ECONOMIC POLICY EVOLUTION

IN

HISTORICAL PERSPECTIVE IN BANGLADESH

A. H. Sahadat Ullah

SHORT TERM CONSULTANTS REPORT-2

HIID/ESEPP Project
Planning Commission

April, 1988

Table of Contents

I. Historical Perspective of Economic Policies

In Bangladesh economic policies evolved with political developments as products of history and contemporary situation. This evolution took place in 3 distinct historical phases. First phase covers the period of British dominion in India till the creation of two new states, India and Pakistan, in August, 1947; the second phase is the period (Pakistan period) between 1947 and December 1971 during which Bangladesh was a constituent region of Pakistan, and the third phase covers the period since independence of Bangladesh. The first phase, during which the region was only one of many constituencies of a much larger political domain was characterised by economic policies which had no particular reference to the region. Most important economic policies of this period consisted of tariff protection to infant industries to the dominion, Imperial Reference in trade within the British Commonwealth and the Gold Exchange Standard. All these together with fiscal and monetary policies were common to all the regions of British India. As such the economy of the region fused into the greater economic canvas of the dominion, developing just as a hinterland of the industrial belt of Calcutta.

2. With the partition of India and the creation of Pakistan the region of Bangladesh came into sharp focus as it acquired an international boundary because of the peculiar geographical structure of Pakistan; with this the economy of the region also became a geographically defined entity, separated from the rest of Pakistan. Subsequent development process led from geographical differentiation to such a degree of economic differentiation

between the two regions of Pakistan that the concept of two economy began to emerge by the middle of 1950's. It is this economic differentiation and subsequent breakup of Pakistan that make the study of the economic policies of this period one of particular significance.

3. The partition of British India gave Bangladesh the first geo-political outline; it also brought to the surface the economic backwardness of the region (Bangladesh) along with that of the new state of Pakistan. The new state was utterly dependent on export markets for its two important commercial crops, raw jute and cotton and on import for manufactured consumer goods. There was no jute mill in Pakistan at the time of partition and had only few textile mills (5000 looms and 206 thousand spindles). Industrial output accounted for 5.8% of GDP in 1949/50 of which the share of large industries was less than one-fourth. The share of industries in the regional GDP of the then East Pakistan (now Bangladesh) was somewhat lower (4.2%). So the first economic policy, in addition to those inherited by the new government of Pakistan, was the Industrial Policy announced in April 1948 and later codified into Development of Industries (Federal Control) Act of 1949. This policy left a permanent market on the economic development of Pakistan as a mixed economy as it reserved a number of industries for the public sector as well as retained for the government right for selective interference while giving the private sector main role for industrial development. That impression is carried even today by the economy of Bangladesh, though the degree of mix - the relative role of the state and private sector has been changing continuously.

4. The industrial policy is the centre-piece of the economic policy of any developing country; therefore, this policy deserves a brief discussion. As implied by the concept of mixed economy, the policy defined the role of the government and the private sector in industrial development. While the main role was given to the private sector the government assumed primarily a supportive role, though it retained the exclusive right for the development of the strategic industries like arms and ammunition and telecommunication industries. That the supportive role of the government in the development of private sector was of high priority is reflected in the fact that the government set up a number of corporations such as the Pakistan Industrial Finance Corporation (1949), Pakistan Industrial Development Corporation (1952), the Pakistan Industrial Credit and Investment Corporation (1957), the Industrial Development Bank (1961); National Investment Trust (1962), Investment Corporation of Pakistan (1966) and a number of official committees and boards for high level decisions, e.g., the Economic Committee of the Cabinet (1951) and the Planning Board (1951). On the economic policy side the Industrial Policy led to its logical remifications into others affecting investment, exchange rate, import and fiscal policies involving diverse degrees of state interventions and controls, depending on given historical circumstances. As these policies evolved over time by fits and starts in reaction to situations, they came to constitute a potpourri of policies and lacked coherence and articulation and adequate comprehension of the economic problems (1).

5. The first economic plan of Pakistan came into force in 1955/56; so until then the Industrial Policy played the pivotal role in the evolution of various policies. In this drive Pakistan seized the opportunity when in 1949 its

major trading partners, England and India devalued their respective currencies, it decided not to follow the suit. Main argument underlying this decision was to make machinery import cheaper for rapid industrialization, while the supplies of agricultural raw materials like jute and cotton were considered inelastic. Nondevaluation however had immediately a disastrous effect on foreign trade. Export of raw jute declined from 6.1 million bales in 1948/49 to 3.4 m bales in 1949/50, and in value terms, from Tk. (Rs.) 1195.6 million to Tk. 525.8 million. As a result, total export of the then East Pakistan was reduced by half to Tk. 683 million. Since India was one of the major consumers of raw jute there was also a trade deadlock with her which called for a barter agreement for import of essential consumer goods. Cotton export however rose by 18.5% in volume and 9% in value terms; yet total export of Pakistan declined by 14%.

6. Cheapening of import as a result of nondevaluation of home currency against Pound Sterling made import of machineries and millworks rise from Tk. 34.5 million in 1948/49 to Tk. 66.8 million in 1949/50 while overall import declined by 13%, from Tk. 1286 million to Tk. 1119 million as a consequence of the fall of export. The country was in a serious foreign exchange crisis which began to unfold into various controls of foreign exchange and imports. Korean war eliminated resource constraint as jute export doubled (Tk.1098.4 million). Awash with the flood of foreign exchange government adopted the Open General License. With it import of textile goods together with yarn exceeded the 1948/89 level.

7. In pursuance of the Industrial Policy the government sought the standard incentives system to promote industries. In 1950 Protective Duties Act was adopted; export duties on raw jute and cotton were raised, preferential import

duties were allowed on machineries and much higher duties were imposed on consumer goods. Average duty on machinery and millworks import was 7.6% in 1950/51 against the average duty of 23.8% on textile goods where the industrial development was first to take place. Export duty on raw cotton was raised on 23rd Nov. 1950 to 5 times the level of 5th Oct. 1949 and on raw jute by one-third to 50% depending on the grades. All these strappings had very little effect on the pace of industrialization under the relaxed environment created by booming export earning of Rs. 2549 million in 1950/51, a record to hold until 1965/66. The increased export earning released the foreign exchange constraint so much so that in July, 1951 trade was liberalized to allow 85% of private import virtually without any license under OGL (Open General License). Under this the country grew as a trading nation. Trade rather than industry was the immediate interest of the business community. Though machinery import increased from Rs. 66.8 million in 1949/50 to Rs.111.9 million in 1951/52, its share (5%) remained below that of 1949/50 (5.2%) as total import increased from Rs.1248 million to Rs. 2237 million. Even import of textiles (coth and yarn) increased from Rs.369.5 million in 1949/50 to Rs. 626 million in 1951/52. Against this import looms capacity increased from 5 thousand to 8 thousand looms (33.3% increase) and spindle capacity from 263 thousand to 481 thousand spindles (82.9% increase), but local output lagged behind (50% growth) because of import and per loom output declined from 19.9 thousand yard to 18.6 thousand yards a year.

8. While quick profit from liberal import rather than rapid industrialization under an overvalued currency was sought by the business community, the fiscal requirement of the new government also could hardly be compromised with a

distant gain from rapid industrialization. Korean War boom only created a congenial, though shortlived, condition for the pursuit of these immediate goals. They explain the changes that took place in the composition of the central government tax revenue. In 1949/50 customs acccunted for 58.8% (Rs. 422.5 million) of the tax receipts (Rs. 718.4 million); its share rose to 64.8% in 1951/52. In those days excise on local production was a small fraction of tax revenue - 7.2% in 1949/50, which declined to 5.6% in 1951/52. Taking advantage of strong international demand for jute and cotton under Korean War export duty on jute was raised by two-thirds in case of jute cuttings from Rs. 6 to Rs. 10 per bale and by three-fourths in case of both long jute and kutcha bales - from Rs. 20 to Rs. 35 in case of long jute and Rs. 4 to 7 in case of Kutcha bales (plus a license fee for export to India). In 1950/51 export duty on raw cotton was raised from Rs. 40 per bale for short staple at the beginning of the year to Rs. 300 by the end of the year. This rate prevailed until the end of the Korean War. Yet the world demand was so strong that export of cotton increased from 0.96 million bales in 1949/50 to 1.37 bales in 1950/51 and its value from Rs. 397.6 million to Rs. 987.5 million after which export value declined continuously. Export duty on Jute and cotton accounted for 52.1% of customs receipts or Tk.409 million in a total of Tk. 776.2 million in 1950/51 but declined in 1951/52 to 42.2% (Tk. 347 million) due to weakening world demand for these fibres.

9. Because of the mercantilist interest, though among industries cotton textiles promised to be the most potential sector to invest, the growth of the sector was not any different from other industries in the early years as the following table shows:

Table 1

Growth of Industries
(1949/50 to 1951/52)

Industries	Annual Growth Rate
1. Textiles (cloth)	22.4%
2. Cigarettes (1951/52 over 1950/51)	40.0%
3. Sugar	22.3%
4. Cement	11.0%
5. Vegetable Products	33.5%
6. Overall Industrial quantum Index (1951/52 over 1950/51)	24.8%

Source: Central Statistical Office (Pakistan); 20 years of Pakistan in Statistics 1968; pp.82-88.

From these evidences it follows that it was mercantile capitalism that was in the making in the early years of Pakistan.

