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He Role of Donor A.Gencies in The Formulation of Industrial Policy in Bangladesh

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THE ROLE OF DONOR AGENCIES IN THE FORMULATION OF INDUSTRIAL POLICY IN BANGLADESH

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DECLARATION

I do hereby declare that the thesis entitled **"The Role of Donor Agencies in the Formulation of Industrial Policy in Bangladesh"** submitted to the University of Rajshahi, Bangladesh, for the degree of Master of Philosophy is my original work. No part of this thesis , in any form, has been submitted to any other university or institution for any degree or diploma.

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CERTIFICATE

Certified that the thesis entitled **"The Role of Donor Agencies in the Formulation of Industrial Policy in Bangladesh"** is a record of independent research work carried out by Khandaker Md. Shariful Islam, Lecturer, Department of Public Administration, Rajshahi University, under our joint supervision. This is the candidate's original work and is not a conjoint research work with any one. We approve of its submission for the award of Master of Philosophy in Public Administration. This has not been previously submitted for the award of any Diploma, Degree, Associateship, or other similar title.

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THE ROLE OF DONOR AGIENCIES IN THE FORMULATION OF INDUSTRIAL POLICY IN BANGLADESH

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ABSTRACT

Policy making in developing countries are conditioned by many actors and factors existed in the national as well as in the international environment. As a key actor donor Agencies' role in the development process in general and in the policy formulation in particular has been debated for a long. Whether donors can influence the public policy making process of Bangladesh as a recipient country has been a matter of debate and great concern on part of the academicians, researchers, pressmen and policy makers. There exists different and sometimes conflicting views over the issue of whether donors can really interfere in the policy making of Bangladesh and compel the policy makers to mould the policy in their preferred direction. Controversies continue to exist over to what extent the donors should interfere in the domestic policy making process of developing countries. The present study attempts to examine the extent of donors influence in the policy process of Bangladesh by focussing on industrial policy in details.

The main objective of the study is to make a critical assessment of the existing practice of public policy making in Bangladesh assuming the donors' role as the key actor. It modestly attempts to focuss on how the donor agencies intervene in the industrial policy formation of Bangladesh. The study is undertaken to deal with the following specific objectives:

a) to make a general overview of the process of public policy making in Bangladesh;
b) to illustrate the role of different donor agencies in the public policy making process in Bangladesh;
c) to examine the formulation of industrial policy in Bangladesh with particular reference to the critical role being played by different donor agencies.
d) to find out the actual role of the Government of Bangladesh as the key actor in the making of industrial policy of Bangladesh vis-a-vis donor influences.

The study is mainly based on secondary sources. For the collection of necessary information, existing literature (books, journals, magazines, dailies) relevant to the study have been consulted. Various government publications and documents of relevant agencies of Bangladesh such as Five Year Plans, Annual Development Plans, Industrial Policies, Economic Surveys, Bangladesh Bank Annual Reports etc. have been dealt with. Moreover, relevant World Bank, IMF, ADB and other donors' documents such as various World Bank Country Reports, Seminar Papers, Research Reports, Aid Group Meeting Report etc. are also consulted.

It is found in the study that like many other developing countries Bangladesh in the process of policy formulation has been under the donors' persistent pressure and influence. This is because of the fact that Bangladesh is heavily dependent on aid for her economic and social development and in crisis times for her economic survival. Major part of the development budget comes from the donor countries and agencies.

Donors provide inputs into the policy and watch feed backs of the policy implementation. Donors intervention in the domestic policy making and policy implementation process of Bangladesh become visible through various ways and means. There are some formal arrangements such as aid consortium meeting held every year in Paris, bilateral talks between the donors and Bangladesh Government, local consultative group meeting organized by the World Bank Resident Mission in Bangladesh etc. which provide the donors a great deal of power to influence the policy formulation process of Bangladesh. Besides, some informal instruments are used by the donors to influence the policy process such as seminars and symposium conducted by World Bank or other bilateral donors, World Banks time to time published reports, visit to Bangladesh by the donor governments or agiencies' high official, informal gathering and meetings organized by the donors or Bangladesh Government etc. These are as influential as formal ones.

In the ultimate analysis it is observed that Bangladesh has been following a path of aid-dependent industrialization strategy for a long time. The policy changes have taken place in line with the desires and directions of the donors especially with the revommendations made by the World Bank and the IMF. The donors not only clearly articulated their views on these policy changes but also very closely watched their implementation process. Moreover, policy changes have been taken place at the implementation stages. But the expected results have not been achieved. The privatization programme which is introduced in Bangladesh following the recommendations of the donors has made no positive impact on the economy. In the name of economic liberalization Bangladesh, one of the poorest countries in the world, has been flooded over by foreign goods andas a result of this local industries are being ruined.

This donor-dependent development strategy in Bangladesh has a pervading effects on her socio-political as well as economic life. Easy access to foreign aid has created and supported an elite group of indentors, contractors, consultants and business groups who along with upper echelon of bureaucrats and political leadership in control of the government machinery, benifits from various commissions from foreign aid. The over dependence on aid reinforced a system which has been inimical to both the mobilization of domestic resources and to the effective use of the productive capacity of the economy.

The intervention by the donors into the process of policy formation of Bangladesh stems largely from the latter´s own failure in governance. Our endeavor therefore, should be to develop the economy with our own resources. Side by side, foreign aid that comes with all the conditionalities detrimental to our economy should be rejected. We must formulate such policy which can help us attain economy for which we will feel proud. Industrialization strategy of the government should be based on a comprehensive economic program. The future donors dictated policy directions should be carefully examined so that it does not jeopardise our long term goals.

List of Abbreviations

ADB	Asian Development Bank
ADP	Anual Development Plan
BEPZA	Bangladesh Export Processing Zones Authority
BKB	Bangladesh Krishi Bank
BOI	Board of Investment
BSB	Bangladesh Shipla Bank
BSCIC	Bangladesh Small and Cottage Industries Corporation
CIDA	Canadian International Development Agency
DANIDA	Danish International Development Agency
DCCI	Dhaka Chember of Commerce and Industry
DFI	Development Finance Institution
DTI	Department of Trade and Industries
EFF	Extended Fund Facilities
ESAF	Enhanced Structural Adjustment Facilities
EPZ	Export Processing Zone
FDI	Foreign Direct Investment
FPI	Foreign Private Investment
FSRP	Financial Sector Reform Program
FY	Financial Year
GoB	Government of Bangladesh
IFC	International Finance Corporation
ILO	International Labor Organization
IMF	International Monetary Fund
JSAC	Jute Sector Adjustment Credit

LGED	Local Government Engineering Department
LMC	Like Minded Countries
MIDAS	Micro Industries Development Assistance Society
MOU	Memorandum of Understanding
NAFTA	North American Free Trade Area
NCB	Nationalized Commercial Bank
NGO	Non-Government Organization
NIRD	National Integrated Rural Development
NORAD	Nordic Assistance for Development
ODA	Overseas Development Administration
OECD	Organization for Economic Cooperation and Development
PE	Public Enterprise
PFP	Project Framework Paper
SAF	Structural Adjustment Facilities
SAPTA	South Asian Preferential Trade Agreement
SAL	Structural Adjustment Lending
SECAL	Sectoral Adjustment Lending
SOE	State Owned Enterprise
UN	United Nations
UNDP	United Nations Development Programme
USA	United States of America
USAID	United States Agency for International Development
VAT	Value Added Tax
WB	World Bank

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CHAPTER 1

INTRODUCTION

In Bangladesh as in many other developing countries aid dependence has become self-perpetuating. This is because of the fact that the flow of external resources remains the most crucial factor sustaining the official development programs in Bangladesh. It is being realized that the external alignments of Bangladesh, as well as its domestic economic policies remain increasingly vulnerable to the growing pressures of the donor countries and agencies dominated by them. Aid dependence has its own price for Bangladesh society which we need to carefully evaluate.

1.1 Background of the Study

Whether donors can influence the public policy making process of Bangladesh as a recipient country has been a matter of debate and great concern on part of the academicians, researchers, pressmen and policy makers. There exists different and sometimes conflicting views over the issue of whether donors can really interfere in the policy making of Bangladesh and compel the policy makers to mould the policy in their preferred direction.

As Humphrey (1992:84) argues, "I found that outside pressure has been exerted in Bangladesh less than expected". On the other hand, in evaluating the role of the donors in influencing the domestic economic policies of Bangladesh it has been concluded elsewhere that, "in Bangladesh donors have tended to freely express their views on the suitability of various policies enacted by the government of the day, the quality of the administration and their political integrity. This attitude originates from the belief that the size and importance of their contribution to Bangladesh's development efforts give them a position to dictate how it should conduct its development affairs" (Sobhan, 1992:202).

Rahman opined that, "A completely new reality now faces Bangladesh in which it has little contribution to the formulation of fundamental economic policies that guide economic activity in the short-run and shape its destiny in the long-run. This is a price Bangladesh must pay for excessive dependence on foreign aid" (Rahman, 1991:121).

I concur with the opinion that donors are the most influential actors in the policy making process. That should not be interpreted to imply that whatever policies these agencies are persuading the government to adopt are all inappropriate or harmful for the country. Rather the following discussion reveals that Bangladesh being an independent state cannot exercise authority to make policy independently. It has to depend upon donors, one of its influential supra systems, in one way or the other. External dependence had diverted the policy makers to the have to raise resources from the people. This made governments less accountable to the people and more dependent on donors for securing patronage in order to grasp state power. The outcome of the Paris consortium meeting was thus always more central to the concerns of the Government of Bangladesh than the passage of the national budget by parliament (Sobhan, 1993:263).

The power and influence that World Bank and IMF wield over policy-making are often greater than that of the ministerial Cabinet or the Parliament, and certainly far in excess of their contribution. A very unpleasant aspect of this situation is that while the elected representatives of the country and the populace in general are ultimately responsible for the consequences of the policies actually implemented, they do not have much freedom to frame these policies. But the individuals, the economic and financial technocrats of the World Bank and the IMF, who actually frame these policies have no responsibility for their consequences. Moreover, these technocrats are often distant bank officials with very limited experience of the real life situation and political problems of the country. There is then the possibility that they may be tempted toward intellectual adventurism to test some pet theory. Indeed, some of their recommendations are nothing more than common sense economics.

Industrialization policy has been under debate throughout the economic history of Bangladesh. Possibly industry is the sector of the economy where most marked changes have taken place in a relatively short span of time, from the early days of independence to this date. Bangladesh has been following a path of aid-dependent industrialization for a long time. The policy changes have taken place in line with the desire and directions of the donors especially with the recommendations made by the World Bank and the IMF. But expected results are yet to be achieved. Hence the study would examine the extent of intervention of the donors in the formation of industrial policy in Bangladesh and at the same time would analyze whether this aid-dependent strategy has succeeded in achieving the expected goals.

1.2 Review of Aid Literature in Bangladesh

This section of the study highlights on the researches so far conducted in this area with a view to focussing the attendant shortcomings of these studies and demonstrate the present state which eventually lays the justification of undergoing the present study.

There already exists a significant amount of economic literature as to how the donors through the mechanism of foreign aid attempt to influence the economic policies of the recipient Third World countries. Ever since the birth of Bangladesh the role of foreign aid in the development process of the country has been debated by academicians and policy makers as well as media men. Numerous studies have been carried out, but only a few of them have been undertaken to analyze the extent of influence and effects of foreign aid on the policy formation process of studies, as would be seen in the discussion, are either in the category of general or macro study of aid or are intended to focus on some specific donor's aid program.

Khaleque's work (1980) is a reflection of the author's liberal thinking and it provides interesting answers to a variety of questions which express doubt about, and fury against, the proclaimed benefits of foreign aid. Thus he seeks to broadly identify political costs and benefits of foreign aid in economic terms and vice versa.

The study by Rahman (1984) attempted to evaluate quantitatively the effects of foreign aid on the economic development of Bangladesh during the decade 1972-73 to 1981-82. He analyzed the reasons behind those adverse effects, with a view to assessing their perspective implications for initiating a process of self-reliant development.

Ole (1990) viewed foreign aid to Bangladesh from the conflicting point of view of recipients and donors, and assessed experience and prospects of research co-operation between Bangladesh and Norway.

Khan (1986) attempted to shed some light on the way a major donor, the World Bank, has perceived problems pertaining to distribution of agricultural inputs and extension services during the 1970s and the kind of influence it had brought to bear on the Government.

The focus of Matin's study (1986) relates to Bangladesh's using Fund credits under Stand-by and Extended Fund Facility (EFF). In examining conditionality-based relations, the study has tried to highlight the basic imperatives of IMF's creation in order to place the concept of conditionality in its right perspective.

Faaland's work (1981) is an examination of the relationships between Bangladesh and the international aid community. He reviewed several separate and distinct aspects and issues of the development of aid relationships as they affected the country.

Sobhan and Islam (1988) in their studies have examined the political economy of aid dependence and its macro economic dimensions.

One of the studies that deserves special attention in the context of the present work is Sobhan (1990). The author examined the various perspectives on the modalities of operation of donor agencies in Bangladesh. The study goes on to discuss the political economy of aid-dependence through an analysis of the beneficiaries of foreign aid and then reviews how donors influence the policy making process of Bangladesh. It then moves on to present the nature and scope of a self-reliant development strategy and its socio-political implications.

Innumerable micro-level studies on specific aid programs are also available in Bangladesh. The Studies such as Sobhan (1982), Alam and Hossain (1986), Bhattacharya and Sen (1986) have looked at the impact of particular aid programs. Alam and Hossain's work have dealt with the socio-economic implications of *National*

Integrated Rural Development (NIRD) Project. Bhattacharya and Sen's work is a comparative review of *Rural Employment Programs* in Bangladesh.

A large part of the aid literature in Bangladesh took the form of aid-evaluation from the recipient's perspective. At the same time works on aid-politics from the donors' perspective are also not scarce. Guhathakurta (1990) falls in this category. She analyzes the politics of British aid policy towards Bangladesh through the analysis of the dynamics of the aid policy formation in Britain.

The above mentioned studies on aid and donors contribute to a better understanding of the problem of present interest. However, a detailed and systematic study on donors' intervention in the policy formation process remains to be undertaken. Such an exercise will be taken up in the present study.

1.3 Objectives of the study

The main objective of the study is to make a critical assessment of the existing practice of public policy making in Bangladesh assuming the donors' role as the key actor. The present study modestly attempts to focus on how the donor agencies intervene in the industrial policy formation of Bangladesh. The study is undertaken to deal with the following objectives:

(a) to make a general overview of the process of public policy making in Bangladesh;

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(d) to find out the actual role of the Government of Bangladesh as the key actor in the making of industrial policy of Bangladesh vis-a-vis donor influences.

1.4 Significance of the study

Various exogenous and endogenous actors and factors play critical role in the formulation of public policy in the developing countries. Donor agencies are considered to be the most critical actors in the policy making in Bangladesh. It has been reported by the media and policy critics as well that donor agencies like the World Bank, IMF, ADB and USAID have played a crucial role in the process of formulation of industrial policy in Bangladesh.

In recent years there has been a debate on what should be the role of the donors. The popular and dominant view is that public policy should be formulated by the legal policy makers of the country keeping public interests foremost and not by the donors to promote their own interest even though they provide fund for the policy. The proposed study therefore attempts to make an overview of the dynamics of the formulation of Industrial Policy in Bangladesh within the purview of donor influence.

1.5 Methodology

The study is mainly based on secondary sources. For the collection of necessary information, existing literature (books, journals, magazines, dailies) relevant to the study have been consulted. Various government publications and documents of relevant agencies of Bangladesh such as Five Year Plans, Annual Development Plans, Industrial Policies, Economic Surveys, Bangladesh Bank Annual Reports, etc. have been properly consulted. Moreover, relevant World Bank, IMF, ADB and other donors´ documents such as various World Bank Country Reports, Seminar Papers, Research Reports, Aid Group Meeting Reports, etc. are also consulted.

1.6 Limitations of the study

It has already been mentioned in the review of literature section that no comprehensive study from the specific policy making aspect appears to have been made on the subject so far in Bangladesh. Only general studies on foreign aid or donors´ role are available. Therefore, this study may be the first of its kind in the country. However, some limitations do persists:

First, not much literature on the subject in the form of text books, research studies, reports etc., journals and magazines were available in the country. However, efforts have been made to procure them from various sources, as far as possible, and to use these for the purpose.

Second, there were many obstacles in collecting data and information from various government sources. Most of the high government officials were not willing to provide information because of preoccupation with their own work. Another major problem was the very secret nature of many government documents and publications. Moreover, donors´ documents were not also available as these were often highly confidential in nature and only to be used for official purposes. Specially it is to mention here that the researcher had to face serious problems in collecting various Aid Group Reports from World Bank and ERD sources.

In spite of all these limitations, efforts are made to collect as much data as possible to fit the study with the fact.

1.7 Organization of the Study

The study on the subject entitled "The Role of the Donor Agencies in the Formulation of Industrial in Bangladesh" is divided into eight Chapters.

Chapter 1 provides an introduction to the work.

Chapter 2 discusses the historical evolution of Industrial Policy in Bangladesh.

Chapter 3 deals with the conceptual framework of the study.

Chapter 4 describes the dynamics of public policy formation in Bangladesh.

Chapter 5 explores the extent of Bangladesh's dependence on foreign aid for development.

Chapter 6 is concerned with the various mechanisms through which the donors intervene into the policy process of Bangladesh.

Chapter 7 examines the donors' role in the formulation of industrial policy in Bangladesh.

Chapter 8 manifests the general observation and conclusion of the study.

CHAPTER 2

EVOLUTION OF INDUSTRIAL POLICY IN BANGLADESH

This chapter presents a historical perspective of the evolution and growth of the industrial sector in Bangladesh since independence. Bangladesh inherited its industrial policy framework from Pakistan which focussed on a bureaucratic control of a largely private industrial sector with emphasis on import substitution and near exclusion of foreign investment. Around this control grew a complex system of licensing, exchange rationing and quantitative restrictions on imports which affected every aspect of the behavior of private sector industrial firms. After independence, the industrial sector, to which these policies applied, changed dramatically in terms of structure of ownership when the new Government of Bangladesh nationalized all industries abandoned by West Pakistani entrepreneurs and also all Bangladeshi-owned enterprises with fixed assets exceeding Taka 1.5 million.[1]

2.1 The First Phase

The first industrial policy statement issued in January 1973 restricted the role of the private sector by limiting permissible

[1]See Bangladesh Industrial Enterprises (Nationalization) Order 1972, March 26,1972, referred to as *Presidential Order*

investment to Taka 2.5 million which could be expanded through reinvestment of profits. Direct foreign investment was allowed only in collaboration with the public sector and only with minority equity participation. It, however, ensured a ten-year moratorium on nationalization and provided fiscal and other incentives to potential investors. Despite these incentives, the overall policy was clearly aimed at fostering and maintaining public enterprises in large and medium scale industry, limiting private sector activity to only small industries.

Since 1973, the government's policy shifted towards encouraging private sector activity in manufacturing and reducing, through disinvestment, the dominant role of the public sector. In July 1974, the industrial investment policy was revised, and investment ceiling was enhanced from Taka 2.5 million to Taka 30 million. The number of industries reserved for the public sector was reduced to 18. Fiscal and monetary incentives were expandedly used to stimulate private investment. For purpose of incentives (import duty rebates, tax holiday, etc.), the country was classified into developed areas, development areas and priority development areas. Private investors, both local and foreign, were allowed to set up enterprises along with public sector corporations except in some basic industries. In addition, the moratorium on nationalization was increased from 10 to 15 years, and tax holiday for less developed areas was extended from 5 to 7 years. Also, a *Priority* in October 1974.

2.2 The Second Phase

Since the response of the private sector to these policy changes was still very poor (presumably because of domestic and international stagflation and inadequacy of foreign exchange allocation), the industrial policy was further revised in December 1975 and important changes in policies and institutions were initiated to improve the investment climate. Investment approval and loan disbursement procedures were simplified, and 22 sub-sectors of industries out of the total of 193 published in the *Industrial Investment Schedule* were declared free sectors where no formal permission was necessary to set up industries, provided capital machinery was imported under *Wage Earners' Scheme* or non-repatriable foreign investment. The investment ceiling was raised from Taka 30 million to Taka 100 million and then finally withdrawn in September 1978 (though projects above this size required approval by the National Economic Council). Private investment, both local and foreign, was permitted in an additional 10 sectors, thus reducing the reserve sector to a hard-core consisting of eight categories of industries.[2] In these 10 sectors preference was to be given to joint ventures of public and private firms, though proposals for pure private

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[2]The reserved sectors were: (1) arms and ammunition,(2) atomic energy,(3) jute,(4) cotton (excluding handloom and specialized textiles),(5) sugar,(6) air transport,(7) telecommunication, and(8) generation and distribution of electricity.

investment were also to be considered.[3] Investment in all other areas was open for private investors. However, public firms were still free to invest in these open areas. In addition, the assurance of a moratorium on nationalization was withdrawn because it was felt that any discussion on nationalization would deter private investors, and it was declared that fair and just compensation would be made in case any industry were ever nationalized in special situations.

2.3 The Third Phase

The most significant policy reform in the field of industry took place in June 1982 when the Government of Bangladesh announced a New Industrial Policy. The main objective of the new policy was to stimulate industrial development through the private sector and to that end the New Industrial Policy made fundamental changes in the industrial policy environment and promotional instruments. Various changes introduced under the New Industrial Policy included, among others, the transfer of nationalized jute and cotton textile mills to their local owners, and grouping of industries under three lists, namely, a reserve list of six strategic industries for public sector investment, a concurrent list of 13 sectors where both public and private investment would be allowed, and all other industries reserved

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[3]The 10 industries open for joint ventures between private and public sectors were: (1) paper and newsprint,(2) iron and steel,(3) shipbuilding and heavy engineering,(4) heavy electrical industry′(5) minerals, oils and gas,(6) cement,(7) petrochemicals,(8) heavy and basic chemicals and basic pharmaceuticals,(9) shipping, and (10) mechanized forestry.

for the private sector.[4,5] Besides, the number of industries in the Free List in which investment under certain conditions could be made without formal permission was enlarged from 22 to 49. Project approval authority was decentralized to various agencies, Development Finance Institutions, and commercial banks, and time limits were set for project appraisal and approval. In addition, to provide *one stop service* facility regarding processing of projects, acquisition of land and arrangement for power/gas etc., an Investment Assistance Unit was set up in the Department of Industries. To promote regional development and to that end for providing preferential fiscal and monetary incentives, various areas of the country were re-categorized into two areas: developed area and less developed area instead of the previously existing three categories.

These policy changes providing for a growing role of the private sector were also addressed to attract foreign private investment. *The Foreign Private Investment (Promotion and Protection) Act* of 1980 was drawn up to promote foreign private investment either directly or in collaboration with local investors. Besides, liberal terms and incentives were made

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[4]Industries in the reserved list were: arms and ammunition, atomic energy, air transport, telecommunication, generation and distribution of electricity, and forest extraction (mechanized).

[5]The concurrent list covered jute, cotton textiles, sugar, paper and newsprint, iron and steel, ship-building and heavy engineering, heavy electrical industry, minerals, oil and gas, cement, petrochemicals, heavy and basic chemicals and basic pharmaceuticals, shipping and appliances and equipment for telecommunication service.

available to foreign investment in the Chittagong Export Processing Zone (EPZ).

The New Industrial Policy was further revised in 1986, and the Revised Industrial Policy made further relaxation and changes in which all industries except seven strategic industries of the reserve list were open for private investment.[6] Indicative investment opportunities in the form of *Industrial Investment Schedule* for sectors meant for private investment were prepared by the Director General of Industries for large and medium industries, and by the Small and Cottage Industries Corporation (BSCIC) for small and cottage industries. There was also a *discouraged list of industries* covering 12 sub-sectors to warn potential investors/financial institutions against investment in such sectors for non-viability and over-capacity.

After the introduction of the Revised Industrial Policy 1986, no approval was required for investment if the investors imported machinery equipment using their own resources and/or through the Secondary Exchange Market and if imported raw materials constituted less than 50 percent of total requirement. The public sector corporations were intended to be converted into public limited companies in order to make up to 49 percent of their share available for public subscriptions. They were also

[6]Areas reserved for public sector investment were: (1) arms and ammunition,(2) generation, transmission and distribution of electricity,(3) mechanized forestry,(4) telecommunication (excluding distribution and services),(5) air transport and railways,(6) atomic energy, and (7) security printing. See Ministry of Industries, *Industrial Policy* 1986.

given operational autonomy in pricing, procurement, etc. Under the Revised Industrial Policy a large number of fiscal and other incentives were also introduced/expanded in order to promote rapid industrial development of the country. A number of import bans and quantitative restrictions were relaxed to promote industrial efficiency. Promotion of foreign private investment and export-oriented industries was given greater emphasis and a one-stop investment service agency, Board of Investment, was set up which commenced operations on January 1, 1989.[7]

2.4 **The Fourth Phase**

The latest industrial policy announcement is made in July 1991 which reiterates the objectives of the New Industrial Policy and the Revised Industrial Policy for achieving a rapid expansion of the private sector and for its transformation into a more competitive market economy. To solve the existing problems of the industrial sector, some additional institutional and policy changes have been proposed in the new (1991) policy. As in

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[7]The functions of the Board of Investment include promotional work; approval and registration of industrial projects; expatriate personnel; assistance in obtaining local financing; allotment and approvals from administrative agencies; customs clearance for imported equipment and post-investment services. To increase the effectiveness of the Board of Investment as a one-stop agency, a number of government institutions such as the high-powered Facilities Board, the Standing Committee of the National Council for Industrial Development, and the Hard Loan Committee were abolished with the creation of the Board of Investment. The Department of Industries was also merged with the Board of Investment. The Board of Investment took over *one-stop service* function from the Department of Industries. For details, see Board of Investment Ordinance No. 32, 1988.

Revised Industrial Policy 1986, seven industries are earmarked for the public sector. The indicative or the discouraged lists have been deleted. The Government will, however, frame rules from time to time for certain industries to protect environment, public health and national interest, and such industries could be established subject to these rules. These industries will be treated as *regulated industries*.

2.5 Salient Features of the Policy

The Industrial Policy, 1991 is based on the philosophy of liberalized and competitive market economy (GoB, 1991). The objectives of the Policy are to:

- o develop the industrial sector in order to increase its contribution to the gross domestic product, income resources, and employment;
- o expand industries by putting more emphasis on development of the private sector and in this respect to make the role of the government *promotional* rather than *regulatory*.
- o encourage domestic and foreign investment in overall industrial development;
- o develop export-oriented, export-linkage and efficient import-substitute industries;
- o encourage specially the development of small and cottage industries;
- o expedite development of labor intensive industries through acquisition and improvement of appropriate technology;
- o encourage the development of agro-based and agro-supportive industries;
- o stimulate development of industries based on indigenous raw materials and indigenous technology;
- o motivate investment in the intermediate and basic industries;

- o confine the role of the government particularly in establishing strategic and heavy industries and to improve efficiency of the public sector;

- o create possible opportunities for revitalizing and rehabilitating sick industries;

- o make effective arrangements for improving standards and controlling quality of products; and

- o take appropriate measures for preventing environmental pollution and maintaining ecological balance.

A major goal of the 1991 industrial policy is to increase efficiency and productivity in the industrial sector by transferring public sector industries to the private sector. With this end in view the present process of privatization will be strengthened. The policy also envisages a number of measures to improve the operational efficiency and economic viability of the public sector enterprises. Sanctioning procedure has been further simplified. No approval will now be necessary to set up industries and for BMRE of existing industries with entrepreneur's own fund, or with funds from private banks or private financial institutions. Investment incentives, in particular for export-oriented and export-linkage industries, have been expanded and simplified. For purpose of such incentives, there will be no discrimination between domestic and foreign investors. Further, protection of foreign investment from nationalization, repatriation of proceeds from sale of shares, profits and dividends, tax exemption on royalties, on interest on foreign loans and on capital gains from the transfer of shares etc. are assured. To assist in the establishment of export-oriented industries, more export processing zones with all kinds of facilities will be established.[8]

In this connection it may be pointed out that the industrial policies of Bangladesh are the outcome of interactions of many domestic as well as international forces and factors rather than the result of pragmatic thinking of the government. Although the nationalization scheme of Awami League (AL) was termed as a step to socialism (Yusuf, 1985:71) yet the party in power did not explain as to what they meant by *socialist pattern* (Jahan, 1980:99). In fact the AL was not a socialist party as it was composed of lower middle class as against the rule of large-scale industrialists and land lords (Islam, 1979:22). The revision of industrial policy in 1974 to some extent was the result of revival forces of capitalist within the AL (Sobhan and Ahmed, 1980:175). The food crisis of 1974 had a significant impact on revision of industrial policy. Following this phase of crisis, the Bangladesh Government responded to Western donors' pressure on agreeing to an aid consortium which it had rejected earlier (Sobhan and Ahmed, 1980:247) and subsequently this international pressure group played a vital role in changing the very philosophy of development strategy relevant to industrialization.

