

# Learning from Policy Debates

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*BIGD online lecture series “Making Policy Work for Development”*

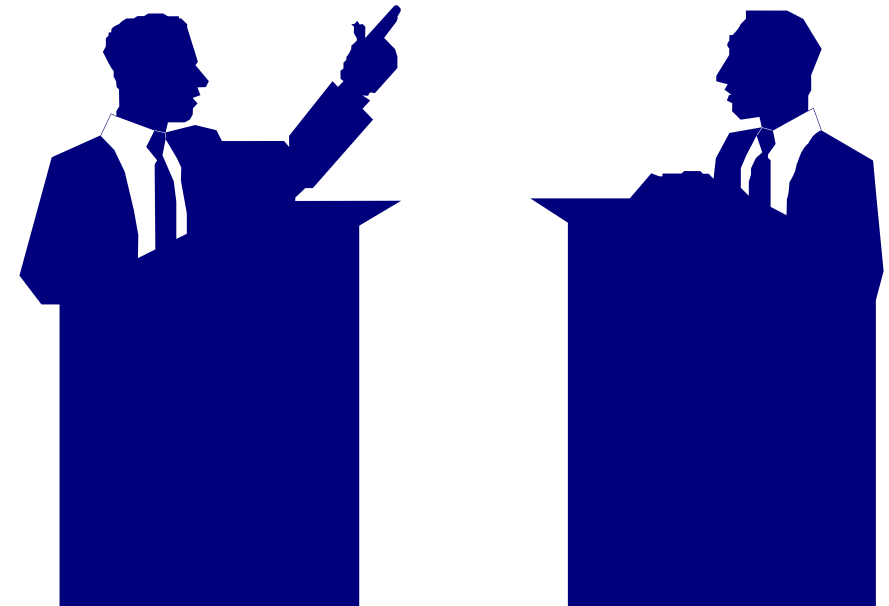
*July 13, 2023*

*This is a shorter version of a presentation made by the author at the Annual BIDS Conference on Development held in Dhaka on December 1, 2022, titled “Debates, Dialogues and Decisions: A historical look at policy making in Bangladesh”*

# Effective policy making requires stakeholder inputs

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- Policies help realize development goals
- Development goals must reflect the needs and aspirations of the people
- Thus, the policy formulation and implementation processes must be informed by evidence and research that brings out the needs and aspirations of the people
- Since different stakeholders may view policy priorities differently, the policy process typically involves a lot of debates
- Research often helps trigger, shape or resolve these debates



# Some contemporary policy questions

Should the forty-year-old RMG industry still receive subsidies from government?

Should the government let market forces determine the exchange rate?

Should we move away from rigid interest rate policy?

How long should the electronics industry be given protection? Is protection diluting incentives for the industry to be more efficient and competitive?

Who benefited from the support packages provided by government during Covid?

Why is government providing mobile telephony services (Teletalk) when there are several private mobile companies?