10. In fact, industrialization of Pakistan began per force in the middle of 1950s because of the change in international environment, rather than due to the national policy. It was the end of the Korean boom that both advanced and created the necessity for industrial development. Under the foreign exchange problem that followed the end of Korean boom the Commonwealth Finance Ministers Conference of June, 1952 adopted a new import policy to reduce the strain on reserve and in March 1952 import from hard currency area (then $) was restricted. As a matter of fact 1952/53 was the turning point in the industrial process though the industrial policy was adopted in 1948. Due to the end of the Korean War export declined sharply. Its problem was aggravated by the fiscal policy which tried to tax out windfall gain from the Korean boom by enhanced

export duties in the middle of 1950/51. After the boom export declined from its highest level of Tk. 2554 million in 1959/51 to Tk. 1510 million in 1952/53; so to restrict import first the margin for OGL import was raised to 75% (and for licensable goods to 50%) and then in November, 1952 OGL import was totally abolished. It had singular effect on textile import which declined to Tk. 147 million in 1952/53 from Tk. 626 million in 1951/52. Import restrictions of 1952/53 unwittingly created condition for new industries though with some time lag. Machinery import which declined in the aftermath of import restriction received together with raw materials import preference over consumer goods. They picked up slowly over the years to reach a record height (Tk.218.5 million) in 1954/55 and their share rose from 54.6% in 1951/52 to 76.2% in 1954/55 (2). Textile capacity which was experiencing a slugish growth since 1950/51 gained momentum under import restrictions and more than doubled in 1954/55 compared with the 1952/53 level. That import restriction under severe foreign exchange constraint contributed more to the industrialization process than such positive action as tariff policy is well recognised (3). The effect of import restriction is reflected in the wholesale price index of cloth which rose by 20 to 30% between 1951 and 1954 when the general wholesale Price Index declined by 30% (4). Being mainly family or clan oriented, public response to the development of cotton textile industry was rather slow. This is reflected in the total number of listing with the Karachi Stock Exchange which increased from 26 to 52 while that of cotton textile mills rose from 3 to 10 only (5).

11. Some important policy antecedents of industrial development had to be recalled here. First, on the heel of the Industrial Policy came the Exchange Control Regulation (1948) and Protective Duties Act (1950). Except the period

of the Korean Boom, exchange control has been a powerful tool for import control. Where several import restrictions became unavoidable, it also became necessary to reflect the scarcity price of foreign exchange; so in August, 1955 home currency was devalued by 30.5%. This together with the Suez War helped jute and raw cotton regain substantially the old export levels in 1955/56 and consequently, the overall export rose from Rs.1,223 million in 1954/55 to Rs. 1748 million in 1955/56 - a net increase of 11.8% in constant $. This led to another import surge in 1956/57, turning a favorable balance of trade that the country was enjoying during the preceding four years into negative balance and bringing a sharp reduction in foreign exchange reserves. There was significant revival of import of textile products, partly as a result of initiation of a new political process. This stop and go approach to economic management, particularly to foreign exchange management, reveals that the Industrial Policy was followed too narrowly to meet the long term need of the country, though a Planning Commission had been in place entrusted with the responsibility of formulating a comprehensive development policy.

12. Two observations are in order about the various economic management policies pursued till about the end of the First Plan of Pakistan. First, it is clear from the above historical narration that the policies evolved in response to short term situations against the broad objective of the Industrial Policy. This flexibility had the obvious virtue of being pragmatic as diverse interests had to be served. As mentioned already, fiscal interest of the new state could hardly be subordinated to the private indsutrial interest such that fiscal policies (e.g. import tax revenue) apparently worked against the Industrial Policy, though in the early years private capital could grow only out of expanding import such that whenever exchange reserve would

permit import had been liberalized. This organic relationship of domestic capital formation and overall import is indisputably reflected in the movement of import level and the level of capital issues (Table 2) showing the mercantilist character of the economy in early years of Industrial Policy.

Table 2

Levels of Import
And Capital Issues

(Tk. in million)

Year	Import	Capital Issue
1948/49	1487	110.9
1949/50	1284	76.9
1950/51	1620	136.7
1951/52	2237	325.1
1952/53	1383	291.5
1953/54	1118	296.0
1954/55	1103	254.3

Source: CSO (Pakistan); 20 years of Pakistan the Statistics; 1968; pp. 107, 254.

Note: Capital issue is for calender year in which fiscal year closes; so there is an implied time lag between capital issue and import.

14. Secondly, since the Korean boom was the period for capital formation as is evident from table 2 above that capital issue reached its peak in 1952 and thereafter started to decline, it is important to assess the impact of various policies pursued during that period on the economic development of the region which is now Bangladesh. To start with, contribution of large industries to Gross Domestic Product of the region increased from Tk.69 million in 1949/50 to Tk. 200 million in 1954/55 at 1959/60 factor cost against which the increase in West Pakistan was from Tk. 277 million to Tk. 802 million, showing about the same

annual rate of growth - 24%, in the two regions. The issue of capital in the two regions was however highly disproportionate. Between 1949 and 1954 average annual level of capital issue in the former region was Tk. 43 million while in the other region it was Tk. 206 million - exceeding the proportion of industrial output. Besides the structural peculiarities of the regional economies one conjecture is that, finding imports restricted, the trading class moved into machinery imports for nest-feathering. Advances by the commercial banks also were equally disproportionate. As on 30.6.55 commercial bank advance to the manufacturing sector was Tk. 33.6 million in the then East Pakistan against Tk. 142.2 million in West Pakistan. This differential state of affairs followed from the fiscal policy. The inherent conflict between the Industrial Policy and need for foreign exchange and government revenue resulted in differential treatment of jute and cotton also. Jute was subject to much lower level of export duty than cotton, though cotton was traded in a more competitive World market. At the height of Korean Boom export duty on cotton was five times as high as in 1949 - Tk.300 against Tk. 60 per bale, while in case of long jute export duty was raised from Tk. 15 to Tk.20 only per bale. The result was that in 1951/52 receipt from export duty on cotton declined from Tk. 317 million to Tk.219 million while that from jute increased from Tk.92 million to Tk.128 million. Export receipt from cotton declined by Tk.210 million which was twice as large as that in jute, Tk.102 million. As the Korean Boom ended, there was a crash in the domestic price of cotton - wholesale cotton price falling from Tk.99.8 in 1951/52 to Tk. 66.3 per maund in 1952/53 in the Karachi market, while the domestic price of jute continued to remain strong. Thus the fiscal situation created a domestic price condition which favoured development of cotton textile industry more than jute textiles. The first jute mill - a small one, was established in 1951 to be followed by the largest jute mill in Asia in 1952 after which jute mills did not grow much until 1954/55.

15. The economic experiences of the first quinquennial of coming into existence of Pakistan brought it clearly at home that the Industrial Policy of 1948 could not alone redress the economic backwardness unless conceived in a comprehensive macro framework; so after experimentation through successive stages of institutional development the Planning Commission was established in 1953 with the primary responsibility of formulating national economic plan. The First Plan of Pakistan, launched in 1955 sought to correct structural imbalances in the economy also while pursuing the objective of economic growth (6). Imbalance between agriculture and industry, balance of payments crisis, regional imbalance, chronic unemployment and income distribution remained the main problems of planned development of Pakistan.

17. Regional Development: As the economic policies need to be consistent between instrument variables and impact variables (planned objectives), the efficacy and efficiency of the economic policies need also be assessed by changes in the impact variables. First, because of the regional characteristic of Pakistan there was emphasis in all plans of Pakistan to reduce regional imbalance. By the first year of the First Plan the difference in the pace of regional economic development let the concept of two Economy State grow in the intellectual circle of East Pakistan (7). This and the change in the political process in the middle of 1950's made the policy change encourage capital formation in

East Pakistan through accelerated import which in the early 1950's helped the growth of mercantile capitalism in the west zone. Share of East Pakistan in total import rose to 35.9% in 1957/58 from 29% in 1954/55 and the average share of 29.8% over the period, 1949/50 to 1954/55. But the recurrent balance of payments problem posed the hard choice to make between maintaining higher level of import in the East and satisfying the import need of industries in the West. The conflict led the country to the first ever Army Rule in Pakistan at the end of the first decade of its existence followed by a decline in the import share of the East.

18. The centre-piece of all the plans of Pakistan was invariant to change in political commitments that they were basically production and investment oriented with general policy scenarios in monetary and fiscal areas. Against their unconditional reliance on the private sector following the Industrial Policy of 1948, the conflicts between planned goals and private choice reflected in regional growth, industry vs. agricultural growth, import need and export growth, etc.. One singular effect of the unique choice for the private sector as the main agent for development was growing disparity between the two regions which the following table clearly brings out:

Table 3

Regional GDP Growth Rate(%)
(1949/50 - 1969/70)

(at factor cost of 1959/60)

Regions	1950-55	1955-60	1960-65	1965-70
1. East Pakistan	2.2	1.7	3.9	4.0
2. West Pakistan	3.1	3.1	6.8	6.7

Sources: (i) Country GDP from 20 Years of Pakistan in Statistics; CSO, p.5 for years upto 1964/65; (ii) West Pakistan's GDP from Pakistan Economic Survey, 1980/81

(ii) East Pakistan's GDP for 1969/70 at 1959/60 factor cost from W.B's CEM, 1974.