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[8]For details see *Industrial Policy 1991*, (as modified up to December 1992), Ministry of Industries, GoB.

CHAPTER 3

CONCEPTUAL FRAMEWORK

This chapter is devoted to clarify the use of various concepts related to the present study such as *Foreign Aid, Donors, Industrial Policy,* etc. It also makes a modest attempt to highlight the imperatives of foreign aid and existing arguments against it. Finally the chapter focuses on the literature on public policy process relevant to the study in particular.

3.1 The Terms and Concepts

The very title of this study "The Role of Donor Agencies in the formulation of industrial policy in Bangladesh" presents some related key words which demand clear and operational definition.

AID: Aid — used in the context of the flow of resources from developed countries to less developed countries — has many different interpretations. On the one extreme it is narrowly interpreted (by the United Nations for example) to mean grants and long-term loans for economic purposes. Those who accept this definition tend to get exasperated when, say, loans at high rates of interest are described as *aid,* since they regard such loans as no more than ordinary commercial transactions. But, at the other extreme, aid is defined as including virtually all aspects of economic relations between developed and developing countries — not only grants and loans but private investment and trade.

Those who hold to the narrow definition of aid are surely correct if the word is given the meaning of *subsidy* or *succor*. However, what they tend to forget is that, for example, the economic and frequently political prospects in some developing countries are such that official loans at even *commercial* rates can constitute aid, since private commercial sources often would not hazard money in such countries.

Since basically the object of this study is to present an outline of economic influence generally placed upon the Third World Countries by the economically developed ones, it takes the broadest of definitions of aid — without agreeing that all the subjects discussed necessarily constitute aid in the very strict sense and not hesitating to draw attention to aid given in circumstances where the harshness of its terms covers it into non-aid; such a broad approach to aid seems to be entirely justified so long as the different elements that make up a donor's aid effort are clearly identified and not lumped together in something which passes for a vast international charity drive to help the developing countries (Arnold, 1966:10).

DONORS: Bangladesh is heavily dependent on various donor agencies and donor countries for fund because its development budget is almost totally dependent on donors' generosity. In years right after liberation the principal donors were India and Soviet Union. With the change in attitude towards aid, USA emerged as the single most important donor, only recently the place has been taken over by Japan. However, the influence of USA remains paramount because of its dominance in the multilateral agencies like World Bank, International Monetary Fund (IMF) and Asian Development Bank (ADB). Because of heavy dependence of Bangladesh on aid the donors, particularly World Bank, IMF, and USAID have tended to freely express their views on various policy measures. However the Nordic countries, Canada and Netherlands who together constitute what has recently come to be known as the Like Minded Group exercise pressure on the formulation and conduct of policies. It should be realized that not all the donors are equally concerned with all the policy issues of Bangladesh. For example we notice that UK more often expresses its perception about policies in the gas and power sector, irrigation system and railways, whereas the Netherlands shows more interest about flood control, river management and land reclamation (Sobhan, 1990:184). At the same time, it is reckoned that the degree of influence which a donor can exert upon Bangladesh is directly proportional to the quantum of aid which it is providing in the related venture, project or sector. For example the Nordic countries as donors prove a relatively smaller share of the Bangladesh aid budget so their influence over policy is comparatively limited. In contrast World Bank, USAID, Asian Development Bank, Japan, etc. can exercise much greater leverage in moulding the domestic policies of Bangladesh (Sobhan, 1990:184).

INDUSTRIAL POLICY: Industrial policies are government actions and programs that support particular firms or industries.

These policies are conditioned by different institutional and policy settings and aimed at different objectives and some times reflect overall economic strategy. A wide array of controls (direct regulatory policies) and instruments (indirect economic policies) are often deployed to guide and influence the pattern of investment in industrial activity in the desired directions. The major direct controls are investment sanctioning, import licensing and exchange controls, and allocation of areas of activities for private and public investment. The main indirect policy instruments are tariffs and quantitative restrictions, investment incentives, policy on foreign investment, provision of industrial finance, and incentives for promoting export activity. In Bangladesh these policy instruments have been designed essentially by the industrial policies announced and revised from time to time but have been further buttressed by policies relating to trade and payments (import, export and exchange rate policies). The controls and policy instruments that are employed to influence industry are thus complementary and contain elements of both industrial and trade policies.

3.2 Imperatives of Foreign Aid

Developing countries have mixed feelings regarding foreign aid. On the one hand, aid is a symbol of the dependence relationships from which most of them would like to become free. On the other hand, aid is viewed as a useful (though temporary) means of achieving economic independence more rapidly. The rationale behind foreign aid as claimed by its proponents are stated below:

1. The fundamental objectives of Less Developed Countries (LDCs) is to achieve rapid economic development. But in the road to economic development LDCs are trapped in the vicious circle of poverty. According to Ragner Nurkse, in all LDCs low income is the result of low productivity which is, in turn, due to deficiency of capital. Low income leads to low saving which again leads to low investment. Low investment leads to low capital formation resulting in deficiency of capital and, in turn, low productivity and again low income. That is a circular causation of forces tending to act upon one another in such a way as to keep a poor country in a state of poverty. To break this vicious circle of poverty a huge amount of investment, both physical and financial, is required. To generate this higher level of investment, foreign aid is a great source.

2. The familiar *two gap analysis* provides rationale for foreign aid. Most of the LDCs suffer from deficiency of domestic savings as well as from deficiency of foreign exchange for raising the level of investment. The two gaps are (a) savings gap, and (b) foreign exchange gap.

(a) Savings Gap: It is argued that for economic development of a country it needs to save 10 to 12 per cent of its gross domestic product (GDP). But survey of LDCs in Asia, Africa and Latin America reveals that they save only 5 to 6 per cent of their GDP. As savings is low, the level of investment is low. Again domestic savings, even if they are adequate for meeting the demands of the largest investment, cannot be mobilized for economic development. and as such there is a huge gap which remains domestically unfulfilled. It is argued that foreign aid may come forward to bridge this gap.

(b) Foreign Exchange Gap: Moreover, for economic development LDCs have to import capital goods which requires huge amount of foreign currency. LDCs also have to import bare necessities like medicine, cloth, food etc. LDCs are generally earning foreign exchange through exporting primary products. The prices of their exports are increasing day by day. The value of their imports are greater than the value of this exports and thus raising a foreign exchange gap.

The two gap analysis assumes that foreign aid is entirely used to supplement domestic savings or to augment foreign exchange availability in order to finance economic development of LDCs.

3. Foreign aid helps economic development by supplying technical know-how and experts, etc.

4. Foreign aid will help improve the allocation of resources of the recipient country. Foreign country will dictate for proper allocation of resources and thus danger of misallocation of resources can be minimized. If resources are being properly used, economic development will take place.

5. Infrastructural development is an essential factor for economic development. But it requires huge amount of investment with long gestation period for return. Domestic investors generally do not come forward to invest for infrastructural growth. Since LDCs are poor, they cannot afford to invest much on infrastructural development. Foreign aid given to the government of LDCs will help domestic investment for infrastructural development.

6. Private foreign investment not only fills up the savings gap but also brings along with foreign exchange as well and ascertains some essential missing factors of production like

technology, results of research and development, management, entrepreneurship and skill. It thus helps to improve the efficiency of production. It also creates employment.

7. The availability of foreign exchange in the form of foreign aid helps to improve the balance of payments deficit problems. It helps to stabilize the exchange rate and the value of domestic currency.

8. The availability of foreign aid stimulates domestic export in the long run because debts on foreign aid are paid by foreign exchange. This repayment is only possible by increasing exports. To increase the exports LDCs will have to set up more exports led industries.

9. Foreign aid helps the establishment of heavy industries which are domestically not possible i.e. either import substitute industries or export led industries.

Thus foreign aid plays a vital role in the economic development of an aid receiving country as claimed by the proponents of foreign aid.

3.3 Arguments Against Foreign Aid

Foreign aid plays a vital role in the economic development of an aid receiving country as claimed by the proponents of foreign aid theoretically. Bauer is one of the few Western economists who does not view foreign aid as indispensable for the economic development of LDCs.[1] To him, "Foreign aid is plainly

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[1]The discussion primarily follows M.L. Jhingan, *The Economics of Development & Planning*, Konark Publishers Pvt. Ltd.

neither a generally necessary nor a sufficient condition for emergence from poverty" (Bauer, 1974).[2]

The most compelling argument against aid is that it saps self-reliance to produce a mentality of dependence upon the part of the recipient. Aid creates dependency and undermines self-reliance. It leads to dependency because the donors insist on aid-tying to the purchase of goods and services at costs much higher than the competitive world prices, and on monetary and fiscal policies detrimental to the national interest of the recipients of aid. For instance, the recipient may be required to keep an overvalued exchange rate, low real interest rates and to neglect export promotion and fiscal restraint.

Foreign aid is often used for extremely wasteful projects which make large losses year after year. They absorb more local resources of greater value than their net output when the costs of administration, maintenance and replacement of fixed assets originally donated for the projects are taken into consideration.

Foreign aid does not always bring about an increase in net investment. As a matter of fact, all LDCs receiving foreign aid impose severe restrictions on the inflow and use of foreign capital. These retard the operation and expansion of private enterprise within the economy. Consequently, both foreign and domestic private enterprises are forced to work below capacity.

1988, Ch. 49 and Guy Arnold, *Aid and the Third World The North/South Divide,* Robert Royce Limited, Sussex, 1985, Ch. 1,

[2]Quoted in Jhingan, 1988:462.

Thus foreign aid may reduce rather than increase net investment within the recipient country.

The case for foreign aid to overcome balance of payments difficulties and to avoid inflationary pressures is often claimed to be a misconceived one. Foreign aid encourages governments of LDCs to embark on ambitious plans involving large expenditures financed by inflationary monetary and fiscal policies and also to run down their foreign exchange reserves. But inflationary policies, balance of payments difficulties and extensive economic controls engender a widespread feeling of insecurity or even a crisis atmosphere. All these inhibit domestic savings and investment and even lead to a flight of capital. These, in turn, serve as arguments for further foreign aid.

Further, foreign aid frequently influences policies into inappropriate directions by promoting unsuitable external models, such as Western-type universities whose graduates cannot get jobs, Western-style trade unions which are only vehicles for the self-advancement of politicians, and a Western pattern of industry even where it is quite inappropriate.

It is contended that foreign aid helps in increasing food, raw materials for exports and producing import substitutes. But the experience of many LDCs has been that much aid directly or indirectly finances uneconomic enterprises or activities which produce neither exports nor import substitutes.

Foreign aid often politicizes public life in LDCs and thereby contributes to social and political tensions which ultimately retard material progress. It is on the basis of political pressures that many recipient governments in LDCs restrict the activities of highly productive and economically successful minorities.

Finally, Bauer (1981:72) who takes a hard critical line on almost all aspects of aid says, "The concept of the Third World or the South and the policy of official aid are inseparable. They are two sides of the same coin. The Third World is the creation of foreign aid. Without foreign aid there is no Third World".[3]

3.4 Public Policy

Since this study is going to deal with the formulation of government policy, it is important to understand the studies carried out in the area of public policy process. This naturally leads one into the field of public administration and the related issues of public policy.

Simply, public policy is that policy which is developed by the governmental bodies and officials (non-governmental actors and factors may, of course, influence policy development). To speak more clearly, any policy that takes care of public interest and formulated by legitimate public authority is called public policy. Therefore, public policy has two distinct dimensions as presented in Fig. 3.1.

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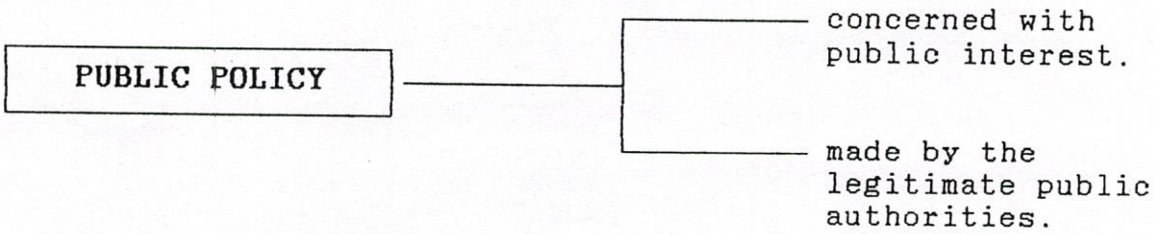
[3]Quoted in Arnold, 1985:24.

Figure 3.1 Dimensions of public policy



Dye (1981:1) defines public policy as "whatever governments choose to do or not to do". We generally assume that if a government chooses to do something there must be a goal, but realistically our notion of public policy must include all actions of government and not just stated intentions of governments or governmental bodies.

Since public policy is a vast field, it will be useful to categorize the different approaches used in it. Hood (1990) in his article, for the purpose of analyzing public policy, has categorized the different *approaches* used in the field of Public Administration in the following manner:

a. The policy approach, which takes "generic policy programs, processes, choices or outcomes as its focus of analysis" (Hood, 1990). This will be dealt with later.

b. The organizational sociology approach, which offers theories explaining the structure and behavior of all formal organizations (Hood and Dunsire, 1981).

c. Neo-marxist state theory which lays down some foundations for the development of radical and marxist approaches to public administration (Dunleavy, 1982).

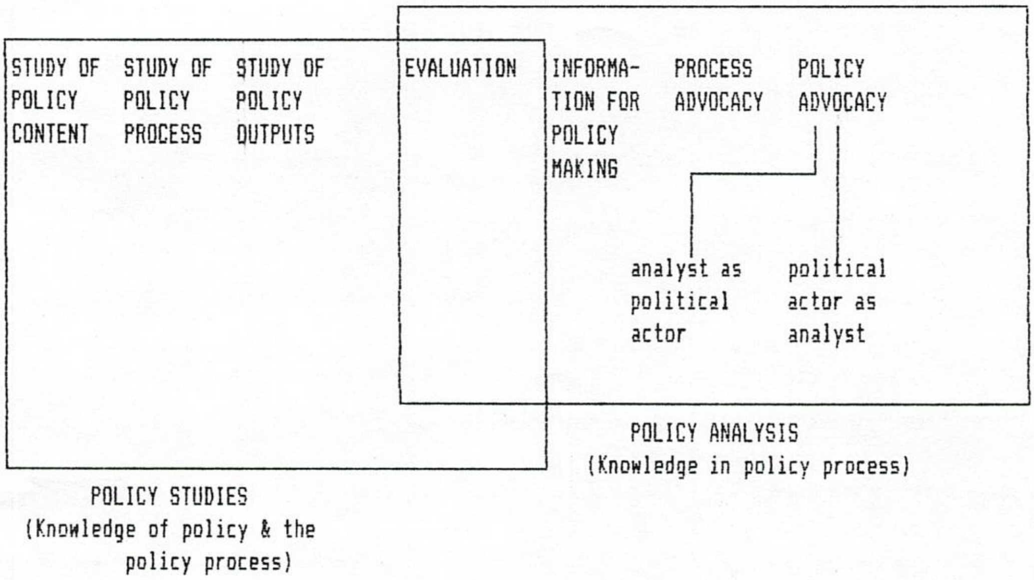
d. The critical or philosophical approach, which generated the debate as to whether public administration should have an ethical stance or not (Kernaghan, 1980; Hodgkinson, 1978).

e. The public management approach, which is derived from the theory and practice of private business management (Eliasson and Kooliman, 1987).

f. The public choice approach, which emphasizes consumer choice rather than producer monopoly, smaller-scale rather than larger-scale service, the aims for service provision through organization other than class public bureaucracies and for services financed by user-charges rather than from allocations from a general fund budget (Hood, 1990).

In drawing up a framework of the policy analysis however, it is the policy approach which will be of relevance. But the scope of the policy analysis literature is also quite large. Hogwood and Gunn (1984) have drawn up a chart which helps us to classify this field (Fig. 3.2).

Figure 3.2 Types of study of public policy-making



Source: Hogwood and Gunn (1984)

The main distinction which Hogwood and Gunn (1984) make in their typology of policy-making and which is restated by Ham and Hill (1985), is between those studies which deal with the analysis of policy and analysis for policy. The distinction is between those analysts who are interested in the understanding of policy and those who are interested in improving the quality of policy. In between come those who are interested in doing both.

In the first category are studies of policy content in which analysts seek to describe and explain how particular policies originate and develop. This is usually done through working out case studies. It involves the examination of individual policy problems (e.g., water resource management, civil rights, foreign policy decisions) in considerable detail in order to illustrate a particular example of policy formulation.

Secondly, there are studies of the policy process in which attention is focussed on stages through which issues pass and attempts are made to assess the influence of different factors on the development of the issue (Ham and Hill, 1985:8). Although analysts working in this vein may find a lot in common with those concerned with policy content, the main interest of the later group is to uncover the various influences on policy formulation. The authors of the literature of policy process endeavor to be descriptive rather than prescriptive. In terms of models of public policy, the elite/mass, group, systems, institutionalist, neo-institutionalist, and streams-and-windows models would fall crudely under the rubric of this literature (Henry, 1986:246). In brief, advocates of the elite/mass model contend that a policy-making/policy-executing elite acts in an environment characterized by apathy and information distortion and thereby governs a largely passive mass. Policy flows down from the elite to the mass. The model which is known as the *hydraulic thesis,* conceives of the polity as a system of forces and pressures acting and reacting to one another in the formulation of public policy. The systems model relies on concepts of information theory (such as feedback, input, and output) and conceives of the public policy-making process as essentially cyclical. This model is concerned with such questions as: What are the significant variables and patterns in the policy making system? The institutionalist model focuses on the organization chart of government i.e., it describes the arrangements and official duties of bureaus and departments but has customarily ignored the links between them. The neo-institutionalists, on the other hand, attempt to categorize public policies according to policy-making subsystems with an eye toward generating theoretical predictions about how policy types relate to the branches of government, to the generally, and to the typologies of political behaviors associated with each policy arena. The advocates of the streams-and-windows model found the policy-making process to consist of three streams that flow largely independently. The first of these is the *problems stream,* which involves focusing the public´s and policy-makers´ attention on a particular social problem. The second stream is the *political stream*. It is here that the governmental agenda — the list of issues or problems to be resolved — is formed. The third stream is the *policy stream*. It is in this stream that the decision agenda, or alternative specification, is formulated.

Thirdly, the study of policy outputs treats policies as a dependent variable, which are understood in terms of social, economic, technological and other factors. There is also a tributary effort to prescribe ways to improve the content of public policy by improving the way public policy is made. This stream is represented by the incremental, rational, and strategic planning models of public policy making. In brief, according to incremental model, the policy process can be best described as a series of unrelated decisions each of which is taken as a result of an examination of alternate choices of action that differ incrementally rather than qualitatively from the *status quo.* Rationalists, on the other hand, attempt to be the opposite of incrementalists. They try to learn all the value preferences in a society, assign each value a relative weight and discover all the policy alternatives available. They also attempt to know all the consequences of any one policy which will affect the remaining alternatives in terms of opportunity costs, and ultimately select the most efficient policy alternative in terms of costs and benefits of the social values that the policy embodies. The strategic-planning approach is an eminently useful concept in that it attempts to combine the strongest features of incrementalism and rationalism yet avoid their pitfalls. It concentrates on decisions rather than on extensive documentation, analyses, and forecasts. Thus it is decision-oriented -- strategic planning blends economic and rational analyses, political values, and the psychology of the participants in the organization.

The fourth category, evaluation studies, marks the borderline between analysis of policy and analysis for policy. They may take the form of *aid-effectiveness studies* and may be either descriptive or prescriptive.

Fifth comes the category of studies called information for policy-making in which data is marshalled so that decision-makers can reach decisions. These may take the form of regular monitoring process of the government.

Sixth is the process advocacy strand of policy analysis where the study seeks to improve the machinery of government through the reallocation of functions and tasks, and tries to improve the quality of policy-making through advocating the development of new planning systems and new approaches to option appraisal.

Finally, "the policy advocacy approach involves the analyst in pressing specific options and ideas in the policy process, either individually or in association with others, perhaps through a pressure group" (Ham and Hill, 1985:10)

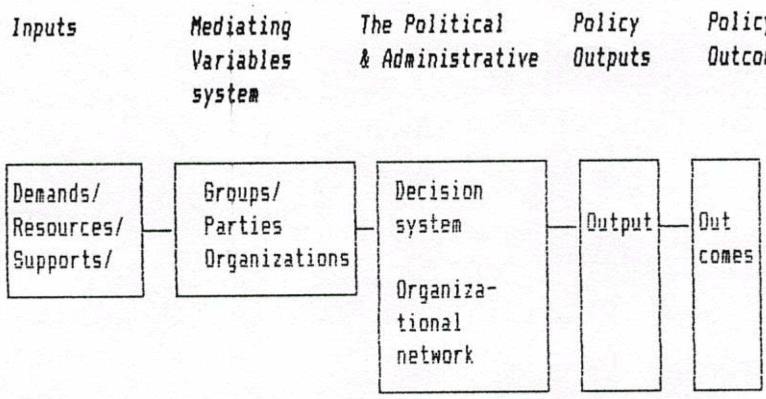
CHAPTER 4

DYNAMICS OF PUBLIC POLICY FORMATION IN BANGLADESH

This Chapter deals specifically with the policy making process of Bangladesh and various key actors and factors which are involved in the policy formulation process or otherwise influence the process.

In order to understand the policy formulation process in Bangladesh we must identify the most important policy actors that exist in the socio-political and administrative as well as in the international environment. According to the popular definition public policy means that governmental policy which looks after the interest of the general public and is formulated in the parliament But in practice this view of public policy making is only partially correct, since it fails to recognize the critical role performed by different domestic and international policy actors in shaping public policy. The policy decision in government is not an isolated act of the legislature only. Rather, it is the result of an interplay of many forces and many brains. This explanation of public policy can best be understood with the help of a system model of policy making (Fig. 4.1).

Figure 4.1 Systems Model of the Policy Making Process



Policy demands : demands for action arising from both inside and outside the political system.
Policy decisions: authoritative rather than routine decisions by legitimate political authorities.
Policy outputs : what the system does ,thus, while providing goods and services are the most tangible outputs.
Policy outcomes : consequences intended or unintended resulting from the policy action and inaction.

Source: Easton (1953)

The dynamics of policy-making are therefore, not readily captured in any simple pattern of thought.

However, at the risk of overgeneralization or over simplification let us examine the individual role and influence being played by these actors. The actors that have dominant role in the policy process in Bangladesh may, broadly, be categorized as follows:

1. Internal Actors

A. The Formal Policy Makers:

(a) Parliament

(b) The Political Executive: (i) The Prime Minister
(ii) Cabinet &
(iii) Ministers

(c) The Permanent Executive: (i) The Secretariat
(ii) Ministries &
(iii) Divisions

(d) The Courts

(e) Policy Staff Within Government

(f) Advisory Boards

B. Unofficial Participants:

(a) Political Parties

(b) Service Associations

(c) Trade Unions

(d) Professional Bodies

(e) Clientele Groups

(f) Mass Media.

2. External Actors

(a) Donor/Funding Agencies

(b) Foreign Investors

(c) Regional and International Economic and Political Forums

(d) International Pressure Groups

(e) International Experts/Consultants

4.1 The Domestic Context of Policy Making in Bangladesh

Public policy is a form of guideline to government action which is sometimes technical in nature and often, where many competing interests are involved, subject to political and economic pressures operating within the domestic milieu of the country. In the case of Bangladesh attempts have been made to indicate the general nature of the indigenous interests and institutions which have a bearing on the politics of policy formulation. In more than one way these forces and factors are involved in most instances of policy determination, with their varying importance from problem to problem.

A. The Formal Policy Makers

The question - who makes the policy in Bangladesh - is not easy to answer. In a democratic country this is generally the function of the parliament. In practice, this has become the function of the executive branch of the government, i.e., the Cabinet headed by the Prime Minister in a parliamentary form of Government or the President in a Presidential type of government. More precisely, in a Ministry/Division, the Policy is initiated by the Minister who is responsible for policy matters (GoB, 1976). In practice, he is advised by the Secretary who is assisted in collecting data and information by the subordinate offices and officials. But the parliament has the ultimate power and authority of approving or disapproving any policy enunciated by a Ministry and approved by the Cabinet. It may review, criticize and even modify the policy already prepared.

However, when we talk of policy-making in a Ministry or Division of the Government of Bangladesh under constitutional rule, we generally refer to two parties taking part in it. One consists of the political, non-technical and non-permanent officials and the other non-political, expert and permanent officials. Among the officials, again, there are two categories - one belongs to the Secretariat and the other to the concerned Directorate.

Parliament

The easy response to the question "What do the legislature do?" is to say that they legislate, that is, that they are concerned with the central political task of law making and policy formation in a political system. Therefore, Parliament is known as the nursing home of public policy. The parliament's (or *Jatiya Sangsad's*) most important function is its legislative or law making function. In enacting laws, it is ratifying the results of policy making and providing the means through which policy may be implemented. On average, in every session, between 10 to 12 bills are passed (UNDP Report, 1993:19). At present, most of the bills are either to amend existing legislation or to regularize previously promulgated ordinances. In support of its legislative function, the *Jatiya Sangsad* has the power to appropriate funds, censure, and investigate. Its censuring function (defined as criticizing the government on issues of importance) is central to public management and is accomplished through legislative debates, question time, questions without notice, censure motions, etc. Its investigating function is also critical to public management since governmental actions are often subjected to parliamentary inquiry through standing committees constituted to deal with specific Ministries or other public organizations. There are both Standing and Select Committees. Standing Committees are constituted at the commencement of the life of each parliament. Select Committees are appointed by resolution to examine draft bills and other legislative proposals, review the enforcement of laws and propose measures for such enforcement, or investigate or inquire into the operations of a ministry. Two important Standing Committees of the fifth parliament are the *Public Accounts Committee* (PAC) and the *Public Undertaking Committee* (PUC) both chaired by non-ministers. Important inputs into policy making and policy revision are derived from performance of the investigating function and, to the credit of the fifth parliament, both the PAC and the PUC sat over forty times and released three reports (two from PAC and one from PUC) which touched upon irregularities in 13 ministries and 19 autonomous bodies (UNDP Report, 1993:29).

The Political Executive: The Prime Minister, Cabinet and Ministers

The Haldane Committee of 1914 in the United Kingdom summarized the functions of a cabinet under a parliamentary system as follows:

- O Final determination of policies to be laid before the parliament;
- O Supreme control of national executive in accordance with the laws passed by the parliament; and
- O Continuous coordination and delimitation of the various governmental departments (UNDP Report, 1993:22).

The Constitution of the People's Republic of Bangladesh [As modified up to 10th October, 1991] follows the prescriptions of the Haldane Committee by clearly establishing the constitutional position of the Prime Minister and the Cabinet as the head of the

Executive. Chapter II, Part IV, of the Constitution states that "The executive power of the Republic shall, in accordance with this Constitution, be exercised by or on the authority of the Prime Minister.." and indicates that the Prime Minister will head the Cabinet (Section 55). The same Section states that: "The Cabinet shall be collectively responsible to Parliament". The Prime Minister may at time request a Minister to resign, and if such Minister fails to comply with the request, may advise the President to terminate the appointment of such Minister. If the Prime Minister resigns from or ceases to hold office each of the other Ministers shall be deemed also to have resigned from office.

Rule 159 of the parliament provides for a non-confidence motion against a minister.

All discussions in the cabinet are categorized as highly classified and minutes of cabinet meetings are not to be read by anyone below the levels of Secretary or Additional Secretary-in-Charge. The cabinet discusses all important policy matters.

The Permanent Executive: The Secretariat, Ministries and Divisions

Perhaps the paramount role performed by public bureaucracy is involvement in public policy making. This role is fulfilled by bureaucracy for several reasons. It has the skills, legitimate authority, and clientele contact. Although bureaucracies ordinarily are officially subordinate to elected executives, legislatures, and courts, their size, their expert staffs, and their linkages with interest groups give them a power potentially unmatched by other coordinate branches of government.

