

# Debates, Dialogues and Decisions

A historical look at policy making in Bangladesh

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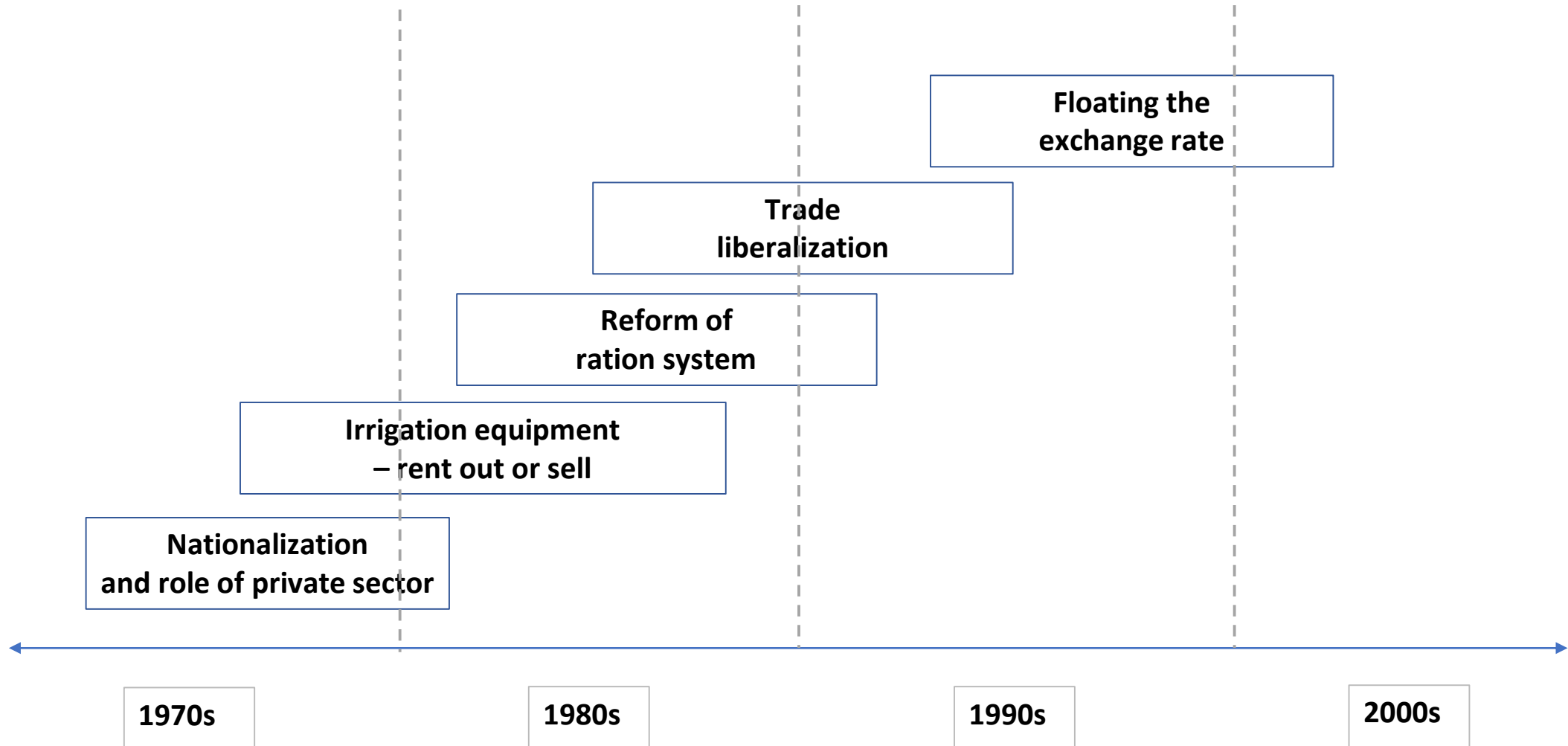


## In the light of the past

*“The master-economist must study the present in the light of the past for the purposes of the future.”*