19. The main reason for growing regional disparity was highly disproportionate investment in the private sector as shown below:

Table 4

Share of East Pakistan in Development outlay(%)

Sectors	1955-60	1960-65	1965-70
1. Public	19.1	38.3	43.2
2. Private	46.7	32.5	25.7
Total share	30.1	35.8	36.3

Note: Public expenditure is development outlay; private expenditure is investment. Public expenditure includes Works Programme and Indus Basin.

Source: (i) Public sector expenditure under the 1st plan (1955-60) from the 2nd Plan. 408 ; and East Pakistan Economic Survey 1964/65

(ii) Second Plan (1960-65) data from Final Evaluation

(iii) Third Plan (1965-70) date from evaluation of The Third Plan

Thus, over the three plan periods of Pakistan, the then East Pakistan received a third of total development expenditure. Since public development outlay included non-development expenditure also, share of East Pakistan would be even lower because of much lower share in private investment.

20. Strategy for Development: Agriculture Vs. Industries: Though the first economic policy that was explicitly adopted by the new government of Pakistan was the Industrial Policy, the recurrent crop failures made the authors of the First Plan realize that "The inadequate agricultural output was sooner or later bound to affect and slow down the pace of industrial progress" (8). During the period prior to the First Plan, Pakistan had to import 12 million tons of food, roughly equal to a normal year's domestic output preempting substantial foreign exchange resources; yet the government pursued the policy of compulsory procurement of food at low price to feed urban population during the First Plan period. It was the Second Plan which in moving toward a more liberal economic regime recognized the debilitating effect of "disguised taxation" on agriculture of compulsory procurement of food at fixed prices; it therefore recommenced replacement of procurement system by a satisfactory direct tax (9). The First Plan period witnessed a very slow increase in overall agricultural growth, less than the population growth which fueled a spate of inflation. During the second and third plans agricultural growth accelerated due to (i) availability of high yield seeds, (ii) price incentives and (iii) irrigation and large scale water development projects,the latter particularly in West Pakistan (e.g. Indus Valley Project). In the East agricultural growth which decelerated during the 1st Plan period regained its position during next two plan periods. The overall agricultural growth in East Pakistan however remained sluggish even during these periods as shown in the table below:

Table 5

Comparative Growth Rate

(at constant factor cost of 1959/60)

	1950-55	1955-60	1960-65	1965-70
(a) Pakistan				
Agriculture	1.3	1.4	3.4	4.7
Industries	9.1	5.7	9.9	7.9
(b) East Pakistan				
Agriculture	2.6	0.8	3.0	3.2
Industries	6.6	7.0	5.6	7.4

Sources: (i) CSO (Pakistan): 20 Years of Pakistan in Statistics; 1968; p.5
(ii) Pakistan Economic Survey, 1980/81;
(iii) BBS: A Handbook of Comparative Statistics, 1968

The table clearly brings out the fact of greater emphasis on industries sector in spite of significant narrowing down of the gap in relative growth rates; in the east zone however agricultural growth over the entire Pakistan period was less impressive than in the other wing.

21. Small vs. Large Industries: The industrial strategy pursued during the Pakistan period with its open-endedness toward the private sector had, on the other hand, a disastrous effect on small industries. The contribution of small industries to GDP of Pakistan increased at the annual rate of 2.6 against 14.4% growth in the large industries sector. In the East growth of both over the 20 years period was 2.5 and 14.6% respectively; but, since large industries output in 1949/50 was small, overall growth of industries was much subdued - 3% against 8.8% in the West. This large industries bias had adverse effects on both

employment and efficient use of capital. Industrial labour (CMI) which was expanding during the 1st Plan at the rate of 15.8% suffered a decelerated growth (4.8%) during the Second Plan of Pakistan. Factory employment under Payment of Wages Act, 1936 increased at the annual rate of 9.4% between 1949 and 1959 after which it remained almost stagnent through the Second Plan, though the economy was opened to market forces around 1959. According to a Survey about half of small firms operated below capacity in 1960/61 against 10% of large firms (19).

II. Economic Policy Evolution

22. Political urge of the government of Pakistan expressed itself in exuberance of state control. Though the Industrial Policy of 1948 had chosen the private sector as the main vehicle for industrialization, many vestiges of state control of theSecond World War period such as rationing and control of prices of essential commodities continued. The difficult economic condition which was created in international trade after devaluation of pound sterling and again after bust of Korean Boom brought in new state intervention as foreign exchange fell short of need and domestic supply of essential commodities continued to be scarce except during the Korean Boom. Most of the early interventions were of the nature of direct intervention leading to the establishment of new institutions and committees in the public sector. Given their diversities there was "no effective policy for ensuring steady development of the country as a whole" according to the First Plan (11), though it still felt the need for more control. It argued: "It will clearly be necessary to continue the controls on imports, foreign exchange, new industrial enterprises and capital issues in order to make sure that the scarce resources of foreign exchange and capital are directed into the uses that will yield the largest contribution to development. Direct physical control may be needed to meet the shortages of important commodities which cannot be countered

by application of various possible monetary and fiscal measures. In particular, price controls and rationing may be necessary when essential supplies were short and the ordinary price mechanism threatens to cause serious hardship to the more vulnerable elements of the community" (12). The First Plan may thus be viewed as the beginning of the phase of a planned state control. There were two severe limitations of such a plan. First was the limitation of data about the economy which was dominated by the traditional sector, while a comprehensive control mechanism would demand sufficient knowledge about the working of the economy. This limitation was recognized by the Plan. Such lack of information could not but encourage economic policies of ad hoc nature rather the long-term ones and direct institutional control rather than indirect control through macro economic policies. It is not therefore too severe a judgment to pass that economic policies during the 1st Plan were degenerate, short term measures "keeping the administration always in readiness to introduce controls to restrain prices of essential commodities" (13). Secondly, a comprehensive control mechanism to meet desired objectives of the Plan was apparently in conflict with the Industrial policy which sought to promote the private sector and encourage long term investment. These limitations under resource scarcity produced and strengthened two new classes, business class and the bureaucracy (14), and an economic management on permit system.

23. The macro-economic management in a state of foreign exchange shortage had its primary concern with inflation which could follow from investment and unrestrained aggregate demand. There were many options for aggregate demand management such as higher interest rates and higher taxes, postponement of capital issues for non-essential industries, control over building construction, economy in nondevelopment expenditure and last of all, curtailment of expenditure programme all of which, not surprisingly, have so familiar tone even today.

In many aspects however reality was different. During the First Plan food prices rose at an average rate of 18.8% in East Pakistan after having declined by 14.7% during the preceding 5 years period as food output on 3 years' average basis remained stagnent during the First Plan period against 1.2% growth during the preceding period, while money supply grew at the rate of 4.6% during the plan period. At Pakistan level money supply increased at about twice that rate (8.6%) which is more relevant than regional money supply because of financial flows. In 1955 Rupee was devalued by 30.5% which substantially contributed to domestic inflation, but monetary expansion eroded the impact of devaluation. One of the prescriptions of the planners to combat inflation was to increase tax to reduce disposable income and demand, but Tax-GDP ratio rose from 5.33% in 1954/55 to 5.95% only in 1959/60, taking GDP at current factor cost. Income tax receipts increased at the rate of 10.5% a year-about one percentage point above the growth of overall tax receipt and accounted for less than a quarter of the total tax receipts. Thus, major burdent of increasing rax continued to fall on the consumers.

24. While the fiscal management was not as unsatisfactory as the monetary management, the management of the external resources was completely at bay. The management was extremely short-sighted as reflected in the mercurial increase (74%) of import in 1950/51 and 1951/52, and sharp decline (49.3%) in 1952/53. This behaviour was repeated in 1956/57 when import more than doubled over the 1954/55 level in rupee term (in real terms over 75% increase), snapping again by a third in 1958/59. In December 1958 gold and foreign currency reserves was 21.4% above that of 1954 in terms of Rupees, though the home currency was devalued by 30.5% in 1955. Fiscal dependence on customs which accounted for over half of total tax receipts even at the low ebb of import flow in 1954/55 (72.6% in

1950/51) naturally had a decisive role to play in the management of external resources, reflected in sharp rise and fall of imports with exports.

25. Since the main objective of 1955 devaluation was to encourage export and discourage import to overcome the stringent foreign exchange condition, its impact on export needs to be examined in the background of the indusrial policy which mainly centered around the cotton textiles. Since raw jute ane cotton had also been the major export commodities of Pakistan, the conflict between industrial development and these exports in a state of devalued currency could be resolved only by imposing enhanced export duty on these exports. Export duty on raw cotton was raised by two-and-half times from Rs. 76.39 per bale in 1954/55 to Tk. 192.73 in 1955/56 on an average, and that on raw jute by over 30% from Rs. 12.94 to Rs. 16.84 per bale, in order to make agriculture subserviant to the interest of indsutrialization. In addition, compulsory procurement of food at fixed price imposed a disguised tax on the agriculture sector. A further tax was imposed on jute, when the Bonus Voucher system was introduced in 1959 in favour of manufactured goods export.

26. But devaluation of Rupee in 1955 was of little help to export promotion. Except in 1955/56 which coincided with the Suez Canal War, value of export at current dollar term declined continuously until the introduction of the Bonus Voucher system in 1959 which helped export recover and show some gain in 1959/60. At current dollar term, total export increased at an annual rate of 2.9%, about half the rate of industrial growth, such was the pull of domestic market before the introduction of Bonus Voucher. Industrial development was mainly based on import substitution.