Since the British colonial days, the Secretariat has been the pivot around which the entire public management process revolves. It may be described as the nerve center of all government activities, where policies are conceived, designed, initiated and apportioned to field agencies for implementation. In more simple terms, the Secretariat refers to a conglomerate of all Ministries/Divisions.

The principal purpose of the Secretariat is to establish among discrete self-contained hierarchical units a formal network of authority relationships, control, command and communication to maximize coordination and to achieve an integrative approach to governance.

Specifically, its role may be summarized as follows:

- 0 formulation of public policy;
- 0 policy and administrative planning;
- 0 framing legislation, rules and regulations;
- 0 budgeting and control of expenditures relating to its activities;
- 0 policy coordination;
- 0 interpreting policies;
- 0 supervising personnel management of cadre personnel in Ministries/Divisions and higher level personnel in statutory bodies, attached departments and subordinate offices; and
- 0 advising and assisting ministers in their administrative duties/responsibilities vis-a-vis Parliament (UNDP Report, 1993:25).

In shaping public policies, the secretariat collects, collates, analyzes, evaluates and synthesizes data, facts, figures and other information/evidence.

While Schedule I of the Rules of Business allocates the functions of the ministries and divisions, Chapter IV provides for compulsory inter-ministerial consultations.

Planning Commission and Policy Staff Within Government

The Planning Commission is an important body which allocates resources between various Ministries during the formulation of five-year plans. The annual budget is controlled by the Ministry of Finance, but the Planning Commission has a say in the long-term allocation of resources. The research conducted on policy making and analytic capacity of the government of Bangladesh revealed an absence of units within government with individuals skilled in policy analysis and responsible for developing and analyzing specific information bases in support of policy making (UNDP Report, 1993:30). The Planning Commission is a policy analysis/research unit but concentrates on development projects. Other units such as O&M unit of the Ministry of Establishment could be involved in policy analysis but this unit seems to concentrate more on routine matters. Policy analysis units are often referred to as internal (to government) *think tanks*. Government must have the capacity to develop policy based on fact and on conjecture.

Advisory Boards

From time to time government creates advisory boards to consider issues involved in policy making. For example, one of the most successful advisory boards was the Martial Law Committee (1982) on Organizational Set-up of the Government whose recommendations were examined by a Review Committee and submitted to and approved by the Chief Martial Law Administrator.[1] The Chief Martial Law Administrator ordered the implementation of the Committee's findings and recommendations on 26 December 1982. The work of this Committee led to the development and maintenance of organograms and manning tables for all government organizations. In part, the success of this advisory board was due to its direct access to the chief executive.

Finally, the courts often greatly affect the nature and content of public policy through the exercise of powers of judicial review and statutory interpretation in cases brought before them. Judicial decisions as case law often serve as a guide to help formulate policy making in absence of clear existing law or any rule relevant to it.

B. **The Unofficial Participants**

The actors and factors whose primary initiatives are outside the formal or governmental field Would be focussed under the next headings.

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[1]General Ershad constituted a Martial Law Committee (MLC) under the chairmanship of Brigadier Enamul Huq Khan which chalked out the functions and responsibilities of each organization of the Government in the shape of organogram. The recommendations of the MLC was reviewed by another committee headed by General Atiqur Rahman.

Political Party

There have been parties and cliques in government from early days, but the political party as we know it today is an institution which aims at providing the program and personnel of the Government. Ideally it is an external non-official body. Because of the complexity of modern public administration and the need for widespread acceptance of the policy to be implemented the political party, as a programm-making body, is essential to effective government. The fundamental character of any policy is greatly influenced by the belief, ideology or philosophy of the political party in power despite the opposition parties play an important role in shaping any policy by criticizing or supporting it in the parliament or by mobilizing general people.

There are political parties in Bangladesh representing the radical, conservative and reformist ideologies. In fact, followers of the same ideology have not yet been able to gather together under a single banner. That is why there are about ninety political parties though, broadly speaking, these parties may be grouped under those three categories. Hence they can hardly play any positive role in the policy formation of Bangladesh.

Service Associations, Trade Unions and Professional Bodies

Service associations are permitted under civil service conduct rules but political activity by these associations is prohibited. All civil service cadres have their associations. The clerical staff has its association. The peons (MLSS) have their own association.

Trade Unions are permitted under labor law and are very active in pressing the demands home. Both service associations and trade unions have exerted influence on such government policies as pay scales, civil service management and the privatization of the public enterprise sector.

There are few professional bodies in Bangladesh such as the Bangladesh Economic Association, the Political Science Association and the Institute of Engineers. Through seminars and symposia, they provide forums for analysis and discussion of public policy and these activities influence policy making in government. For example, the views (based on fact) by members of the Bangladesh Economic Association were considered in the preparation of the Fourth Five Year Plan.

Mass Media

Dissemination of information is vital to the health of the community and important to the effective formation of policy. The Press is the outstanding institution in this field and it is essential that it should be free in its opinions and not tied to act as a propagandist organ of the State. Wireless broadcasting now runs very close to the press as a mass media. Under this heading may also be included contemporary writings of all kinds on political, social and economic matters, and also propagandist tracts, any of which may have incalculable influence in the shaping of policy.

Clientele Groups

These are groups of citizens formed to further some set purpose, such as the protection of its members' interests or the achievement of some particular reform. In our country commercial and industrial policies have been discussed with organizations such as the Federation of Chamber of Commerce and Industries. There are medias for consultation and interaction in the government. These are the Consultative Committees for various Ministries (Commerce, Industry, Finance). Moreover, these committees meet with the Prime Minister and other Ministers from time to time. These groups attempt to make public policy the instrument of their aims. Their techniques include the methods and channels of publicity; withholding or offering financial or voting support; sanctions of cooperation or non-cooperation; and personal contacts with public officials through innumerable channels of social, professional, and official association.

But general public as consumers have only begun to organize. In 1992, a consumers association was formed but its effectiveness is yet to be seen. In some areas where clientele have been involved in government operations, there have been positive results. The outstanding example of interaction between government and clientele groups involves government efforts to expand the availability of electrical power. The societies under the Rural Electrification Board, the *Biddutayan Samitees*, have been formed in different areas of the country and each society decides where to provide electrical connections. Similarly, in the field of agriculture, Deep Tube-Well management committees have been formed and they decide on channels and connections (UNDP Report, 1993:31).

In some countries, policy analysis is conducted by such organizations as universities and private or non-profit *think tanks*. There appears to be some activity in this area in the universities in Bangladesh and some private or non-profit *think tanks* are or have been established. University teachers often help the Government to formulate policy in the light of their research experience and indepth knowledge in their field. Moreover, various research findings undertaken by them also help the Government in this regard. Given government's needs in this area, encouragement of universities and non-government organizations to develop capabilities and increased capacity in policy analysis could have a very positive impact on policy making.

4.2 The International Context of Policy Formation In Bangladesh

The domestic policy environment within which Bangladesh operates has been discussed so far. However, policy analysis in a developing country like Bangladesh would not be adequate unless we consider the external variables that intervene.

The international relations and world economic trends are always important considerations to the policy-maker. Policy must consider the international laws and the world opinion for no country can live an isolated life. International law is constantly becoming important and every member living in the family of nations must play the game according to rules.

In analyzing the international situation which set the scene for Bangladesh public policy making, three aspects need to be taken into account:

(a) Bangladesh's links with the multilateral aid groupings such as the World Bank, the IMF, the ADB, IBRD etc. and aid giving countries.

(b) Various multinationals such as BTC, Lever Brothers (Bangladesh) Ltd., Glaxo (Bangladesh) Ltd. etc. and International NGOs working within the country such as USAID, DANIDA, OXFAM etc.

(c) Bangladesh's memberships in different regional organizations such as SAARC, etc. and international organizations such as UN, OIC, Commonwealth etc.

It is well known that different donor agencies and countries wield enormous influence on Bangladesh policy process and are able to make their views prevail[2]. This influence would be more clear from Rahman's comments on Structural Adjustment Program of the World Bank-IMF,

> The initiative in holding consultations, meetings, etc. with the staffs of the Bank and Fund does not always appear to lie with the borrowing country government. Often public officials are not fully aware of the agenda for discussions with the Fund and Bank prior to their meetings with the latter. Discussions related to the formulation of the Policy Framework Paper (PFP) is restricted to a handful of very high government officials. Senior economists in key government ministries and department are left out of the negotiation and monitoring process. And, there is practically no link with professional economists outside the government" (Rahman, 1990:223).

[2]A detailed discussion on this aspect of policy making of Bangladesh would be made in Chapter 6 and 7.

Privatization of the economy and disinvestment of public sector enterprises have been among the most visible manifestations of the outcome of donors' influence in Bangladesh.

Donors serve the interests of their respective country's business classes. This scene can be clear from the motive of the aid policy of UK government toward Bangladesh. The Department of Trade and Industry (DTI) in UK has given the responsibility to support UK companies in their pursuit of major contracts overseas. As such, the DTI is subject to constant representation from business interests which perceive gains from particular directions in aid policy. Individual firms, especially large contractors, consulting engineers and representative organizations[3] lobby the Government through the DTI. Major exporters lobby MPs and Ministers claiming that particular aid orders or aid in general will significantly benefit the economy and that tied aid is essential in order to compete with other donors (Guhathakurta, 1990:164).

The interests of the international experts and consultants in the policy are also articulated through these donor agencies and countries. Consultants are required by the donors to design and supervise projects, and make evaluations. In the case of construction projects consultants develop the design of the project which incorporates the layout. Consultants also draw up estimates of costs and specification of materials. Quite often

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[3]Such as the Confederation of British Industry, the Export Group for the Constructional Industries and the Association of Consulting Engineers.

the bids by contractors are evaluated by the consultants. Once construction begins, consultants are supposed to maintain close supervision. In aided projects, consultants are almost always foreign. In tied credit projects, stipulations are usually made in favour of hiring donor country consultants. Consultants receive income not only for their service but also from contractors as payoffs to facilitate their bill payments. This normally amounts to a 3 per cent *fee*. In certain situations consultants can (and do) favor a specific construction firm by providing them with inside information on design and specification and thus earning an additional few percentages as payoffs (Sobhan, 1990:152-153).

The multinationals working in Bangladesh, because of their large size and the power they wield, can have control over economic policy. The government consults them in prior to adopt those policies which the government thinks might affect them. For example, in the formulation of the Export Policy of 1989-90 the authority (the Export Promotion Bureau) had consulted the matter with the multinationals such as Bata Shoe Company (Bangladesh) Ltd., Lever Brothers (Bangladesh) Ltd., Duncan Brother (Bangladesh) Ltd. and Bangladesh Tobaco Company Ltd.[4]

Various international NGOs working within the country play dominant role in shaping and influencing governmental policy in Bangladesh. In recent years, many western governments as well as

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[4]See for details *Proposals on Export Policy 1989-90*, Export Promotion Bureau, GoB, June 1989.

the World Bank have accepted the contributions of these agencies as valuable complement to governmental development efforts. They provide data and information to the government as policy inputs through their working experience and research within the society. A review of NGO activities over the past two decades shows that NGOs have concentrated their efforts in certain specific areas of intervention in consonance with their long-term objectives and vision. Such areas may be identified as follows:

- O Establishment of effective democratic processes at grass-root level;
- O Poverty alleviation;
- O Women's rights;
- O Education;
- O Health and family planning and
- O Environment (Task Force Report, 1990:375).

It is evident that in these areas they have their specific policy design which they put before the government of Bangladesh on various seminars or otherwise. However, some political parties, particularly the left ones, criticize NGOs for taking funds from western donors to serve the interests of these donors and fulfil their objectives of subverting the processes of politization and social revolution. Most of these left political parties argue that NGOs use the funds to provide easy credit and material support to the poor, creating in them a sense of dependence and increasing their temptation for economic gains at the expenses of their political urge to fight for their class-interest and for consequent social revolution (Task Force Report, 1990:380).

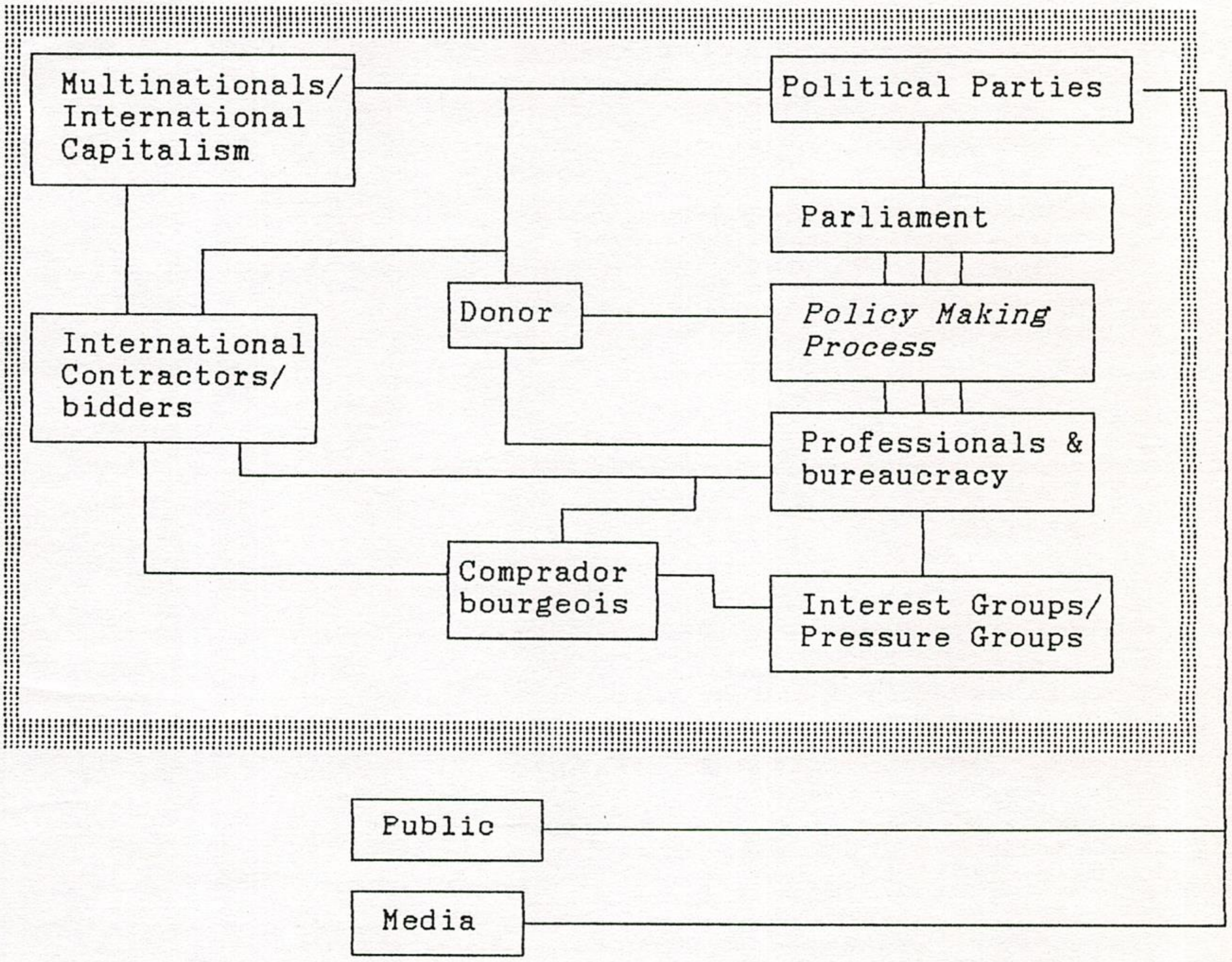
A more important external influence on Bangladesh policy process arises from country's membership of various international and regional political and economical organization. Being a member, she has to abide by these organization's rules and regulations while framing any policy. For example, employment of child labor in factory is strictly prohibited by labor law in Bangladesh which has been framed in pursuance with the relevant laws of the United Nations. Furthermore, as a member of the SAARC, Bangladesh will have to abide by the rules of the NAPTA while making trade agreement with any other country.

4.3 Integrating the Domestic and International Context of Policy Formation

It is evident that the public policy making process in Bangladesh is a very complex continuous and continuously changing process which is conditioned by many domestic and external actors and factors. Both individually and as a whole, these conditioning and influencing factors themselves might undergo changes and provide scope for freedom as well as circumscribe policy making or any course of action that may be contemplated. Thus, various exogenous and endogenous actors and factors play critical role in the process of policy making in Bangladesh. Some are involved in the process due to their formal authority to formulate the policy, some to provide technical, financial or other kinds of support while others are to advocate their own interests.

Each level of politics which exists in the structure of policy formation has been identified and discussed separately in order to clarify the different dynamics of policy formation in Bangladesh. Now it is time to look at the framework as a whole.

Figure 4.3 Dynamics of Policy Making Process in Bangladesh



Source: Aminuzzaman, 1993.

In the abstract each context of dynamics may be looked at separately. But in reality the politics takes place in such an interrelated manner that they can not be understood by focussing them individually. The above diagram serves to express how these two contexts are interrelated. As the Fig. 4.3 shows the most dominant factor is the donors through which the interest of the international pressure group has been articulated. On the other hand, aid-dependent development strategy created a strong vested interest in the country in favor of perpetuating the dependence. And, as highlighted by several studies,[5] the most visible implication of the aid-dependent development strategy is the expanding and strengthening network of aid-sustained elite which flourishes its exclusive position by trading poverty while in the end the masses of poor continue to grow poorer. As the diagram show,s the general public and the mass media as the instrument of expressing general public´s opinion in the process of policy shaping remain almost isolated.

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[5]See for details, *Report of the Task Forces on Bangladesh Development: Strategies for the 1990s*, Dhaka, University Press Ltd. 1991, Vols. 1-4.

CHAPTER 5

EXTENT OF BANGLADESH´S DEPENDENCE ON DONOR AGENCIES

This Chapter is an attempt to illustrate, through a very close analysis of aid, the extent of dependence of Bangladesh development on foreign aid. It will be an attempt to ascertain how far aid is essential to sustain the development activities in Bangladesh.

Bangladesh is one of the least developed countries of the world and her economy like that of any other developing country, appears to be mired the *low level equilibrium trap*. The country is overpopulated and available resources are very limited. The average standard of living is very low. Whatever limited resources are available in the country are not optimally explored. The most important assets of the country are its land and manpower. But man-land and land-capital ratio are very unfavorable; also the mode of production as well as factor mixes are not naturally conducive to economic growth. Furthermore, repeated natural disasters have created hindrances towards attaining the desired economic goals. In such an economy, domestic savings can hardly be significant. As such, it is simply difficult to pool enough domestic resources for capital investment. In addition the country is suffering from an adverse export-import balance, which usually has to be met by external assistance.

Hence Bangladesh is heavily dependent on aid for its economic and social development, and in times of crisis for its economic survival. Being one of the poorest developing countries and the largest least developed country, Bangladesh's saving capacity is far less than the minimum investment required to keep the economy from sliding backward. The annual investment level has ranged within 13-15 per cent of the GDP. The rate of domestic saving on the other hand has remained less than 3 per cent of the GDP in most years. Substantially flow of remittances by Bangladesh nationals serving abroad helped to raise the rate of national saving to about 6 per cent of the GDP. The gap between investment and national saving is thus about 9 per cent of the GDP, which has been filled in by the inflows of foreign aid. Bangladesh is also vulnerable to frequent natural calamities which warrant urgent international support and assistance. There have been several natural disasters in the last decade.

Foreign aid commitments to Bangladesh surpassed the $2 billion mark in the last couple of years. Actual disbursements, however, have lagged behind commitments and amounted to about $1.6 billion in the last few years. On the average, foreign aid has paid for about two-thirds of total investment, 90-100 per cent of the public investment and 55-60 per cent of total imports (UNDP Report, 1990).

Table 5.1 Commitment and disbursement of foreign aid to Bangladesh.

(Million US$)

Financial Year	Commitment			Disbursement		
	Grants	Loans	Total	Grants	Loans	Total
1971-72	512.72	98.09	610.81	245.17	25.63	270.80
1972-73	483.70	394.71	878.41	486.39	65.05	551.44
1973-74	106.76	448.31	555.07	218.56	242.68	461.24
1974-75	345.22	921.47	1266.69	374.84	526.21	901.05
1975-76	380.55	578.33	958.88	233.81	566.72	800.53
1976-77	400.51	326.47	726.98	255.50	279.21	534.71
1977-78	433.20	714.68	1147.88	392.87	440.99	833.86
1978-79	936.01	824.23	1760.24	501.84	528.21	1030.05
1979-80	485.02	668.23	1153.25	650.56	572.50	1223.06
1980-81	550.00	1009.24	1559.24	593.68	552.78	1146.46
1981-82	805.56	1117.29	1922.85	653.82	585.81	1239.63
1982-83	836.63	685.91	1522.54	587.50	589.88	1177.38
1983-84	858.45	836.54	1694.99	733.73	534.67	1268.40
1984-85	875.00	1099.87	1974.87	703.33	566.11	1269.44
1985-86	873.59	787.85	1661.44	545.59	760.34	1305.93
1986-87	893.72	709.54	1603.26	661.59	933.57	1595.16
1987-88	880.85	648.93	1529.78	823.78	816.60	1640.38
1988-89	661.15	1212.32	1873.47	672.96	995.52	1668.48
1989-90	884.71	1290.36	2175.07	765.88	1043.68	1809.56
1990-91	485.06	885.28	1370.34	831.46	901.11	1732.57
1991-92	1228.73	1086.69	2315.42	925.15	1127.48	2052.63
1992-93	525.52	506.64	1032.16	523.72	659.52	1183.24
Grand total:	14442.66	16850.98	31293.64	12381.93	13314.27	25696.20

Source: Economic Relations Division, Ministry of Finance, GoB.

5.1 Extent of Aid Dependence

As it has been already mentioned in the above discussion that Bangladesh has relied greatly upon foreign aid for a long time. With the passage of time, that dependence on foreign aid has deepened. Islam (1994) has used the following six indicators to show this trends:

(a) aid-GDP ratio (AGDPR);

(b) aid-exports (of goods and services) ratio (AXGSR);

(c) aid-imports (of goods and services) ratio (AMGSR);

(d) aid investment ratio (AIR);

(e) aid-development budget ratio (ADBR);

(f) aid-current account deficit ratio (ACADR).

Aid to GDP ratio (AGDPR in Fig. 5.1) has remained consistently high for Bangladesh since 1971. The ratio reached its highest level (11.4 per cent) in 1976. Although the ratio has, to some extent, declined in recent years, it still remains high (about 8 per cent in 1990) compared to other countries such as India (around 2 per cent)[1], Pakistan (around 4 per cent)[2] and Korea (around 4 per cent)[3] Aid to exports (AXGSR in Fig. 5.2), aid to imports (AMGSR in Fig. 5.3), and aid to current account deficit (ACADR in Fig. 5.4) ratios have also remained quite high over the years (92 per cent, 48 per cent, and 115 per

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[1] See Sukhatme in Krueger *et al* 1989:201.

[2] See Islam, 1972:503.

[3] See Krueger and Ruttan in Krueger *et al*, 1989:228.

cent respectively in 1990). The AMGSR indicates that about half of total imports were being financed by foreign aid.

The Aid-Investment Ratio (AIR in Fig. 5.5) shows that foreign aid has financed about 70 per cent of all investments in 1990 compared to India (5.3 per cent for 1982)[4].

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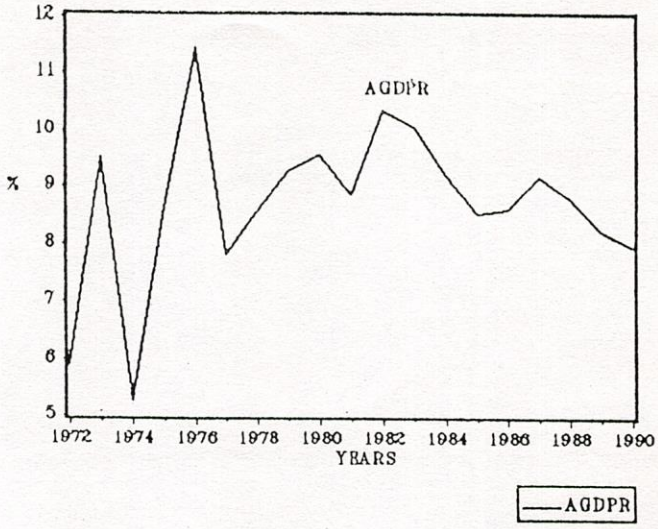
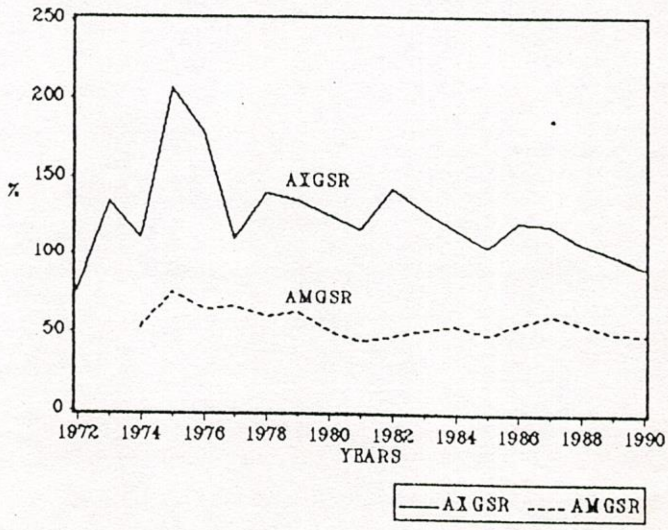
[4]See Sukhatme in Krueger *et al*, 1989:206.

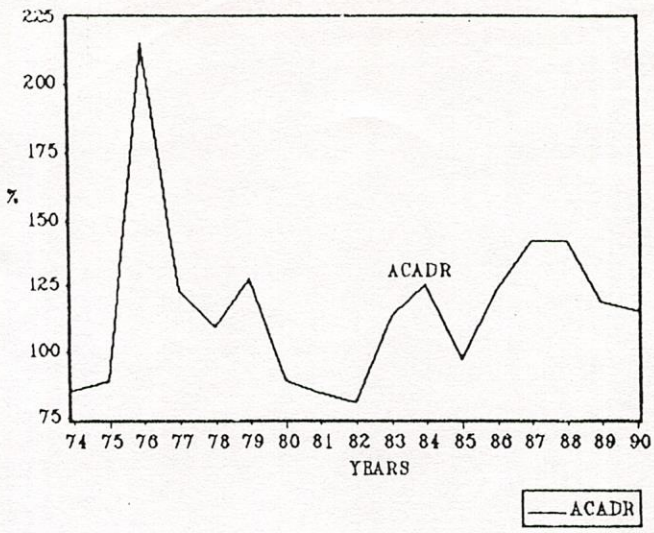
5.1 Aid-GDP Ratio



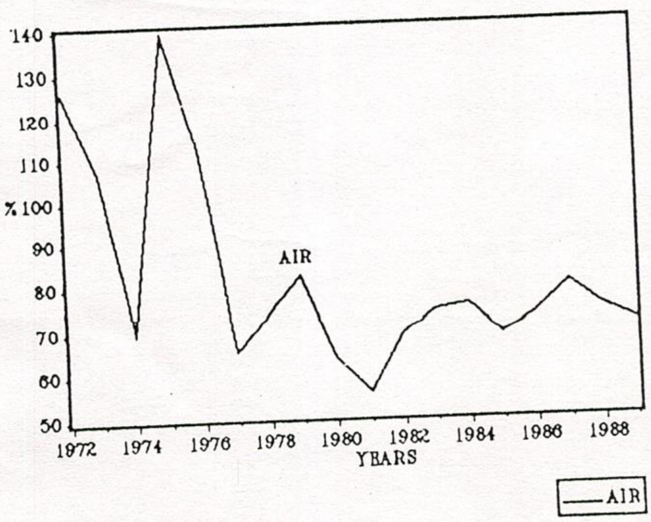
5.2 AID AS A PERCENTAGE OF EXPORTS (AXGSR) AND IMPORTS (AMGSR) OF GOODS AND SERVICES



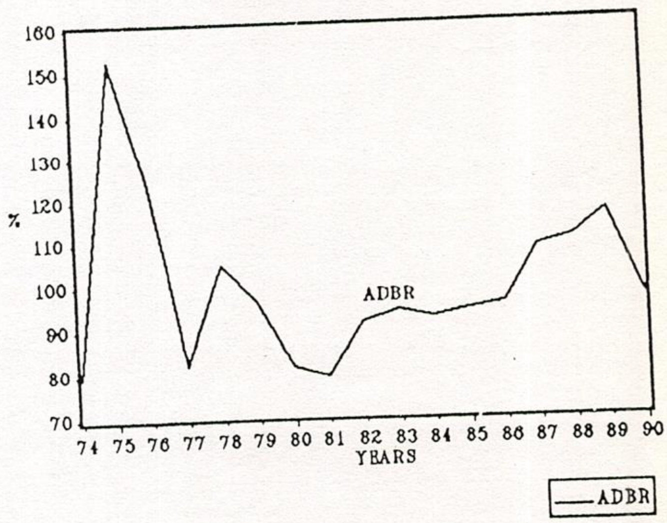
5.3 AID AS A PERCENTAGE OF CURRENT ACCOUNT DEFICIT (ACADR): 1974 - 1990.