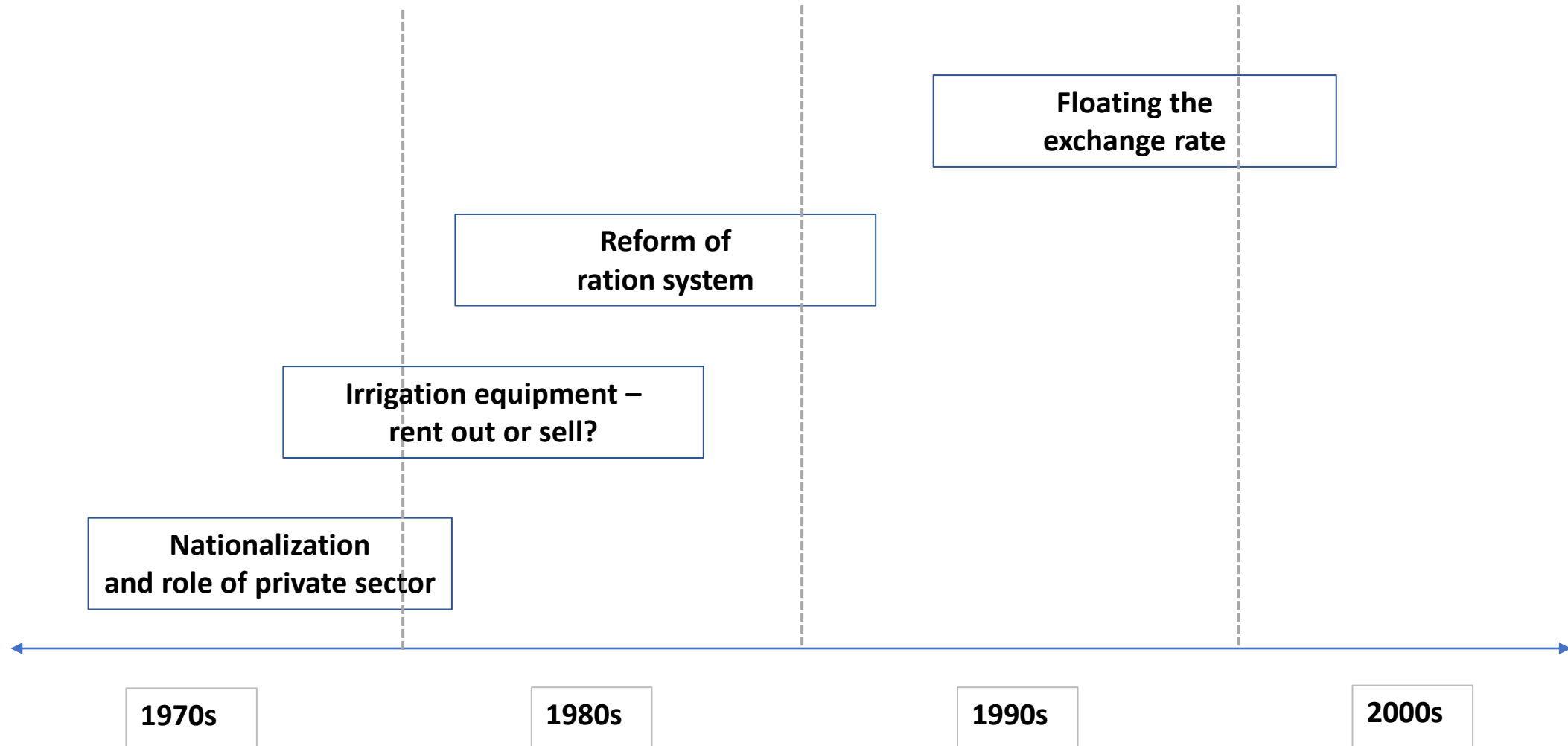


## In the light of the past

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

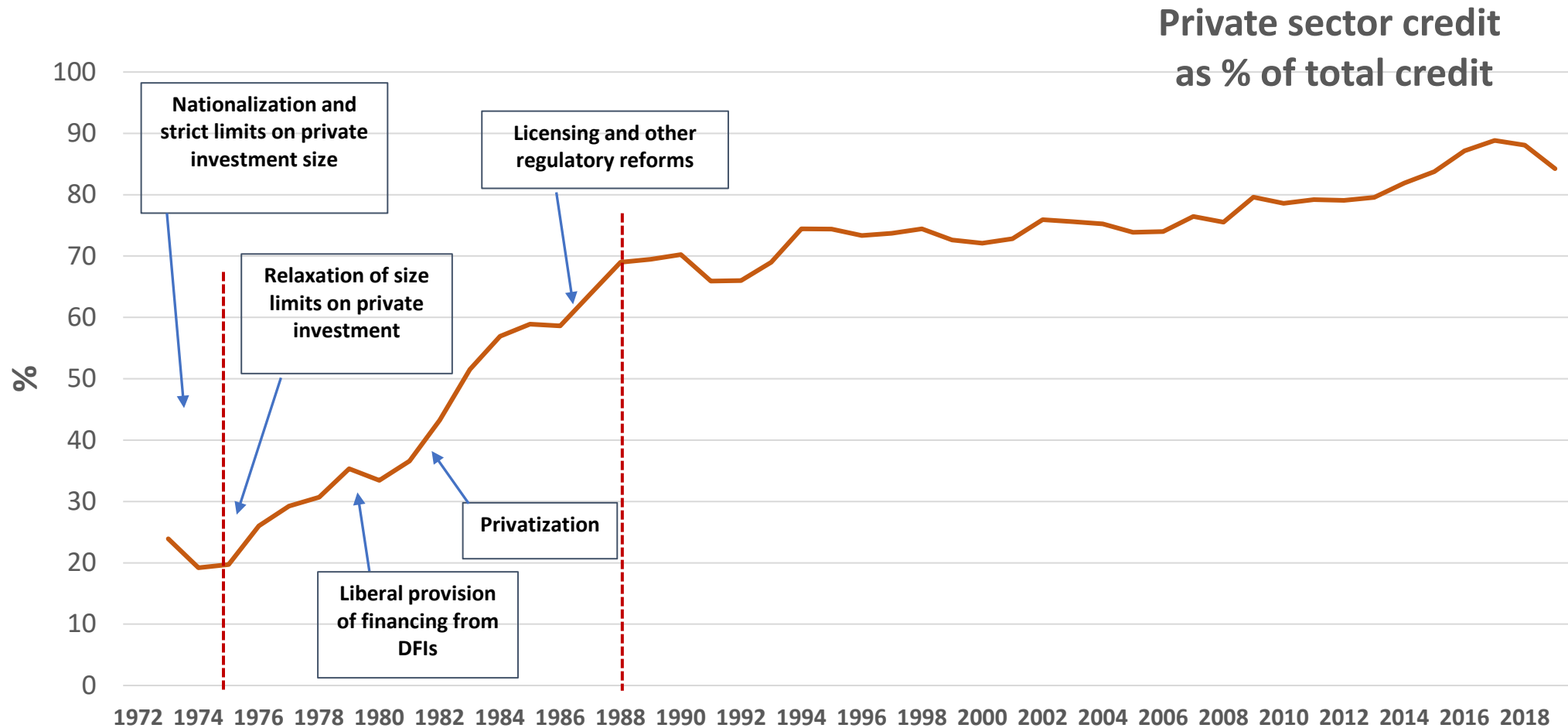
*- John Maynard Keynes*

# Policy debates of the past – four cases



“Nationalization and all that”  
three issues debated

# 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 is 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 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.

# What to do with industrial enterprises owned by Bangladeshis?

## Liberal position

Bangladeshi owners should be allowed to retain and run these enterprises