27. This induce[illegible] [illegible]ialization through rearing . infant industries is reflected in the fact that [illegible]e im[illegible]rt tax receipts from import of consumer goods of industrial origin declined from Rs. 149.6 million in 1954/55 to Rs. 81.6 million in 1959/60, while total of such tax declined from Rs.355.1 million to Rs. 335.4 million and the Import tax receipt from cotton and other textiles (excluding silk and art silk) declined from Rs. 75.4 million to Rs. 16.6 million. Due to reduced consumer goods import overall import duty rate declined from 35.9% in 1954/55 to 18.0% in 1959/60 (15). Not only that competing imports were discouraged through high taxes and their entry drastically limited by an elaborate licensing system to protect the local industries, local industries were also given many domestic tax incentives. Between 1949/50 and 1959/60, to take an example, excise tax collection increased 240% against 500% increase in large scale indsutrial output (16). Between 1954/55 and 1959/60 domestic indirect taxes declined from 12.6% to 10.6% due to decline in such taxes on intermediate manufactures (17), partly due to the specific character of excises.

28. The First Plan's period of 1955 to 1959 can be characterized as the peak of direct control; so the Second Plan (1960-65) espoused "to move away from an ex[illegible] use of direct controls which has tended to retard the pace of development, [illegible] to rely mainly on fiscal and monetary measures to regulate the economy" (18). Greater emphasis was laid on fiscal management for controlling the economy and preserving the financial stability with support from appropriate monetary policies and techniques. Price control was to be adopted as a last resort only for very few essential commodities and for a very short period. In view of high rate (30%) of profit in large indsutries the Plan recommended raising interest rate. Other recommendations were to replace procurement of food at

fixed prices by a satisfactory direct tax and introduce an import surcharge to mop up windfall gain rather than control import. With regard to export duties the Plan was ambivalent as it maintained that "In adjusting export duties, the impact of internal prices, the loss of subsidy for cotton and jute manufactures and the broader implication of a transfer of income from nonagricultural to the agricultural sector will need to be fully considered" (19). Obviously, this was in conflict with the objective of the Plan to make a decisive move towards a more liberal economy.

29. During the Second Plan the economy began to move toward market with less of direct controls. Import control was relaxed by raising import duties. The average import duty rate rose from 18% in 1959/60 to 27.7% in 1963/64 on import of manufactures against a decline from 35.9% in 1954/55 to 18.06% during the First Plan along with raising the share of import of consumer manufactures from 10.3% to 12.4%. Domestic indirect taxes rate also increased to 12.8% after having fallen from 12.6% in 1954/55 to 10.6% in 1959/60; yet industrial growth accelerated. There were also improvements in the Gross Value Added to Gross Value Ratios, particularly in the intermediate goods sector, as shown below:

Table 6

% change in Gross Value Added to
Gross Value Ratios (Incremental)

Industries Categories	1954/55 to 1959/60	1959/60 to 1963/64
1. Consumer goods	- 2.4	-
2. Intermediate goods	-37.0	+ 3.1
3. Capital goods	+12.0	+12.9

Source: S. Lewis & R Soligo, Growth and Structural change in Pakistan Manufacturing Industry 1954-1964; Pakistan Development Review; Vol.V, 1965, No.1; p.101.

30. During the Second Plan East Pakistan witnessed the expansion of the jute textile capacity after a lull in late 1950s as in addition to an export duty on raw jute, it got export bonus. In 1959/60 the export duty on raw jute was Rs. 108/ton which at the then prevailing average export price was 12.2% ad valorem. The export bonus rate which varied between 20-40% was set at 20% for jute goods export. Assuming that domestic price of raw jute was depressed to the fullest extent of export duty, bonus premium which was 120% of official exchange rate afforded jute mills a substantial profit margin. As the jute industry was the vehicle for industrialization of the region in the short run, its long term problem in the face of competition from synthetics was generally overlooked; moreover particular incentive system drained rural resources away from improvement of jute cultivation. The impact of Bonus Voucher on export from East Pakistan could hardly be sustained against competition from synthetics. Between 1958/59 and 1964/65 in six years the Quantum Index of Export from East Pakistan increased by 12.8% only.

31. Besides other limitations (20), the Bonus system was an admission of overvaluation of home currency. In favour of this approach to industrialization it has been argued that alternative to developing (even inefficient) domestic indsutries is to permit the growing labour force to pile up in agriculture steadily reducing the average living conditions there (21). This is obviously a one-sided view for correction of overvaluation across the economy would have also eliminated transfer of resources from agriculture. Whether that alternative position could have been worse than the induced (inefficient) industrialization depends on the relative productivity of the two sectors.

32. High import duties and indirect effect of Bonus Scheme also created a rigidity in the industrial structure. A test of success of fiscal and exchange

rate policies in promoting an outward-looking indutrial development is the degree of diversification of industries and trade. Using Gini-Hirschman Coefficient to export concentration was about the same in 1964/65 (45.2%) as it was in 1959/60 (45.4%) and thereafter declined sharply (22). Moreover though a new OGL system for backward areas/regions was introduced in 1961 large part of total import was still concentrated in the hand of the category and quota hoclers and monopoly profit was still high due to unsatisfied demand at current prices (23). Thus, in evaluating the movement of the economy toward market mechanism the Third Plan of Pakistan had to admit that there is still considerable scope for moving from direct to indirect controls and for further rationalization of economic controls, particularly import and investment controls and control of specific commodities and products." (24), while "the relaxation of direct controls has not always been accompanied by an adequate framework of indirect control through fiscal and monetary policy" (25).

33. As a last commentary on the development process during the Pakistan period it is worth to quote the Fourth Plan of Pakistan: "In the last two decades the basic objective of national economic policy was to seek maximum possible economic growth through the encouragement of private enterprise backed by social, physical and institutional infrastructures. The desired goal of equitable distribution of income had to wait till the level of production had risen sufficiently to make such distribution possible" (26). At the same time it admitted that "concentration of industrial power in a few family groups is leading to preemption of new sanctions and bank credit by big industrial families resulting in a denial of fair opportunities to the late comers" (27). The last year of the 3rd plan therefore witnessed promulgation of order against monopoly, while there was also in the air murmering of nationalization issue (28).

III. Economic Policies Since Independence

34. In the above context of development process the Pakistani period (1947-71) ended with a sombre tone that "The question of nationalization cannot be divorced from the political framework. The ownership of industries in the new political framework may not be judged entirely on grounds of efficiency and profitability" (29). The first national government of Bangladesh indeed, nationalized jute, cotton textiles and sugar industries by the public order No. 27 in March 1972. In definitive sense, nationalization extended public ownership to only 62 jute and cotton mills and one sugar mill privately owned in a total of 235 publicly owned enterprises as the government had been owning most of the large indsutries through the para-statal corporations. However a good number (147 units) of large as well as small industries abandoned by their owners on the eve of the break-up of Pakistan were to be taken over by government for management. The public sector thus had about 400 units under its management which strained the available managerial resources of the country, particularly because the rising bourgeoisie of 1960's was held in suspicion.

35. The problem of management of an expanding industrial sector was enhanced by the limit on private investment to Tk.2.5 million. Under this limit any meaningful industrial development could take place in the public sector only. This changed the course of the industrial economy of Bangladesh and the concomitant policies. The liberal policy toward a market economy which was emerging during the Sixties was reversed under the new economic system by state control in order "to emancipate the toiling masses from all force of exploitation" (30). This required new apparatuses to control. The country already inherited a number of institutions along with economic controls (e.g. exchange control, import licensing, investment control, etc.). Institutional role was enhanced by the

nationalizationof banking and insurance business and jute export. A number of new institutions were set up in industries, finance and trade sectors-all totaling to 43 corporations. As managerial resources were scarce, institutional expansion made the management of the corporations largely depend on the bureaucracy. Over half of the highest positions in 43 corporations was held by people from civil and ex-military services. Both the limitation of managerial resource and the style of management under the new socio-political setup and in a changing international environment due to food and oil crises of 1973 led to serious economic consequences. Both agricultural and industrial productions continued to lie below the preindependence levels though aggregate demand remained unrestrained. With commercial banks placed in the public sector, both government and corporations had easy access to massive bank borrowing leading to run-away inflation during the first two years of independences as shown in the table below:

Table 7

Budget Deficit, Bank Borrowing, Money Supply and Inflation Rate

	1972/73	1973/74
1. Budget Deficit (%)	30	22
2. Money Supply Growth (%)	243.3	17.3
3. Inflation Rate (%)	50	39
4. Net bank Borrowing (Tk/ml)	2905	2799

---

36. Under the growing macro-economic pressures the nationalization policy began to snap quickly. First, the Tk. 2.5 million ceiling on private investment was raised to Tk. 30 million and a 15 year moratorium from nationalization was declared under the New Industrial Policy of July, 1974; however the pre-indepencenc practice of investment control through investment schedule was continued and any private investment above Tk. 2.5 million dependent on import of 20% or more of

raw material cost was required to be approved by the Investment Board because of stringent external resource position. Secondly, the monopoly status of the Trading Corporation of Bangladesh for all current purchases of the public sector corporations was reduced and imports were delegated to the corporations. Thirdly, in view of the run-away inflation the government also introduced selective credit control in October 1974. Lastly, because of inflation cost, a cash bonus system was introduced as the bonus voucher system was discarded by the devaluation of home currency in Januar, 1972.