5.4 AID AS A PERCENTAGE OF INVESTMENT (AIR).



5.5 AID AS A PERCENTAGE OF DEVELOPMENT BUDGET (ADBR): 1974 - 1990



Another grim reality for Bangladesh is the fact that aid has financed about 96 per cent of the development budget of this country compared to 17 per cent for India.[5] Table 5.2 and Fig. 5.6 (ADBR) show the dismayed state of affairs regarding the extent of dependence of Bangladesh development budget.

Table 5.2 Dependence of ADP on Foreign Funds (Taka crore)

Year	ADP	Foreign Flows	% of ADP Financed by Foreign Flows
83-84	3585	3483	97.2
84-85	3508	3307	94.3
85-86	4096	4018	98.1
86-87	4513	4372	96.9
87-88	4651	5086	109.4
88-89	4595	4885	106.3
89-90	5103	5547	108.7
90-91	6121	6103	99.7

Source: Planning Commission, Ministry of Planning, GoB.

Most of the revenue earnings of the government is dissipated in just paying for its current expenditures leaving very little for the development program. As a result almost the entire Annual Development Program is financed by foreign funds. In other words, whatever scanty infrastructural development takes place in the country is due mostly to foreign assistance rather than indigenous efforts.

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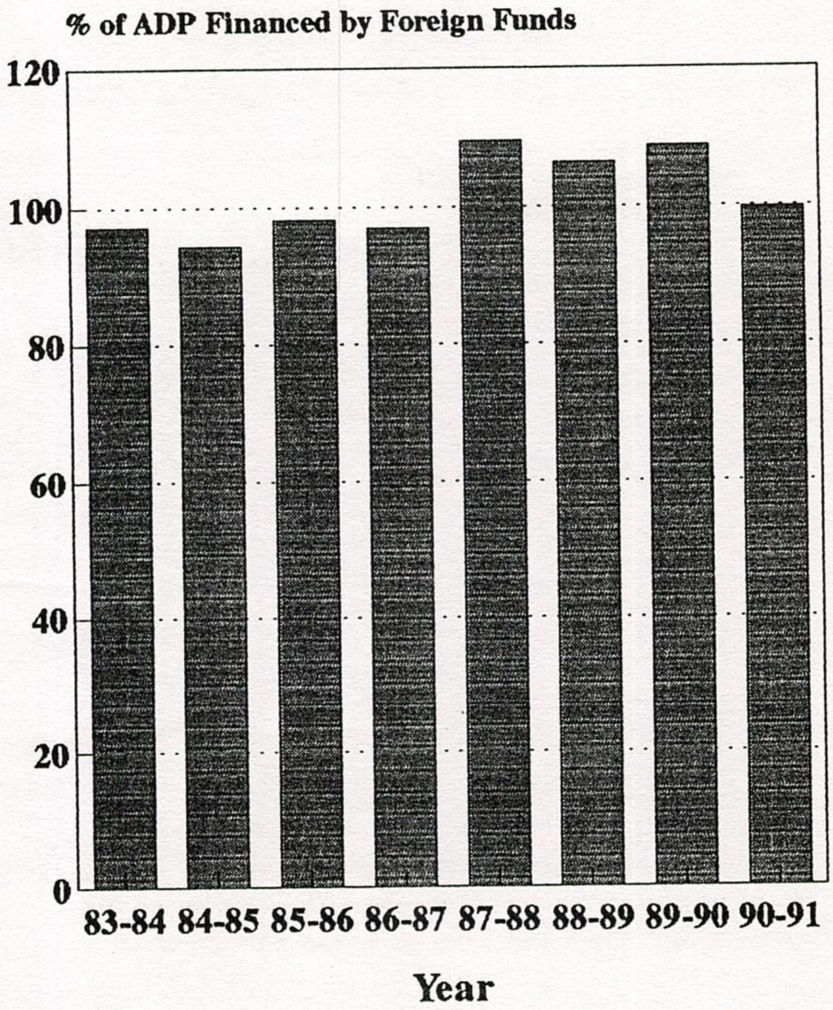
[5]See Sukhatme in Krueger *et al*, 1989:206.

Figure 5.6 Dependence of ADP on Foreign Fund



Source: Planning Commission, GOB

Based on the above indicators and their trends, it is clear that Bangladesh has relied heavily on foreign capital in the past, and the picture is unlikely to change in the foreseeable future. One obvious implication is that this extreme dependence may cause severe balance of payments difficulties in the future.

CHAPTER 6

MECHANISMS OF DONORS' INFLUENCE

This chapter is designed to identify the mechanisms through which donors influence the policy formation process of Bangladesh. There are three parts to the Chapter.

In the first part the modes through which the donors influence the policy formation process of Bangladesh have been mentioned.

The second part attempts to focus on the donors' conditionalities of aid as a means used by them to protect and promote their own interests or at least, to articulate their views.

The third part shows how the *Adjustment Policies* of the World Bank and IMF influence almost every aspect of policy formation in Bangladesh.

6.1 Modes of Donors' Influence

Donors provide inputs into the policy and watch feed backs of the policy implementation. Donors intervention in the domestic policy making and policy implementation process of Bangladesh become visible through various ways and means. There are some institutional arrangements as well as informal weapons which provide the donors a great deal of power to influence the government of the recipient country.

While interaction between donor agencies and Bangladesh Government representatives takes place as a continuing dialogue throughout the year within the recipient country itself, there are three formal meetings that take place in a year between donor agencies and GoB. These are:

1. The Aid Consortium Meeting of all donors held under the auspices of the World Bank in Paris every spring;
2. Annual bilateral talks between donors and the Bangladesh Government held in Dhaka and donors´ country every year;
3. World Bank local consultative meeting of the donor community held in Dhaka.

1. Aid Consortium Meeting in Paris

From the donor´s side, Consultative Group Meeting remains the most important formal forum held annually. Bangladesh´s aid relationship with the donors is complex, not only owing to the large number of aid providers but also for the varying donors objectives, requirements and procedures. World Bank as a leader of all the donors acts as a coordinator among them in this meeting held in Paris every year. As the leader of the Bangladesh Aid Consortium the World Bank obviously exercises the most influence in policy discussions particularly since it prepares the bulk of the documentation placed before the Bangladesh Aid Consortium. The World Bank has a regular system of reporting on the economies of all the countries to which it gives assistance on which the Bank prepares a thoroughgoing review of a country´s affairs. Such basic economic reports are supplemented by others, also covering general economic matters, often prepared at yearly intervals, which form the basis for the Bank´s submission to

Consortium meetings when such exist.

The first of these Aid Group Meetings was held in Paris in October 1974, where 28 delegations attended to raise additional resources, discuss the economic crisis the country, introduce its five year plan for development, and lay the foundation for an exchange of views on the country's problems, prospects and performance. The Aid Group has held regular annual meetings since then, which focus on aid commitments for the coming financial year (July-June), the macro economic progress of the country and other special agenda items.

The donors look at the Aid Group meetings as a forum in which to engage the Government in a dialogue on the various developmental issues which they consider important for their assistance to be effective in achieving the desired goals. The salient common issues have been; food production and distribution, the balance of payments situation, domestic resource mobilization, exchange rate adjustment, the Government's Annual or Five-Year Plans, problems of program and Plan implementation, structural adjustment, population control and encouragement of the private sector (UNDP Report, 1991:10).

The Paris Aid Group has become increasingly concerned with the social dimensions of development and has held intensive discussions on poverty alleviation and income distribution, especially infavor of the landless and rural poor. Central concern of the Group continue to be closely related to those themes but have increasingly included policy measures, particularly those related to structural reforms proposed by the World Bank and the IMF.

The structure is set in the following way. At the end of the calendar year, the Bank sends out a mission to Bangladesh. The members sit with Bangladeshi officials and make a survey of the economic situation of Bangladesh for the year just passed, analyze it, taking into account available foreign exchange and the capacity of Bangladesh to provide local costs for projects. They also take a forward look and try to identify future aid priorities. At the end of it all they produce a couple of substantial documents which are considered by all donors before the meeting. At the meeting they are put forward and discussed with the Bangladesh Officials who discuss them, they either endorse or make general comments on the material.

2. Bilateral talks

Secondly, annual bilateral talks between the donors and Bangladesh Government is another important meeting where donors can influence the policy. For example, annual bilateral talks between the Overseas Development Administration (ODA) and the Bangladesh Government held alternately in Dhaka and London every year. This provides the opportunity to review the program as well as the balance of the aid program; that is , the commodity, project and technical cooperation components of it, and set priorities for future years. The Bangladesh Government looks to maximize its return on aid and carefully shapes its priorities according to what it assesses each donor can do, and what they would like particular donors to do. ODA, from its side of the table, is also working on aid policy towards Bangladesh. This process is rather diffused as it involves the Development Division in Bangkok, the High Commission in Dhaka as well as technical advisors and the Bangladesh desk in the ODA. In addition to that there are the political directives of the Minister and the senior ODA management in the UK. For example, recently the environmental factor has become a policy variable to which all project design needs to be sensitive. The internal country policy papers provide an annual individual country management tool for ODA officials.

These aid-talks provide the opportunity for ODA's internal focus to be discussed with the recipient Government. The UK Government on its part is doing the same thing; reviewing projects and policies. Those thoughts are then fed into the aid framework exercise as it follows just after that (Guhathakurta, 1990:155).

3. Local Consultant Group

The third forum for discussing aid issues between the donors and the Bangladesh Government is provided by the World Bank local consultative group which meets whenever a particular aid or developmental issue needs discussion. This was established in 1974 to coordinate donor views in Dhaka and discuss implementation of projects and policy matters in aid negotiation or aid utilization. Such meetings are organized by World Bank Resident Mission in Bangladesh with the approval of ERD. Donors use it as an occasion to discuss issues in greater details than at the Paris meeting. In these meetings, too, donors specify and demarcate their areas of interest, and there is a great deal of coordination between donors and also between donors and Bangladesh, as this is the best way of ensuring that no one is stealing projects from one another, and of avoiding overlap. All donor representatives send their aid attaches along. There are series of meetings throughout the year. Some may concentrate on sectoral issues; some on individual projects or particular problems. In the word of an aid official,

> "It gives us an opportunity not only to discuss individual projects, but also general beliefs and policies on which sectors to emphasize, exchange views, and provide opportunities on both sides to be open and frank"[1].

For example Mr. Christopher Willoughby, Resident Representative of the World Bank while addressing the meeting of the local consultative group of Bangladesh Aid Consortium on 23rd October, 1993 has focussed three areas of reforms which required combined action by both public and private sectors. These three areas are: (a) industrial deregulation and trade liberalization, (b) privatization and (c) labor market improvement.[2]

The donors have sufficient access up to the highest level of the government and administration. The Resident Representative and the executive directors of the World Bank are on frequent

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[1]See interview with an ODA Official ,Guhatakurta, 1989:125.

[2]See *Local Government Engineering Department* (LGED) Newsletters, October-December, 1993.

meetings with the Prime Minister as well as with the concerned ministers. However the usual routine discussions take place at the level of functional heads of the concerned ministries and Economic Relations Division (ERD). According to a representative, ERD is very approachable and seems to be concerned about various problems. He further added that World Bank in 1982 on behalf of the donors had made certain recommendations to Government of Bangladesh, especially to the President and was of the view that the government has taken these recommendations seriously and worked to put these into effect.[3]

There is a regular practice of consultation meetings between GoB and the UK which takes place every six months at the level of additional secretary of Asia division of the UK ODA program. A review of every project is undertaken in these meetings and detailed components of these projects are scrutinized here. The main focus of these consultation meetings, according to an interviewed UK aid official, is to identify the priority areas for British assistance with an eye to maximize the developmental efforts of the projects (Sobhan, 1990:214).

In Bangladesh USAID maintains a large mission and engages in continuing bilateral policy dialogue with the government. The USAID maintains communications with the authorities in the concerned ministries, including the minister, secretaries, ERD officials and in some cases with the head of the public sector

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[3]See interview with the Resident Representative of the World Bank (Sobhan, 1990:213-214).

corporations. The Scandinavian donors, the Dutch and the Canadian also maintain their independent channels of negotiations. Indeed *policy dialogue* is more effective than policy conditionality in persuading a recipient to go further down a path which the donors want to go.

Various seminars and symposium conducted by World Bank or other bilateral donors are one of the strong medias of influence. Through these donors provide forums for analysis and discussion of public policy and these activities influence policy making in government. For example, in February 1989, a UNDP sponsored workshop on agricultural sector review in Bangladesh concluded that, given the rural condition of the country, the food poverty problem might be solved by paying attention to a more equitable distribution of new assets created by the government in the rural sector (*Bangladesh Observer*, February 25, 1989).

The World Bank time to time publishes reports on certain policy measures of the GoB or on the overall economic situation of the country which remain another weapon upon the Government. The general perceptions of the World Bank regarding the socio-economic policies of Bangladesh are put forward in the World Bank reports which are not secret or confidential documents and the government of the recipient country has the right to go through them. Recently published World Bank documents on Bangladesh which have tremendous effects on our Industrial policies include "*Bangladesh: Issues and Prospects for Industrial Development*" (1978), "*Bangladesh: Adjustment in the Eighties and*

Short Term Prospects" (1988) ,*"Bangladesh: Manufacturing Public Enterprise Reform"* (1989), *"Bangladesh: Managing the Adjustment Process- An Appraisal"* (1990),*"Bangladesh: Review of the Experience with Policy Reforms in the 1980s."* (1990),*"Bangladesh: Implementing Structural Reform"* (1993), *"Bangladesh: Privatization and Adjustment"* (1994), etc. These reports contained specific policy recommendations which the World Bank wanted GoB should take into consideration while making Industrial policies or reforming them.

Besides, some informal instruments are used by the donors to influence the policy of recipient country. These are often as influential as formal ones. One of the such measures is the visit of aid recipient country by the donor government's or agencies' high officials. Correspondence by telephone or by letter is another strong instrument. Donor governments or agencies express their satisfaction or dissatisfaction over certain policy. In such a letter to Bangladesh's Prime Minister IMF Managing Director Michel Camdessus lauded economic uplift in Bangladesh recently. It has commended, Bangladesh's economic development, saying "Despite all its problems, Bangladesh has been one of the best performers amongst those countries whose structural adjustment programs have been supported by the Fund. The many structural adjustment reforms allowed the country's economy to continue to grow as it has become more open and less regulated" (*Bangladesh Observer,* April 25, 1994).

Informal gathering and meetings sometimes provide a means for exchanging views over certain policies of Government among the donors and the government officials. For example, the Canadian aid mission sometimes organizes such gatherings where the civil servants, entrepreneurs and the politicians take part. The informal discussions which take place in such meetings, according to a CIDA representative help to clarify their thoughts on aid related issues.[4]

Dinner and cocktail parties are also exploited by the donors to communicate with high ranking officials of GoB. The discussions which take place on such occasions later leave a strong imprint on the aid documents, agreement and contracts.

6.2 Donors´ Conditionality over Bangladesh´s Public Policies

Bangladesh Government´s inability to mobilize adequate development funds provide the scope for the donors in retaining control over the direction of Bangladesh´s development. In fact, aid is now determining both the direction and structure of Bangladesh´s development policies. The donors have thus become progressively more assertive in seeking policy reforms from the GoB. Without reference to the experience of all other Third World countries it is difficult to say whether donors exercise an unduly high leverage over the GoB´s development policies. However the extent to which they seek to influence policy in Bangladesh remains quite breathtaking in its compass (Sobhan, 1993:235).

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[4]See interview with a CIDA representative, Sobhan, *1990:214.*

Over the years the donors have been increasing the number of conditionalities attached to any project loan agreement. However with the increasing resort to program loans in place of the former commodity loans the World Bank and the ADB have been providing the GoB cash foreign exchange on condition that policy reforms are carried through in a variety of areas of the economy. some of the program loans used in recent years for imposing such conditionalities on the GoB include:

Figure 6.1 Donors' Conditionality over Public Policy

Credit Sector	Funding Agencies
Industry Energy Finance Small Irrigation	World Bank
Food Crop Public Enterprize	ADB

In each of these sectors the GoB has to commit itself to a program of reforms designed to improve the management of the sector. Thus for example in the Industrial Sector Credit of the World Bank commitments are sought for import liberalization and privatization of public enterprises. The Financial Sector reforms were designed to improve loan recovery and market orientation of the financial sector.

The above of conditionalities just provide a sample of the measures that donors place on offer in our aid programs.

The Aid Consortium meeting held in Paris every year has been remain the most convenient forum for the donors to intervene in the policy issues of Bangladesh by setting a bulk of conditionalities. For the purpose of our discussion only a few of them relevant to our industrial policy has been summarized in the following table.

Table 6.1 Summary of Donors´ Policy Recommendations

Policy Recommendations	Donor
Substantial reduction in the industry allocation of the Plans.	World Bank
Abolition of the ceiling private investment.	World Bank, USAID
Review of the licensing Procedure to permit import by individual producers.	World Bank
Denationalization of smaller public sector units and units which are not major national importance.	World Bank
Enactment of new labor legislation to establish World Bank, the principle of one enterprise - one union.	World Bank, USAID
Appropriate legal and institutional measures should World Bank, be taken to improve the labor-management relationships. In order to bring discipline in the labor sector, immediate consultative meetings should be initiated with ILO and the World Bank.	World Bank, USAID
Revised labor and pricing policies are needed for profitability of the public sector enterprises.	All donors
For improving the policy framework for the private sector, more emphasis should be given to policy instruments than controls.	World Bank, USAID
More autonomy should be given to industrial public sector and also some efficiency related incentives are essential.	World Bank, USAID

Upgrading of management - technical training, revising pricing policies by separating social factors from productive efficiency, undertaking balancing and modernization programs are needed for public sector.	World Bank, USAID
Greater reliance on private investment and market forces.	World Bank, USAID
All out initiative should be made to strengthen and reorganize the Investment board	World Bank, Japan
Industrial strategy should include steps to safeguard against retaliation by improving countries against export; incentives should be designed to provide certainty and stability to exporters and import substitution, both local and foreign.	World Bank
The strategy should be an export led industrialization.	World Bank, France, Norway, USAID, ADB
Need for developing private sector rural industries as a means of generating off-farm employment.	USAID
Bangladesh should not be allowed to lose too many of its able managers and administrators.	FRG
For continued industrial growth the supply of raw materials have to be ensured.	France
Increased attention should be paid to capacity utilization instead of going for creation of new capacities.	Netherlands
Government of Bangladesh (GoB) should immediately take strong and complete measures against the default borrowers of the public sector banks and financial institute.	World Bank, IMF
Abolish the strict import and export restriction for the industrial sector. Attempts should be made to rationalize and reduce duties/taxes.	World Bank, USAID
Diversification of export is important for Bangladesh.	France, Norway, USAID, ADB
Feasibility studies for establishing a free trade zone should be taken up.	World Bank

There is a necessary of streamlining administrative procedures in the export import-sector.	World Bank
Higher level of sincerity of the administration will help domestic resource mobilization.	Norway
Immediate relaxation and gradual elimination of legislative and administrative restrictions on trade.	World Bank
Internationally acceptable quality control system is essential for export products.	Denmark
Duty free access of exports of Bangladesh into developed countries market should be ensured.	UNCTAD

Source: Various Aid Group Meetings held in Paris from 1978-1994.

It will not be irrelevant to mention here that national interests of the donors are the prime criteria which are reflected in the assistance conditionalities of most of the donor countries. A more clearly articulated measure of how the donors protect and promote the interests of the companies of their own country, through use of aid leverage can be best demonstrated by the Country check list, project check list and Standard item check list of American Aid. These lists envisage general and funding source criteria for country eligibility to receive assistance from various American sources, lays down criteria for project selection, provision of procurement, construction and other restrictions. The legal basis of these check lists has been provided by the Foreign Assistance Act (FAA) legislated by the American Congress.

To illustrate this point we can mention here some of the relevant articles from the check lists for one of the American AID financed projects, namely, the *Rural Finance Project.*[5] For example, Article 3 of the Country Check list states that:

> If assistance is to a government, has it taken any action which has the effect of nationalizing, expropriating, or otherwise seizing ownership or control of property of American citizens or entities beneficially owned by them without taking steps to discharge its obligation towards such citizen or entities. Only a negative answer against this article makes the country eligible for aid (FAA Sec. 620(e)(1), cited in Sobhan, 1985:38).

Obviously this statutory criteria is an effective instrument in the hands of the donor. The recipient country now has to consider the consequences of taking any step to nationalize or expropriate such properties covered by American aid conditionality.

If the above mentioned article allows American aid to be used as sanction to protect existing American business interest in Bangladesh, Article 8 of the Project Check List aims to further promote American commercial interests in an aid recipient country. The Article states:

> Information and conclusions whether project will encourage efforts of the country to: a. increase the flow of international trade; b. foster private initiative and competition......(FAA Sec. 601(a,b).

But the real essence of these lines has been explained in the following Article which asks for:

> Information and conclusions on how project aid will encourage American private trade and investment abroad and encourage private American

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[5]See *American AID Project Paper*, Bangladesh Rural Finance Project, 338-007, May 1983.

participation in foreign assistance programs (including use of private trade channels and the services of American private enterprise).

Naturally only affirmative answers to these questions will make the project concerned eligible for American aid.

The listing of such examples can be extended, especially concerning procurement, transportation, construction, etc. However, the conclusion which emerges is that USAID as a donor is using its leverage as a donor as a sanction to expand and perpetuate American commercial interests among aid recipient countries including Bangladesh. Whilst such interests remain predominantly commercial and specially tied to the aid program, where PFI or its possibility is present, particular donor governments will continue to exercise the influence originating from their position as donors on behalf of their investors in the recipient country.

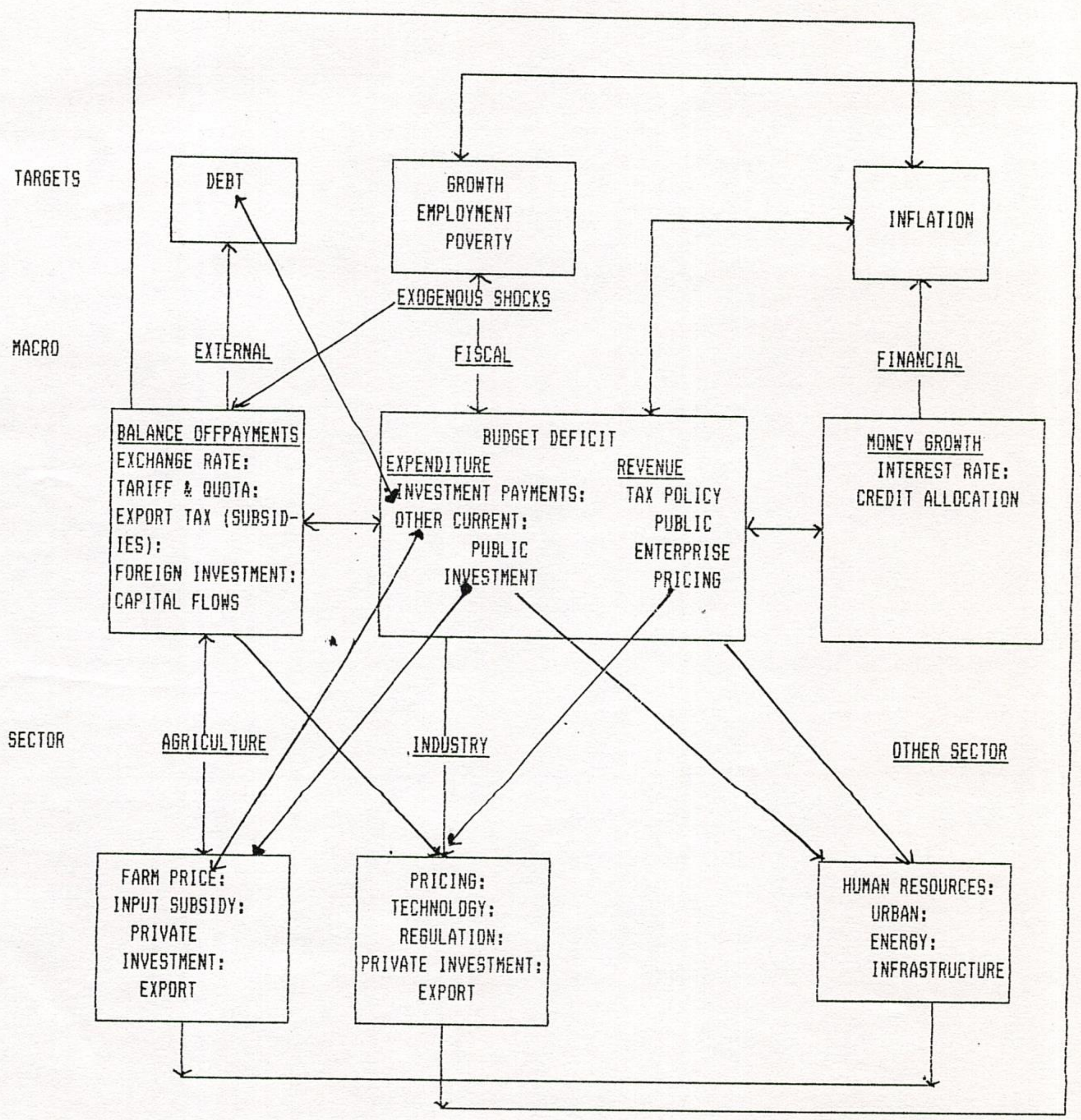
6.3 Structural Adjustment program as a Strong Weapon of Donors' Influence in Bangladesh :

Structural Adjustment policies have been implemented in developing countries by the IMF and the World Bank receiving major external economic assistance from these two multilateral aid agencies since the early 1980s. These policies concern a wide range of reforms, microeconomic (e.g. taxes), macroeconomic (e.g. fiscal imbalance), institutional (e.g. public sector inefficiencies), etc. in response to the serious balance of payments problems affecting many developing countries. IMF lending may be divided into low and high conditionality loans. The Financing Facility, Buffer stock Facility, the Oil Facility and Trust Funds are low-conditionality schemes, while the Extended Fund Facility, Structural Adjustment Facilities (SAF) and Enhanced Structural Adjustment Facilities (ESAF) are high-conditionality loans. Any member seeking loans under the IMF Structural Adjustment Facilities (SAF) must develop, with the help of the staffs of the IMF and World Bank, a Policy Framework Paper (PFP) for a three- year adjustment program. The PFP describes the government´s macroeconomic and structural policy objectives and priorities, and the measures they intend to adopt in the 3-year period. It also describes in detail the structural reforms and macroeconomic policies to be implemented in the first year. The more sensitive conditions and preconditions accepted by the borrowing country government are contained in a *Letter of Intent* signed by the government. Both the *Letter of Intent* and the PFP are closely guarded classified documents. Benchmark values of financial and structural target variables of the SAF program are stated in the PFP against which performance monitoring is carried out mainly on a quarterly basis. The PFP is also used as a reference policy framework by the World Bank and in recent years by other multilateral and bilateral donors as well. The PFP is reviewed by the Executive Board of the IMF and by the Executive Directors of the World Bank in the *Committee of the Whole*. It is updated each year for the 3-year period.