- 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

- Since the government had declared an intention to build a socialist economy, all major industries should be nationalized irrespective of the ethnic origin of the owners.

# What to do with industrial enterprises owned by Bangladeshis?

*“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

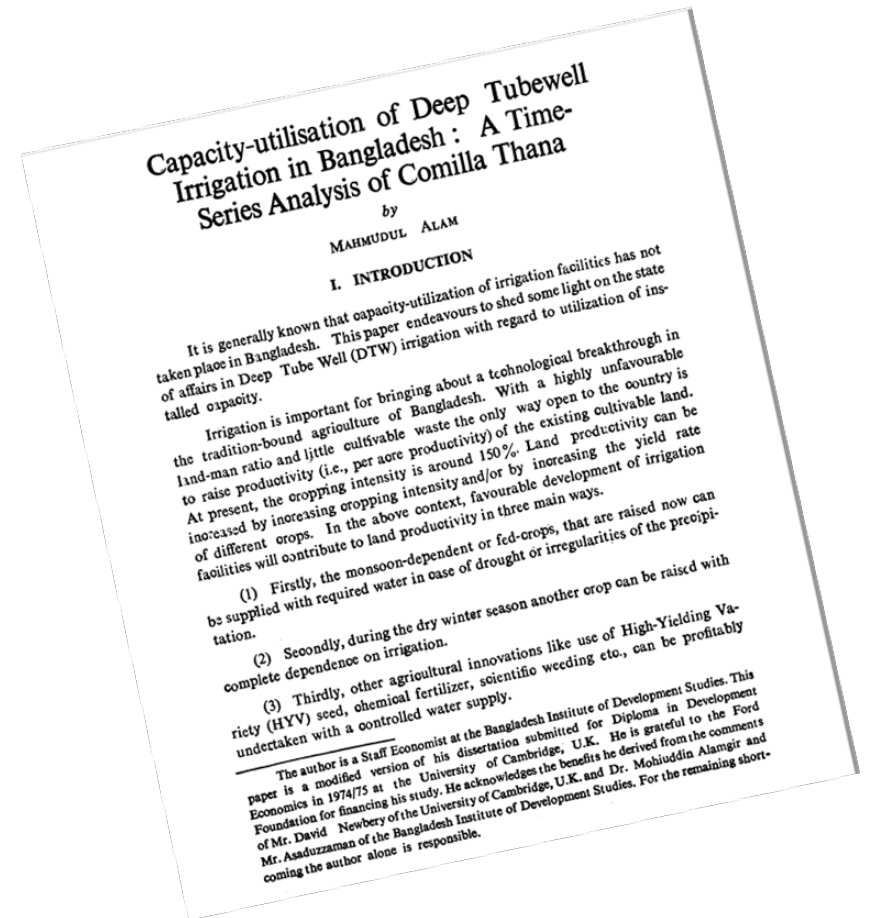
# Efficiency of use of irrigation equipment was a big concern in 1970s given resource constraints