37. Major policy changes however began to take place in the spring of 1975 in the background of deepening balance of payments problem, fiscal imbalance and spiralling inflation. It began with the demonetization of currency notes of large denomination immediately in April, 1975 followed by the second devaluation of home currency in May, 1975 by more than half of the prevailing rate. In December, 1975, after the change of the government, the public corporations were reorganized to improve management efficiency. While by that time agricultural sector more or less recovered its pre-independence day position, industrial output continued to lag behind for lack of demand, domestic and international, and inadequate supply of imported raw materials and spares due to scarcity of foreign exchange. To reduce the management burden on sector corporations abandoned units were placed on disinvestment list. The Investment Policy was revised raising further the ceiling on private investment from Tk. 30 million to Tk. 100 million, while out of 18 indsutries in the public sector's reserved list, 10 were opened for collaboration with private investors. In addition, private investment in new lines of products in Jute (e.g. yarn) and cotton (specialized textiles) textiles were allowed. As the moratorium for 15 years from nationalization was a source of confusion and uncertainty for private investment, the revised policy also

provided for compensation for nationalization on fair and equitable basis. It further provided for sale of disinvested units under voluntary declaration of income.

38. While private investment was being encouraged and corporate efficiency emphasized, price control on 19 commodities was retained. In case of cotton cloth and yarn, edible oil, milk food and C.I. sheet local manufacturers and importers were allowed to fix their own maximum retail prices. Parallel to changes in indsutrial policy a significant policy change also took place in the agriculture sector. Compulsory procurement of food was replaced by voluntary procurement at market prices to make it consistent with input pricing policy which reduced subsidies since independence.

39. These measures - reorganization of public sector corporations, pricing flexibility, increased role of the private sector, disinvestment and liberalization of trade and distribution helped the industries sector almost recover its 1969/70 level of output in 1976/77 (99.7%). Together with it, monetary and fiscal disciplines took out the steam from inflation. Index of Wholesale Prices of Industrial products (1969/70=10) which almost quadrupoled (390.4%) in 1974/75 fell to 361.7% in 1876/77. The rate of capacity utilization which declined from 70% in 1969/70 to 49% in 1972/73 increased to 61% in 1976/77. According to the estimates of the World Bank capital-output ratio at 1969/70 prices declined from 3.1 in 1972/73 to 2.1 in 1975/76 and the gross rate of return on capital stock, which declined from 62% in 1969/70 to 20% in 1972/73 recovered to 32% in 1975/76 (31).

40. The economic policy changes which began in April 1975 became a continuous feature during the following decade, 1975-85 and a characteristic motif of the economic reports of the World Bank on Bangladesh. Persistent macro economic

problems of the country still are: (1) domestic resource problem, (ii) fiscal gap, (iii) balance of payments imbalance, (iv) management of corporate sector and (v) development of the private sector. The central focus of the policy changes is however on reorientation of the economy from control to a more liberal, market economy. This phase of development since 1975, therefore, closely resembles the development of 1960's, though under a vastly different conditions of international trade, tariff and aid. Because of these constraints domestic economic problems of developing countries have grown more stringent than in 1960's calling for greater focus on domestic economic policies. The first phase of policy changes initiated in 1975 under the Standby Arrangement with the IMF beginning July 1, 1975, provided for credit ceiling, abstention from deficit financing, increase in tax efforts and liberalization of imports. As policy adjustments would require additional resources to be smooth, IMF had introduced Extended Fund Facility in 1974. Bangladesh entered into in 1982. The World Bank had also been becoming increasingly aware of the necessity for policy adjustments for efficient use of scarce resources. With this in view it introduced structural adjustment loan in 1980. Though Bangladesh did not participate in it, the World Bank used the Import Programme Credit to Bangladesh which she received since 1974 to meet its essential imports as the policy lever.

41. Because of pervasive poverty and unemployment on one side and inherent structural regidities of the underdeveloped economy on the other side, policy changes could however proceed only by steps, particularly under uncertainties of a changing world economy. That is why policy reform has been a continuous theme of the Country Economic Memoranda of the World Bank since 1974. Because of the polarity of the initial conditions of the economy only short-term

approach for crisis management could be taken initially. The initial focus was mainly on food and industries covering issues of pricing, subsidies, taxes investment policy and management of parastatal enterprises. These issues facing the country were articulated first in the World Bank's Memorandum of 1976 under "A Framework For a Medium Term Action Programme". It focused on resource mobilization, balance of payments problem, agriculture and rural development, industrial policy and development administration. Developments in policy areas are discussed below.

(i) Exchange Rate Policy: Bangladesh had a very low level of exchange reserve at the beginning of independence; so the main concern of the new national government was to encourge export and discourage import. To these ends the government took the first major economic policy decision by devaluing Taka currency by around 53% in January 1972. With this the Bonus Voucher System inherited from the past was also discontinued. Through nationalization of jute industries and jute export most of export as well as import came to be on government account; hence, foreign exchange allocation became more or less an administrative fiat. However, the desired result of devaluation could not be realized because of both internal and external circumstances. Because of depressed world demand for jute and jute goods, unrestrained aggregate demand at home due to fiscal deficits and monetary expansion and managemetn problems of nationalized industries export remained depressed. To encourage export a system of export subsidy (cash) was introduced in November, 1973 except for jute, jute goods and tea which continued till the next devaluation in May 1975. There was stagnation of export in nominal terms and a sharp decline in real terms between 1972/73 and 1974/75 though export price index gained by 32.4%. As a result during this period real import also declined in spite of more than doubling of aid disbursement - from $ 420.6 million in 1972/73 to $ 923.7 million in 1974/75 in nominal terms against about a 21.5% increase in Import Price Index. It is against this deepening crisis in balance of payments that the home currency was devalued in May 1975 by over 58%. This together with domestic antiinflationary measures and improvement in world economic condition after the oil stock of 1973 helped export substantially recover in 1975/76. Since 1975 devaluation significant developments have also taken place in the management of exchange rate: first, a secondary exchange market (SEM) was created by introduction of bonus rate on wage earner's remittances and was augmented by the introduction of export performance bonus and secondly, the government adopted flexible exchange rate policy after a further devaluation in August, 1979 by about 20% through pegging Taka first to Pound Sterling and then to Dollar in 1983 in a basket of currencies of major trading partners in order to maintain the real exchange rate at initial level. This has resulted in a sharp depreciation of home currency by 76.7% between August, 1979 and 1984/85. During the period (1975-79) since the beginning of policy reform export grew at an annual rate of 7.8% at 1972/73 prices; during the following period (1980-1985) however growth slowed down to 3.5% (at 1972/73 prices) mainly due to the re-emergence of global economic problems in a more serious way. Yet continued expansion of export with XPL and overses remittances helped expand the role of the secondary exchange markets, liberalize the import regime from administrative controls and reduce the gap between the official exchange rate and the secondary exchange market rate. In 1984/85 27% of export earning was used in the secondary exchange market accounting for 9.5% of total import; another 29.6% of import was financed by wage earners' remittances; thus 39.1%

of all imports was financed through the secondary exchange market in 1984/85. If food import is excluded,48.2% of all other imports was covered by SEM. As a result of this increased flow of foreign exchange into SEM real exchange rate declined by a quarter since 1980.

(ii) Monetary Policy: Exchange rate and monetary policies are like Siamese Twin; being so freedom in one requires sacrificing the other. Attempts to manage both proved disastrous during the early years of independence. While a fixed exchange rate was maintained after devaluation of January, 1972, monetary expansion was preceeding at hectic rate of 27% between June 1971 and June 1975 which increased cost of production and weakened competitiveness of export, requiring cash bonus for export. It was the monetary power that was humbled first by the demonetization of currency notes of Tk. 100 and above and imposition of credit ceiling under Standby Arrangement with IMF. As a result monetary expansion took place at a reduced rate. Between June, 1975 and June, 1980 money supply (narrow money) increased from Tk. 8145 million to Tk. 17250 million giving an annual rate of expansion of 16.2% and then to Tk. 42,502 Million in June, 1985. During the first period (1975-80) recovery of economic growth and increased external resource flow helped contain domestic inflation rate. Between 1974/75 and 1979/80 the annual inflation rate was 6.3% only in terms of Dhaka Middle Class Cost of Living Index against the annual rate of over 50% in the preceding 3 years (1972-75). Between 1979/80 and 1984/85 however price level increased faster at the annual rate of 11.9% due to laxity of monetary discipline. One significant positive development of recent years in monetary management is the pursuit of a positive real interest policy in order to encourage domestic saving and reflect real cost of borrowing.

Until the beginning of the Second Plan (1980-85) real interest rate on 1 to 2 years term deposit was althrough negative except in 3 years, 1975-77 and 1978/79. At the beginning of the Second Plan interest rates were put up generally. One to 2 years deposit rate was raised from 8.2% to 14.0% in October, 1980 and lending rate for general purposes was raised from 11-12% to 15.5%. Interest on saving bank deposit account was raised from 4.5% to 8.5% and from 7% to 10% for checking and nonchecking accounts respectively. Bank rate which remained insensitive to liquidity situation between 1974/75 and 1979/80 at 8% was also raised to 10.5% in order to move to a dear money policy. However, the refinance policy which the Central Bank had been following to ensure credit to desired sectors and economic activities frustrated the dear money policy because of concessionary rates of interests allowed to such sectors. In early 1980s the share of refinance facility provided by the Central Bank in overall credit was about 25%. It more than neutralized the deflationary effect of net resource inflow rate of 11.9%. Nevertheless, the real interest rate on term deposit was positive all over the Second Plan period except in 1981/82. The ratio of time deposit to GDP increased from 8.7% in 1977/78 to 17.4% in 1986/87. The legacy of credit control and rationing of the past in a fast expanding monetary sector has however left behind huge accumulated overdue loans. The need for healthy competition in the financial sector has in recent years led to its opening to private sector, when two private banks nationalized in 1972 were also denationalized. Since the control on foreign exchange has been significantly liberalized, administrative control of credit also needs to be substituted by management of normal monetary leverages in order to reconcile the two conflicting interests of stability and credit need of a growing economy. A financial sector study by the World Bank was completed in early 1980's and another one is underway. In the meanwhile the recommendations of the Banking and Credit Commission are being implemented.