The IMF was established in 1944 with the founding objective of helping countries in need with short term loans to solve balance of payments problems. Its present collaboration with the

World Bank in the structural adjustment programs is in express violation of its Article of Agreements of its founding days. The clauses of a Fund-Bank adjustment program is so comprehensive that it covers almost each and every aspect of a client country's micro and macro economy (Rahman, 1990:67). Fig. 6.2 shows the comprehensiveness and interrelationships of the Structural Adjustment program. Included reforms under adjustment lending are trade policy, public finances, public sector management, the financial sector, poverty alleviation programs, agricultural policy, industrial policy, and so on.

Figure 6.2 How Adjustment Policies Interact



Source: World Bank, 1989:25

The objectives, eligibility and basic program features of the IMF-ESAF are similar to the SAF. The differences relate to provisions for access, monitoring and funding. Adjustment measures are expected to be particularly strong aiming to foster growth and to achieve a substantial strengthening of the balance of payments position. Continued access to loans under ESAF would be linked to fulfillment of performance criteria.

The objective of the World Bank's lending program has also undergone major change. Since 1980 it has also started providing Structural Adjustment Loans (SAL) to LDCs. Lending has increasingly become policy-based, i.e. tied to pursuance of a set of predetermined policies aimed at structural adjustment of the economy.

Bangladesh contracted in 1990-91 a three-year IMF loan under Enhanced Structural Adjustment Facilities (ESAF) scheme preceded by another three-year IMF loan covering the period 1986-87 to 1988-89 under the Structural Adjustment Facilities (SAF). Fiscal year 1989-90 was not covered by any IMF loan although the country was under IMF's strict structural adjustment guidelines. The SAF had the economy-wide Policy Framework Paper (PFP) containing predetermined targets for macroeconomic parameters and clearly specified institutional reforms. The IMF and the World Bank not only hold similar views on structural adjustment policies and closely coordinate their lending and monitoring activities in Bangladesh to achieve the objectives of Structural Adjustment. The Policy Framework Paper (PFP) devised for Bangladesh within the 3-year IMF-SAF agreement was jointly prepared each year by the staffs of the IMF and the World Bank *in conjunction* with the Government of Bangladesh. Both the IMF and the World Bank insist on adherence to the PFP in their lending operations.

In Bangladesh, two sets of benchmarks have been set viz., financial and structural. Financial benchmarks relate to fiscal deficit, credit to the public or private sector, net assets of the banking system, external debt management, exchange rate policies, pricing policies, etc. Structural policy benchmarks in Bangladesh relate to public enterprise reform and privatization, tax reform, agricultural and industrial policy reforms, public investment reform, liberalization of the trade regime including exchange controls, civil administration reform and financial sector reforms, viz., interest rate and structure, banking reforms, etc.[6]

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[6]See for details Sobhan (ed.), *Structural Adjustment Policies in the Third World: Design and Experience*, Dhaka, University Press Ltd., 1991 p. 224.

CHAPTER 7

THE ROLE OF DONOR AGENCIES IN THE FORMULATION OF INDUSTRIAL POLICY IN BANGLADESH

In this chapter an effort is made to explore the role of various donor agencies and donor countries in industrial policy formulation in general and with reference to some special issues in particular. This chapter is divided into two parts:

The first part endeavors to explore the issues in which donors influence is manifestly visible in the recent years.

The second part of the chapter focuses on the Jute Sector of Bangladesh as a case of policy intervention by donors.

The issues of industrial policy constitute a necessary component of measures for improving the path of industrialization in Bangladesh. In this respect one thing should be remember that issues in trade policy or in broad terms commercial policy and that of industrial policy are not mutually exclusive. Therefore, these common issues would be focussed. For example, the influence of trade reform on industrial viability is relevant in view of the complex nature of the trade regime involving high tariffs, quantitative controls, duty drawback system and export benefits. Bangladesh donors tend to concentrate specifically on the issues relating to industrial policies. The donors not only clearly articulated their views on these issues but also very closely watched their implementation process. Moreover policy changes have taken place at the implementation stages.

One may find these policy issues overlapping, although separate focus on these issues has been preferred for the convenience of discussion.

As on most policy issues, the World Bank tends to subsume all the diverse donor interest and perspectives in articulating its own views on the industrial policy of Bangladesh. The Bank in December 1978 put forward a comprehensive industrial strategy which concentrated on three main areas: policy toward private industry, policy toward public enterprises and export development policy (World Bank, 1978). For improving the framework for the private sector the Bank called upon GoB to place more emphasis on policy instruments (indirect policy interventions such as customs duties, taxes and incentives policy on foreign investment, mechanism and institutions for industrial finance) than controls (discard regulatory policies such as import licensing, investment schedule, limits on investment, allocation of areas of activities for public and private investment, investment approval procedures). The Bank document further spelt out in detail the particular controls and instruments needed to be improved. For the industrial public sector the Bank strategy suggested improvement of the organization of the public enterprises by giving more autonomy and offering specific efficiency-related incentives, upgrading of management and technical training, revising pricing policies by separating social factors from productive efficiency, undertaking balancing and modernization programs. The main thrust of the proposed industrial strategy was of course greater reliance on private investment and market forces.

Another significant feature of this strategy is that it envisaged for Bangladesh an export-led industrialization strategy. The rationale of this objective, according to the bank document, is supported by the comparative analysis of the performance of other developing countries which fostered liberal, export-oriented economies (South Korea, Taiwan, Hong Kong) and grew faster, weathered recessions better, were more self-reliant and had more efficient industrial sectors than the economies with widespread controls on import and foreign exchange (India, Ghana, Tanzania). The Bank document however, pointed out that the industrialization strategy should include steps to safeguard against retaliation by importing countries against export incentives and should be designed to provide certainty and stability to exporters and import substitution, both local and foreign, without offering excessive protection to any one (World Bank, 1978).

A Trade and Industrial Policy Reform Project was launched in 1983-84 for a period of two years under the joint sponsorship of the World Bank and the Bangladesh Government. The New Industrial Policy of 1982 was revised in 1986 on the basis of report of this study which made major changes in industrial policy. Under the policy government control of private investment was relaxed and financial institutions sanctioning was enhanced.

Subsequently this trend of policy change in industrial sector provide further policy modifications in 1991. Another trade reform program initiated in 1986 by the Bank and GoB was followed by the creation of the Board of Investment (BOI)[1] in 1989 and the announcement of a 1991 Industrial Policy.

However, the general feature of the donors' perception about the industrial sector is that all their policy suggestions centered around two issues: demand for a more favorable investment climate for the private investors (both local and foreign) and better performance of the public sector enterprises (Sobhan, 1990:204). In this respect all the donors were in full agreement with the perceptions of the World Bank.

Any study of the evolution of industrial policy in Bangladesh would readily discern the similarity of the donors' policy perceptions with the policy revisions introduced by throughout the last decade. The most important part of this whole process is that the donors' policy preferences have always preceded GoB's decisions on policy revisions (Sobhan, 1990:204). This suggests that the contribution of the donors on domestic industrial policy was quite substantial, if not the prime mover, in bringing about appropriate changes in the policy. It is thus hardly surprising that when GoB took its own initiative to redesign its industrial investment policy and incentive packages in order to encourage private investment this was met with

[1]Established in January 1989, BOI is the highest authority for granting sanctions to the private sector. However, now sanction is no longer required.

appreciation on behalf of the donors. Thus we see the American representative in the Aid Group meeting of 1984 observes that the GoB's progress in returning government manufacturing units to private sector and in encouraging a greater role for the private sector in the development process has been appreciable. Even the *Like Minded Countries* (LMCs), who sometime differ with Bank and USAID on some issues, seemed to be in full agreement with them on this point. This may be discerned from the statement of the German representative to the consortium stating the disinvestment policy of GoB to be an important step forward in the development of the industrial sector (Report on the 7th Aid Group Meeting:96). Whilst evaluating the policy initiatives of GoB in the industrial sector the donors have not only endorsed them but also termed the Industrial Policy as *courageous* and *a step forward.*

7.1 Selected Issues of Donors' Intervention in the Industrial Policy of Bangladesh

The following issues relating to industrial policy have been identified which donors have intervened either individually or collectively. In these areas donors' interventions are very much visible in recent years.

7.1.1 Export-Oriented Industrialization Strategy

After the First Five-Year Plan period was over in 1978 and preparation of the Second Five Year Plan to be launched in 1980, the World Bank in a report devoted to the issue of industrial development urged the GoB to design an export led development strategy.[2] The Bank appreciated the shift of attitude of GoB from thinking about controls as a means of managing foreign exchange scarcity to thinking about a more liberal trade regime.

It seems however, that diverse views existed among the donors regarding the viability of pursuing an export-led strategy. A section of the donors felt that when the world markets were resuming their growth trend it seemed to be the right time for Bangladesh to plan her policies and to prepare practical export programs so as to benefit from these developments (Report on the 10th Aid Group Meeting:83). Whilst in the 10th Aid Group meeting the French delegate reckoned that Bangladesh can benefit from global development strategy via export growth strategy, the Canadian representative in a subsequent meeting of the Aid Group contested the feasibility of an export led growth strategy for Bangladesh (Report on the 11th Aid Group Meeting:77).

Bilateral donors such as Norway and the USA, and multilateral donors such as ADB have pointed out that diversification of export is important for Bangladesh and continued efforts are necessary in this field. They added that continued stagnation of Bangladesh's exports was a matter of serious concern and export must be increased to sustain an

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[2]See for details, World Bank, *Bangladesh Issues and Prospects for Industrial Development*, Vol. 1, Report No. 2191-BD, Dec. 1978.

increasing development effort.[3]

The donors on various occasions have emphasized the need for increasing the volume of exports as well as diversifying the export base. The British representative in the 7th Aid Group meeting stated that non-traditional exports, in which the private sector can participate, will have to be encouraged by all possible means (Report on the 7th Meeting:31). The French delegate in the 11th Aid Group meeting reckoned that in order to diversify the export regime there should be other incentives besides provision of credit at a lower rate.

World Bank President Christopher Willoughby while visiting Bangladesh on December 1992, highlighted his special recommendations for Bangladesh. One of them was, "Export-oriented Industry should be the future foundation of Bangladesh Economy" (*Illustrated News Weekly*, December 4, 1992). This export oriented strategy has been accepted by the GoB and policy changes have taken place accordingly. The Industrial Policy of 1991 includes,

> Export-oriented industrialization is one of the major objectives of the Industrial Policy, 1991. Export-oriented industries will be given priority and in this respect all out Government support and cooperation will be ensured (GoB, 1991:16).

7.1.2 **Privatization or Denationalization Policy**

From its birth, the World Bank has been wedded to free market economy irrespective of existence of market imperfection. The articles of agreement require the recipient countries to

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[3]See Report on the 7th Meeting, p.30, Report on the 8th Meeting, p.22, Report on the 10th Meeting, p.85

promote foreign and local private investment in all conceivable sectors. The government was to provide institutional framework for the initiation and growth of private enterprises through incentives and development of economic infrastructure which would provide support for such venture.

There is no doubt that the World Bank and the USAID both favor emphasizing the private sector approach to economic development. They have both expressed such beliefs frankly to various Bangladesh regimes (Humphery, 1992:83-84).

The role of the World Bank and IMF and subsequently ADB in rolling back the public enterprise (and public service sector) is noticeable. The Bank and the Fund have in their reports identified government intervention in the productive sectors as the villain causing backwardness and instability in the developing economies; the public enterprises have been portrayed as *privileged deadbeats* which inhibit growth of private initiative and push state finance to an *unsustainable state.* Since the beginning of the 1980s, privatization got relatively greater attention of the World Bank and the IMF in their lending program involving divestiture and liquidation of public enterprises as part of policy-based finance. In quest of economic liberalization and stabilization through structural adjustment policies, emphasis has thus been shifted from efficiency promotion in the public enterprise to a visionary belief in the superiority of private entrepreneurship which need to be promoted and supported through subventions and policy support while such support in favor of private sector small farmers was withdrawn (Ahmed, 1992:12).

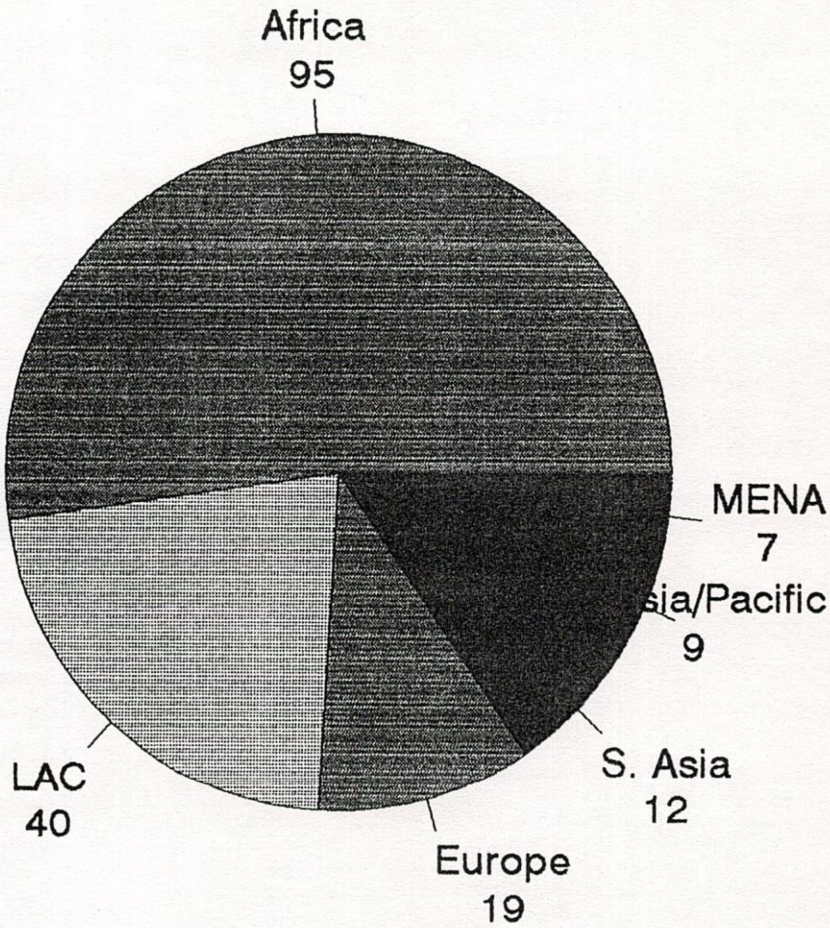
Table 7.1 Bank-Supported Privatization Operations

By Region	
Africa	95
Latin America	40
Europe	19
S. Asia	12
E. Asia/Pacific	9
Middle East & North America	7
By Lending	
SALs	71
SECALs	43
TALs	31
PERLs	18
Other	19
By Fiscal Year	
FY81	1
FY82	2
FY83	2
FY84	7
FY85	10
FY86	11
FY87	23
FY88	23
FY89	21
FY90	37
FY91	29
FY92	18

(As of December, 1991)

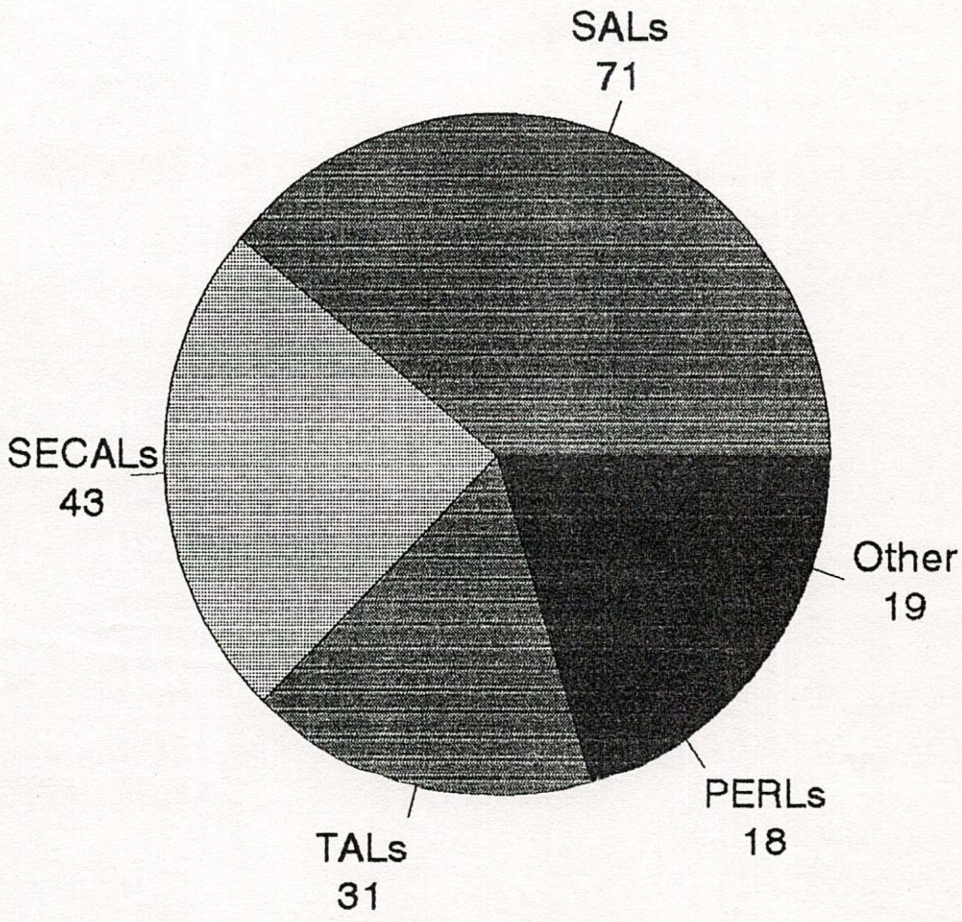
Source: World Bank, 1992:11

Figure 7.1 Privatization by Region



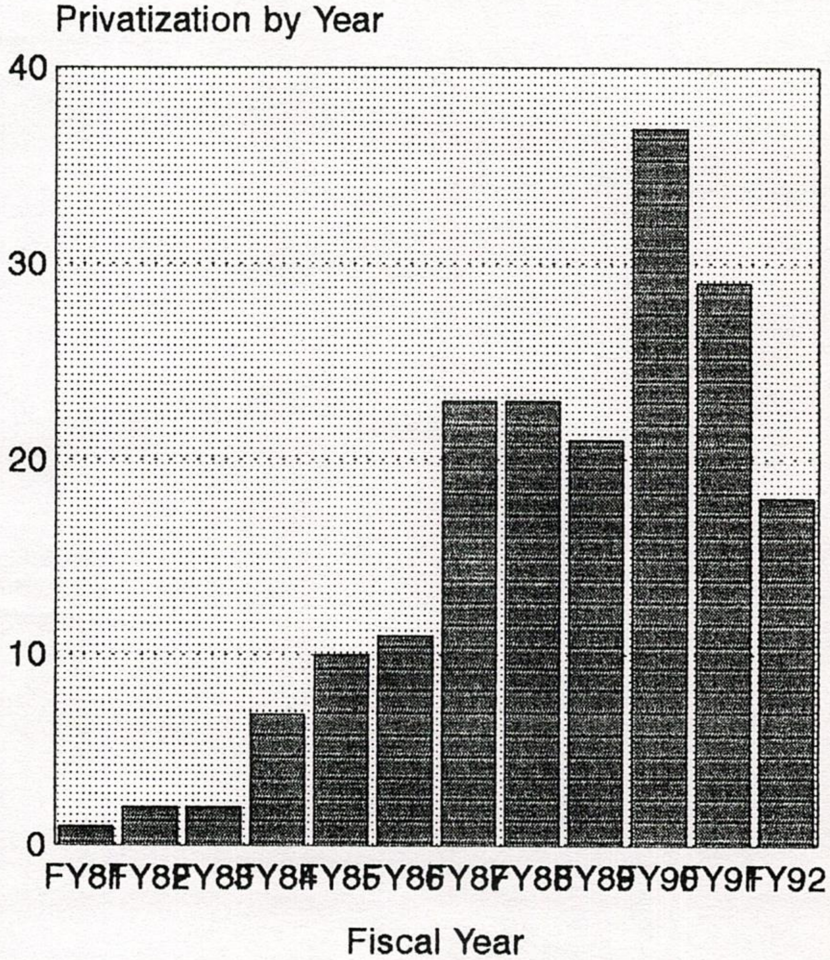
Source: World Bank

Figure 7.2 Privatization by Lending



Source: World Bank

Figure 7.3 Privatization by Fiscal Year



Source: World Bank

After the coup in 1975 the state power was occupied by the military who later shared power with civil bureaucracy and the rising economic groups such as industrial capitalists, traders, contractors, businessmen and the rural rich. As the civil and military bureaucrats originated from the affluent social groups it was easy for them to form an alliance with the groups supporting the private sector. To get the support of these groups the regimes amended the constitution, rejected the *socialist principles* and opted for a policy of gradual denationalization and disinvestment.[4] The donor countries and agencies (World Bank, IDA, ADB, IMF, etc.) supported this policy. There were two main features of the policy taken by the regimes in the post-1975 period. One was to hand over industrial units, banks, insurance companies, etc. to the private sector; the second was to help the Bengalee rich to accumulate capital.[5]

Since 1975, the regimes in Bangladesh have opted for an open door (market-oriented) policy and have continued to adopt a foreign aid-dependent industrial development strategy. The World Bank and the IMF encourage the Bangladesh government to follow the neoclassical economic model and assured them of the required

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[4]For details see the *Constitution of the People's Republic of Bangladesh,* as amended up to 1986; the *New Investment Policy of 1976* and the *Two Year Plan (1978-80)*, 1978.

[5]The government paid Taka 10 billion to the ex-owners as compensation. The new investment policy assured the private accumulators that the source of their illegally earned money would not be looked into if they purchase the disinvested units. Moreover, the government denationalized the profitable industrial enterprises which was contrary to the policy statement.

capital assistance. Their perception was based on the assumption that to implement market-oriented economic policies and to ensure sound economic growth, Bangladesh needed capital. According to the World Bank experts, the inflow of foreign capital fills either a savings or a foreign exchange gap and increases domestic investment leading to rapid economic growth. The main tenet of neoclassical foreign aid theory is that the insertion of aid funds into a developing economy sets in motion a chain of causal relationships between aid, domestic investible capital, domestic investment and growth. If this prescription is correct then we can expect *prima facie* that aid flows will lead to a rise in investment and a higher rate of economic growth. This idea has been challenged by many development economists.[6] According to these writers there is a negative relationship between aid and domestic savings. They also argue that an increase in development aid does not necessarily result in proportionate increase in investment.

In one of the World Bank's first reports on the economy of Bangladesh it suggested a series of measures, which should be taken into consideration while implementing the First Five-Year

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[6]See, for instance, T.F. Weisskopf,"The Impact of Foreign Capital Inflow on Domestic Savings in Under-developed Countries," *Journal of International Economics;* V. Bornschier, C. Chase-Dun and R. Rubinson, "Cross-National Evidence of the Effects of Foreign Investment and Aid on Economic Growth and Inequality: A Survey of Findings and a Reanalysis,"*The American Journal of Sociology,* 84 (1978), 651-683.

Plan (1973-78).[7] These suggested measured included: substantial reduction in the industry allocation of the Plan, review of the licensing procedure to permit import by individual producers, denationalization of small public sector units and units which are not of major national importance, raising of the ceiling of Taka 2.5 million on private investment to at last Taka 100 million. and then altogether, enactment of new labor legislation to establish the principle of one enterprise one union, etc.

In July 1974 the limit on private investment was raised to Taka 30 million and the moratorium on nationalization was increased to 15 years. The investment limit was revised in December 1975 increasing the ceiling to Taka 100 million. The Bank in one of its reports in 1975 noted with appreciation this major change in the industrial policy which greatly increased the scope for the private sector.[8]

By 1978 the nominal limit on private investment was altogether removed, a large number of public sector units had been disinvested, especially the smaller ones and at the same time an additional ten sectors previously reserved for the public sector had been opened up for the private sector whilst imports were also liberalized. When the Two-Year Plan (1978-80) was published it was seen that GoB has not only markedly shifted its

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[7]See World Bank. Report No.455d-BD. *Bangladesh: Development in Rural Economy.* (in three volumes) Vol.1.

[8]See World Bank Report No.7102-BD. *Bangladesh: The current Economic Situation and the Short-Term Outlook.* May 1975.p-ii

alternative attention over from the public to the private sector but at the same time the fervor behind industrialization programs which injected into the First Plan was somewhat deluded in the subsequent plan. Thus by 1978 almost all the recommendations put forward by the World Bank in 1974 regarding the reform of policy toward the industrial sector had been to some extent accepted, at least in spirit, by the GoB. Later on this trend has remained unchanged and clear cut policy statement regarding privatization has incorporated in the 1982 and 1991 industrial policy of Bangladesh. The 1991 Industrial Policy states,

> One of the major goals of the present industrial policy is to increase efficiency and productivity in the industrial sector by transferring public sector industries to the private sector (GoB, 1991:9).

The World Bank as a leader of the donors is playing the dominant role in the formulation as well as implementation of privatization policy of Bangladesh. In the process of privatization of Bangladesh World Bank's role will be clear from its views expressed in a recently published study report that states

> The slow pace of privatization has shed doubts on the GoB's commitment to it. Therefore there is a need to reconfirm this commitment and clarify the program's objectives. The experience with denationalization in the 1980s indicates that: (i) the benefits from privatization, in terms of greater efficiency, will not be achieved unless the GoB ensures that the PMEs would operate in a market friendly environment once they are privatized; and (ii) labor retrenchment and financial restructuring of firms should be carried before their privatization. Moreover, in order to ensure the success of its privatization program and expiate its implementation, the GoB will need to streamline its administration and institute transparent privatization procedures. Swift action must be taken in Financial Year 93 and Financial Year 94 to assure private entrepreneurs that the GoB is determined to implement its stated

policies.[8]

In a seminar entitled *Bangladesh: Implementing Structural Reform* under the sponsorship of the World Bank the Bank made some recommendations on the GoB regarding privatization issue. The matrix presented below summarizes the seminar report's key recommendations in terms of GoB's privatization objectives, namely, enhancement of the fiscal benefit of privatization, enhancement of economic efficiency, and assisting in the development of the private sector.

Table 7.2 Recommendations of the World Bank on GoB in terms of Privatization.

Objective / Recommendation	Enhance Fiscal Benefits of Privatization	Enhance Economic Efficiency	Assist. with Private Sector Development
1. Accelerate program of privatization	*	*	*
2. Sell larger SOEs	*	*	*
3. Allow private participation in infrastructure		*	*
4. Public enterprize reform	*	*	*
5. Rationalize labor and develop safety net for displaced labor		*	

[8] *Bangladesh: Implementing Structural Reform,* World Bank Report No. 11569-BD, March 24, 1993.

6. Reform key aspects of enabling environment	*	*	*
7. Introduce proper regulatory environment		*	
8. Establish proper approach to preparation for sale	*		
9. Develop wider range of financing options	*		*
10. Develop mechanism e.g. Poverty Alleviation Trust, to allow widespread ownership			*
11. Strengthen Administrative Arrangement	*		

Under the 1991 Industrial Policy, GoB identified 40 enterprises for privatization. At the April 1992 Aid Group Meeting GoB made a commitment to privatize a significant share of these enterprises expeditiously. The World Bank expressed dissatisfaction over the delays on the part of GoB over the privatization program (World Bank, 1994:4). Of the 40 enterprises identified in October 1991 by GoB for privatization, sale of 6 units was completed by mid-1992 through sale of shares to a wholly state-owned insurance company, and privatization of only 3 other units has since been completed. Again the ADB's Industrial Sector Program Loan requires that 10 textile mills and 6 other industrial units be offered for sale by December 1992 and an equal number by December 1993. The Ministry of Industries met the December 1993 requirement as desired by the ADB by offering 13 units for sale, but the Textile Ministry offered only 9 units.

The understanding for the Financial Year 1994 at the April 1993 Aid Group Meeting is that GoB would accelerate privatization of state-owned enterprises (SOE) by completing privatization of at least 50 per cent of the 40 industrial units earlier slated for divestiture and of 24 textile mills now intended to be added, by carrying out the first phase of privatization under the jute sector reform as well as by signing contracts for initial private investments in electricity, gas and telecommunication sectors.

7.1.3 **Foreign Private Investment (FPI)**

In recent years, there has been a renewed interest in the flow of foreign direct investment to developing countries, both as a source of foreign capital and of improved technology and management systems. The developing (host) and industrial (source) countries, as well as international organizations, increasingly advocate a substantial expansion in the share of foreign direct investment in the overall flow of financial resources to developing countries that have deficits in their balance of payments.