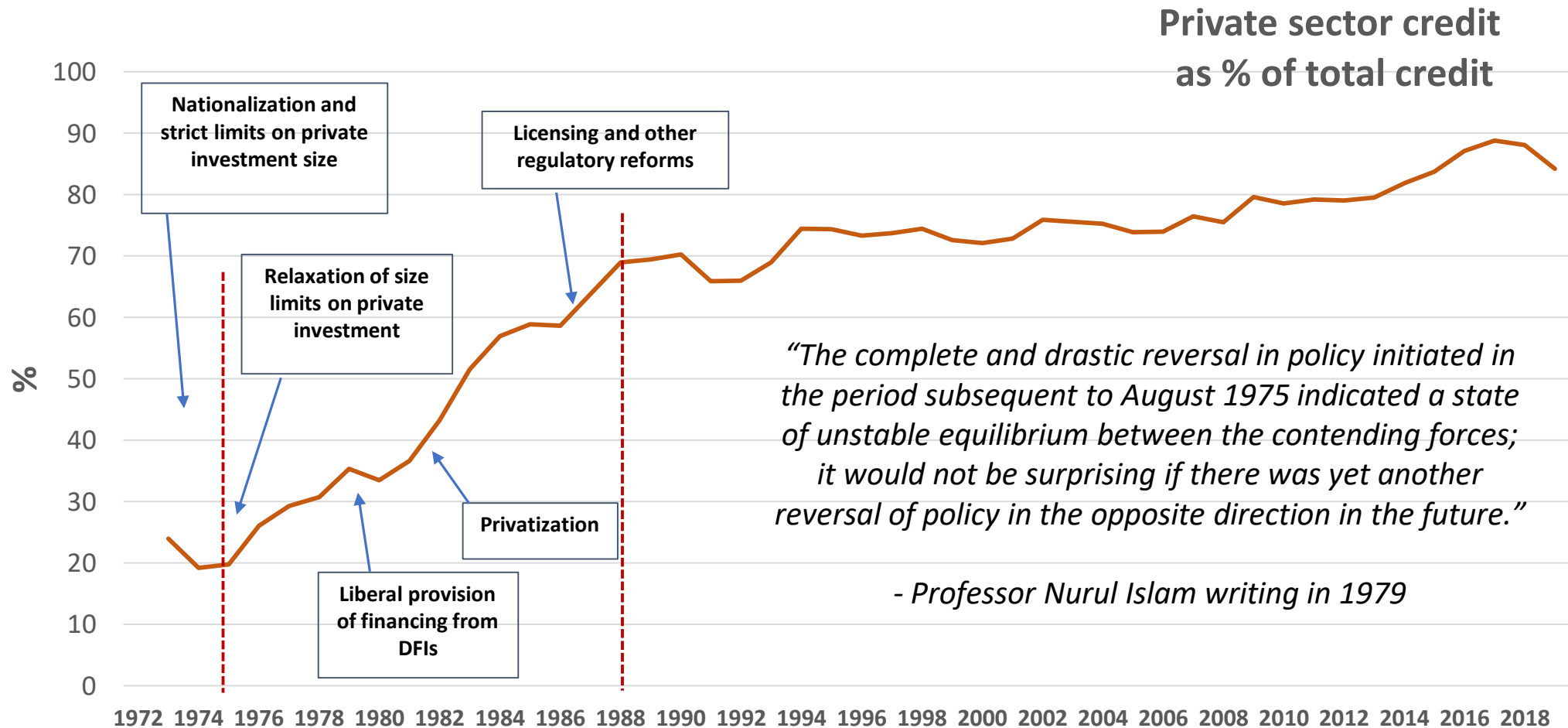
*- John Maynard Keynes*

# Economic debates - over time



**“Nationalization and all that”  
three important debates**

# The transition to a private sector-led approach



# What to do with the industrial units abandoned by the Pakistanis?

Liberal position  
Sell these units  
to Bengali  
entrepreneurs

- The entrepreneurial talents of Bengalis, suppressed during the Pakistani era, should be allowed to flourish in independent Bangladesh.

Radical position  
It was neither  
feasible nor  
desirable to go  
this route

- The regime could not go against the mood of the radicalized students and industrial workers who favored wide-spread public ownership.
- Bangladeshi entrepreneurs would be unable to buy and run these units without considerable financial and other support from the government. Such government largesse was unacceptable in independent Bangladesh.

*“It was periodically asserted in my writings during this period (1967-1971) that the forces unleashed by the movement should not degenerate into an instrument to fulfil the aspirations of the nascent Bengali bourgeoisie but must be directed to realizing the expectations of the masses”.*



# What to do with industrial enterprises owned by Bangladeshis?

Liberal position  
Bangladeshi owners should be allowed to retain and run these enterprises

- In the absence of a strong political commitment to socialism, the benefits of large-scale public ownership of industry would be captured by the politically powerful elements of society, and not accrue to the masses.
- Large-scale nationalization would discourage savings and capital accumulation. Entrepreneurial and managerial talent available in the private sector would be underutilized.

Radical position  
Nationalization should be comprehensive

- The 1970 Awami League manifesto had called for nationalization of industries owned by non-Bengalis. Nationalizing industries owned by non-Bengalis but leaving Bengali-owned industries in private hands would be considered ethnically discriminatory.
- The Planning Commission argued that this logic remained valid even after independence. Thus, nationalization had to be comprehensive.

*“The key issue in the discussions with Bangabandhu revolved around the fate of the Bengali industrialists.....the PM had strong views against sponsored private enterprise of the variety which had flourished in Pakistan .....he was, however, more uneasy about taking over established Bengali-owned enterprises in the jute and textile sector, notwithstanding their sponsored origins”.*



# How large can private enterprises be allowed to grow?

## Liberal position

Leave most sectors for private enterprise. Revise upwards ceiling on private investment.

## Middle-of-the road position

Increase the number of areas where private enterprise can enter but maintain the Taka 25 million ceiling.

## Radical position

Restrict space for private enterprise  
Maintain the Taka 25 lakh ceiling on private enterprise imposed in March 1972



*“The Prime Minister stood in the middle of the contending forces. He responded carefully to the conflicting pressures – balancing off one step in one direction by another in the opposite direction. He sought to respond to radical pressures without eliminating or provoking an extreme reaction from the conservative groups.”*





**Irrigation equipment**  
**To rent or to sell – that is the question**

# Efficiency of use of irrigation equipment was a big concern in 1970s given resource constraints

Policy makers concerned about capacity utilization of irrigation equipment

- Under the irrigation management model of the 1970s, shallow tube wells (STWs) were sold to farmers. Deep tube wells (DTWs) and low-lift pumps (LLPs) were owned by the public sector body, BADC but rented out to farmers' cooperatives.
- BADC remained responsible for delivery, installation, repair, and maintenance.
- Important question: were the irrigation pumps optimally used?

Studies find serious capacity underutilization of irrigation equipment

- Early 1970s; BIDS collaborated with BADC to conduct field studies on capacity utilization of DTWs and LLPs.
- For example, BIDS economist Mahmudul Alam studied usage of DTWs in the Comilla thana for the period 1962/63 to 1971/72. He found:
  - substantial increase in capacity of DTWs, but
  - high levels of capacity under-utilization – varying from 38 to 83 %.



# Reforms happen but produce less than satisfactory results

Findings about capacity underutilization led to reforms in irrigation management model

- Such findings intensified the disappointment with the existing irrigation management model. Demand for reforms grew. Government responded with a major policy shift in 1978/79.
- BADC-owned DTWs & LLPs were sold to cooperatives or private individuals/groups instead of being rented to cooperatives. It was expected that ownership of irrigation equipment would increase motivation to increase coverage, and improve maintenance, of the machines. Considerable privatization in early 1980s.