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.

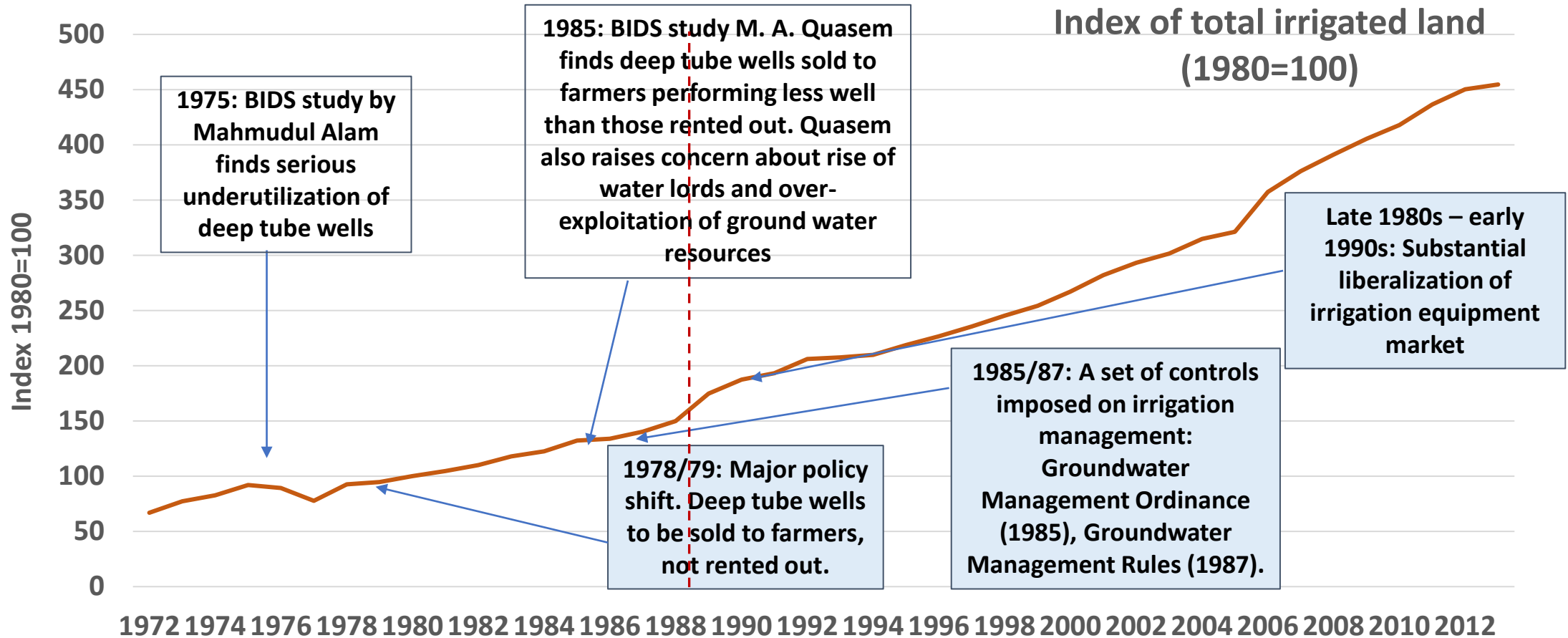
But the reforms  
yielded less than  
satisfactory results

- 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

By the late 1980s, the public food distribution system had become 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.