The Government of Bangladesh is encouraging foreign investment with special importance (GoB, 1991:18). Bangladesh welcomes foreign capital to accelerate the pace of industrial growth as well as to acquire modern technology. Realizing the importance of private initiative as the key to economic success, the Government of Bangladesh initiated a gradual transformation of policy over the years. Liberal policy measures have been adopted to encourage and promote private investment, especially foreign investment and infuse a new sense of dynamism and direction. Bangladesh now offers opportunities for foreign private investment in all areas of its industrial sector.[10] The World Bank has remained the most articulate amongst the donors on the subject of PFI. The World Bank, in the aftermath of the investment policies enunciated by GoB in 1972-73 clearly expressed its reservation on the policy. Their critique covered the then state policy of assigning the dominant role to the public sector as the vehicle of industrialization and their view on PFI. These reservations were articulated in their Report on the First Five Year Plan. The revision of the foreign investment policy in 1974 was naturally welcomed by the World Bank as a positive step.

After August 1975, when successive governments in Bangladesh took a more favorable stance towards PFI, the World Bank as a part of their recommended industrial development policy for Bangladesh, ventured to more explicitly put forward its preferences regarding PFI.[11] These general and specific policy recommendations by the World Bank may be summarized as follows:

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[10]See for details *Foreign Investment in Bangladesh*, Board of Investment, BG Press, August 1993, p.1

[11]See World Bank Report No.2191-BD.*Issues and prospects for Industrial Development* (in Two volumes), World Bank Report No. 2191-BD. VOL.1, December 1978. pp. 20-22.

1. GoB has to determine for itself the long-term role it wishes foreign investment play in the industrial sector;

2. the selection and implementation of a medium term industrial strategy will facilitate this clarification;

3. political instability, fear of nationalization, civil unrest and other disruptions can more than counteract lavish incentives;

4. GoB is already considering a Foreign Investment Protection Act. Properly framed this could be an important stimulant;

5. recent relaxation of Taka 100 million limit on investment (which is also applicable to foreign investment and joint venture) will help in improving the attractiveness of Bangladesh for the foreign investors, provided approval by ECNEC is granted expeditiously;

6. Immediate action should be taken on repatriation rights. Although earned profits paid out in cash dividends can be repatriated in full, subject to appropriate tax, present regulations stipulate that capital grains and reinvestment from profits made during the first 10 years of its operation must be repatriated over a 10 year period. This clause compares unfavorably with the rules in particularly all other Asian and South-East Asian countries, where either there are minimal restriction on such repatriation or where full repatriation is permitted over a maximum of seven years;

7. foreign collaborators in new investments are required to provide the entire amount of the foreign exchange component of the project as equity capital. In cases where the foreign exchange cost of the project is greater than the foreign partner´s share of the joint venture, the balance amount can be provided in the form of a loan. This loan is normally treated as part of the initial capital of the project and is subject to the repatriation rules unless a special agreement is made with the Bangladesh Bank. Regardless of the timing of repatriation, other considerations are important when repatriation rights are being granted. Loans may not be repaid out of sale of assets, only from profits. A company is required to have adequate cash before repatriation is permitted. Current liabilities and short-term bank borrowing are taken into account when determining the pre-conditions for remittance.

The Bank goes on to make the following further suggestions to improve policy towards the PFI:

While it is necessary to have adequate safeguards against malpractice by multinationals, it is also necessary both to set out rules clearly and ensure that the disincentive is not excessive (seemingly attractive incentives with hidden controls).

8. GoB could consider reintroducing an individual 15 years guarantee

against nationalization;

9. the new Act should set out the general provisions of GoB´s attitude to the foreign investors; the purpose, scope, criteria and general authority under which the Act will function;

10. the rules for authorization, registration and the treatment of remittances, repatriation restrictions exemptions and imposition of taxes and benefits should be stated;

11. terms of loans and agreement on technology transfer should be specified as well as nomination of the committees, bodies and institutions empowered to administer the Act;

12. the act should incorporate the decrees and regulations which will govern the procedures to be followed by the foreign investors under the Act; and

13. consideration should be given to the use of Technical Assistance in the form of a consultant to draft and advise on the alternative forms for an Act.

It becomes quite clear from this comprehensive list of recommendations of the World Bank that the AICC donors were very much concerned about the policy towards foreign private capital in Bangladesh. The World Bank, backed by key AICC donors, appears to have taken up the responsibility to protect and promote PFI in the recipient country and to ensure a steady and sufficient return to the investors. Thus the pivotal point of the Bank´s recommendations relates to further relaxation of repatriation rights and the formulation that *immediate action should be taken* in this area.

The other aspect of the recommendations which need to be noticed is that it details the measures which should be incorporated in the prospective Foreign Investment Protection and Promotion Act, then under GoB´s consideration. To further reflect the perspectives of the donors as well as the foreign investors in the new Act, the Bank went on to suggest that foreign consultants should be brought in to draft and advise on the alternative forms of Act.

It is interesting to note that when in 1980 the Act was ultimately passed it carried a recognizable imprint of the Bank's recommendations and a host of others voiced by the donors on various platforms as well as the views of the PFIs.

From then along with a broader liberalization of the economy, Bangladesh Government has been trying to attract foreign investment through creating congenial environment and liberalizing its laws and regulations regarding FDI in line with the recommendations made by World Bank and other donors.

The first serious effort at reform in the realm of private domestic and foreign investment in Bangladesh began with the announcement of a New Industrial Policy in 1982. This policy sought to expand the scope for private sector participation through a partial liberalization of investment controls and introduction of greater flexibility in exercising control on access to various facilities. That policy was subsequently modified with the announcement of a Revised Industrial Policy in 1986 which continued the reform process by further liberalizing the investment sanctioning process and rationalizing the trade policies. The next package of measures were introduced in 1988 when the a number of ways with generous facilities to encourage foreign investment. These reforms were followed by the adoption of a New Industrial Policy in 1991. The policy represents a marked shift in government policy regulation. It is to be noted that the Industrial Policy of 1991 has been undergoing continuous changes for further liberalizing the economy to accelerate foreign direct investment in Bangladesh. Chapter XII of the policy includes that the Government is encouraging foreign investments with special importance. The *Foreign Private Investment (Promotion and Protection) Act, 1980* will continue to be the legal framework for foreign investments. The main provisions that exist in this Act to protect foreign investment include:-

> ensuring equal treatment in all respects for local and foreign investment; protection of foreign investment from nationalization; ensuring repatriation of proceeds from sale of shares and profits. In addition adequate rules will be framed for protecting the intellectual property rights such as, patents, designs and trade-marks and copyrights.

In order to accelerate the pace of investment and growth the World Bank lists foreign direct investment as one of the priorities to Bangladesh (World Bank, 1993). The World Bank recently identified four main problems with Bangladesh's fiscal environment regarding DFI (World Bank, 1994):

> (a) although depreciation allowances are generous, corporate tax rates are high;
>
> (b) other taxes such as stamp duties impede capital market transactions;
>
> (c) widespread tax evasion occurs in certain sectors; and d) tax incentives are overly generous.

This environment, according to the Bank, "gives a set of signals that distort investment decisions, and discourages certain classes of investors, including foreign investors" (World

Bank, 1994).

7.1.4. **Financial Sector Reforms**

During the last few years several important reform measures have been taken in Bangladesh in the direction of economic liberalization, the ultimate goal of which is to make the economy competitive. Reforms in the real sector cannot be complete and perhaps cannot be sustained without parallel reforms in the financial sector. We cannot have a liberalized or deregulated real sector with an overly controlled financial sector. This is indeed the underlying philosophy of donors that guided the various financial sector reform measures taken so far in Bangladesh economy. The *World Development Report 1989* showed that the *interventionist approach* was not successful in promoting financial development and suggested that the developing countries must be prepared to undertake wide ranging reforms of their financial sectors to encourage savings and investments needed for economic growth. Thus Bangladesh has taken various financial sector reform measures being motivated by the advise of IMF and World Bank. On the 14th Annual Meeting of the Bangladesh Aid Group the IMF representative viewed:

> Financial sector reform will focus on restoring the viability of financial institutions, strengthening the effectiveness of monetary policy and removing distortions in the allocation of financial savings. To strengthen monetary policy and reduce distortions in the financial system, money and capital markets will be further developed, indirect instruments of monetary policy will be emphasized, and interest rate structure will be rationalized and made more market determined.

In coherence with the socio-economic development objective, the GoB decided that a comprehensive program of policy and institutional reforms related to the development of the financial sector be initiated by the monetary authorities (Memorandum for the Bangladesh Aid Group, 1991-92:17). In this regard, the GoB setup a National Commission on Money, Banking and Credit in 1986. Following this, a World Bank team also made an indepth study of the financial sector and suggested reforms in the field of (i) fixation of interest rates on deposits and advances, (ii) classification of overdue credits, (iii) restructuring the capital of NCBs and PCBs and (iv) market orientation of banking transactions (Task Force Report, 1991). Largely based on these suggestions, Bangladesh Bank adopted a number of reform measures since 1989-90.

Now, a little reflection over various financial sector reform measures taken in Bangladesh is given.

Devaluation of Taka for Export Promotion:

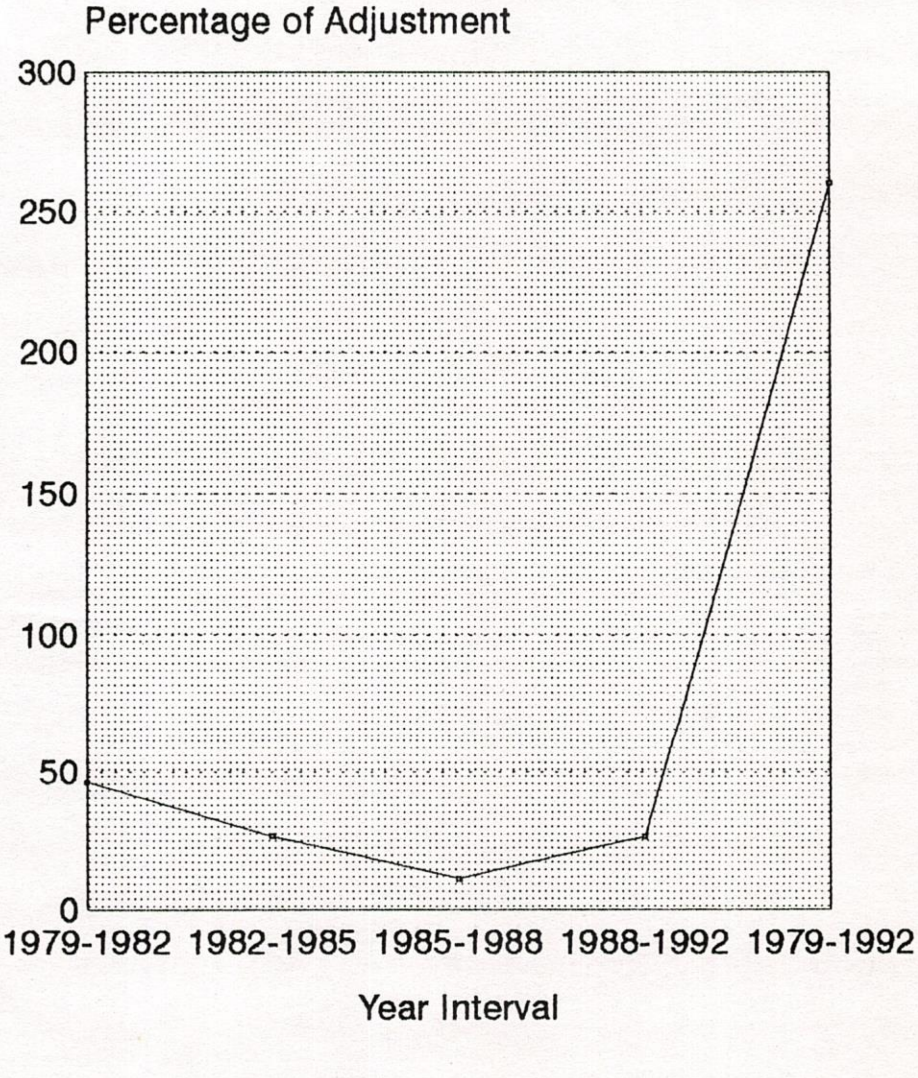
Now we are all for export promotion, either willingly or under pressure exerted by the World and the IMF. This uniform and simple advice to every country irrespective of structural condition is that right prices should be ensured for tradable goods and comparative advantages should be exploited at all costs. By ensuring right prices for tradables, propagates the World Bank authority, resources can be shifted toward production of tradable goods (export and import substitutes) which would ultimately allow for export led economic growth take place. Comparative advantage of a country exists in the production of those goods which it can produce at lower costs relatively to others. In its cost computation the comparative advantage theory fully neglects social, political or environmental costs associated with the private costs. And when the Fund-Bank preaches the infallibility of *right prices* they mean private prices. As regards how to ensure *right prices* for tradable the Fund-Bank prescription is simply to follow flexible exchange rate policy and check any appreciation of real exchange rate. Devaluation is, therefore, necessary. And any devaluation, in order for successfully depreciating real exchange rate and retaining the depreciation so achieved, should be accompanied *inter alia*, by restraint in monetary expansion and real wage. Despite the comprehensiveness of the structure adjustment program, the criteria for success evaluation of program is incredibly simple on the part of the Fund-Bank. A program is branded successful. If at the end of its duration the client achieves a certain set of macroeconomic targets which include, among other things, trade and fiscal deficits, debt service performance, volume of international reserves, etc.

Bangladesh already entered into the flexible regime back in 1979. Since then nominal exchange rate has been adjusted against US dollar and other reserve currencies many times. At present one US dollar is equivalent to Taka 39.3 at official level. During the inception of the flexible exchange regime one US dollar used to be worth Taka 15.12. The exchange rate has been shown in Table 7.3 against selected periods.

Table: 7.3 Devaluation of Taka over the Years

Year interval	Percentage of Adjustment
1979-1982	46.2
1982-1985	26.6
1985-1988	11.1
1988-1992	26.4
1979-1992	260.0

Figure 7.4 Devaluation of Taka Over the Years



We see in the Table 7.3 how remarkably rapidly we did adjust our currency's external value. On simple yearly average term the rate turns out to be 18.6. Against this record, in the period between 1976 and 1979 Taka's external value decreased by 1.8 per cent. No other country in this region of the world can be found to have devaluated currency at a rate we did. We have met the first condition of Fund-Bank by following flexible exchange rate. But according to Fund-Bank assessment we have not done enough; we have not been able to achieve as much real exchange rate (RER) depreciation through the devaluations we actually had, as would earn us satisfactory external competitiveness. According to the World Bank, domestic inflation neutralized or reversed the real depreciation that should have resulted from the nominal devaluations. We do not discharge that domestic inflation reappreciated our currency soon after every time we had attempted to have real depreciation through devaluation. We, however, disagree with the World Bank as regards the source of inflation that causes the appreciation of real exchange rate in the explanation of the World Bank and the IMF. Inflation in the domestic economy results from excessive growth of money supply not commensurate with real economic growth. The recent World Bank explanation of Taka's appreciation is that Bangladesh Government increased public consumption which is a non tradable sector and the cost of public investment (World Bank, 1993). The more expenditure goes to finance non tradables, the more the country loses external competitiveness.

Convertibility of Taka for attracting Foreign Investment

Starting from 1993 Bangladesh Bank has been progressively liberalizing the foreign exchange restrictions in tandem with the Government's reform policies of trade liberalization, export orientation and deregulation with a view to creating an environment conducive to growth in investment and productivity.

On October 19, 1993 Bangladesh Bank declared Taka convertible for international payments on current account. Convertibility of Taka implies a process of strengthening Taka to the status of an international liquidity i.e., to create more confidence in the domestic and par value of Taka for easy acceptability both in national and international economic transactions. The idea of freeing Taka from the rigors of various restrictive measures of exchange control, or simply convertibility, has been prompted by the continuous stability in macroeconomic management, especially the maintenance of monetary stability and reduction of budgetary deficits through effective fiscal measures. The Government's persistent policy commitment to follow a free market mechanism in the economic front with export-led strategy for economic growth further stimulated the process of convertibility concept. This reform process is described in the following paragraphs (Alam, 1993:10).

1) The ground for convertibility of Taka has been prepared by import trade liberalization. Withdrawal of licensing requirements and facilitating the L\C opening by reducing the formalities, abolition of margin requirements and simplification Import Registration are the features of trade liberalization.

2) convertibility in the trade accounts has already been

achieved, with availability of any amount of foreign exchange against Taka from the foreign exchange market for import of all items except the few banned items.

3) Allowing of exporters to retain gradually increasing percentage of their export earnings in Foreign Exchange.
4) Withdrawal of all restrictions on capital inflow and outflow for short-term and long-term capital movement. Increasingly simplifying the procedures for repatriation of capital and profit of foreign exchange market have been vigorously brought about over the past two years.

5) Gradual withdrawal of Bangladesh Bank from the role of regulating and constantly intervening in exchange rate determination and operating in the foreign exchange market as the main source of buying and selling of Foreign Exchange. Bangladesh Bank now fixes Taka/Dollar rate only as the base rate in terms of the REER, and the banks themselves are now fixing the retail/cross rates. When Inter-bank Foreign Exchange market will develop and start functioning, in the true sense Bangladesh Bank will cease to fix the base rate of exchange. Bangladesh Bank will only have its own intervention rate.

6) Bangladesh Bank has stopped providing forward cover facilities to the foreign exchange dealing banks. The foreign exchange dealers have to arrange among themselves for such cover by Swap, Arbitrage mechanism and even dealing abroad.

7) To promote an effective and sound Inter-bank Foreign Exchange dealing Foreign Exchange Dealers' Association of Bangladesh has been formed.

8) Bangladesh Bank is organizing seminar workshop to familiarize the foreign exchange dealing staff of the banks with the concept of convertibility and to orient them with the techniques of exchange rate fixation and the mechanism of overall foreign exchange market operation, in a free foreign exchange regime.

Liberalization of Interest Rates

Since introduction in January, 1990 substantial progress has been achieved in the liberalization of interest rates and making them more market-oriented. In the backdrop of excess liquidity in the banking system and the continuing positive real interest rate because of lower rate of inflation, the bank rate was reduced three times in the recent past (Memorandum for the Bangladesh Aid Group, 1993-94:24) : it was reduced from 9 per cent to 8.5 per cent on June 3, 1992; from 8.5 per cent to 8 per cent on January 24, 1993 and finally, from 8 per cent to 7 per cent on February 24, 1993. The floor rate for fixed deposits was also concurrently reduced. It was reduced from 7 per cent to 6.5 per cent on February 24, 1993.

Interest rate bands in all the lending categories, except three priority sectors, (i) agriculture; (ii) exports; and (iii) small scale and cottage industries, have been abolished. Determination of interest rates on lending to other sectors has been left to the banks themselves. In addition, banks have been allowed to charge two different rates of interest on term lending to medium and large scale industries sector, subject to a maximum difference of one per centage point between loans up to 5 years and those over 5 years (Memorandum for Bangladesh Aid Group, 1993-94:24).

Alongside lending rates, interest rates on deposits have also been liberalized further. Interest rate bands on deposits have been totally abolished. However, taking due consideration of the trend in inflation rate and having regard to ensuring a positive real return to savers, floor rates have been prescribed for saving and fixed deposits (Memorandum for Bangladesh Aid Group, 1993-94:24).

Another feature of the interest rate liberalization measures has been the gradual reduction of the number of subsidized sectors and the rates of subsidy, and complete withdrawal of Bangladesh Bank's confessional refinance facility. Initially there were six subsidized sectors with varying rates of subsidy which have now been reduced to only one. At present, subsidy is admissible at 3.0 per cent only in the case of lending to small scale and cottage industries sector.

Under the Financial Sector Reforms Programme (FSRP) agreed with the World Bank, the GoB is committed to adjust the interest rate structure over the five years time. The policy of providing indirect subsidy by the Bangladesh Bank to the scheduled banks has been discontinued and the cost of subsidy has been made explicit and transparent. Interest rates for priority sectors have been set below the shadow market rates and the banks are reimbursed annually from the Government Budget for interest subsidy to the borrowers. The ultimate aim of the FSRP is to gradually move towards a market-oriented competitive economy, ensuring thereby a larger role of the private sector (Memorandum for Bangladesh Aid Group, 1991-92:12).

The issue of FSRP has been raised in different Aid Group Meeting in Paris and the donors expressed their concerns. Several speakers on the 20th Aid Group Meeting complimented the Government on its efforts to reform the financial sector, in particular the introduction of a Securities and Exchange Commission act. However, Bangladesh's financial system remains weak, and is unable to mobilize savings and allocate them to efficient private investments. It was widely felt that the poor state of the sector is a serious obstacle to the extension of private investment. Speakers recommended that the Government expedite the implementation of reforms in this area. In particular, the regulatory and supervisory capacities of the Bangladesh Bank need to be strengthened, the nationalized commercial banks need to be restructured and, where appropriate, privatized, interest rates made more flexible, and the legal and judiciary systems affecting private investors and financial institutions reformed. The Bangladesh delegates informed the meeting that it has started the process of legal reforms and has created a Law Reform Committee in each Ministry. In addition, the Government is actively pursuing defaulters and is planning to experiment with new techniques to increase the quantity of credit made available to rural areas (Report on the 20th Aid Group meeting:22).

7.1.5 **Improvement in Labor-Management Relations / Linking Wages with Productivity and Enactment of New Labor Legislation**

The World Bank cautioned the government from time to time against any wage hike in the face of mounting pressure from the country's industrial workers demanding a refixation of the national minimum wage at Taka 900. "It (government) should avoid awarding wage increases that are not linked to improve productivity, and which would therefore further erode the country's competitiveness", said a World Bank aid memorandum, prepared to place before the 20th Aid Consortium meeting. Wages and Productivity Commission recommended adoption of a national minimum wage at Taka 900 a month against the previous minimum wage of Taka 600. The workers had planned a 48-hour countrywide blockade beginning March 15 to realize the recommendation of the commission. The World Bank document, however, observed that the recommendation of wage hike was not based on any analysis of either labor productivity or Bangladesh's export competitiveness. Quoting a review of a sample of seven public sector units, the bank claimed that wage have been rising at a much faster rate than productivity since 1985. It warned that the application of the Wages Commission awards will only widen the gap between wages and productivity, and render those public sector units even less viable. The Bank memorandum pointed out that real wages in the public sector increased by around 30 per cent between 1985 and 1992, triggering 22 per cent increases in real private sector wages during the period. On the contrary, it claimed, productivity in manufacturing has declined. The World Bank as well as other major donors were deadly opposed to any wage increase in the industrial sector wages arguing that this would adversely affect the on-going reforms in the public manufacturing sector and further erode the country's external competitiveness. The World Bank Vice-President Joseph Wood in a letter to the Finance Minister made similar caution against wage hike saying any such action would jeopardize the planned reforms in the jute manufacturing sector.[12]

For achieving external competitiveness, the 20th Aid Club meeting called for urgent improvements in labor management relations, by adopting firm arrangements for linking wages with productivity. The pervasive politicization of labor disputes and the large number of strikes and lock-outs, as the tenor of emphasis at the meeting would reflect, led to difficult labor management relations, threatening industrial development efforts. Delegates noted that the Government has so far successfully resisted pressures to implement the Wage and Productivity Commission´s recommendation, and commended its handling of the recent 48-hour national strike.

The American Ambassador to Bangladesh William B. Milam at a meeting arranged by the Dhaka Chamber of Commerce and Industry (March 1993) said that

> Labor unrest undoubtedly has caused enough harm to the economy . The local investors having the potentiality to come forward are not at all anxious to block their money when they see the disquieting atmosphere and utter lack of industrial discipline. The notion of cheap labor in Bangladesh as nothing but a myth. It is a fact that in comparison to productivity output, labor costs in Bangladesh was much higher. Because of the financial bankruptcy of many public sector enterprises, emphasis should be laid on slashing the cost production of industries and labor should no longer be subsidized (*Economy*, March 22-28, 1993).

Employment of child labor in factories was opposed by Mr. Milam. He made the garment exporters understand the gravity of the situation and a move to ban import of garments into America produced by child labor through the introduction of a bill called

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[12]See *Bangladesh Observer*, March 3, 1993.

Harkin's bill in the American congress shortly.

In this regard, donors' tone has been reflected in the Industrial Policy of 1991 which incorporate such provision as,

> the necessary recommendations will be made from time to time about the Government's Labor Policy and effective steps will be taken to increase productivity of labor force and to create a congenial labor-management relationship (GoB, 1991:25).

7.1.6 Increased Management Autonomy and Incentives in the State Owned Enterprises

The World Bank recommended that the GoB should link State Owned Enterprises' (SOEs) top managers' compensation with performance. The Bank argued (World Bank, 1994) that many countries such as Korea, Indonesia and Pakistan have established a linkage between performance and compensation with positive results. Further, if salaries are delinked with civil service pay and brought in line with the opportunity cost of the technical staff, it will be easy to attract and retain high quality staff.

The Bank goes on to say, that if performance is to be linked with the reward structure, management autonomy should be increased. In parallel with linking performance with compensation, therefore, SOE managers should be given the authority to make independent investment decisions and make independent decisions regarding personnel and procurement. As noted in the ADB's technical assistance report,

> The present system of ministries, corporations and Public Manufacturing Enterprises (PMEs) can be characterized as the classic separation of power from responsibility. The management of PMEs are responsible for operating their enterprises but are denied the powers necessary to do so; many of the powers are, in practice even if not always in theory, exercised by the sector corporation or sectoral ministry. The result is that there is no real accountability (World Bank, 1993:28).

The creation of GoB limited liability holding corporations, which would own the SOEs, could help reduce direct interference from government ministries. GoB´s Industrial Policy statement of 1991 announced that

> Public manufacturing enterprises will be managed by the boards of directors... according to the company law, and will enjoy autonomy in their management..." and that sector corporations would be converted into holding corporations. The major objective was to improve the operational efficiency and economic viability of these state enterprises. However, not much progress has been made in the implementation of this policy, and little has been achieved in terms of actual and effective corporations, autonomy, improved budgeting and MIS.

7.1.7 **Against Subsidizing Sick Industries**

The concept of industrial sickness has obsessed the planners, economists and the policy makers for the last three years. The government has taken sick industries rehabilitation as a routine job. The World Bank and the donors had refused to provide funds for rehabilitation of sick units for revitalization. The Ministry of Industries has taken the rehabilitation program of 2300 sick units in the private sector, but the World Bank has rejected rehabilitation program of those in a concerted way (*Insight*, July 11, 1993).

The future of sick industries is rather uncertain due to funding problems. It is learnt that the development financing institutions and nationalized commercial banks have stopped funding sick industries in pursuance of the World Bank directive. The nationalized banks are reportedly changing their portfolios in keeping with the government´s new guidelines for funding viable projects, especially in the medium and small scale sector. The World Bank in its review of the performance of the financing sector has pointed out that 25 per cent of classified loans of foreign direct investment and NCBs have been excluded from loan provisioning. The Bank was also critical of the NCBs for funding many non-viable projects over the last 15 years. The review also revealed defective credit distribution program of four NCBs. The Bank also found absence of portfolio management which has pushed the NCBs to financial difficulties. The Banks should not have taken the risk of providing working capital to non-viable projects due to changes in marketing situation (*Economy*, October 5-11, 1993).

The World Bank and the Asian Development Bank, the agencies shaping the reform formula for Bangladesh, have always been against the idea of sick industry rehabilitation. Recently , Owaise Saad, a senior World Bank Resident Mission official, has voiced his concern of his institution about the government's stance on the issue. He said that any forced lending by banks at this adjustment stage will have a serious destabilizing effect on the entire banking sector in Bangladesh. The Asian Development Bank Resident mission chief also expressed a similar view at a press conference (*Dhaka Courier*, October 16, 1993).

Similar views are expressed in a World Bank published report,

> Given the weak policy framework, and ineffective implementation of announced policies, it is not surprising that during the past two decades the country's small manufacturing sector has grown very slowly

> and evolved a structure weakly correlated to the country´s comparative advantage. It still accounts for a little less than 10 per cent of GDP. The public-sector enterprises faced serious problems. Moreover, many private firms have performed poorly and few have attempted serious restructuring programs. Poor private-sector performers were protected by GoB´s misguided paternalistic attitude and its continuous efforts to support *sick industries* through the injection of credit from NCBs as of December 1992 the GoB has identified 1,555 *sick* industrial units (World Bank, 1993).