(iii) Tariff & Tax Policy: As in the past, fiscal policy in Bangladesh has been pursued with the dual interest of collecting revenue and protecting domestic industries. From the revenue point of view, Bangladesh started with a very low tax-GDP ratio. It was 4.1% in 1972/73 and 4.4% in 1974/75; during the following 5 years it rose to reach 8.2% in 1979/80; but since then ratio has been rather fluctuating around 8% which constrains development programme of the public sector. So there continues the thrust on improvement of tax-GDP ratio through both improvement of tax administration and expansion of the tax base. The Taxation Enquiry Commission set up in 1975/76 laid more emphasis on tax administration and simplification of tax and tariff rules rather than on efficiency of the existing taxation structure. The tax system is still overwhelmingly dependent on indirect taxes, particularly on import duties. Indirect taxes contributed 79.5% of tax revenue in 1986/87 of which over 2/3rds come from import duties. Since over half of imports is aid financed, it remains vulnerable to aid situation and has little relevance to opportunity cost of foreign exchange. Because the agricultural sector accounts for half of GDP involving problems for tax administration, the tax system has become precariously dependent on a small modern sector and import; consequently, manipulation of tax rates has become the favourate game of the tax administration. These limitations are prone to distort the efficiency of the tax system and exhaust the scope of the game, particularly because of the growing emphasis on the private sector in recent years. This is reflected in the stagnation of Tax-GDP ratio between 1980/85. Compared with the period 1972/73 to 1979/80, both elasticity and buoyancy of the tax system have substantially declined tax elasticity corrected for discretionary measures declining faster. In this context import duties deserves special mention not because it dominates tax revenue (54.1%) and indirect taxes (68%) but because of its impact on domestic industries. First to note is that the elasticity of import duty has declined too sharply compared to other taxes. Secondly, as the revenue consideration remains dominat in fiscal management it is necessary to make a clear distinction between such interest and tariff protection. The structure of custom duties however shows in general an inverse relation with domestic Value Added; in other words, closer an import to its final use, higher is the rate of duty, reflecting the general belief of intensity of protection of tariff. Besides multiplicity of import duties under customs schedule and their wide range, duty rate varying between Zero to 300% on some finished goods, the system is biased for manufacruting in favour of domestic market against export. So in order to rationalize the tariff structure the Industrial and Trade Policy Study was undertaken during the Second Plan. According to its findings and recommendations the main structural change introduced is the reduction of ad valorem duty rates from 24 to 11 basic rates (see further Sec. on Export Policy).

(iv) Price Policy: The price policy has been closely related to exchange rate and tariff policies in a somewhat simple way. Since devaluation and high import duties raise domestic prices along with tax revenues, recourse has been taken to price policy to reduce their impact on users in a selective way. Price control has also been a creature of import control because of scarcity of foreign exchange; it was sometimes accompanied with physical control over distribution also. Because of import liberalization through the secondary exchange market and continued rationalization of tariff price control is now limited to some goods and services produced or supplied by the public sector. Here, too, prices have come to increasingly reflect the resource cost. Direct subsidies have been eliminated or reduced substantially. Food subsidy which accounted for 8.4% of current public expenditure in 1980/81 fell to 1.3% in 1985/86 and further to 1.1% in 1986/87 as a result of continued increase in ration prices with increased cost of food procurement. Fertilizer subsidy which, borne by the development budget, was 5% of the Annual Development Programme in 1979/80, was eliminated in 1986/87. Rates of public utilities have also been raised many fold since 1975, particularly after 1982 and public corporations have come to enjoy greater freedom to reflect increased cost of production in their product prices.

(v) Private Investment Policy: While the investment policy was mainly private-sector oriented during the Pakistan time, the early investment policy in Bangladesh was predominantly public sector oriented as private investment was limited to Tk.2.5 million (Tk.3.5 million including reinvestment of profit). To cover, spiralling inflation the limit was raised under the Revised Industrial Policy of July 1974 to Tk. 30 million and 15 years moratorium for nationalization was ensured. But as the control under the Investment Schedule was retained involving lengthy sanctioning procedures while there was a general lack of confidence among the private investors, very little progress in private investment was there during the first two years of the First Plan (1973-78) of Bangladesh, though new concessions such as low (8%) import duty on machinery import below Tk. 1 million and extended tax holiday were added to the ones inherited from the past. Investment sanctioned during 1972/64 and 1974/75 were Tk. 87.4 million and Tk.150.5 million respectively against an annual average of Rs. 325 million sanctioned during the Second Plan of Pakistan. Investment policy went under further change after 1975. The private investment ceiling was raised to Tk.100 million, the provision for moratorium from nationalization was dropped and active disinvestment and compensation policies were pursued. These created new envoronment for private investments. A liberal interpretation of P.O.27 under which jute and cotton textiles industries were nationalized allowed private investments in new lines of cotton (e.g. specialized textiles) and jute products (e.g. carpet backing and yarns). In some cases investments exceeding Tk.100 million were also allowed. As a result private sector regained its confidence significantly as reflected in over 3-fold increase in sanctions for private investment from Tk.150.5 million in 1974/75 to Tk.701.1 million in 1975/76; actual investment however, improved marginally only from Tk.133.2 million to Tk.198 million. Investment picked up significantly only in the last two years of the First Plan; it rose to Tk.450 million in 1976/77 and to Tk.750 million in 1977/78. Though there has been gradual expansion of investment, efficient operation of industries remained constrained. Foreign exchange scarcity subjected raw material imports to quantitative restrictions and import entitlement to one-shift operation. Industrial policy therefore went under further revision in 1982 and 1986 both of which enlarged the scope of private investment. In

1982 the decision to denationalize jute and cotton textiles was taken. This led to the transfer of 40% of cotton textiles (No.27) and jute textiles mills (No.35) to the private sector.

(vi) Export Policy: It may be reemphasized that all institutional controls and tariff restrictions follow from one single primary constraint, i.e., the constraint of foreign exchange. So from the very beginning policies have been directed to save foreign exchange by restricting import through licensing and develop import substitute industries through tariff protection in an overvalued exchange market. After independence the first step taken to encourage export and eliminate built-in import bias of the foreign exchange policy was the devaluation of home currency by over half and the discontinuation of the bonus voucher system. Thiswas of significant consequence for the two main exports, jute and jute goods. In 1969/70 the nominal effective rate of exchange for jute goods was Tk. 11.6 per $ against Tk. 4.8 for jute. In 1972/73 these rates were Tk.9.2 and Tk. 7.7 respectively, increasing thereby the cost of raw jute for the jute mills. But as run-away inflation increased cost of production, in November 1973 a discriminatory cash subsidy system was introduced for non-traditional goods, while loss of jute mills and jute exports, being in the nationalized sector, were directly borne by the government. The difference in effective exchange rate between jute goods and raw jute further declined in 1974/75 to 7% only; effective exchange rate was Tk. 9.1 for jute goods agains Tk. 8.5 for jute. Both were however losing their competitive strength in the world markets as home currency was increasingly becoming overvalued due to inflation. Against this distortion in exchange rate a 20% license charge was imposed on imports in July 1974 but main export remained to be discriminated against until the devaluation of May, 1975. This raised the nominal effective exchange rates for jute goods and jute to Tk. 15.6 and Tk. 13.7 respectively. To encourage non-traditional exports i.e. goods other than jute, jute goods and tea, an Export Performance License System (XPL) was also introduced in 1975/76 allowing their exporters an additional import license over their normal share of export. The XPL system permitted such licenses to be traded for import of a wide range of specified commodities. Initially such licenses commanded a high premium as there was foreign exchange scarcity and worked as a powerful incentive for nontraditional exports, but as XPL was calculated on gross value rather than on value added it also encouraged import of inputs. Its impact also waned with the reemergence of inflationary pressure and consequent overvaluation of home currency. More importantly, as the system discriminated between commodity groups through different XPL rates, it implied virtually adoption of a multiple exchange rates in the same way as cash subsidy system did after the 1972 devaluation. Therefore, the XPL system has now come to be based on value added. There are also other forms of Export Incentives such as tariff preference, tax rebates and interest rate concessions but their total effect was calculated to work out as an export subsidy of about 8-9% of official exchange rate by the end of the Second Plan. The diversities of export incentives with discrimination among commodities, slow growth of export and continued balance of payments crises against the policy of moving toward a market economy were the subject of three major studies in 1980's, namely the <u>Export Development Programme</u> under the 7th Import Programme Credit, Trade Policy and Development of Bangladesh Bank and Boston University and the Trade and Industrial Policy Study by HIID. The Trade Policy and Development Study concentrated on the issue of Domestic Resource Cost (DRC) of industrial development and the Trade and Industrial Policy Study (TIP) along with other issues, focused mainly on DRC and Effective Rate of Protection (ERP) in order to develop a rational system of tax incentives for trade and industry. In the existing tariff structure, rates varying directly with the level of processing of imported commodities were found to be equated erroneously with positive effective protection: "Resulting tax anomalies were found to be common in Bangladesh such that assistance is often provided to industries that save little or no foreign exchange at enormous domestic resource costs" (32). In spite of XPL's positive impact on non-traditional exports, the incentive structure was still more in favour of import substitution than for export (33). The Duty Drawback scheme, the main instrument for export development, was found to be ingrossed with lengthy administrative procedure. The TIP study has proposed a single, simple instrument for export promotion with backward integration which is called Tax Exemption Certificate to be tradeable for payments of duties and sales taxes only.

