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Poverty and Reforms in Bangladesh

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I. INTRODUCTION

In a memorable speech to the United Nations General Assembly, Nikita Krushehev predicted that communism would bury capitalism. In less emotive and more economistic terms, he was saying in effect that centrally planned economies would outperform market economies in terms of both output growth and social justice. History has not been kind to Krushehev. Not only central planning but even milder forms of state interventionism now stand discredited, and developing countries round the world are desperately trying to install functioning market economics. This sea-change in development philosophy generally owes something to donor conditionalities associated with structural adjustment credits, to the extent that "reforms" and "structural adjustment" have become virtually synonymous. Short-term internal or external balance crises, and longer-term stagnation, also signalled to policy-makers the bankruptcy of over-interventionist policies—a lesson driven home by the phenomenal growth performance of the NIC's, apparently the fruit of market-friendly policies.

In general, reform measures can be classified into three types: expenditure-reducing, i.e., monetary, fiscal and wage restraints, expenditure—switching or supply-side measures intended to shift resources from non-tradable to tradables, e.g. real devaluation, tariff and subsidy reduction (aimed at bringing domestic prices in line with world prices for tradables), and institutional and policy reforms primarily armed at providing the private sector with a congenial environment. The policy package appropriate for a century will depend on initial conditions, e.g. demand-side policies will be most effective in a country where desired absorption exceeds full employment output capacity. And a country whose social and cultural backgrounds are conducive to rapid response to expenditure switching will have less need for expenditure reduction with its inevitable contractionary consequences.

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The fundamental problem with reforms lies precisely in this, that demand-side policies are contractionary and act rapidly, while supply-side policies, which will hopefully stimulate growth, take longer to implement and to show results. Reforms therefore tend to lead to a (hopefully short-run) decline in economic activities, with the brunt being borne by the poor and possibly other “excluded” groups—women, ethnic minorities. The first signs of such a contraction may lead to displays of discontent by the affected groups which scare the government of the day into aborting the reforms, thus compounding the problem. It is therefore being increasingly recognised that reform programmes must have built into them protective policies for the poor. It should be kept in mind, however, that those who are must vocal against reforms are not usually the real poor—very often they constitute “labour aristocracy”, like employees in state-owned enterprises.

II. THE REFORM-POVERTY LINKAGE THEORY AND EVIDENCE

Reforms may impinge on poverty directly or indirectly, via their effect on growth. Other things being equal, reforms that increase the growth rate will alleviate poverty. Arguably this is in fact the only sustainable poverty-reduction strategy. The direct effect of reforms are however likely to be negative. Trade liberalisation, privatisation, and labour market reforms may generate unemployment and lower the income of small-holder producing for a (protected) domestic market. Labour market rigidities and labour militancy will usually prevent instantaneous reallocation of labour. Also, public expenditure cuts associated with fiscal discipline are likely to fall most heavily on social expenditure, which benefit, or at least are expected to benefit, the poor.

After looking at the available evidence, Cornia, Jolly and Stewart conclude:

> “… in almost 60 percent of [IMF-assisted] countries growth deteriorated or did not improve in the first programme year, and real investment levels also declined or stagnated between 1980 and 1983 … with falling output and, at best, mixed evidence about changes in income distribution … the number of people in poverty in many “adjusting countries” increased” (p. 67).

Evidently, one year is far too short a time period in which to expect reforms to show their real effects.

A World Bank study [Jayarajah *et al.* (1996)] reports findings much more favourable to adjustment policies:

> “… Poverty has declined in 23 of the 33 countries for which two data survey points are available and increased in the remaining ten. In the

> sample of 23 core adjusting countries … poverty has declined in 15 countries and increased in eight" (p. 72).

III. REFORMS IN BANGLADESH

In a sense the reform process started in Bangladesh in 1975, when the new regime started dismantling some elements of the command economy which the Awami League government had attempted to install. The ceiling on private investment in industry was abolished, denationalisation of public sector enterprises began a secondary foreign exchange market was introduced. In the 1980s, a more systematic approach to reform became apparent as they were incorporated as conditionalities in credit agreements with the World Bank and the IMF. The eighties may be called the decade of reforms.