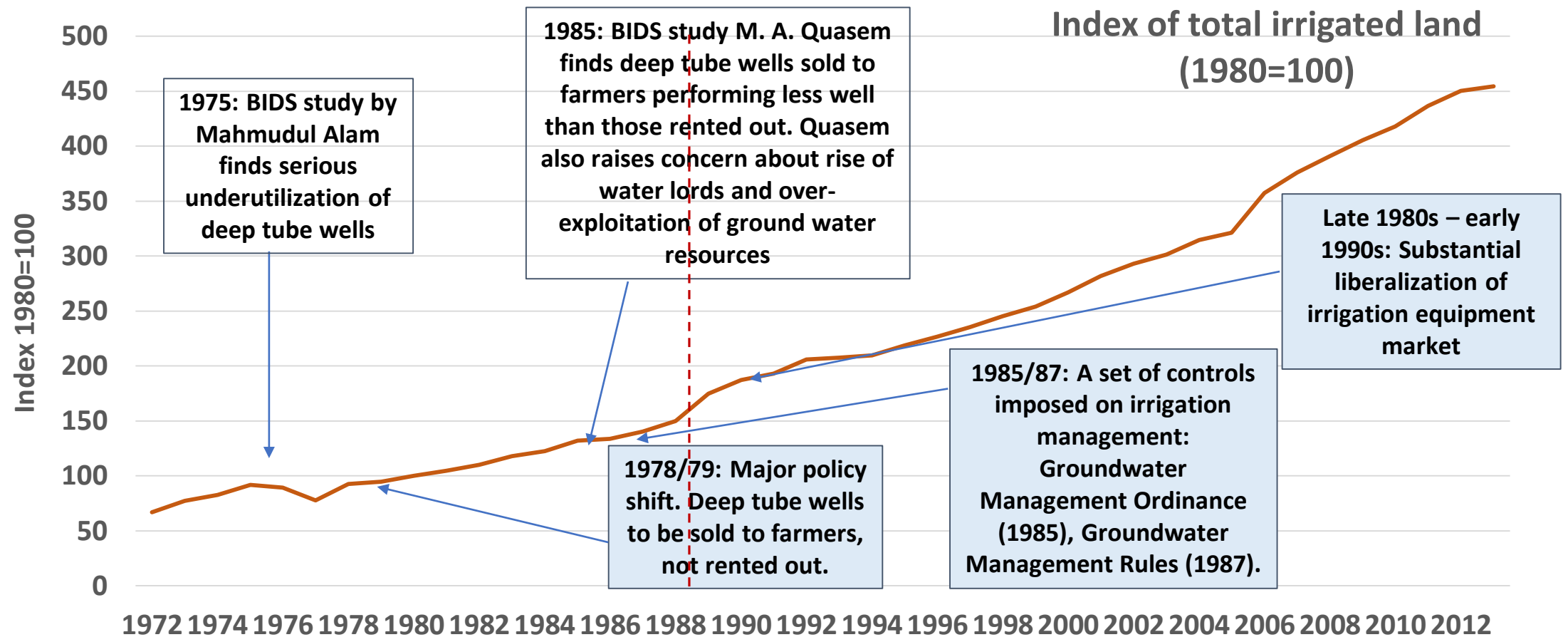
But the reforms yielded less than satisfactory results

- The impact of this new arrangement was studied by BIDS economist M. A. Quasem. His findings, published in 1985, showed mixed results from the new policy:
  - Contrary to expectations, capacity utilization was higher and irrigation costs lower in irrigation pumps operated under the traditional model (rented out to cooperatives or individuals), than for pumps owned by cooperatives or individual farmers.
  - New irrigation equipment was being bought primarily by large farmers who sold the water to others.

*“The new owners are more interested in becoming water-lords than in using the water. The new system is therefore, undesirable on both efficiency and equity grounds.”*

*-Economist M. A. Quasem writing in 1985*

# The interplay of economic studies and policy changes



**Public food distribution  
-the retreat from rationing**

# 1980s: debate intensifies within government over maintaining the ration system

Different ministries take different positions: the battle lines harden

- As early as in 1978, the Planning Commission started advocating phasing out ration subsidies.
- Finance ministry started getting restive from the early 1980s concerned with the fiscal burden.
- But other ministries had different views.
- Food ministry, tasked with ensuring food security, wanted to keep ration prices low
- Agriculture ministry, concerned about returns to farmers, wanted to maintain a high procurement price for rice.

By the late 1980s, the public food distribution system becomes huge

- Accounted for about one-seventh of total national consumption.
- \$250 million delivered each year in direct food subsidies.
- Rising fiscal burden plus allegations of corruption.

*“By the late 1980s, evidence on the ineffective, or even counterproductive, nature of the old set of policies was mounting, and the government and its development partners were convinced that the country's food policies had to be changed. Both food rationing and public procurement were found ineffective; and none of the then-existing public distribution programs were reaching the poor.”*

*- Showkat Ali and co-authors*

# Studies by economists provide very useful data on the working of the public food distribution system

Studies find that much of the benefit of urban rationing was going to the non-poor

- Mid-1980s: BIDS economist Nuimuddin Chowdhury carries out a set of rigorous studies on the rationing system, both its urban and rural versions.
- Chowdhury said this of the beneficiaries of Statutory Rationing (SR) : “SR beneficiaries tend to be an elitist lot. They have on average 15 years of urban residence behind them. Four fifths of them have usually secure job, in coveted Governmental and other public sector bodies.”

The same was true of rural rationing

- Chowdhury’s study of the limited rationing system in the rural areas, the so-called Modified Rationing (MR) System also indicated that the poor did not necessarily benefit from the system.
- IFPRI’s Akhter Ahmed found that 70% of the estimated annual subsidy of US\$60 million on food grain leaked out of nonpoor households.

## Accounting for Subsidized Food Resources Distributed in Statutory Rationing in Bangladesh by NUIMUDDIN CHOWDHURY\*

The beneficiaries of Statutory Rationing are an elitist lot. They have on average 15 years of urban residence behind them, four-fifths having secure jobs in coveted Governmental or other public sector. Per capita income of typical SR beneficiary household during 1984/85 was estimated (in a companion paper) as significantly in excess of the corresponding figure for the average urban household. It is not surprising that this lot is not overly protective of each and every aspect of their entitlements under SR. For example, only 59% of full ration entitlement of an average beneficiary household are utilized. While not overly protective, household's attitude to SR foodgrain is nevertheless informed by economic discretion. This is because underutilisation is not so much due to irregular sitting as to partial lifting. SR is taken advantage of on the strength of skewed calculation of relative prices between the ration and market regime. Between 12 and 13% of the total allotment— or somewhat over 20% of what's lifted—is resold, presumably for gain. The hallmark of a rationing system in a poor country ought to lie in the foodstress characteristics of those aided, not in their ability to take discretionary advantage of it. For, if rationing becomes virtually an extension of the market regime, the distinction is not worth making in practice. SR should in such a case be eliminated. It is befitting, although somewhat belated, that all subsidies on SR will be eliminated by 1989.