IV. Policy Planning and Decision Process

42. Since early 1950's socio-economic development has been pursued by successive governments through some kind of development plan. This naturally entailed involvement of administrative machinery of the government in decision process. Though specialized planning agency and other institutions were set up to plan and promote development objectives, the decision process varied with

the character of the government. During Pakistan time Planning Commission used to be consulted on major policy issues (34), but in general the role of Planning Commission in policy decision was very limited (35). There were two main reasons for its limited role, one flowing from the method of planning and the other from the method of economic management. As to the first, methodologically policy planning was never an integral part of macro plan which mainly concerned with investment and production programmes, policy issues being treated ad hoc. Secondly, economic management was largely based on direct control both because of past legacy and exigency of contemporary situation. "Pakistan inherited an elaborate resonably well-functioning control system from the British. As with all such institutional arrangements, sheer intertia would tend to preserve it and to lead to elaborating rather than scrapping it" (36). Objective conditions obtaining after partition favoured the extension of control mechanism as there were general scarcities of essential consumer goods with foreign exchange resources. Though after 1959 control mechanism was liberalised and increasing emphasis was laid on the fiscal and monetary instruments, many vestiges of control continued through 1969/70. After independence with the adoption of a new economic system, economic management assumed the character of official fiat, when planning approach remained unaltered and many old policies continued (37). Against this back-drop, the decision making role of the Planning Commission was apparently very limited, though its technical capability and status were both at their peaks. High rates of inflation and monetary expansion of the early years of independence are the sad commentaries on the failure of economic management.

43. Increased role of the private sector since 1975 implies less economic control and greater dependence on market forces. The process starting as gradual relaxation of direct administrative control on the economy has not only led the government to focus more on the macro-economic variables such as exchange rates, interest and tariff but has also reached a stage when the role of the government has come to be defined in terms of macro economic norms such as ratios of revenue, balance of payments gap and liquidity to GDP.

44. This switch from direct to indirect controls has important implication for the decision process for the reason that, whether control is direct or indirect, the decision process takes place within the administrative machinery of the government. The quality of any decision therefore critically depends on the capacity of the administrator to analyse the objective situation scientifically in relation to policy objectives. In this respect direct and indirect controls have distinct characteristics. Direct controls under scarcity are explicitly discriminatory involving judgment about the merit of individual case. Under this approach everything, goods or services, partakes the nature of personal service ensuing from administrators and analysis of problem is least important because of value judgment. Direct controls were thus least concerned with efficiency of economic decision. The underlying psychology of direct controls is said to be preventive in nature in a scarcity situation (38). Indirect controls on the other hand are nondiscriminatory, general in character rather than being concerned with individual, and therefore more conducive to promote efficiency, probably even equity.

45. Direct controls have been a natural preference for the bureaucracy, since indirect controls require more of both economic knowledge and information than under direct controls. Conversely, that is also why direct control is more a job of an administrator then of a specialist. It has something to do with the composition of bureaucracy; it continues to be an amulgum of academics from diverse disciplines, trained specially for running administrative machinery. As the power of this machinery enhanced after major political changes like partition of British India or independence of Bangladesh bureaucracy enjoyed increased authority and direct controls gained momentum. During the preindependence period it is said that economic policies had to take into account the wishes of the "New class" of the civil service (39). However, both before and after independence the overall limitations of the bureaucracy, set up after the British model in a new role of government for national development was recognized; so, Planning Board/Commission was set up as an essential outfit of Government, while the generalists continued to occupy important administrative, decision making positions for decisions which required analytical knowledge which they did not possess; so "self-confidence and prestige often shaded into conceit and contempt of the technical staff" (40). After independence, nationalization of industries expanded the role of the bureaucracy in managing public corporations, further agravating the problems of decision making and management.

46. Because of the bureaucratic system's overall limitation role of the Planning agencies grew in importance from the middle of Sixties till it reached its peak during the first half of 1970s. The fact still remains that an administrative system that is trained for quick response to emerging value

crisis such as starvation and hardship can hardly wait for policy planning. This is clearly reflected in the location and relocation of the planning agencies in administrative section of the government. The frustration that the Commission suffered in Bangladesh is borne out by erosion of its technical staff long before the change of the government in 1975.

47. The management of the economy has been the most discussed issue since independence. It largely focused on the status of the bureaucracy and the Planning Commission on one hand and the bureaucracy and the corporation on the other hand. The First Five Year Plan of Bangladesh was clearly aware of the limitations of the bureaucracy (41). In the international donor community economic management continues to be a recurrent theme. In its review of the First Plan the World Bank expressed serious doubt about the capability of the bureaucracy to implement the PLan (42). Liberalization of economic controls in favour of market mechanism reflects the deep rooted management problems to resolve which many basic changes have also been brought about by steps. The policy reforms as discussed earlier are still continuing. The focus has come to rest on decision process in a less controlled economy. This concern in domestic economic management is reflected in the 1983 World Development Report of the World Bank which selected economic management as its special topic, concentrating on prices and growth. This was followed by a high level seminar on economic management organized by EDI in 1984 at Aspen Institute. Its main theme was policy planning in order "to provide decision-makers with a clear evaluation of the resource costs (short and long term) of particular policies and programmes and to offer, if possible, options for achieving specific goals (43). The seminar also recognized that the transition to an efficient set of

policies would be slow; so it was stressed that "Adjustment cannot today, be seem as a temporary phenomenon. It is likely to be at the center of our attention for many years" (44).

48. While the need for efficient management of the national economy and policy planning have been persistently focused in the changing world economy since early 1970s, the question of policy analysis and decision process in the government was only posed in qualitative terms such as feasibility and flexibility of policies. The fundamental question of policy analysis and decision process in a government remained unabashed until the 1987 when EDI-KDI jointly sponsored seminar on "Policy Analysis and Government Process". The seminar centered around the following basic proposition:

"The style of policy work is influenced by many factors among them (i) variations in the degree of openness of debate and political competition; (ii) bureaucratic competition; and (iii) the organization of interest groups. Given these differences in country context what measures can be taken to improve the use of information and analysis in making policy and implementing it?" (45).

49. The central institutional question was the relationship between the political authority, bureaucracy and the technocrats. About the relationship between the first two parties in the decision process considerable diversity was found to exist in between different (participating) countries -- interaction between the two spreading between a 'mafia' system to a tradition of distance, given the historical evolution of a political system. Bangladesh was said to have a tradition of distance with its 'quasi-mandarin' tradition.

This view is undoubtedly debatable after what was said by Prof. G. Papanak on the basis of his experienced in Pakistan. Any distance will be impossible at least because of the colonial past. In respect of interaction between the political authority and the technocrats emphasis was laid on free market for ideas but there could not be a free market for economic policy if there was no free market for political ideas also. The seminar emphasized the need for open policy dialogue as in ROK. But such open debate can be only academic in order to mould public attitude towards various policy options, but a public dialogue as a decision process cannot be compatible with some problems such as devaluation of currency. As regards the relationship between the bureaucracy and the technocrats which constituted the crux of the problem of policy analysis and decision process, it was recognized that laying to much importance on the role of technocrats would be counter-productive, if policy conclusions could not be translated into decisions also. Therefore, while the necessity for think tank for policy analysis was recognized, at the same time its affiliation to the administrative structure was also an important issue. The need for a central think tank was felt necessary because of ramified effects of important policy adjustments (e.g. devaluation); so the view was that the think tank should be independent to be impartial and at the same time be linked to the dominant economic institution in the country.

50. Feeling the wind of change of international environment with its growing thrust on structural adjustments and its concomitant policy implications Planning Commission in late Seventies undertook a study in collaboration with the Center for World Food Studies at Free University (Amasterdam) for formulating an applied general equilibrium model (AGEM) for Bangladesh. As its

focus was on food and agriculture in an international setting as a part of the Food and Agriculture Programme of the International Institute for Applied System Analysis, Loxemburg (Austria), it is known as Bangladesh Agricultural Model (BAM), but it covered nonagricultural sector as well. The model has three components, a supply component, an exchange component and a policy component for government intervention in the market. The supply component has a linear programme for the agricultural sector and an I.O. component for tradeable commodities. Exchange lags behind supply (output) by one year giving the model a dynamic character. The policy component, in addition to public investment, has a number of other variables such as taxes, official prices, inventory control (e.g. for food) and exchange rates with upper and lower bounds for intervention by the government. Since the fundamental issues in development of Bangladesh are poverty and growth, the model adopted also a Social Accounting Matrix (SAM) with 10 socio-economic groups so that the impact of development, particularly of government policies on various social groups can be evaluated. The BAM was adopted as the macro-economic framework for the Third Plan of Bangladesh (1985-90).

