractive for foreign investors. I don't know what was done in India about the changes in exchange regulations but as



Zahiruddin Khan

far as Bangladesh is concerned, as yet nothing has changed. We still have a very thick manual which has not been amended.

Mahfuz Anam: Can you be specific? What sort of rules are you talking about? What kind of changes would you like to see?

J P Raynaud: You see it's a whole manual. You are talking about convertibility and trade transactions, but there are still many obstacles such as the passbook and various other things, the control of imports and exports which is still a very big impediment. Mr Venkitaramanan could probably tell us how the exchange regulations were amended in India.

The second point is that it is still very vague to us what are the objectives of the govern-

If we go for deregulation how will the exporters or importers take forward cover? The Bangladesh Bank, along with commercial banks, should find a mechanism to ensure that this service is available.

ment, what will be the rules of the game. I think it will be good for the banking system to have at least a time frame, how and when the reforms will take place, what will be the extent of convertibility because convertibility can be many things. How will Taka be floating? Right now, for instance, there is a limited floating of the Taka because every morning the

Mahfuz Anam: May I now request Mr Raynaud from the Indosuez Bank?

Bangladesh Bank is providing two rates, though it is very limited floatation of the taka.

It would be interesting to know what mechanisms the central bank will choose to put into place to manage exchange rates. I am not aware of the Indian system, whether rates are provided on application to the banks or whether the central bank doesn't do anything at all. That would really be floating rates. It would be interesting for the banking system to have more details about the objectives and the framework of the new convertible currency, to get ready and be prepared for this.

Mahfuz Anam: Thank you, I think there will be a lot of questions coming to Mr Venkitaramanan. Do you want to answer all together, or one by one?

Venkitaramanan: I think I will answer this one now. When we went into the exercise of partial convertibility in March 1992, we did it on a specific date and we've done the whole process very confidential to the extent possible. Because we felt that speculators would take ad-

offer and determine the rate. So the Reserve Bank of India doesn't determine the rate. It is the market for foreign exchange in which the rate is determined from time to time. It can vary from hour to hour and a man who wants foreign exchange can have the pick of what he wants. He can take it from whichever bank offers him a better offer.

But we have a system by which the Foreign Exchange Dealers' Association of India (FEDI) announces a rate at ten o'clock which is a summary of information collected from all the clearing banks, all the banks which are dealing. It is not a reference rate in the sense that it is mandatory for people to follow it. Therefore, it is a float rate so far as foreign exchange available in the market is concerned.

This rate is not determined by the RBI, but RBI keeps a watch on it in the sense that if it becomes very adverse to exporters then it tries to interfere to make the rupee a bit weaker by buying to the extent possible. But I think there are limits to what it can do. I think we

There is tremendous interest in the public mind on this issue (Taka convertibility). We hope this round table will help to answer some of the urgent questions.

vantage of it. So the date was made to coincide with the date of the budget. But the important thing is that deregulation of foreign exchange market involved a number of relaxations in exchange control. This was simultaneously done.

A number of restrictions were relaxed and freedom was given to various service and trading areas for release of foreign exchange. It is not total convertibility. Compared to the limits given earlier, it was much more relaxed.

As far as foreign investors are concerned, the freedom for remittances, the freedom for bringing in the money, taking out the money, all this was specified in the new resolutions. And the Foreign Exchange Resolution Act, a very big compendium, which led to the manual being so very complicated, has been amended very substantially. It is now a very pale shadow of its former self. That is one aspect of your question. The second aspect is, how do we manage the rate?

Everyday it is the banks, which are the authorised dealers, with offers and demands for foreign exchange. It is they who

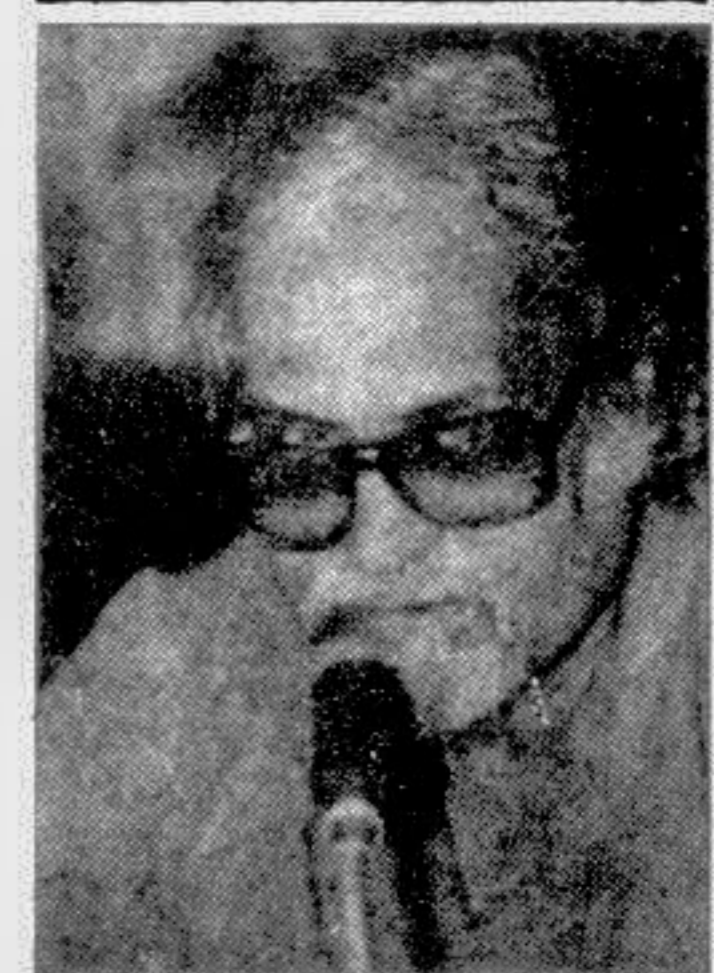
You can have convertibility but you cannot have floats. Then again, another concept is that we are going to start our convertibility only on trade account and service account as the Finance Minister has said. Yesterday there was a consensus that in Bangladesh we have been liberalising or deregulating our foreign exchange control for quite sometime.