### I. INTRODUCTION

Government intervention in foodgrain market in general and rationing in urban areas in particular are recurrent features of the food economy in the developing world. Considerable resources are channelised through the medium of urban rationing in many developing countries, ostensibly to stabilise availability of statutorily determined quantities of staple foodgrain at fixed prices to the obvious financial benefit of urban population. And yet, there are not too many quantitative studies that critically examine such systems in general or, for that matter, such a system within given countries. Such an examination could probe the character of such intervention in terms of the income distributional implications, the occupational types and social standings of its typical beneficiaries, the issues of legitimate use of ration foodgrains as opposed to leakage, and, finally, the *de facto* rationale of such a system. The income distributional effects of Statutory Rationing (SR) — which is an archetypal example of urban rationing referred to in the foregoing —

\*Nuimuddin Chowdhury is a Senior Research Fellow at Bangladesh Institute of Development Studies, Dhaka. The comments of Dr. Bruce Curry on an earlier draft have improved the paper, as also have some of those made by an anonymous referee. These two persons are to be thanked but not implicated due to any of the remaining shortcomings of the paper.

# These findings help resolve the debate in favor of very substantial reforms of the system

Reform  
proponents are  
emboldened by  
the findings

- Development partners such as the USAID and World Bank who had been pushing for more substantial reforms to the ration system are emboldened
- So are pro-reform elements within government, such as the Ministry of Finance.
- These groups eventually prevailed.

Very substantial  
reforms happen  
during 1989-1993

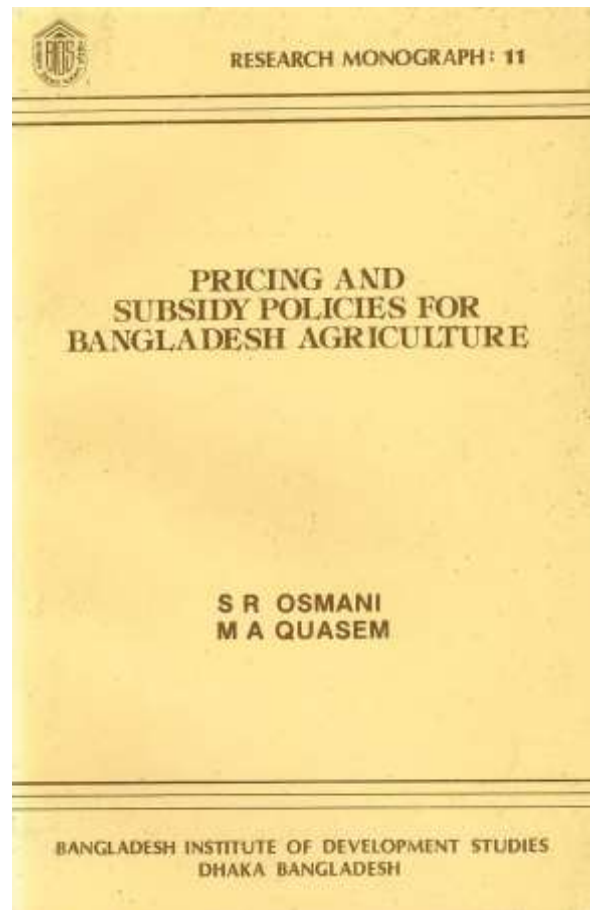
- 1989: The urban-based Modified Rationing system replaced by the Rural Rationing system.
- The latter lasts only 3 years and is eliminated in 1992.
- Restrictions on in-country movement of food grain removed in 1989, private wheat import allowed in 1992 and that of rice in 1993.
- A host of other reforms happened in 1992-1993.

*“For drama and intrigue, the story of food policy reform in Bangladesh is difficult to match. Played out over two decades, since the 1970s, this fascinating and complex tale has involved powerful interest groups, including at least three different governments of Bangladesh”*

*- Tawfiq-e-Elahi Chowdhury and Steven Haggblade*



**Although poor people did not benefit much from the ration system, other studies have found poor economic actors benefiting from subsidies on certain products**



## **Trade liberalization**

**- too little, too slow or too much, too fast**

# Despite push from development partners, trade liberalization was modest till end-1980s

Development partners were advocating trade liberalization from the mid-1970s

- The second stand-by arrangement signed with the IMF in 1975 called for import liberalization.
- World Bank programmatic loans such as the Import Program Credits of the 1970s and 1980s also had conditionalities related to import liberalization.

Modest amount of reforms happened before late 1980s.

- Although substantial reforms in industrial regulations took place in the second half of the 1980s, the pace of trade liberalization was modest.
- A major reason for this was the ambiguity in the minds of Bangladeshi economists on the issue.