51. The first two plans of Bangladesh were based on I.O. model. The limitation of I-O model was recognized by the planners from the beginning from the point of view of policy support to the plans. Though policy formulation and adjustments are mainly phenomena of annual budgets, their implications could not be traced out a priori in the I.O. macro-framework. This limitation of I.O. model could be overcome only through the use of AGEM which allows for price formation in the exchange component. This is accommodated in the Third Plan by the dichotomy of sectors into nontradeables and tradeables

latter being open to border prices.

52. In spite of the availability of AGEM policy planning continues to be more a decentralized process than investment and production planning. The latter two elements continue to constituate the main core of medium-term plans of Bangladesh. This is partly due to past legacy and partly due to nature of constraints of development. The main constraint of development of a poor country has been traditionally equated to shortage of resource due to low level of saving; hence allocation of limited resource is the main focus of development plans which, in turn, necessitated centralization of allocation of limited resource. Thus, development plans have turned into investment programers for which I.O model has been a useful tool. Given the inherent limitation of this tool with respect to policy planning, all plans are therefore found to be declaratory in respect of policies, but they never constituted an integral part of macro framework, though the importance of macro-economic policies has been recognized by all plans. The change in international economic situation in 1970's and onward shifted the focus from investment programme to policy planning as they brought on the surface the structural problems of developing economies. At the same time they also exposed the limited capacity of development administration to respond to this new need because of their diverse academic make-up. The latter limitation has its admission in the recognition and establishment of a central planning agency. What needs to be emphasized here that since macro-economic policies are concerned largely with monetary and fiscal issues there arise the problems of conflict and coordination with the Ministry of Finance which has the traditional authority in those two areas. Solution has

has been sought in different ways in different countries and even within a country at different times, sometimes with shifting locus of Planning agency in the government organizational structure, depending on how policies are viewed, whether in short-term perspective to manage crisis or in medium-to-long term perspective for economic development.

53. Though it is centrally focused at Planning agency the development planning process in Bangladesh runs through the administrative network of the government because of the nature of a plan involving allocation of limited resources for investment by development agencies; toward this end the Planning process starts with an evaluation of the state of the economy. This, in historical context, means a review of performance of the economy during the preceeding plans. This review provides a set of benchmarks and a guideline for new plan. The review followed by a guideline is shared with line ministries and development agencies for their views. Parallel to this work an independent review is undertaken by sectoral panels consisting of governmen agencies and public bodies and individuals. It is to mention that at the time of formulation of a plan a number of panels are set up to elicit experience and views of knowledgeable persons both in the government and public. The panel reports are then synthesized within the overall macro-framework,obviously because of competing claims on limited resources, for establishing programme feasibilities. A set of policy guidelines is then approved by the government for preparation of plan outline with investment size, sectoral allocation and output targets with strategies and broad policy issues. The outline developed by the Planning Commission undergoes a process of revision in two stages: first, at the stage of discussion with

ministries and development agencies,[a19] the second modification takes place at the highest level of planning process i.e. the cabinet after which the plan is adopted by the national economic council.

54. As a plan primarily consists of the output and investment targets the next process in planning is the project cycle through which the targets are strived to be achieved. In this phase of planning process line ministries and the development agencies play the key role. It is primarily they who conceive projects as building-blocks of a plan. In this respect Planning Commission has only a regulatory role to see that the blocks are logical components of the approved plan and they are the best alternative available to the country. The current project approval process consists of a multi-tier system, depending on the investment cost of a project. From the point of view of size, projects are divided into 3 categories -- A, B and C. A category of projects costing less than Tk.20 million is approved by line ministries; such decision is however taken in a consultative way through the Departmental Project Evaluation Committee (DPEC) with representatives from the Planning Commission, Ministry of Finance and Establishment Division of the government. Projects under B&C.categories are processed by the Planning Commission through the inter-ministry Project Evaluation Committee (PEC), but their decisions are recommendatory only. A PEC recommended project is either approved by the Planning Minister if the cost of the project is below Tk. 50 million or by the Executive Committee of the National Economic Council (ECNEC), if the cost of a project is Tk. 50 million or above.

55. Both in DPEC and PEC of the Planning Commission have crucial role to play in making investment decisions but as they are organized in the image of

the administrative structure of the government they generally fail to reflect intetsectoral issues. Secondly, as project concept directly ensues from production and investment targets, there develops a gap between plan and projects as a result of absence of structured programme. Thirdly, projects are conceived in a static framework with little or no concern for policy issues. In fact, because of their personnel composition economic issues can hardly be posed with professional calibre. In this situation it is only natural that when external environement changes drastically plan is also to undergo revision. Lastly, there is a rigid dichotomy between development programme and current revenue expenditure. The functional allocation of the latter is the responsibility of the Ministry of Finance, while the former is with the Planning Commission. This dichotomy between Annual Development Programme and current revenue expenditure isolates capacity expansion such as in education or health sectors from capacity utilization which depends on current revenue expenditure for operation and maintenance (O&M). Because of the two level decision-capacity expansion at the level of this Planning Commission and capacity utilization at the level of Ministry of Finance, a serious problem of underutilization and capital consumption continues to impede the development process.

55. In case of policy planning the situation is still more serious. A mentioned already, policy decisions continue to be mainly decentralized. The whole economic management is characterized by single objective policy decisions by ministries such as taxation with little concern for growth implication, protection without efficiency consideration, pricing without

consideration of resource cost and equity, investment without adequate concern for incentive for saving and efficiency and exchange rate policy without consideration of realtive prices of tradeables and nontradeables. The Trade and Industrial Policy Study revealed weaknesses in many of these areas. The study used a general equilibrium model to assess the implications of TIP reforms in totality. Some of the results are revealing such as higher official reserve leading to a decline in exchange rate. The locus of this study successively shifting through the administrative structure of the government is equally revealing of the policy planning process in Bangladesh. It ran a complete cycle - starting from the Planning Commission it passed through two intermediate houses in the Ministry of Industry and Bangladesh Bank to be back to the Planning Commission again.

56. Because of the inertia of the system planning in Bangladesh had to depend on technical support from outside. First Plan, particularly its technical framework, was prepared in close cooperation with the Bangladesh Institute of Development Studies. In fact, because of the personal character of the top echelon of Planning Commission there was unique intellectual identification of the two organizations but beginning 1975 this relationship began to break down and by the end of First Plan separation of the two was complete. As a result the technical framework of the Second Plan was prepared with support from the Universities and BIDS on individual basis. For sector inputs of the I-O model of the Second Plan expertise of field specialists such as in forestry and fisheries were also used. During Third Plan BIDS was more closely involved as the technical arm of the Commission in the areas they had developed expertise. Besides undertaking studies on

fiscal and other economic issues, BIDS also ventured into more fundamental issues, the questions of self-reliance and local level planning. A self-reliant planning LP Model with fixed per capita consumption has since been developed.

57. As policy planning has remained generally outside the normal activities of Planning Commission, it is largely concerned with (i) preparation of medium term investment and production plan, called 5 Year Plan, once in every 5 Year with mid-term revision, (ii) preparation of annual investment programme, called ADP, for the public sector and (iii) processing of investment proposals, called project. However, since early seventies the importance of macro-economic policy issues have overshadowed the investment-oriented planning because of stagnation of aid. This has changed the focus from the level of investment to efficient use of limited resources available. This together with the expansion of the scope of the private sector has increased the importance of policy planning to substitute direct control of the economy by administrative fiat by indirect control through economic policy intervention. Against this changing situation not only the analytical capability of the ministries directly involved in policy implementation remains far below the required level but that of the Commission as a professional body is also very limited, a point that has been repeatedly brought up Country Economic Memoranda of the World Bank.

—

-54-

References:

1. Pakistan Planning Commission; First Five Year Plan 1955-60; p.12

2. ______________________; op cit. ; p.41

3. ______________________; op cit. ; p.418

4. G. Papanek; Pakistan's Development; p.38

5. J. Andrus and A. Mohammed; The Economy of Pakistan; p.402

6. Pakistan Planning Commission; op cit.; pp.12-13

7. A. Sadeque; The Economic Emergence of Pakistan (Part III); p.55

8. Pakistan Planning Commission; op cit, p.11

9. Pakistan Planning Commission; The Second Five Year Plan 1960-65; p.509

10. G. Papanek; op cit.; p.125

11. Pakistan Planning Commission; First Five Year Plan; p.397

12. ______________________;op cit.; p.88

13. ______________________; ibid.

14. G. Papanek; op cit.; pp. 139-40

15. S. Lewis and R. Soligo; 'Growth and Structural Change in Pakistan Manufacturing' Industries in 'The Pakistan Development Review', Vol.V, 1965, No.1; pp.122-25

16. Pakistan Planning Commission; The Second Five Year Plan 1960-65; p.49

17. S. Lewis and R. Soligo; op cit.; pp. 122-24

18. Pakistan Planning Commission; The Second Five Year Plan 1960-65; p.77

19. ______________________; op. cit.; p.52

20. G. Papanek; op.cit. ; pp. 128-30

21. J.H. Power; 'Industrialization in Pakistan: A Case of Frustrated Take-off?' in 'The Pakistan Development Review', Vol.III, Summer, 1963, No.2: p.205

22. S. Lewis; 'The Pakistan Development Review', Vol.IX, Summer, 1969, No.2; p.214

23. S.N.H.Naqvi; 'Import Licensing in Pakistan' in 'The Pakistan Development Review', Spring, 1964; p.67