Thus, the manufacturing sector in Bangladesh has failed to transform itself into a competitive export-oriented sector that could help generate productive employment for the country´s vast labor force.[13]

However, it is to be mentioned here that although the Industrial Policy of 1991 include such provision as "the sick industries will be rehabilitated through BMRE, rescheduling of old loans to applicable cases, and providing new loans on easy terms (GoB, 1991:25)" the GoB is following the path of the donors and is reluctant to rehabilitate the sick industries.

7.1.8 **Removal of Excess Labor from Industries (Golden Hand Shake)**

The donors are very much critical of the excess labor in various public sectors. The World Bank-ADB´s *Golden Hand Shake* program is recently an widely discussed issue in Bangladesh. The World Bank and the donors at the 19th Aid Group meeting in Paris were biased on retrenching 15 per cent workers in the loss-making public sector enterprises and autonomous bodies, while the government expressed unwillingness to implement the program of removing the excess employees and workers in the

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[13]See for details *Bangladesh: Implementing Structural Reforms, World Bank Report No. 11569-BD, 1993.*

public sector enterprises on a massive scale (The *Friday,* 30 April- 6 May, 1993). The employees and workers of the public sector enterprises have become restive following announcement of a policy to retrench part of the workers.

7.1.9 **Import Liberalization**

Bangladesh has been steadily liberalizing its Import Policy particularly since the signing of the Industrial Credit-I Agreement with IDA in 1987. As per this Agreement, a total number of 442 entries were removed from the Negative and Restricted Lists of Import Policy between 1987-88 to 1989-90. In fact, these two lists were merged into a single list called Control list in 1989-91. 68 entries were deleted from the Control List in 1990-91 and in 1991-1992, additional 59 entries stand removed from the Control List leaving only 193 in the present Control List. Most of the remaining items are likely to be eventually replaced by tariffs over the next few years.

Meanwhile significant liberalization measures have been introduced in the Import Policy Order, 1991/93. Some of the steps taken so far in this behalf are as follows:

(1) the industrial entrepreneurs have been exempted from obtaining IRC exemption certificate from the office of CCI & E for import of capital machinery for setting up industries;

(2) the one million Taka ceiling for commercial import of capital machinery has been waived so as to make the capital machinery of any value easily available in the local market;

(3) the provision for obtaining prior permission from the concerned sponsoring authority for import of old/reconditioned machinery exceeding the value of Taka 3.5 million has been done away with;

(4) recognized industrial units have been allowed to import raw and packing materials as recorded in their pass books on *Direct Payment Abroad basis*;

(5) industrial units will not be required to obtain Exemption certificate from payment of IP Fee from CCI&E in case of import of capital machinery for setting up industries in less developed areas. From now on, the Customs authority will clear such machinery only on the recommendation of the sponsoring authority;

(6) all categories of exporters (excepting ready-made garments) have been allowed to import samples up to the value of US$ 1000 without any sort of permit;

(7) registration Fees for small importers have been decreased;

(8) import value for the purpose of exemption from IP/CA Fees has been increased from Taka 50000 to Taka75000;

(9) import value for the purpose of import under SEM without opening L/C against LCA has been raised from US$1500 to US$2500;

(10) for import of banned or restricted items for recognized/approved foreign aided projects, no ROR from the Ministry of Industries nor any permission from the Ministry of Commerce will be required;

(11) there will be no restriction on import of aluminum products in the public sector, previously, such items were importable only in the private sector;

(12) gift articles from abroad of the value up to Taka 5000 can be cleared from customs without any Import Permission;

(13) import on FOB basis has been allowed without any prior permission from Bangladesh Bank.

Table 7.4 shows the progress that the GoB has been making in reducing import restrictions since Financial Year 88. The balance of items subject to control declined at an average annual rate of 24 per cent between Financial Year 88 and Financial Year 92, falling from 2306 items (18.9 per cent of the total) in Financial Year 92. The process has been accelerated in

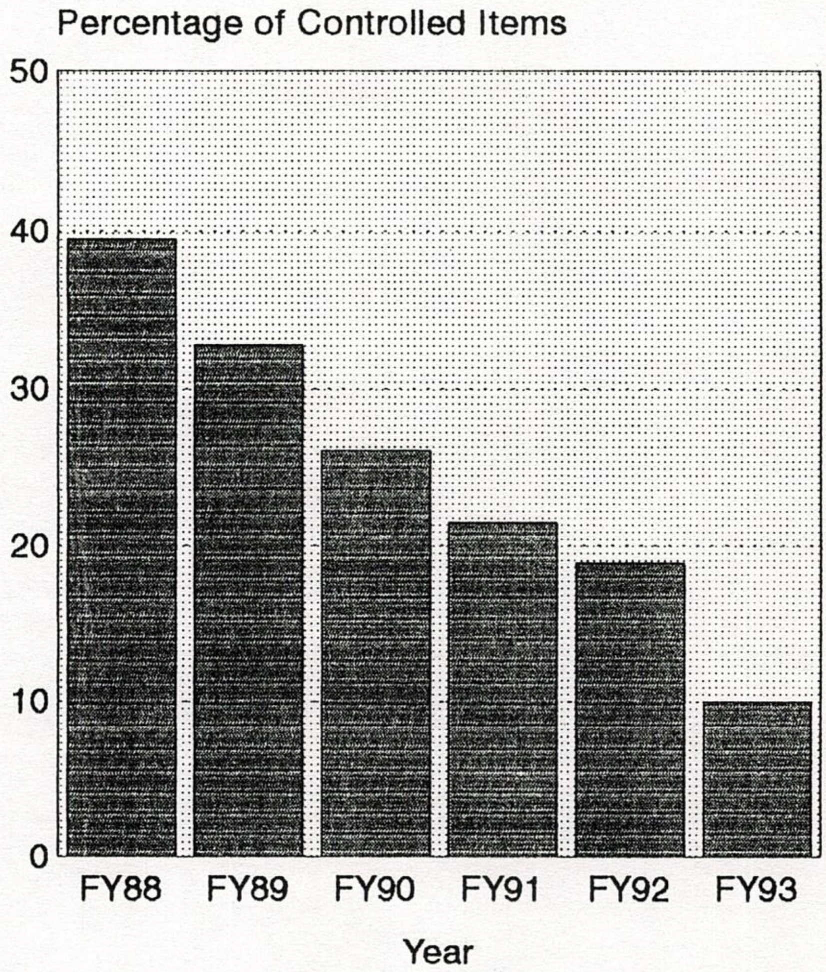
Financial Year 93, when the number of controlled items is being halved to 584 items (10 per cent of the total). About half of this balance comprise restrictions which could be retained for religious and public safety reasons in Financial Year 94, although the Government has indicated that it may wish to retain a few protective restrictive restrictions as well.

Table 7.4 Progressive Removal of Import Controls

	Number of Controlled Items (HS-8 level)	Share of Controlled Items In Total
FY88	2,306	39.5%
FY89	1,907	32.7%
FY90	1,525	26.1%
FY91	1,257	21.5%
FY92	1,103	18.9%
FY93	584	10.0%

Source: Calculated from data provided by the Ministry of Commerce and National Board of Revenue.

Figure 7.5 Progressive Removal of Import Control



Source: Ministry of Commerce and Board of Revenue

7.1.10 **Efficient Bureaucracy to Implement Sound Policy**

Efficient and effective public administration has been always emphasized by various donors to realize the policy goals of Bangladesh. "Having adopted the appropriate policy and articulate its vision for the future, the main challenge for the GoB would be to ensure that it is implemented efficiently by a public administration that has been accustomed to managing a highly controlled system" (World Bank, 1993:71).

The World Bank and the donor agencies, in their review on economic performance of the country have identified centralization of power and bureaucratic hassle as disincentives to investment. The World Bank mission chief in Dhaka said in a recent seminar on *Expanded Private Investment* that the government should remove all bottlenecks in the way of investment with a view to gearing up the privatization program. He singled out the implications in the investment policy (*Economic Times*, May 8,1993).

The visiting Executive Vice President of International Finance Corporation (IFC) Sir William Ryrie singled out bureaucracy as the major obstacle to the inflow of foreign investment in Bangladesh. He said at a press briefing at the end of his five-day visit to Bangladesh that he got a strong impression from discussions with local and foreign investors in Bangladesh that primarily bureaucracy was blocking the growth of private investment, both local and foreign.[14]

7.1.11 **Rural Industrialization**

Recognition of the vital role of small scale rural industries for Bangladesh's development can be found in the project papers prepared by USAID which stressed the need for developing private sector rural industries as a means of generating off-farm employment for supporting the agricultural sector, improving income distribution and promoting overall country stability along with development.

As a necessary first step in projecting its views on industrial policy the USAID mission prepared a policy study to identify and recommend structural reform needed to stimulate rural industries. However, instead of working with a GoB Ministry, the Mission promoted the policy that the consultants will work directly with the private sector entrepreneurs under the auspices of the Bangladesh Federation of Chamber of Commerce. In 1980 the USAID Mission provided a grant to the Asia Foundation to establish a Micro Industries Development Assistance Society (MIDAS), a private sector entity which is supposed to provide technical and managerial assistance and product promotional information to small scale entrepreneurs.[15]

Under a project called *Enterprise Development Project*, the

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[14]See for details *Dhaka Chamber of Commerce and Industry Monthly Review*, Feb. 1993:14.

[15]For details see the USAID *Bangladesh: Country Development Strategy Study-FY 83*

USAID is to provide US$13.5 million to generate employment for an estimated one hundred thousand youths. The project, a private sector enterprise, will take five years to complete in phases. Decidedly a development project to increase employment through industrialization of rural areas can yield the desired results if it is based on small industries. In preparing the schedule for disbursement of funds, the USAID mission in Dhaka is likely to give priority to the setting up of export-oriented small industries. It is also expected that innovative approach by the potential entrepreneurs will be preferred. The funding of small-scale industries under the project will include feasibility studies, insurance payment and needed support service.

7.1.12. **Increasing Public Savings and Investment**

At the 20th meeting of Aid Club, the emerging consensus among the donors was that Bangladesh *now has an excellent opportunity* to accelerate structural reforms to increase public saving and investment and develop the private sector. And the donors stressed the urgency of seizing this opportunity by quickening the pace of structural reforms in order to reap the benefit of such reforms. Many speakers identified the very low and stagnant levels of investment in Bangladesh as a major obstacle to faster growth, employment generation and poverty alleviation. Concern was also expressed about the quality of public investment and the related need to strengthen implementing institutions and to set and enforce clear priorities in the selection of public investments. The meeting welcomed the

Government's commitment to increasing domestic resource mobilization, reducing the losses of the public enterprises, enhancing the effectiveness of the civil service, and improving aid utilization. The delegates praised recent efforts to increase public investments through reform in the tax system, particularly the implementation of a Value Added Tax (VAT) as well as efforts to accelerate project implementation (Report of the 20th Aid Group meeting:25).

7.1.13 **Combating Industrial Pollution**

The Asian Development Bank (ADB) approved a 600,000 dollar technical assistance grant for industrial pollution control management in Bangladesh. The grant would be financed from the Japan Special Fund and the executive agencies will be Department of Environment and the Ministry of Industries. A report said; Bangladesh's small industrial base accounts for only 10 per cent of the gross domestic product, but the problems of industrial pollution are quite serious because of unplanned establishment of manufacturing plants in the past without consideration of their impact on the environment. Water and air pollution are of greatest concern and solid and hazardous waste pollution are on the rise. Major source of industrial pollution are tanneries and textile mills which account for half of the 900 polluting industries identified by the Department of Environment. The technical assistance will assist the government in strengthening the existing framework for improving the industrial environment and for monitoring industrial pollution control measures. The possibility of developing an industrial pollution control credit facility will be examined to encourage industries to introduce environment control measures (*DCCI Monthly Review*, January 1993:13-15).

7.1.14 **Small Scale Industries Development**

In the post-liberation Industrial Policy of 1972-73, small scale industries was defined as an unit with not more than Taka 2.5 million in fixed assets including the value of land (Planning Commission, 1973:266). Bangladesh Small and Cottage Industries (BSCIC), the main promotional institution for small industry development in Bangladesh, has adopted this definition.[16] The Department of Industries has defined small scale industry as a unit having fixed costs up to Taka 1.0 million excluding cost of land.[17]

In Bangladesh, small scale industries in general have a weak capital structure. They do not have recourse to the organized capital market. To ensure a regular and adequate flow of credit, the Government of Bangladesh entered into development credit agreements with different international and foreign agencies like IDA, World Bank, NORAD, Saudi Arabia, USAID, etc.

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[16]BSCIC has revised the definition of small industry and according to the new definition "the industry in which the fixed investment in plant and machinery does not exceed Taka 2.5 million are considered to be small industry. See M.R.M. Abdullah, ed.,*Bangladesh Small and Cottage Industries Corporation and Development of Small and Cottage Industries in Bangladesh* (Dhaka:BSCIC, 1982), P.3

[17]See *Guide to Investment in Bangladesh*, Department of Industries, GoB, 1977, p.3

By a Development Credit Agreement in June, 1978, the Government of Bangladesh contracted with the IDA for a credit of US$7 million (Second IDA Credit) for the growth and development of small and cottage industries in Bangladesh. Sonali Bank and Janata Bank were nominated to carry out the project financing activities under the program.

The government entered into *Third Development Credit Agreement* with IDA in October 1980, for 26.7 million SDRs equivalent to US$35 million (Third IDA Credit) for bridging the finance gap facing the small and cottage industries and for meeting the growth and employment objectives set for these industries in the Second Five Year Plan of Bangladesh (1980-85). Sonali Bank, Janata Bank and Agrani Bank were nominated to carry out the project financing activities on behalf of the Government of Bangladesh. The credit had two major components consisting of US$30 million for project loan and US$5 million for servicing the technical and marketing needs of the small and cottage industries. The Government placed the credit with Bangladesh Bank for refinance to financing banks.

The policies of the Government towards financing of small scale industries have undergone changes from time to time starting from pre-liberation period to date. The policies also differed depending upon the loan or aid-giving agencies. In case of foreign agency loans, interest rate policy, security policy, repayment period policy, debt-equity ratio policy, inspection policy, etc. are determined after consultation with the agencies and the project agreement between the government and the aid giving agency.[18] For example, the repayment period of different credit programs are different. Actually, there is no definite government policy with respect to the repayment period as well as grace period. In case of foreign agency loan, the period of loan depended upon the period for which the aid is given to the government. However, the repayment period is also different in case of capital finance and working capital loan. The repayment period varies from 2 years to 12 years in different loan schemes. In case of *Third IDA Credit*, it ranges from 2 years to 12 years. In case of *Credit Scheme for Unemployed Youths*, it is 3 years. The period is five years in case of *BSCIC own Fund, BSCIC-BSB Joint Collaboration*, *Special Credit Program* and *WEDP* Loan. It is 8 years in case of *BSCIC-BKB Light Consortium of Commercial Bank* loan under *Saudi Grant*. The period varies from 7 years to 12 years in case of *Second IDA (825BD)* Credit depending upon the gestation period of the project. But the maximum period is 3 years for working capital loan in any program.

Donor agencies like the USAID, the CIDA, DANIDA, SDC, GTZ, etc. and the ILO/UNDP started programs to promote small enterprise development in Bangladesh from mid-1980s. Programs were launched in both the public and the private sector. ILO/UNDP increased support to BSCIC, BMET and PWS (BEA) for small

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[18]See for details *"Some Aspects of the Policies of Financing Small Scale Industries in Bangladesh"*, Ranjit Kumar Chowdhury, Chittagong University Studies, Commerce Volume I 1985.

enterprise development and the USAID funded the establishment of MIDAS. Other donor agencies funded IDE, MCC Proshika, BRAC, RDRS and a host of other non-government organizations. CIDA and the Canadian high commission at Dhaka participate in some of these efforts to create employment by small enterprises and Canada seems to have a better record of taking early actions in respect of such development efforts over other donors. MIDAS offers entrepreneurship creation programs besides usual management training, technical assistance and sooner funding for selected projects.[19]

7.1.15 **Setting up of Export Processing Zone**

Export Processing Zones (EPZs) are one of several administrative instruments advocated by the World Bank for providing free trade status to manufactured exports. Along with a realistic exchange rate, sound macroeconomic policies, and liberalization and reform of import policies, making economy wide duty-free systems work well for manufactured exports is a principal element of the trade policy reforms advocated by the World Bank Group since 1979.[20]

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[19]For details see, A review of Enterprise Development Policy in Bangladesh, M. Shamsul Haque, *Bangladesh Quarterly, June 1992,* Department of Films and Publications, GoB.

[20]See for details *Export Processing Zones,* Policy and Research Series No. 20, Industrial Development Division, The World Bank, Washington D.C. U.S.A. 1992.

Table 7.5 Number of EPZ in operation in Asian region in 1990 under the World Bank Sponsorship

Country	Number of EPZs in operation
Bangladesh	2
India	7
Indonesia	3
Korea, Republic of	3
Malaysia	12
Philippines	4
SriLanka	2
Taiwan(China)	3
Thailand	3
Subtotal:	36

Source: World Bank, Industrial Development Division, 1993.

The Bangladesh Export Processing Zone Authority (BEPZA) was established in 1983 to pursue an *open door policy* to attract foreign investment to Bangladesh (BEPZA, Brochure 1992). The objective of BEPZA is to "provide special areas where potential investors would find a congenial investment climate, free from too many complications". *With this stated objective,* BEPZA has established the Chittagong Export Processing Zone in 1983. Later on the Dhaka Export Processing Zone at Savar started operation in 1993. The Khulna Export Processing Zone is at its initial phase. These initiatives are directly linked with the policy of rapid industrialization of the Government of Bangladesh. The main elements in that policy were to make credit lines from the World Bank and other donors.

EPZ is an area compared with an island economy that is free from other influences in a country. The capital invested in this *island* is greatly curtailed so that an investment decision can be made solely in terms of profitability. Second, internal political instability (which is a major deterrent to fetch long-term investments in many Third World countries including Bangladesh) becomes less important for long term and multimillion dollar investment decisions. Third, unionism is generally restricted in such islands so it becomes easy for investors to run business. Based on these considerations and influenced by the then President of the World Bank Sir Robert Mcnamara, the Government decided to establish EPZ in Bangladesh.

7.1.16 **Quality Control**

The donors stressed the need for developing a quality control system in Bangladesh as a part of its export promotion strategy. The delegates from Denmark in the 10th Aid Group Meeting stressed on this issue for Bangladesh. The statement of the British representative in the Aid Group meetings regarding tea industry (where there is a substantial British capital) is also an example of this case. In the 7th Aid Group meeting the UK representative stated that the quality of Bangladesh tea needed to be improved.[21] Industrial Policy 1991 of the GoB has assured the donors in this regard by including such provision as "quality control measures shall be strictly observed by all industrial manufacturers and be appropriately enforced by the Bangladesh Standard and Testing Institution"(GoB, 1991:23).

Apart from the above mentioned general preference of the donors for an industrial sector in Bangladesh, some of the donors noticed other issues of the industrialization process. For instance, the German delegate at the 7th Aid Group meeting dealing with the problems of industrialization pointed out that Bangladesh should not be allowed to lose too many of its able managers and administrators whereas the French representatives noted that for continued industrial growth the supply of raw materials has to be ensured. In the 8th Aid Group meeting the Dutch representative maintained that increased attention should be paid to capacity utilization instead of going for creating of new capacities.

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[21]*See Report of the 7th Aid Group meeting.*

7.2 Jute Sector: A Case of Donors' Influence

Jute continues to be the prime-mover of the economy. It is the most important industry in Bangladesh from almost any standpoint: capital investment; industrial capacity; financial markets; domestic and foreign earnings; production; employment; and political, social and even cultural issues. It has always been the prime impetus for privatization by the donors. In recent time marked changes have been introduced in this sub-sector of the economy in line with the direction chosen by the World Bank. The issue has been discussed various times in the Aid Group Meeting.[22]

Based on a level of demand of 4.5 lakh tons of jute goods a year, the excess capacity in the public sector jute mills was established at 4715 tons. The elimination of this excess capacity translates itself into closing down of 9 public mills and substantial downsizing of 2 large public mills by the government. The closure program is to be implemented in two phases: in the first phase 4 mills will be closed down and 1 mill will be substantially downsized before May 31, 1993; in the second phase, 5 mills will be closed down while 1 will be downsized before December 31, 1994 (*Memorandum for Bangladesh Aid Group*, 1993-94:19).

As a measure of privatization, the Government in January, 1989 offered its minority shares in 33 jute mills to the private

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[22]See the Reports of 18th, 19th, and 20th Aid Group Meeting.

majority share-holder. The Government ownership will be progressively reduced from the present 15713 looms to 3963 looms by closing down 9 mills and privatizing about 17-18 mills. The privatization program will be carried out in two stages: first by privatizing 8-10 mills before December 31, 1994 and then by privatizing additional 7-9 mills before June 30, 1996. In January 1992, the Government decided to wind up the Bangladesh Jute Corporation (BJC). The liquidation process is on which would be completed before December 31, 1994.

The Government of Bangladesh and the World Bank have signed *Memorandum of Understanding* (MOU) on *Jute Sector Adjustment Credit* (JSAC) on December 1993 in Dhaka. Subsequently the final agreement was signed on January 1994.

The adjustment in the jute sub-sector is to take place in accordance with the recommendations of a study titled *Jute Manufacturing Study* (JUMS). The recommendations of the study were discussed and areas agreed upon with the IDA which is providing a credit JSAC (*Memorandum for Bangladesh Aid Group, 1993-94*).

After signing the final agreement on the three-year long JSAC program, Bangladesh has received a total amount of 175 million SDR (equivalent to US$250 million) as loan from the World Bank for restructuring the country's jute sector. The loan, with 0.75 per cent service charge, is repayable in 40 years with a grace period of another 10 years.

The salient feature of the JSAC program are grouped into eight areas:

1) downsizing the industry;
2) employment rationalization;
3) social safety-net program;
4) restructuring the past debt;
5) privatization;
6) reforming the wage policy in the jute industry;
7) training of workers and managers in the retained mills; and
8) elimination of government intervention in the jute sector.

7.2.1 Downsizing the Industry

The government of Bangladesh has decided to eliminate the excess capacity in the industry by closing 9 public mills and substantially downsizing 2 large public mills. The mills to be closed/downsized have already been identified. Employees of the closed mills will be retrenched and equipped auctioned off or transferred to other mills.

The capacity to be closed in the public sector mills amounts to a total of 4700 looms which is about 30 per cent of the total installed looms in the public sector. The government has already taken 2000 looms out of operation by closing 4 mills and downsizing another. The remaining 5 mills will be closed and one other mill downsized before December 31, 1994. The government has prepared a monthly schedule for these closure and downsizing with the objective of progressively reducing the interim financing requirements that will be made available to the industry during the course of the year.

In the private sector, mills will be free to retrench employees or to close it down. The level of interim financial support that the private sector mills receive will be set at a level that will encourage the efficient mills to remain in the sector. It is therefore expected that a number of the less efficient private mills will either improve their performance or cease operation.

7.2.2 Employment Rationalization

In the financial year (FY) 91-92, the government reduced the number of permanent workers by 15000 in the public mills under a voluntary departure program. There exists additional excess employment of about 20000 which is 20 per cent of the total employment in the public mills. Of these, 14000 are production workers and 6000 staff/officers. Under the proposed reform program, the government will reduce the permanent positions in the public mills to 80650 by retrenching 20000 employees of the closed mills. The 8000 of these have already been retrenched. The remaining 12000 were scheduled to be retrenched before December 31, 1994.

As the capacity in the public sector is being gradually downsized with closure and privatization, employment in the BJMC headquarter and regional offices will also be reduced. The government has reduced the BJMC's employment from 850 to 650. Employment was scheduled to be further reduced to 200 by December 31, 1994, and to about 100 before June 30, 1996. In addition to having a better control on employment until all public mills are privatized, the government is to establish manning norms for the public mills and ensure compliance to these norms, and introduce legal retirement age for production workers in the public mills.

7.2.3 Social Safety-Net Program

The government will implement a safety-net program for the affected workers which includes *separation benefits* and retraining, particularly for self-employment. Under the current legislation, the separation benefits for an employee of about 25 years of service vary from Taka 100000 (US$2600) to Tkaka 500000 (US$13000) depending on whether the employee is a production worker or an officer. About 4000 of the 20000 affected workers are expected to leave the mills as a result of normal attrition over the next two years. A comprehensive program has been developed to retain the remaining 16000 workers for alternative employment.

The Ministry of Jute will contract with a reputable, non-profit NGO to serve as the principal organization to coordinate the training services. It is estimated that the cost of the program would be about US$3.5 million. The government has already issued tender to hire an NGO to implement the program.

7.2.4 Restructuring the Past Debt

Total outstanding debt of the jute sector amounted to US$1.030 million as of December 1992. This is composed of : Taka 13.3 billion (33.5 per cent of total debt) due from BJC; Taka 13.7 billion (34.5 per cent of the total debt) due from the public mills; Taka 7.8 billion (20 per cent of the total debt) due from the private mills; and Taka 4.9 billion (12 per cent of the total debt) due from private spinners, traders and exporters.

BJC debt: The operations of BJC were terminated in January, 1992. The government will repay the banks′ 70 per cent of the total amount owed by BJC; the remaining 30 per cent will be written off by the creditor banks during the banks current fiscal year. The payments will take the form of bonds to be issued in two equal installments. The first installment has already been issued. The second installment was to be issued later during the fiscal year 1994.

Private mills: The government recognizes that the private mills accumulated debt also need to be restructured to restore commercial viability. The government has therefore, decided to take the following measures: The banks will write off one-third of the private mills total accumulated debt with the remaining two-thirds to be rescheduled for 15 years with zero interest and no principal repayment during the first three years; during the remaining 12 years the interest rate will be 3 per cent and principal repayment will proceed in gradually rising installments. All debt restructuring exercises were to be completed by December 31, 1994.

Public mills to be privatized: The banks will write off one-third of the total amount outstanding; the remaining two-thirds to be assumed by the buyers of the mills will be rescheduled.

Public mills to be closed: The government will pay the banks 70 per cent of the total amount owed by the public mills to be closed; the remaining 30 per cent will be written off by the creditor banks. To the extent that the write-off by the creditor banks fall short of such amount the government will make the additional repayments. The payment will be in the form of bonds.

The government has issued bonds for the debt of the 4 public mills already closed.

Interim financing: It has been recognized that the restructuring of the industry would take time and that the mills would still be incurring losses during the interim period (defined as 18 months from July 1, 1993 for the private and privatized mills and three years for the public mills). The government has decided to undertake the following measures in this regard.

(a) Financing of normal working capital needs of both public and private mills will be from the banks against the security of mills export revenues.

(b) Operating losses of the private mills will be pre-estimated on the basis of actual losses of the ten (five public and five private) best performing mills, expressed as a per centage of export sale and financed as follows: one-third by fresh capital injection in cash by the private shareholders and two-thirds by banks. Operating losses of the public mills will be financed by the banks. Such financing will be administered on a mill by mill basis. In the first year 100 per cent of losses will be financed. In the second year mills which remain in the public sector will receive 85 per cent of the financing they received in the first year of the program. In the third year mills remaining in the public sector will receive 85 per cent of the financing they received in the second year of the program. The number of mills in the public ownership will decline from 25 to 2 in the program period.

(c)other than (a) and (b) no further financial support will be provided to both the public and private mills from the banks or any other sources. If a public mill fails to reduce its operating losses to the levels specified in (b) it will be closed.

(d) The financing by banks for operating losses of both the public and private mills will be on grant basis. All interim financing will end before December 31, 1994 for the private and privatized mills and before June 30, 1996 for the remaining public mills.

(e) The banks will be fully reimbursed by the government in

> the form of 3-year bonds carrying a 7 per cent interest for financing the operating losses of both the public and private mills. The costs of this arrangement will be fully recognized in Financial Year 94.

Financing after the interim period: After the interim period all new lending by the banks to jute mills would be strictly on market terms; the banks would also be free to decline a loan request. As a further safeguard the Bangladesh Bank would also issue a new regulation on prudence *guidelines* providing strict eligibility criteria for new bank lending for the mills while at the same time rescinding all previous instructions/guidelines to the bank on lending to jute mills.

Announcement of the program and banks' right: The private banks and mills will be under no compulsion to accept the above arrangements of debt write-off, restructuring, and interim financing.