In fact our trade account is totally deregulated now. Anything that is permissible to be imported into Bangladesh is now totally deregulated. One does not have to go to Bangladesh Bank for provision or doesn't have to have any licensing. Everything that is to be legitimately exported can be exported without reference to Bangladesh Bank. And there is no foreign exchange ceiling fixed on it, so to this extent I would say it is deregulated. But up to now, we do it on a foreign exchange rate which is given by Bangladesh Bank everyday.

I believe convertibility will not change things much. The only change on the trade account is that the rate of exchange will be determined by the market. And what is that market? That market will be the scheduled banks who are known as the authorised dealers. They will determine the rates? On the basis of demand and supply of foreign exchange, of foreign currency in the market. This is in a nutshell what is going to happen.

But the question is when the actual implementation of the market comes there will be a lot of problems. You must realise that foreign exchange market in Bangladesh has been totally regulated. Right from the very beginning, not only from 1972 but from 1947 there has never been a deregulated foreign exchange market in this part of the world although we had a secondary foreign exchange market. But that secondary foreign exchange market excepting for a few years in the beginning, was also carried out under intervention of the Bangladesh Bank.

So we never had in fact a total free market, totally free from restrictions or interventions of the Bangladesh Bank. Now either from October 1 or from October 15 we are expecting that our regulated banking sector, either in the public sector banking or in the private sector



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banking, will certainly wake up. If everybody in the market, all the authorised dealers are trying to play safe in the market then how is the market going to be active? This is a very fundamental point and I think unless this point is resolved by Bangladesh Bank and by the Minister of Finance the very purpose of convertibility, the very purpose of having a market for foreign exchange will be destroyed.

Bangladesh Bank has a buying and selling rate of foreign currency. They will buy only dollars and no other currency. So let us say our authorised dealers who are the commercial banks will say they are interested in making money. They will not keep their money idle for speculative purposes. And you must also realise that only four Nationalised Commercial Banks (NCBs) in Bangladesh control well over 60 to 70 per cent of the total banking activities. This nationalised

sector handles most of the inward remittances of Bangladeshis working abroad which is about one billion dollars. This is a very big thing that nationalised banking sector has. And these are the institutions which are fully owned by the government.

It should be clear to what extent these four NCBs will be dominating the foreign exchange market, will be given the flexibility to use their own judgement because their judgement can prove to be wrong. If they hold some money for speculative purposes, and if they lose money, how are they going to account for it? I would say that these are some of the very important things that we have to clear before we can create a market for foreign exchange in Bangladesh where you can have convertibility, either partial or full.

As far as I understand the government policy is that convertibility and rate are two different issues. Let's not confuse this. Convertibility is when you put down taka you can convert it into dollars; rate is another issue. Even Japan could not control its float. But there is a unique mechanism in Hong Kong from where the money market works. You know the HK dollar was under tremendous pressure. It was seven point something, it went to 16, there was so much flight of capital. The HK dollar can be converted across the table, but the rate is allowed to fluctuate within a limited range.

In Hong Kong, if you have to go to change money after banking hours, it's a bit difficult. They charge you a little higher because you really don't know what the buying or selling rate is. But the difference is not much. I believe that our effort in the subcontinent is to replicate what is being done in Hong Kong.

I think float would be a misnomer in our case. Float means you trade in currency as a commodity. No longer it is linked to trade, its just a demand for dollar or a demand for taka. If you get into situation like this, Bangladesh would become a serious victim to speculators, because I think our trade imbalance is nearly three times or more.

So I feel that Mr Venkitaramanan and our state bank officials should clear this issue. There is a lot of confusion between convertibility and rate, whether we are going to follow something similar to what is happening in Hong Kong.

Mahfuz Anam: Mr C K Hyder, would you like to say something?

C K Hyder: I will take on what Mr Jamaluddin was touching upon. It is about the full convertibility, the capital account convertibility of Taka. Current account convertibility is being extended to service account, that's all. But as regards to operation of market, determination of rates and withdrawal of import restrictions, these have been the very visible features of our exchange rate management.

So this is some improved fine tuning but there is not much difference in what is going to be done. At the same time we have to attract both foreign investment and foreign savings. So why not capital account convertibility? I personally feel that this is the best time to get a very solid reserve and think about capital account convertibility.

There are risks but with no risks we cannot expect any gains. After all, what India is going to do now, we had for the last 15 to 20 years. Now having suggested capital account convertibility, I would like to say something different but more fundamental.

I just read about free exchange doctrines. David Ricardo in his theory suggested that if you allow free exchange, if you remove the tariff and non-tariff areas, countries will benefit from trade. But nowhere he suggested that all countries will benefit equally. The benefit will vary from country to country. And the countries who will benefit most will be the countries who can ensure the most competitive production cost based on their comparative advantage.

Exchange rate management is a facilitator from that point of view. Other factors like inflation control, overall credit discipline and productivity are equally important. Good governance and law and order situation are also crucial factors which have very serious implications on the