Different ministries take different positions

- Planning Commission (from 1978) and Finance Ministry (from early 1980s) wanted to phase out ration subsidies.
- But Food and Agricultural ministries opposed them.
- Food ministry favored low ration prices low in order to ensure food security
- Agriculture ministry, concerned about returns to farmers, wanted to maintain a high procurement price for rice.

# 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 utilised. While not overly protective, household's attitude to SR is nevertheless informed by economic discretion. This is because foodgrains is not so much due to irregular lifting as to partial lifting. SR is underutilised is not so much due to shrewd calculation of relative prices between taken advantage of on the strength of shrewd 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 channelled 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 Currey 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, as is 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. Restrictions on in-country movement of food grain removed.
- 1992: Rural Rationing system eliminated. Private wheat import allowed.
- 1993: Private rice import is allowed

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*

INTERNATIONAL MONETARY FUND  
BANGLADESH  
Selected Issues and Statistical Appendix  
Prepared by Marijn Verhoeven, Quazar Hussain, Abdel Serhadji and Yan Sun (all APD), and Raj Nallari (PDR)  
Approved by the Asia and Pacific Department  
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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.”

CPD Occasional Paper Series

**Exchange Rate Policy of Bangladesh:  
Not Floating Does Not Mean Sinking**

Paper 20

Dr Mirza Azizul Islam

# “Let’s manage the risks”

- *Fakhruddin Ahmed*

- Bangladesh Bank Governor Fakhruddin Ahmed wanted to make the exchange rate regime flexible.
- He was aware of the risks but did not shy away from the reform because of risks.
- Instead, he decided to first build capacity in the Bangladesh Bank to manage market liquidity so that speculative attacks on the Taka could be minimized.
- The central bank needed tools to both assess excess liquidity in the market and to mop it up when needed. The officers in the Bangladesh Bank had to be trained in such tools.
- Ahmed asked for help from both the IMF and other central banks in the region. The help came promptly, and it was only after adequate capacity had been built to manage liquidity that the government decided to float the exchange rate in May 2003.
- This policy episode has an important lesson for economic management in Bangladesh: Risks can be assessed and managed.



# Fears of volatility did not materialize

- 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.

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## An Assessment of Exchange Rate Policy under Floating Regime in Bangladesh

MONZUR HOSSAIN\*  
MANSUR AHMED\*

This paper examines the exchange rate policy in Bangladesh for the period 2000-2008. Regime classification of the paper suggests that Bangladesh maintained a *de facto* managed floating regime by intervening in the foreign exchange market on a regular basis. This is at odds with the Bangladesh Bank's claim of maintaining *de jure* freely floating regime since end-May 2003. A high exchange rate pass-through is observed along with high market pressure during the period of expansionary monetary policy. Given the thin foreign exchange market and high pass-through (inflation) effects, it appears difficult for Bangladesh to maintain a freely floating regime. Although Bangladesh maintained average competitiveness throughout the period with depreciating REER, the currency remained somewhat overvalued. Estimates of export demand functions suggest that with lowering the REER volatility, positive impact on overall exports rises. Moreover, net foreign assets have significant effect on the REER appreciation while terms of trade, real interest rate differential, and government budget deficit are significant to REER depreciation. Based on the findings, foreign assets have significant effect on the REER appreciation while terms of trade, real interest rate differential, and government budget deficit are significant to REER depreciation. Based on the findings, some pragmatic policies in managing the exchange rate in Bangladesh have been suggested.

\* The authors are respectively Research Fellow and Research Associate at Bangladesh Institute of Development Studies (BIDS). The authors are grateful to K.A.S Murshid for funding their study through the BIDS-PRP project, and his critical review of an earlier version of the paper. They are also thankful to M A Taslim Zaid Bakht and Salehuddin