*“Although efforts at rationalizing the tariff structure during the 1980s have been notable, on the whole, **the Government approached the issue of tariff reform guardingly.***

*As a result, the net effect of the reforms has not been appreciable as distortions in the trade regime, especially those emanating from high rates and exemptions, remain excessive, suggesting that efforts must continue in earnest to rectify the situation.”*

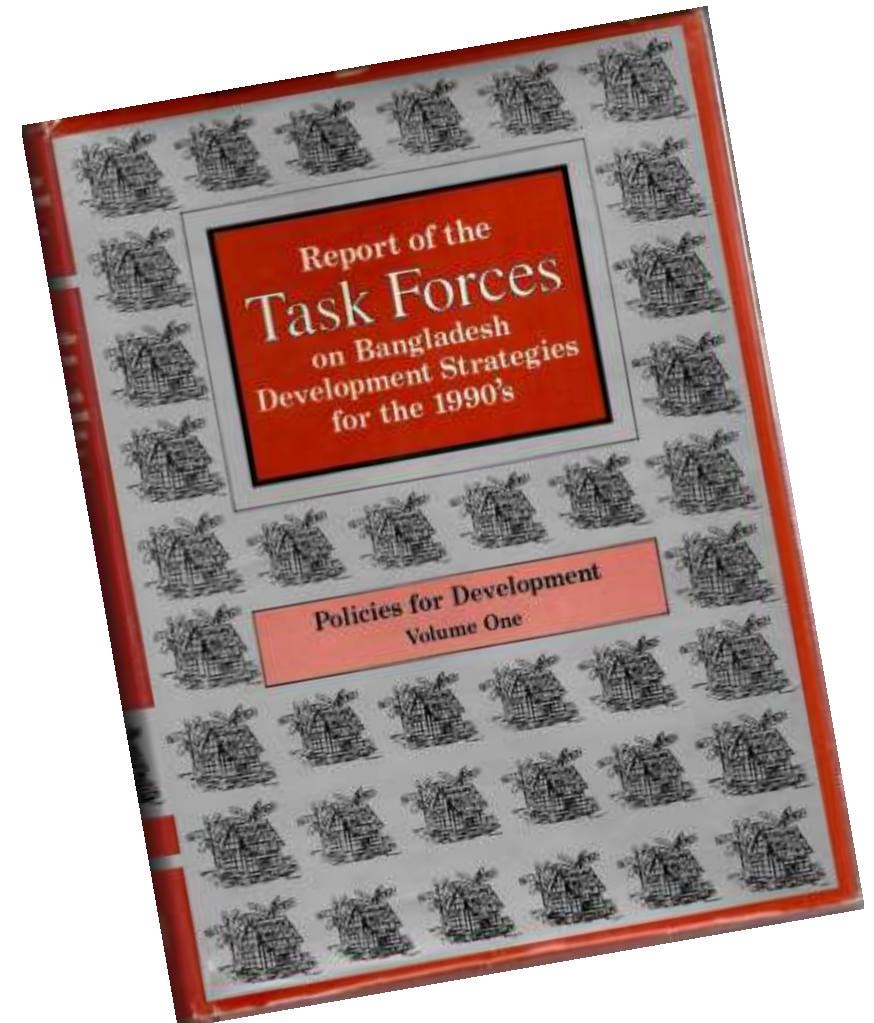
*- World Bank evaluation of Bangladesh reforms in the 1980s*

# There was concern about how trade liberalization will impact industry

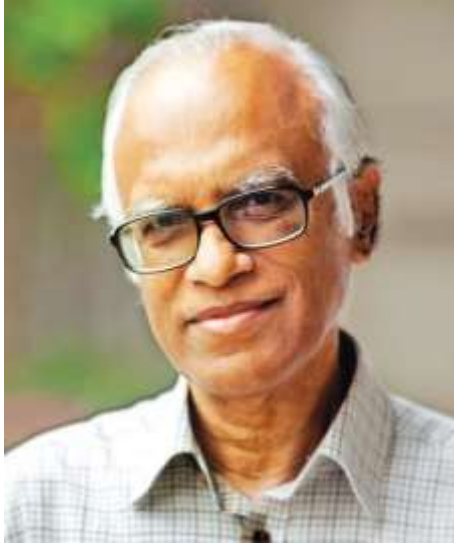
*“While lowering protection may be desirable, there are important considerations regarding the speed and sequencing of such reforms and their general policy context.”*

- *from Report of the 1990 Task Force on Macroeconomics led by Professor Wahidudin Mahmud*

- It is important to ensure predictability of the incentive structure over a long enough time horizon. Otherwise, credibility of the government’s policy initiatives will suffer.
- Protection does help inefficient industrial firms to survive. But low industrial productivity is not necessarily due to protection.
- Industrial development in Bangladesh is still at the stage of easy import substitution. Many industries and related institutions are still at a nascent stage with a lot of sunk investment.
- Thus, increased exposure to world market, particularly if the transition is too rapid, can have very adverse effects.
- **View: Trade liberalization should happen after improvements in investment climate.**
- **Also concern about revenue losses due to liberalization.**



## Nonetheless, substantial reforms happened in the first half of the 1990s....



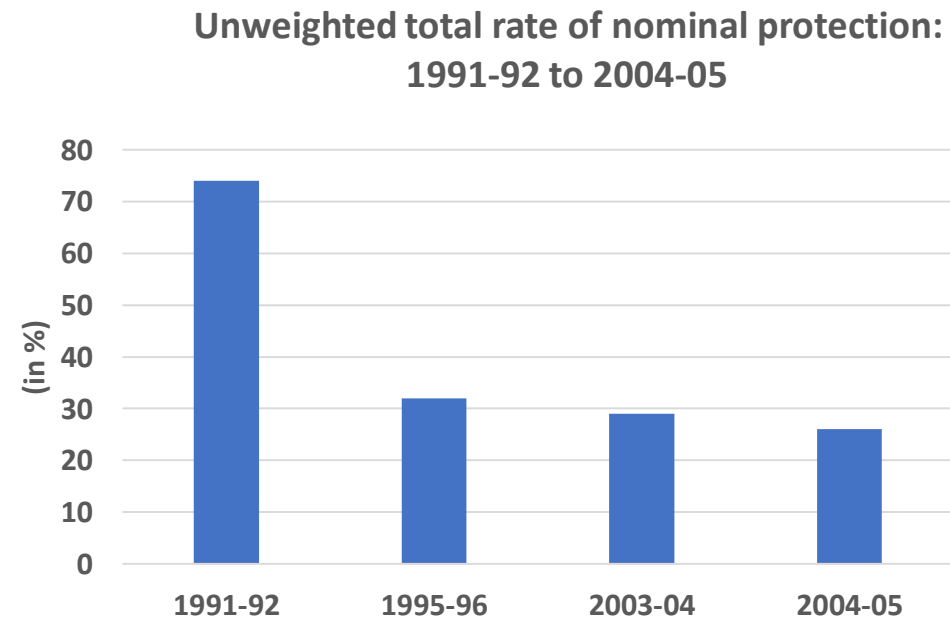
*By international standards, Bangladesh has had **one of the most rapid episodes of import liberalisation**, from the withdrawal of quota restrictions in the late 1980s to the reductions in tariffs in the first half of the 1990s.”*  
- Wahiduddin Mahmud