The main accomplishments of the reform agenda may be summarised as follows:

1. Fiscal reforms: revenue effort has been significantly improved while lowering marginal income and corporation tax rates The Value Added Tax has replaced sales taxes, though coverage remains incomplete. On the expenditure side, there were significant outbacks in subsidies and economic sector expenditures while increasing essential social expenditure, notably on primary education. The overall budget deficit, which averaged 9.3 percent of GDP in the period 1980–84, was brought down to 5.7 percent in FY96 and an estimated 5.4 percent in FY97 [World Bank/ADB (1998) Statistical Appendix]. This has contributed to a low rate of inflation, which averaged 13.4 percent annually over the period 1980–84, but came down to 1.8 percent in 1994. (There has been some upward pressure since then, and currently may be as high as 8 percent).

2. Monetary policy: The financial sector in Bangladesh was based on four Nationalised Commercialised Banks, which had little freedom to act as true commercial banks. They were primarily used as vehicles of directed credit, with little attention to the economic viability of the activities being financed. Not surprisingly, debt default mounted and by the end of the eighties the financial sector was near collapse. In 1990 a Five Year Financial Reform Project was initiated, which aimed to improve the loan classification system, recapitalise banks suffering from capital inadequacy, improve the supervisory and regulatory system, introduce more market-based interest rate policies, improve loan recovery, and encourage private sector initiatives in banking.

Success has been limited so far, specially in the matter of recovering defaulted loans. In the meantime, the tight money policy adopted to discourage further buildup of bad debts is penalising legitimate borrowers.

However, monetary aggregates and interest rates have probably moved in the right direction (Table 1). Credit to government is erratic, but credit to "other public sector", which includes notably the parastatals, shows a downward trend, while

Table 1

credit to private sector has been tightened somewhat. Expansion of total liquidity has been curbed somewhat, reflecting, hopefully, concern with quality.

3. Trade and Exchange Rate Policy. Bangladesh has liberalised the foreign trade regime to a significant extent, specially in the nineties. Tariff rates have been significantly reduced, bringing down both nominal and effective protection rates, as shown in Tables 2 and 3 below.

There has also been significant progress in removing non-tariff barriers, which now cover only about 2 percent of tariff lines. This, however, covers the important textile sector.

Table 2

Nominal Protection Rates

	Agriculture	Mining	Manufacturing	All Tradables
Pre-reform				
1990-91				
Unweighted	90.5	54.1	89.0	88.6
Import-weighted	20.9	24.0	51.8	42.1
Dispersion (CV)	63.3	51.7	58.6	59.0
Post-reform				
1995-96				
Unweighted	26.0	13.6	24.6	24.6
Import-weighted	10.1	18.8	21.9	21.0
Dispersion (CV)	56.7	82.2	73.5	72.7

Source: World Bank, Dhaka, October 1996, Table 1.

Table 3

Effective Protection Rates

	Agriculture	Industry	Overall	SD	CV
1992-93	45.71	119.52	88.15	107.73	122.22
1993-94	37.96	67.06	54.7	45.52	83.22
1994-95	31.29	57.25	46.22	39.9	88.33
1995-96	23.50	49.03	38.18	34.16	89.45

Source: As for Table 2, Annex 2.

Currently the government seems to have got cold feet about carrying trade policy reforms to their logical conclusion, which would be a uniform low tariff rate on all imports.

Bangladesh continues to operate a managed float of its currency. A series of mini-devaluations since 1995 have nominally depreciated the Taka by more than 20 percent. The real effective exchange rate, however, continues to appreciate, reflecting stronger devaluations of the currencies of its trading partners.

4. Industry: the scope for private investment in industry has been gradually expanded. This is specially true for export-oriented industries, who enjoy bonded warehouse and duty drawback facilities as well as a cash subsidy. Foreign investment is being actively wooed with an apparently highly attractive incentive package. But poor infrastructure, inefficient bureaucratic support and political uncertainty neutralise much of the perceived gains to foreign investors, or for that matter to domestic investors.

The government is in principle committed to privatisation of state-owned enterprises, but progress is slow due to labour militancy, and possibly also a residual attachment to state enterprises in some quarters.