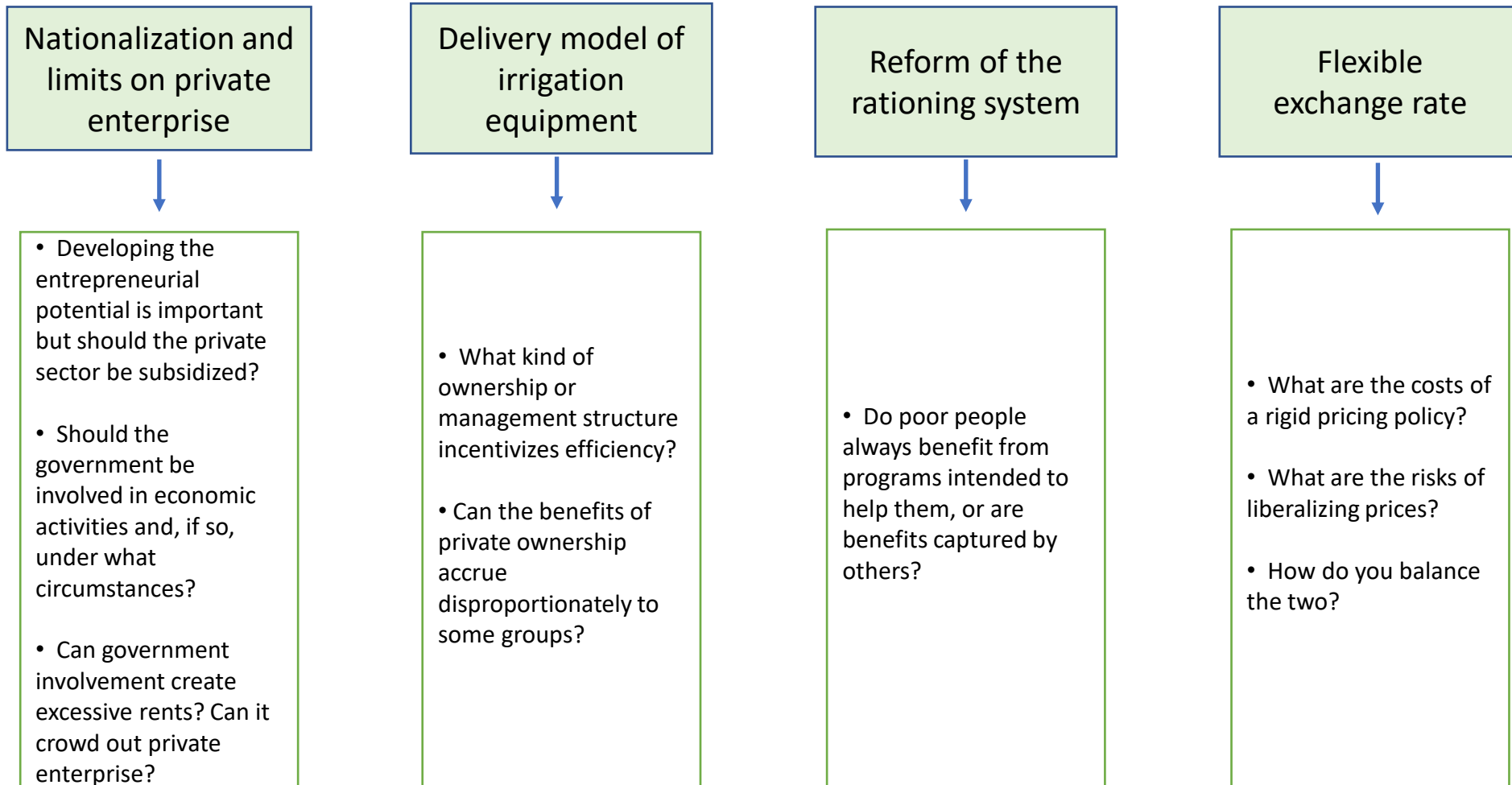
# Choosing the middle ground

- 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

Developing the entrepreneurial potential is important but should the private sector be subsidized?



Should the forty-year-old RMG industry still receive subsidies from government?

Should government be involved in economic activities and, if so, under what circumstances?



Why is government providing mobile telephony services (Teletalk) when there are several private mobile companies?

Do poor people always benefit from programs intended to help them, or are benefits captured by others?



Who benefited from the support packages provided by government during Covid?

Is our private sector still at a nascent state and needs protection?



How long should the electronics industry be given protection? Is protection diluting incentives for the industry to be more efficient and competitive?

What are the costs of a rigid pricing policy? What are the risks of liberalizing prices? How do you balance the two?



Should the government let market forces determine the exchange rate? Should we move away from rigid interest rate policy?