*“The 1990s was truly the **golden period of trade policy developments** when you consider the whole gamut of radical changes in the trade policy regime that were launched at the start of the decade.”*  
- Zaidi Sattar

# Significant reduction in the rate of protection

- The BNP government that came to power in 1991, faced a BoP crisis. It approached World Bank & IMF for support. The support came but with conditions. One reform area to pursue was trade and tariff policy reforms.
- The import-substitution lobby opposed such reforms. Nonetheless, the reforms were substantial, even if partial.
- Since QRs on imports had been reduced in the late 1980s, the reforms in the first half of the 1990s focused on tariff reduction and rationalization.
- The average nominal protection rate fell from 73.6% in 1991-92 to 32% per cent in 1995-96.
- But then the rate of progress slowed with increased use of para-tariffs.



# Initially mixed results from trade liberalization but substantial positive impact in the long run

- Almost half of the country's 4-digit industries contracted during the first half of the 1990s.
- Productivity improved in import-substituting industries, but mainly due to exit of inefficient SOEs, not technological improvements at the firm level.
- Small- scale manufacturing activities (excluding handlooms and cottage industries) fared better than large-scale manufacturing, growing at an average rate of more than 9 per cent annually in the 1990s.
- Import liberalization helped them by allowing better access to imported inputs and capital machinery, while their products faced less competition from imports than that of large firms.
- Clearly, domestic industries need to improve production efficiency in order to be able to withstand a further reduction in protection. Thus, extent and speed of further import liberalization remain a contentious issue in the country's economic reform agenda.

- Wahiduddin Mahmud writing in 2004

*“To keen observers of the Bangladesh economic scene the trigger that unleashed the forces of rapid economic growth would have to be the radical change in direction of trade policy (complemented by market orientation and deregulation) during much of the 1990s decade.*

*It is now possible to make the assessment that after the first two decades of prevarication in trade policy Bangladesh was able to change course and get it right – at least partially so.*

*In my assessment nowhere in the policy space was there such a radical change of direction as in the case of trade policy. In my view, **switching gears in trade policy in the 1990s, from an inward-looking, import-substituting to an outward-looking export-oriented trade policy was the game changer.**”*

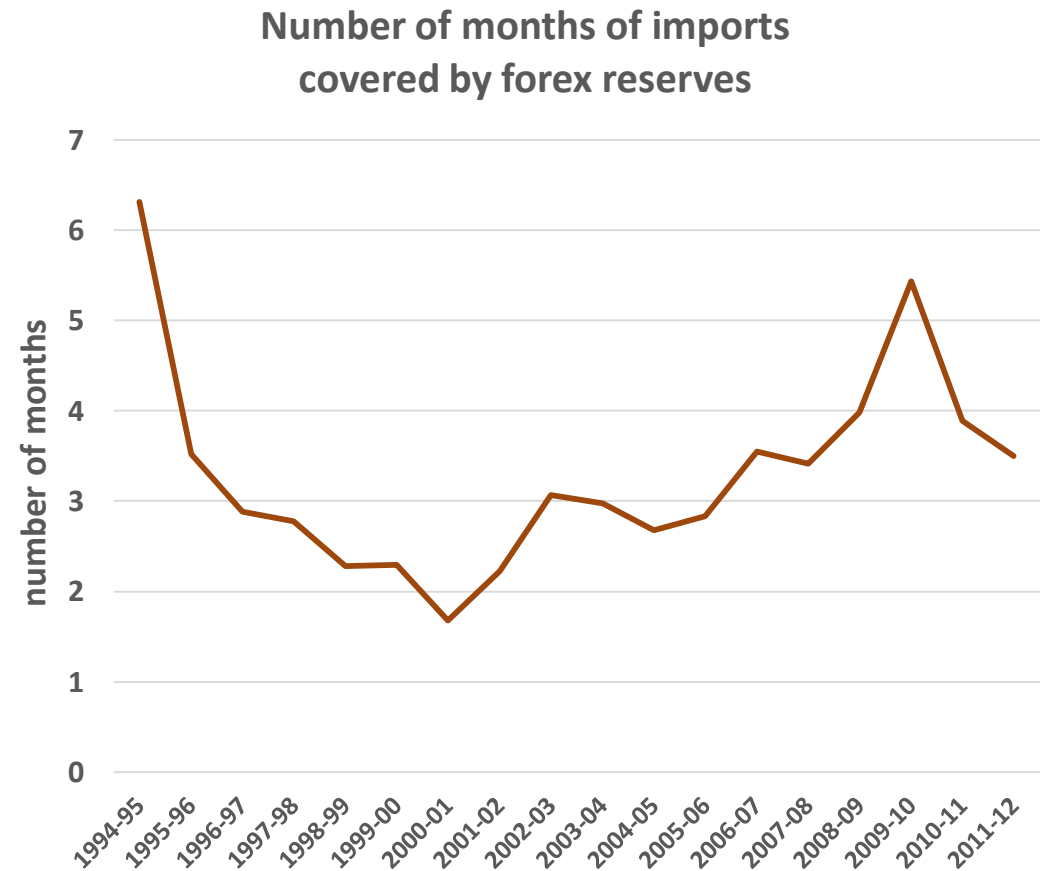
- Zaidi Sattar writing in 2021

**Floating the exchange rate**  
**“Don’t fix what ain't broken”**



# Ups and downs in foreign exchange reserves during the 1990s

- Bangladesh's foreign exchange reserves rose steadily in the first half of the 1990s. At end 1994/95, it was equivalent to 6.31 months of imports, one of the highest levels achieved in Bangladesh.
- But then reserves steadily fell. By the end of June 2001, reserves were equivalent to just 1.68 months of imports.
- Within six years, this important indicator dropped from one of its highest levels in the history of Bangladesh to one of its lowest.