5. Agriculture: starting from the late seventies, input markets, in particular fertiliser and minor irrigation equipment, have been progressively liberalised. By 1991, all wholesale and retail trade in fertiliser, including imports, was in private hands, though the ex-factory price if urea and TSP continued to be set by administrative fiat. From 1988, importers were allowed to import duty-free any brand of irrigation engine (instead of brands approved by the Ministry of Agriculture). Siting and zoning regulations were also abolished. Irrigated area and fertiliser use boomed, and by 1992 Bangladesh was a marginal rice exporter. However, the early nineties saw a slump in rice production, with production declining in 1994-95 and 1995-96, and recovering to trend level in 1996-97.

In 1994-95 there was a crisis in the urea market, caused primarily by excessive public sector exports in tandem with a rise in demand caused by an abrupt lowering of the ex-factory price from Tk. 202 to Tk. 186 per 50 kg, and also by rising rice prices. But the government chose to see this as a failure of the market, and reintroduced some controls-only licensed dealers could lift from factories or government a godowns, and they had to sell within areas specified in their contract with the designated factory.

IV. INCOME AND POVERTY IN BANGLADESH

On the whole, therefore, Bangladesh has made considerable progress towards implementing economic reforms along the lines recommended by the major bilateral donors. One would therefore expect at least a temporary contraction of the economy, accompanied by some increase in poverty.

In point of fact, in the eight years from 1983-84 to 1990-91, year-to-year GDP growth rates (at constant 1984-85) market prices was above 5 percent in only one year (1989-90, 6.63 percent), above 4 percent but less than 5 percent in three years, and below 4 percent in the remaining four. In the seven following years to 1996-97, the growth rates were above 4 percent in all but one year (1990-91, 3.4 percent), and above 5 percent in 1995-96 and 1996-97).[1] The former period can perhaps be considered somewhat contractionary, but we have seen that most of the major policy reforms were implemented only near the end of the eighties. It is worth noting that this is the first time in the history of Bangladesh that a four percent or above growth rate has been sustained for five successive year, and that too at a time when agriculture was stagnating.

A study by CIRDAP [CIRDAP (1998)] defines the period 1974–1986 as the pre-reform period and 1987–1995 as the reform period. Using a simple regression model with a dummy for the reform period, they find that growth rate of GDP was 3.8 percent in the pre-reform period and 4.1 percent in the reform period. The difference was not statistically significant.

It would seem, therefore, that so far Bangladesh has managed to escape the contraction usually associated with the early phases of a reform programme. This may be partly due to the fact that some of the really tough measures, like extensive privatisation, remain half-done.

Nor does available evidence suggest any significant increase in poverty—on the contrary, there appears to have been a modest improvement (Tables 4 and 5).

Can these developments be related to the reform measures? The effects of certain sectoral reforms are relatively uncontroversial. There is no doubt, for example, that liberalisation and privatisation of agricultural input markets, particularly irrigation equipment, fuelled unprecedented growth in crop production. Liberalisation of cereal imports in 1994 also helped to contain poverty by putting a natural cap (the import parity price) on rice prices, which is a major determinant of poverty. Fiscal restraint may have helped by keeping overall inflation low. More to the point, public expenditure cuts have not been disproportionately on social expenditures from which the poor can expect some benefits. The main safety nets, Food for Work and Vulnerable Group Development, have also escaped the axe. In fact, social sector public expenditure in real terms rose from less than Tk. 8 billion in 1989-90 to Tk. 28.5 billion in 1995-96 (Table 6).

But the main reasons for the relative success on the poverty front probably has little to do directly with economy-wide reforms. The main credit has to go to micro-credit programmes of the kind pioneered by the Grameen Bank and subsequently (or concurrently) taken up by NGOs and government programmes. It has been estimated that the three largest such programmes, Grameen Bank, BRAC (an NGO) and RD-12 (a government programme), together had 3.5 million loanees, who constituted (assuming one member per household) 45 percent of the target household. By 1994 they had disbursed US $1.3 billion in loans [Khandkar, Khalily and Khan (1996), p. 9)].

[1]World Bank (1998), Table 2.