Impact on banks : The government recognizes that the above proposals will have a direct impact on the recapitalization needs of the NBCs. As indicated above the government will substitute 70 per cent of the BJC debt and the debt of the public mills to be closed by issuing bonds to the banks. The write-off of the remaining 30 per cent of the BJC debt and the debt of the public mills to be closed and the terms of debt settlement with the private mills and the mills to be privatized will also have a negative impact on the banks' capital. The government will compensate the NBCs for losses resulting from the write-off of the BJC debt and the debt of the closed public mills and jute sector debt restructuring in the context of their overall recapitalization needs. The private banks will be compensated for the total amount of write-off for the BJC debt and the debt of the closed public mills and the write-off under the debt restructuring program.

7.2.5 Privatization

The government has decided to substantially privatize the public mills. The government's privatization program in the jute industry has the following three components:

Public jute mills: The government has decided to progressively reduce its ownership from the present 64 per cent (15800 looms) of the total capacity in the industry to no more than 20 per cent (4000 looms) by privatizing 18 mills. This will be achieved in two stages. In the first stage, before December 31, 1994, the government's ownership will be reduced to 7000 looms (about 35 per cent of the total capacity of that time) by privatization of 9 mills. In the second stage, before June 30, 1996, the government's ownership will be reduced to 4000 looms (about 20 per cent) by privatization of the remaining 9 mills. The government has established a Privatization Board to be responsible for planning and implementing all privatization programs in Bangladesh. The government has already prepared a monthly schedule for privatization of the first 9 mills.

BJC: The liquidation process of BJC is already on. The government has put up some of the godowns and press houses of BJC for tender and reduced its total employment from 2700 to 209 at present. The government will complete the liquidation before December 31, 1994.

7.2.6 Reforming the Wage Policy in the Jute Industries

The main objective of the wage policy will be to reduce the share of wage bill in total revenue from the present 55 per cent to 30-35 per cent during the restructuring period. This will be achieved by retrenchment of excess employees, an increase in productivity and restraint in wage increases.

The government will keep the nominal wages (the basic wage and all supplements) in the public jute mills at the present level until wage determination process is decentralized in the jute sector and profitability permits wage increases on a mill by mill basis. The decentralized system would allow wage settlements based on labor productivity, capacity of the mills to pay, and the competitiveness of the industry in the international markets.

7.2.7 Training of Workers and Managers in the Retained Mills

The government has developed a program to provide training for operatives, front-line supervisors and middle-level managers both in the public and the private mills on a cost-sharing basis. The government will contract with a consulting firm to implement the program. The cost is estimated at US$2 million.

7.2.8 Elimination of Government Intervention in the Jute Industry

In the past the government put restrictions on mill closure and staff retrenchment in the private sector to protect employment. This right to intervene originates from provision in the sale agreements prepared between the mills and the government when the mills were partially privatized in 1982-86, which stated that the government would have the right to intervene in the affairs of the mills. The government has decided to retract this provision and has sent letters to the private mills seeking their agreement to make the necessary modifications to the sale agreements.

In addition the government has made a formal policy announcement that the government will henceforth not intervene in the operations of the jute mills including their financing by the banks well as their decisions to shut down and/or liquidate the mills.

CHAPTER 8

OBSERVATIONS AND CONCLUSION

In this concluding chapter observation will be made about the aid-dependent development strategy of Bangladesh as a whole and donor-recommended industrialization policy specifically. Finally, on the basis of findings of the preceding chapters, some recommendations will be made for use by the policy makers.

Whether donors can influence the public policy making process of Bangladesh has been a matter of debate and great concern on the part of the academicians, researchers, pressmen and policy makers. There exists different and sometimes conflicting views over the issue of whether donors can really interfere in the policy making of Bangladesh and compel the policy makers to mould the policy in their preferred direction. Controversies continue to exist over the extent the donors should interfere in the domestic policy making process of developing countries. The present study attempts to examine the extent of donors' influence in the policy making process of Bangladesh by focusing on industrial policy in detail.

The main objective of the study is to make a critical assessment of the existing practice of public policy making in Bangladesh assuming the donors' role to be the key actor. It modestly attempts to focus on how the donor agencies intervene in the industrial policy formation of Bangladesh.

It is found in the study that like many other developing countries Bangladesh in the process of policy formulation has been under the persistent donors' pressure and influence. This is because of the fact that Bangladesh is heavily dependent on aid for her economic and social development and occasionally for her economic survival in crises. Major part of the development budget comes from the donor countries and agencies.

Donors provide inputs into the policy and watch feed backs of the policy implementation. Donors' intervention in the domestic policy making and policy implementation process of Bangladesh become visible through various ways and means. There are some formal arrangements such as aid consortium meeting held every year in Paris, bilateral talks between the donors and Bangladesh Government, local consultative group meeting organized by the World Bank Resident Mission in Bangladesh, etc. which provide the donors a great deal of power to influence the policy formulation process of Bangladesh. Besides, some informal instruments are used by the donors to influence the policy process such as seminars and symposiums conducted by the World Bank or other bilateral donors, World Bank's report published from time to time , visit to Bangladesh by the donor governments' or agencies' high officials, informal gathering and meetings organized by the donors or Bangladesh Government, etc. These are as influential as formal ones.

In the ultimate analysis it is observed that Bangladesh has been following a path of aid-dependent industrialization strategy for a long time. The policy changes have taken place in line with the desires and directions of the donors especially with the recommendations made by the World Bank and the IMF. The donors not only clearly articulated their views on these policy changes but also very closely watched their implementation process. Moreover, policy changes have taken place at the implementation stages. But the expected results have not been achieved as were expected. The privatization program which has been introduced in Bangladesh following the recommendations of the donors appears to have made little positive impact on the economy. In the name of economic liberalization Bangladesh has been flooded by foreign goods and as a result of this local industries are being ruined.

8.1 Observations

Foreign aid in Bangladesh has pervading effects on her socio-political as well as economic life. The cost of aid, for our purpose, can be assessed in the following two ways:

1. overall assessment of the aid dependence of Bangladesh ;
2. assessment of specific policy measures advocated by the donors.

8.1.1 General Assessment of Foreign Aid Dependence

One of the expectations of foreign aid inflow is that it will encourage domestic savings. The relationship between (a) external debt and GDP and (b) Aid and GDP gives an indication that foreign aid inflow did not work as was expected (Table 8.1).

Table 8.1 Foreign Aid and Growth of Bangladesh (1974-90)

(In Million US$)

	74-75	81-82	85-86	86-87	87-88	88-89	89-90
GDP at current price	13855	11870	14768	16911	18560	20013	21450
Total External Debt	973	4959	7438	8364	9438	9886	10615
Export f.o.b.	355	652	909	1000	1186	1286	1524
Trade Balance	-845	-1385	-1455	-1620	-1800	-2089	-2235
Current Account Balance	-1015	-1537	-1055	-1040	-1156	-1376	-1541
Aid Disbursement	901	1240	1306	1595	1641	1668	1810
Debt Service Payment	99	338	500	593	492	478	547
External Debt as % of GDP	6.7	41.8	50.4	49.5	50.8	49.4	49.5
Aid as % of GDP	6.5	10.4	8.8	9.4	8.8	8.3	8.4
Trade gap as % of GDP	6.1	15.9	9.8	9.7	10.4	10.4	
Current a/c Balance as % of GDP	7.3	12.9	7.4	7.9	7.5	7.4	7.2
Debt Service Payment as % of Export	27.9	51.8	55.0	59.3	41.5	37.2	35.9

Source: *Report of the Task Forces, 1991.*

Twenty years' experience of aid-dependent development practice suggests that due to easy access to foreign aid, the regime and the major recipients of aid did not formulate appropriate policy to promote investment especially in productive sectors. This means that there was no pressure to divert resources from domestic consumption to investment. As a result of low domestic savings, aid remains the main capital component of development. The low level of industrial investment and increased commercial activities by the entrepreneurial class in Bangladesh illustrates the saving crisis prevailing in Bangladesh. It is the high level of aid flowing to the non-productive sector that kept the rate of domestic saving low.

Easy access to foreign aid, moreover, has created and supported an elite group of indentors, contractors, consultants and business groups who along with upper echelon bureaucrats and the political leadership in control of the government machinery benefit from the various commissions from foreign aid. Indeed, researchers found that only 25.08 per cent of the foreign aid funds is spent in Bangladesh (Sobhan and Hashemi, 1982:48). Though a major part of the rest is spent for products and services that do reach Bangladesh, these funds do not generate any multiplier effect within the domestic economy. In fact, with markups and high fees for consultants and contractors, a good portion of the foreign aid funds is actually never used for development in Bangladesh. Of the amount spent in Bangladesh, indentors receive 11.6 per cent, consultants receive 3.23 per cent, contractors 2.03 per cent, while engineers and bureaucrats receive 10.57 per cent as bribes and payoffs. The existence of this rent seeking group is intrinsically tied to the continued expansion of aid funds. Hence foreign aid has been used to fund projects whose feasibility or social relevance are questionable (Sobhan, 1990:116).

Sobhan (1982:38) has been critical about the Bangladesh government's dependence on foreign aid. He suggests that aid dependence has in fact been self-perpetuating in the sense that it has over the years served both domestic and foreign interest groups who have a vested interest in continuous aid flows and also in the sense that over-dependence on aid reinforced a system which has been inimical to both the mobilization of domestic resources and to the effective use of the productive capacity of the economy.

An inexorable consequence of the over-dependence on foreign funds is that the country's political and economic freedom to choose is substantially compromised. Each year the government has to seek funds from donor countries to keep up its modest development activities. A failure to attract sufficient funds means that many development projects would have to be shelved. Since foreign aid is a major source of employment of the educated people and of aggregate demand, a drying up of aid could cause serious resentment and dislocation in the economy. The resulting resentment and consequent turmoil can easily unseat the ruling government. The bargaining power of the government in the aid-consortium meetings is, therefore, limited. The wealthy donor countries usually require, as a precondition of aid, a recommendation from the World Bank-IMF that the recipient country has adopted or are adopting economic policies that are regarded by them as conducive to rapid economic growth. This gives the agencies immense power over the aid-seeking countries. They make full use of this power to force upon them economic policies of their liking.

Their power to do so has been further enhanced by the utter mismanagement of the economy by the political, administrative and business elite of the country. These agencies are no longer the overseer of the economic policies of the government. The Policy Framework Paper (PFP) they prepare contain the economic blueprint for the recipient government, whether democratic or autocratic. Any significant deviation from the stipulated conditions is swiftly penalized by withdrawal of credits as Bangladesh found out much to its misery. Despite the fact that Policy Framework Paper virtually regulates the economic policy of the country, it is regarded by World Bank as a very confidential document the contents of which cannot be divulged even to the members of the parliament of the country (Taslim, 1994:293) Sometime ago a seminar was held to discuss the experience of structural adjustment policies which many developing countries including Bangladesh were goaded into accepting by World Bank-IMF. Although many leading academics, professionals, administrators and government officials were invited to the ceremonial sessions, only a select few were permitted either to listen to or to participate in the more serious deliberations on the adjustment policies (Taslim, 1994:294). More recently, in a seminar attended by top government officials, politicians and social scientists of the country, a former minister suggested to his successor and opposition leaders that in order to minimize disruptive public debates, they should debate the Policy Framework Paper in the parliament and build up a broad consensus before it is actually implemented. He was immediately rapped on the knuckles by the local mission chief of the World Bank who reminded him and the rest of the audience of the generosity of the World Bank and warned that no public discussion on the paper would be tolerated. It did not occur to anyone to pursue the matter further (Taslim, 1994:294).

The social cost of this aid dependence is perhaps even more severe. People at all levels have become dependent on external assistance, whether the state or donor agency, to resolve even the most basic problems. Instead of rebuilding a tornado-hit school roof, local leaders spend time and money at the government offices to seek funds; mobilizing the local people to construct a dirt road, rural officials wait for access to the Food for Work grain; using the youth to clean up the neighborhood, the community people complain about the lack of municipal services.

Foreign aid has distorted the political environment. It has created a political process which brings people who promise larger amounts of foreign aid to leadership positions. People who advocate hard work and insist on mobilization of local resources, on payment for services, on assuring individual, local and national responsibility, are ignored and bypassed.

The cost of foreign aid to Bangladesh is best stated in the Task Forces Report,

> "the last two decades have therefore witnessed a fast erosion of national self respect, manifested both in terms of scorning domestic products and in rejecting local initiatives. We hardly have any vision of our own. We even borrowed our vision from our donors. Creative initiatives are generally stifled. The Nation has forgotten to appreciate its own ideas and activities. We appreciate something only if it is appreciated by the donors. We wait to see the reaction of our donors before we dare to express our own opinions. There is also total apathy regarding the plunder of national wealth, of state resources. Rather than outrage there is even a common effort to *make it* by competing for patronage. It is therefore imperative that our national goal be redefined to incorporate self reliance as the central theme in all our future endeavors" (Task Forces Report, 1991:100).

8.1.2 Assessment of Specific Policy Measures

The Government of Bangladesh has been pursuing privatization policy for at least 15 years. A senior official of World Bank, Elliot Berg called Bangladesh the champion of privatization (*Dhaka Courier*, March 25, 1994). But these privatized enterprises did not operate at all or operate with less efficiency or capital utilization than before.

Many commentators in Bangladesh have charged the privatization program to date with failure. They cite the losing and closed enterprises as evidence. Information on the performance of 497 small and medium industries from a survey undertaken by the Ministry of Industries show that 49 per cent of the divested units have closed down since divestiture (Table 8.2). Leading commentators claim this is because of the manner in which privatization was carried out and the lack of capacity of the private sector. The private sector, they believe, has neither established its efficiency nor its honesty. In essence they argue there is no evidence in Bangladesh that the private sector is any more efficient than the public sector (World Bank, 1994:24).

Table 8.2 *Present Status of Disinvested Industrial Units.*

Location (Greater Districts)	Total units surveyed	Present position		
		In production	Closed	No trace
Dhaka	206	95	53	58
Chittagong	117	62	36	19
Rajshahi	5	1	-	4
Khulna	24	7	8	9
Others	136	49	36	51
TOTAL	488	214	133	141

Source: World Bank, 1994:24

The privatization program introduced following the recommendations of the World Bank has made no positive impact on the economy. It is thus evident that the privatization strategies in Bangladesh have aimed at maximizing short-term revenue rather than building up competitive market to encourage private investment.

The public sector does not make only losses which are avoidable. Sobhan recently remarks in an article that in Asia among the first 10 enterprises (out of a large number) making the highest profits, several belonged to the public sector (Taslim, 1994:297). With sound policies and good management these public enterprises could be just as efficient, if not more, as private enterprises. Moreover, the cost benefit analysis of these enterprises from the social standpoint has to be taken into account.

The government has accepted World Bank and IMF terms regarding restructuring of tariffs and import duties under a liberal industrial climate. This has made the process of industrialization rather complicated. Local goods have become uncompetitive to imported and smuggled goods as a consequence.

The Trade Liberalization involves lowering the tariff rate to a more or less uniform level. The success of the reform depends on how far the industries can become internationally competitive by increasing their efficiency and thereby be able to compete with imports. There is a question of the speed of the reform involved here. We have the question whether tariffs are being reduced too quickly, particularly when the tariff rates still remain high in our neighboring countries such as India. Textiles is an important example in this context. The tariff rate on textiles which was 100-150 per cent in 1993 was reduced to around 30 per cent in 1994. Can the industry survive further reduction in protection particularly when there is stiff competition with imported cloths, some of which are smuggled from India?

Experts believe that there is a potential for making our handloom industry more efficient by providing support services in respect of design, marketing, credit, etc. They argue that existing protection in handloom industry should be continued particularly because the handloom sector is an important provider of employment in the informal sector of the economy. On the other hand tariff rates are still high in many industries which may call for lowering the protection through selective reforms.

Through the mechanism of deregulation and tariff reforms Bangladesh has opened up its domestic market to the world. But its neighbors, especially India and some other countries like China, have refused to reciprocate. They are still protecting their domestic markets by retaining a tariff wall. Consequently, Bangladesh is flooded with goods from China and India. Trade imbalance with India has sky-rocketed. During fiscal year 1993-94 Bangladesh's adverse trade balance with India exceeded US$500 million. Table 8.3 shows the extent of Bangladesh's adverse balance in the last five years with India.

Table 8.3 Bangladesh's Export Balance With India

Year	Export	Import	Balance of Trade
1988-89	9.22	103.25	(-) 94.03
1989-90	19.61	145.19	(-) 125.58
1990-91	31.06	180.54	(-) 149.48
1991-92	2.07	231.33	(-) 229.26
1992-93	9.85	341.98	(-) 332.13

Source: Bangladesh Bank, 1994

Informal trade between the two countries amounts to more than double the official trade figures. This means Bangladesh has become a over US$1.5 billion market for India.

In the name of economic liberalization Bangladesh, one of the poorest countries in the world, has been flooded over by foreign goods. As a result of this local industries are being ruined on the one hand and on the other hand the country is facing a serious trade imbalance.

Table 8.4 Balance of Trade (in crore taka)

YEAR	EXPORT	IMPORT	BALANCE
1978-79	963	2207	-1244
1979-80	1100	3052	-1952
1980-81	1148	3729	-2581
1981-82	1239	3873	-2634
1982-83	1802	4526	-2724
1983-84	2014	5087	-3073
1984-85	2622	6826	-4204
1985-86	2740	6293	-3553
1986-87	3368	6850	-3482
1987-88	4116	9159	-5043
1988-89	4269	9508	-5239
1989-90	5141	11330	-6189
1990-91	6027	11188	-5161
1991-92	7422	13224	-5802

Source: Bangladesh Bank, 1993

Although World Bank-IMF officials are in favor of private initiatives and forcing the government to privatize the economy and remove all barriers to the operation of the free market, they have been totally reluctant to provide loans to private entrepreneurs or make any direct investment in the country. When there is a shortage of entrepreneurial skill, direct foreign investment may be preferable to foreign aid as the former provides both savings and know-how whereas the latter provides only savings. Furthermore, in case of the latter the country is obligated to pay back the loans even the project ends up in loss. But in the case of the former, a loan is serviced only if the projects turn out to be profitable.

The UNDP complains in its Annual Development Report (Report 1993) that the industrially developed countries including the 7 most developed one's surplus of annual capital (about US$62 million) has not been invested in the developing countries. Rather they are mutually investing to their own countries. One of the prime responsibilities of the World Bank is to invest the surplus of developed countries to the developing world. The report complained that the World Bank has failed to carry this responsibility. In fact, the World Bank seems to be less interested in the industrial development of developing countries including Bangladesh rather it only prefers to test its new theories and ideas. Moreover, the report expressed that many Asian countries are frustrated by the formation of the integrated EC market and the NAFTA.

Since the announcement of a liberal industrial policy in 1991 the government has been championing liberal investment in the country and, in pursuance thereof, it has withdrawn restrictions on foreign exchange transaction and investment. The recommendations of the World Bank, IMF and the donors have been adhered to by the government. Despite drastic economic reforms and policy liberalization, the multinational investment institutions are very shy to invest in the country's private sector. International institutions like the Asian Development

Bank (ADB), the International Finance Corporation (IFC)[1] the Asian Finance and Investment Corporation (AFIC), the Islamic Development Bank (IDB), Netherlands Development Industrial Bank (FMO), etc. have so far made a few million dollars' direct investment in the private sector.[2] The Asian Development Bank has so far invested only US$13.4 million in the private sector as against the several billion in the public sector. The position of the IFC was more critical. The World Bank affiliated organization has a 17.5 per cent equity share in the Industrial Promotion and Development Company whose equity stood at Taka 90 million. This organization had also participated in a private sector cotton spinning mill through the SABINCO. Its stake would not be more than three to four million dollars. The Saudi-based IDB has no direct investment in the private sector other than its collaboration with the Islami Bank (BD) Ltd. In 1984, the IDB had provided 10 million dollars credit to the Bangladesh Shilpa Bank (BSB). Since then the IDB refrained from providing further industrial credit to Bangladesh either in the public sector or in private sector. Recently SABINO approached the IDA for a US$20 million loan to invest in the private sector industrial projects. So far, officials of both sides have met thrice to finalize the agreement. The AFIC and the FMO had also invested a few million dollars in two separate textile projects.

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[1]An affiliated body of the World Bank.

[2]See *Financial Express*, June 28, 1994.

The concept of industrial sickness in Bangladesh has obsessed the planners for the last two and half years. The government had taken rehabilitation of sick industries as a routine job, while the World Bank and the donors are not in favor of revitalization of the sick units in both public and private sectors. The country faces uncertainty following refusal of the World Bank and the donors to provide funds for rehabilitation of selective sick units and assessment of the sick units for revitalization although they always talk about our industrialization. Most of the problems of these sick industries could be overcome and it is possible to make them profitable. These industries can contribute a lot to our industrialization. For example, the small-scale textile weaving industries have become sick due to circumstances beyond control of the entrepreneurs. They have become sick due to uneconomical size, lack of working capital, unbalanced machineries, loss of local market to smuggled fabric, loss of production due to chronic power trouble and in general failure of the government to create an environment conducive to growth of local industries.

Bangladesh adopted export oriented industrialization strategy with a hope to export goods to the American and European markets. The government did not take into account the possibility of encounting protectionist policy in the potential markets. One important reason why exports did not grow enough was that Bangladesh needed duty-free access of her exports to the markets of the developed countries. But even the donor countries failed to reduce tariffs to support the export promotion endeavors of Bangladesh. The imposition of restrictions by some Western countries on certain exports from Bangladesh is regrettable. It is confusing that while Bangladesh is for free economy, these donor countries are pursuing policies which are not in conformity with their recommendation.

Bangladesh devaluated its currency on several occasions. This policy weakened the economy as far from alleviating the situation, it created more imbalance in the balance of payments. Theoretically, devaluation allows exports to compete overseas by lowering external prices. In Bangladesh the export sector is very small, and almost all the inputs of this sector are imported. The policy discouraged the export sector in many ways (Alam and Rahman, 1993:71). First, it reduced the profitability of exporting as an activity. Imported inputs or domestically produced import-competing inputs were purchased by the export industries at a very high price. Second, it provided an environment for a protected industry to tolerate relatively more inefficiency than an unprotected one. Third, the entrepreneurs did not need to grasp possible export opportunities because production for the existing domestic market was more profitable and assured for them.

8.2 Policy Recommendations

In the light of our investigation the following policy recommendations can be made for the policy makers.

First, dependence on foreign aid should gradually be reduced. Attempts should be made to develop the country with its own resources however meager they might be. Bangladesh needs to put much greater emphasis on mobilizing domestic public and private resources. Public savings can be increased through various fiscal, monetary, and administrative reforms with the specific objective of generating a greater amount of public savings.

Second, the focus of government policy should shift from the current emphasis on foreign aid to export-led growth. In Bangladesh, the rapid growth of the export oriented garments industry in recent years supports this conclusion.

Third, dependence upon exports alone will make the economy vulnerable as it has to depend on the conditions of other economies. The main impetus should be given to developing a large domestic market. We advocate for a balanced judicious industrialization program. Export-industries should be promoted, but import-replacing industries should not be neglected nor should they be deprived of reasonable protection. After all *infant industry argument* is still considered to have some validity. Many instances can be given to support the view of protecting local industrial units for some period. Many countries adopted the practice of liberal import policy only when local industries become competitive. What is needed most is that the *baby* should be properly nursed before reaching a certain level of growth.

Fourth, the industrial nations must also adjust to the new world economic conditions and should not shy away from necessary restructuring because of shortsighted interests. This means, above all, that they must open their markets to products from the Third World. While countries like Bangladesh have embarked on structural changes and various policy reforms, it is imperative that the World Bank and IMF should create an international environment supportive to these efforts.

Fifth, one important point is that the representatives of the donor agencies, who work at the headquarters, should carefully assess the situation in Bangladesh and should advise the government on realistic lines.

Sixth, industrial development will depend too on the what happens to the agricultural sector which is the most important sector in Bangladesh with about 80 to 85 per cent of the total population depending on it. It is, therefore, essential that this sector along with all its sub-sectors undergo a very rapid transformation and development because it is in this sector where a surplus can be generated. This generated surplus will result in raising the level of aggregate demand which is essential for raising the demand for industrial products. Without this mechanism the industrial sector will continue to remain moribund and stagnant.

Seventh, the public sector has a role to play in areas not suitable for private enterprise, in the social interest particularly in a poor country like Bangladesh. Private enterprise has its role to play in numerous fields which are suitable for them. An example is the Indian case where the *commanding heights* of the economy belong to large public enterprises.

Eighth, privatization is not merely a technocratic exercise, it is also a political process. The Government should attempt to build as broad a consensus as possible on this issue. If privatization is inevitable, a well-planned and well-timed privatization program is strongly favored. Hasty privatization will only allow accumulation of unearned wealth and lost jobs.

Ninth, now-a-days market economy does not necessarily imply a laissez-fair strategy. South Korea is one of the best examples in this regard. The Government's policy of denationalization of all the public enterprises can therefore, be revised.

Tenth, at the moment unemployment is a very serious problem in the country. Under the circumstances, instead of retrenching employees from the public sector as suggested by the donors, existing surplus workers may be transferred to other industries or new employment opportunities may be created with the fund which otherwise would have been spent in the name of *golden handshake*.

Eleventh, there is no reason to accept all suggestions of the World Bank, particularly in wage determination. Market mechanism is not effective here and public sector is still the largest employer. So the government has to ensure minimum wage to ensure subsistence wage of workers.

Twelfth, the industrial policies and macroeconomic policies of Bangladesh advocated by the donors have certainly discriminated against small enterprises. Industrialization has been promoted in three main ways, viz., by regulating trade, by investment incentives, and by directly undertaking public sector investments. The whole strategy of import substitution encourages large-scale capital-intensive industries whether in the public or private sector. The same is true of investment incentives. Therefore, small-scale enterprises should be encouraged by industrialization policies of the Government.

8.3 Summary and Concluding Remarks

The study aimed at discovering the areas and extent of donors´ influence in the policy making process of Bangladesh by focussing on industrial policy formation process in details. It has already been mentioned elsewhere that it was not the prime objective of the study to make a critical assessment of the donor-recommended policy strategies. Rather the study emphasized more the issue whether Bangladesh being an independent state has been exercising its due power and authority in its policy making process. However assessment of donor-dependent industrialization and industrial policy formation process of Bangladesh had also been made to explore whether these strategies have brought or can bring about desired objectives as the donors have been frequently advocating.

We can easily conclude here that the donors intervention in the policy formation of Bangladesh, specially in the industrial policy formation, have been very much clear in recent years.

Everyone knows that nothing happens here without the approval of the World Bank. So the first and foremost job of the GoB is to convince the *donors' parliament*, i.e., the aid consortium meeting rather than to bring the matter in the national parliament of the country. Donors' satisfaction over the government's policy is a certificate for the government to remain in power.

These policy dictations by the donors are very much visible in the industrial policy formation in Bangladesh over the years. In recent years the World Bank, IMF, ADB, etc. and other bilateral donors are very much concerned about various policy matters related to the industrialization strategy of Bangladesh. Revisions of policy issues on dictation by the donors will lead one to the conclusion that under the broader philosophy of market economy all their policy suggestions centered around mainly the issues of privatization of government sector industries and the creation of a congenial environment for the development of the private sector. The tragedy is, as the Finance Minister said recently, "the package is cooked in Washington without relevance to our country and delivered at Dhaka which the aid-hungry government accepts" (*Bangladesh observer*, November 22, 1993). Their universal, eternal prescriptions for Bangladesh, which were prepared without pragmatic knowledge, have failed to yield expected results for the country. Thus we are theoretically sovereign but in practice, we have to swallow advises against our national interest.

The intervention by the donors into the process of policy formation in Bangladesh stems largely from the latter´s own failure in governance. If we had the capacity to generate domestic resources the scope for donors to intervene in our policy formation affairs would be immeasurably less. To the extent that we continue to live with a significant resource gap: donors will continue to exercise leverage in our affairs (Sobhan, 1993:234). Our endeavor should be to develop the economy with our own resources. Side by side, foreign aid that comes with all the conditionalities detrimental to our economy should be rejected. We must formulate such policy which can help us attain economy for which we will feel proud. If donors are ready to assist us in that case, those would be welcome. Industrialization program of the government should be based on a comprehensive economic program. In future donors´ policy dictations should be carefully examined for consistency with our long term goals.

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