# This triggers questions about the wisdom of the existing exchange rate regime (fixed yet adjustable)

*“In recent years, Bangladesh has maintained a fixed yet adjustable exchange rate regime in the face of an expansionary fiscal policy, rapid growth of domestic credit, and unanticipated adverse external conditions. Although inflation has remained low, **this policy has led to a steady erosion of the international reserve position, exacerbating the country’s vulnerability to external shocks.**”*

*- IMF Country Report for Bangladesh 2002*

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# Demand grows for floating the Taka

*“Given the overall policy environment and external vulnerabilities, **the usefulness of the fixed exchange rate system has run its course. Greater exchange rate flexibility** is needed to ensure that the exchange rate sends appropriate market signals and to enhance authorities’ ability to address more effectively and timely both domestic imbalances and external real shocks arising from a rapidly changing global environment.”*

*- IMF 2002 Country Report on Bangladesh*

# A debate between two class-mates



**Fakhruddin Ahmed**



**Mirza Azizul Islam**

# “Don’t fix what ain't broken” - *Mirza Azizul Islam*

- In his paper, Islam laid out two major arguments.
- The economic and institutional prerequisites of a floating exchange rate regime, such as sophisticated financial institutions and broad and deep markets for foreign exchange, were not met in Bangladesh. Hence, such a move would lead to significant volatility in exchange rates and deter much-needed investment.
- The existing exchange rate system has worked well.
  - “The present exchange rate regime in Bangladesh has served the country quite well. No major misalignment with equilibrium exchange rate has occurred and real effective exchange rate has not been allowed to appreciate. There has been satisfactory performance in terms of certain key macro-economic indicators such as export growth, current account deficit, inflation and remittance by non-resident Bangladeshis.”



# The Taka was floated but many fears did not materialize

- On May 30, 2003, Bangladesh moved to what was officially called a freely floating regime.
- There was concern that this will lead to immediate, and significant, depreciation of the Taka.
- Monzur Hossain and Mansur Ahmed studied the effects of this policy reform in a paper published in 2009.
- They found Taka depreciating less than 1% from June 2003 to April 2004. Then about 20% by 2006 to reach Taka 70 per US\$ before stabilizing around that level.
- They calculated an index of exchange rate volatility. Value of index:
  - January – March 2000 (pre-floating): 2.65
  - June 2003-February 2006: 3.03
  - March 2006-June 2008: 0.71
- Hossain and Ahmed concluded: It was *de jure* a freely floating exchange system, but *de facto* a managed float.





# Choosing the middle ground

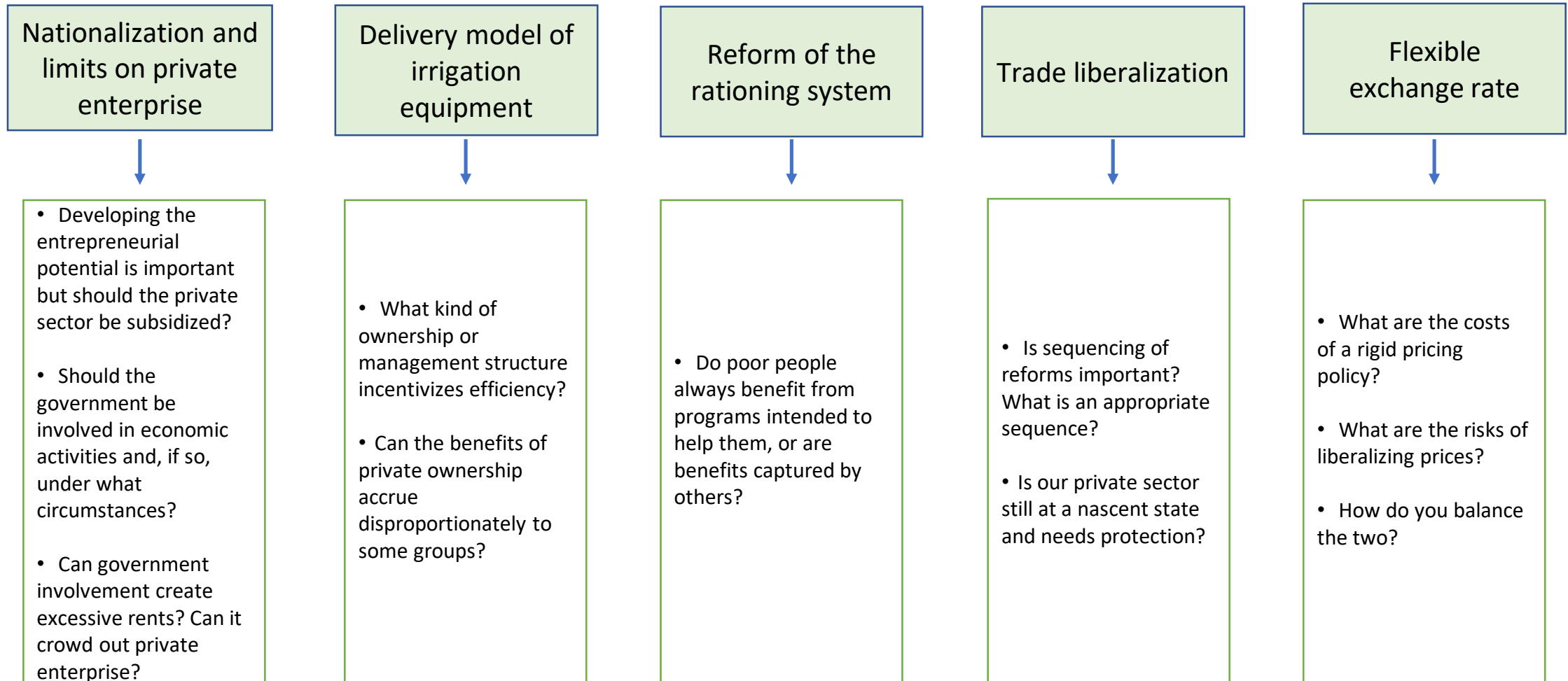
- It appears that, by opting for a de facto managed float system, the government eventually settled on a middle ground between Fakhruddin Ahmed's proposal to move to a freely floating exchange rate and that of Mirza Azizul Islam to maintain the status quo of a fixed (pegged) system.
- Such a pragmatic approach of choosing a middle ground is not unique to the exchange rate management system.
- Indeed, a history of policy debates in Bangladesh suggests that such compromises have often been the way the debates were resolved.