Table 4

Trend in Poverty in Bangladesh, 1983–95

	Head-Count Index (%)		Poverty-Gap Index (%)		Squared Poverty-Gap Index (%)	
	Source 1[a]	Source 2[b]	Source 1[a]	Source 2[b]	Source 1[a]	Source 2[b]
National						
1983-84	52.3	58.5	14.5	16.5	5.7	6.6
1985-86	43.9	51.7	10.4	12.3	3.5	4.2
1988-89	47.8	57.1	12.5	15.4	4.6	5.8
1991-92	49.7	58.8	13.6	17.2	5.1	6.8
1995-96	47.0	53.1	12.8	14.4	4.9	5.4
Urban						
1983-84	40.9	50.2	11.4	14.3	4.4	5.8
1985-86	30.8	42.9	7.3	10.9	2.5	3.8
1988-89	35.9	43.9	8.7	11.1	2.8	3.8
1991-92	33.6	44.9	8.4	12.0	2.8	4.4
1995-96	26.3	35.0	6.0	9.2	1.9	3.4
Rural						
1983-84	53.8	59.6	15.0	16.8	5.9	6.7
1985-86	45.9	53.1	10.9	12.5	3.6	4.3
1988-89	49.7	59.2	13.1	16.0	4.8	6.1
1991-92	52.9	61.2	14.6	18.1	5.6	7.2
1995-96	51.1	56.7	14.1	15.4	5.5	5.7

Source: Binyak Sen and Atiur Rahman, *Fighting Poverty: Emerging Perspectives South Asia Poverty Monitor 1998;* BIDS, Dhaka, 1998.

Note: [a]Estimated by using CBN method based on per capita expenditure distribution (grouped data). Base year non-food poverty line was updated by using non-food CPI; food poverty line is estimated by costing the fixed bundle using implied prices calculated from the survey, see, Ravallion and Sen (1996) and Sen (1998).

[b]Estimates are based on CBN method using per capita expenditure distribution (unit-record data). Food poverty line is estimated by costing the fixed bundle using implied food prices derived from the survey. Non-food poverty line for each survey data is estimated by assessing the total amount of per capita non-food expenditure incurred by households whose per capita food expenditure roughly corresponds to the food poverty line [see, World Bank (1998)].

Table 5

Changes in the Incidence of Rural Poverty, 1987 to 1994

Indicators	1987	1989-90	1994
Head Count Ratio			
(Percent of Households)			
Extreme Poor	25.8	30.7	22.5
Moderate Poor	31.7	28.6	29.2
Extreme and Moderate Poor	57.5	59.3	51.7
Poverty Gap Ratio (Percent)			
Distributionally Sensitive	21.7	24.8	19.2
Measure (FGT-index)	10.9	13.5	9.6

Source: Analysis of Poverty Trends Project, 62 Village Resurvey, 1995.

Table 6

Annual Development Programme: Social Sector Expenditures in Constant Prices

Spending Category	Fiscal Year 1990	Percentage of ADP	Fiscal Year 1996	Percentage of ADP	Fiscal Year 2001 (Planned)	Percentage of ADP
Total Social Expenditures	7.93	9.95	28.54	24.39	45.45	29.43
Education	3.15	3.96	15.88	13.57	23.88	15.45
Health	1.37	1.71	5.85	5.00	13.80	8.93
Family Planning	3.07	3.85	4.94	4.22	4.83	3.12
Social Welfare	0.36	0.45	1.87	1.60	2.98	1.93
Total ADP	71.75	100.00	117.00	100.00	154.52	100.00

Source: World Bank (1998), Table A4.1.
Note: Education includes spending for religion in 1996 and 2001. Sports and culture not included.

Another development that has helped hold poverty at bay is the growth of non-farm activities in rural and semi-rural areas. These represent growth linkages from the "Green Revolution" as well as public expenditure on infrastructure.

IV. CONCLUSION

Bangladesh appears to have managed to implement a significant part of the economic reform agenda without suffering from any drastic ill-effects. However, contrary to the French proverb, it may be the final steps that hurt. For the time being, poverty alleviation initiatives by NGOs and a social expenditure that is at least moderately pro-poor has complemented the reform effort and made the transition to a market economy relatively painless.

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