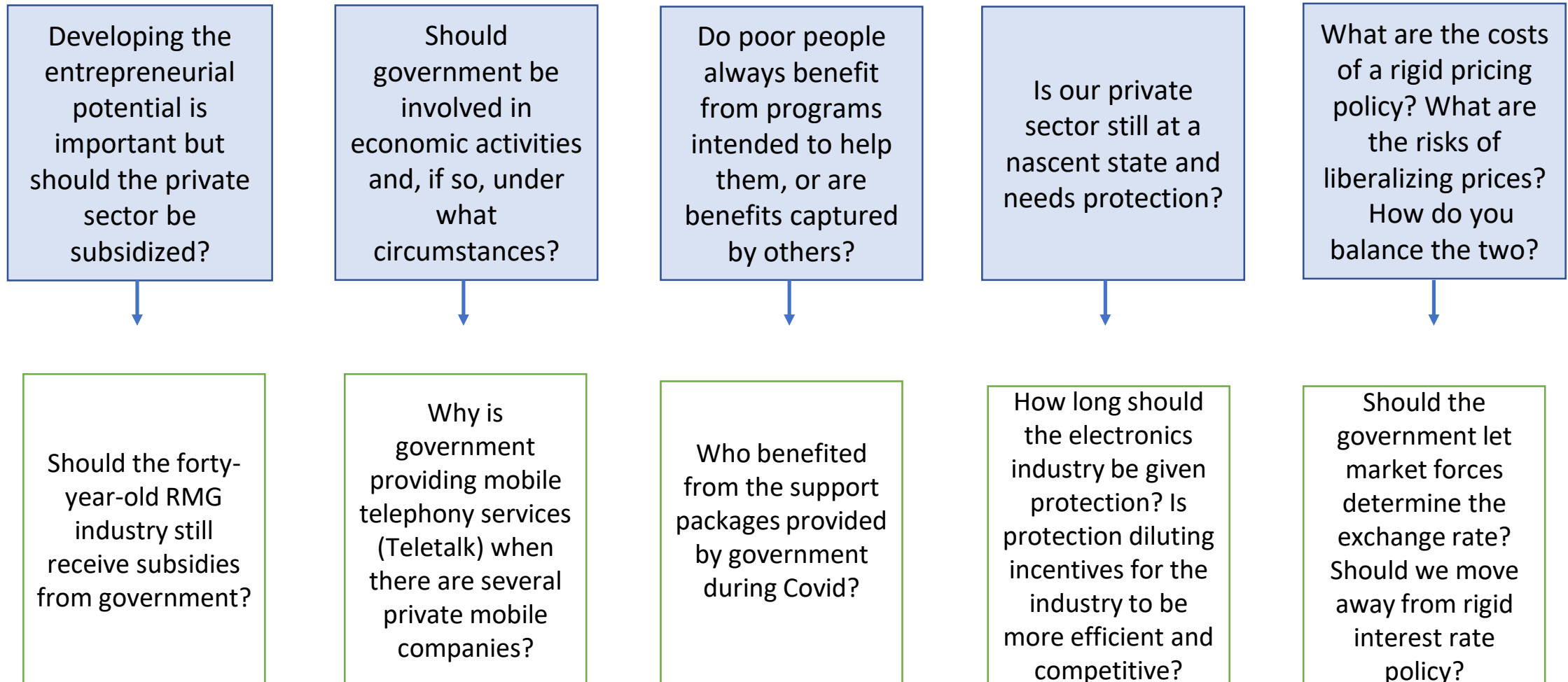
# **The main take-aways**



# Some topics are no longer the subject of debate, but the underlying issues remain very relevant



# Contemporary relevance of issues raised during earlier debates: some examples



# The many facets of policy dynamics

*“Motives and tactics have changed over time, with the principals exhibiting a wide range of behavior – from idealism to opportunism; from gentle persuasion to explicit conditionality, to the application of military force- and, not least, patience and guile.”*

*- Tawfiq-e-Elahi Chowdhury and Steven Haggblade on the reforms to the public food distribution system*

*“The master-economist must possess a rare combination of gifts .... He must be mathematician, historian, statesman, philosopher — in some degree. He must understand symbols and speak in words. He must contemplate the particular, in terms of the general, and touch abstract and concrete in the same flight of thought. .... He must be purposeful and disinterested in a simultaneous mood, as aloof and incorruptible as an artist, yet sometimes as near to earth as a politician.”*

*- John Maynard Keynes*



## Keynes once again

***“The master-economist must study the present in the light of the past for the purposes of the future.”***

# About the speaker



Syed Akhtar Mahmood is an economist. He was Lead Private Sector Specialist in the World Bank Group, where he worked in various parts of the world for three decades on privatization, state enterprise reforms, investment climate, competitiveness, and more broadly private sector development. His professional interests also include policy capture, political economy, and the mechanisms of policy reforms.

Dr. Mahmood studied, and later taught, economics at Dhaka University in the late seventies and early eighties. He obtained a D.Phil. in Economics from the University of Oxford in 1989 for his work on public manufacturing enterprises in Bangladesh and was a visiting fellow at Yale University from 1988 to 1990.

His publications include *The Political Economy of Development Policy Change* (co-authored with Gustav Ranis), Blackwell 1991, and *Privilege-Resistant Policy Making in the Middle East* (co-authored with Meriem Ait Ali Slimane), World Bank 2018.

He is currently working on a book that seeks to explain Bangladesh's economic transformation through the interplay of entrepreneurship, market development, economic analysis and policy dynamics. He writes a fortnightly column, *Patterns and Trends*, in Dhaka Tribune. He currently lives in Maryland, USA.