

Trade not Aid: The Shining Case of Bangladesh

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According to the International Monetary Fund, Bangladesh was ranked as the 48th largest economy in the world in 2009, with a Gross Domestic Product (GDP) of US\$256 billion. The economy has grown at a constant average of 6-7% per annum over the past few years. However, there really is no secret to the self-sufficiency of Bangladesh from Foreign Aid. Foreign Aid dependence, primarily, was a result of economic setbacks suffered by the nation due to a series of both man-made disasters and the recurrence of natural calamities of rather immeasurable magnitude for much of the nineteenth century.

1 – Foreign Aid Trends

As a brief backgrounder, external assistance has played a vital role in the economic development of Bangladesh, assisting in bridging the internal gap (savings-investment gap) and the external gap (export-import gap). The costs, risks and maturity structure related to external debt management analysis are important. The cost of external debt is low as the most of the foreign loans received are through the concessional window of IDA, ADB and the Government of Japan[1]. The structure of maturity of the external debt of Bangladesh is composed of medium and long-term debt with an average grace period of 10 years and a repayment period of 20 years. With the shrinkage of share of grant aid in the external aid package in recent years, the volume of external borrowings is increasing which has resulted in a progressive increase of per capita debt obligation which stood at US\$ 139.9 in 2006. From 1972 to 30 June 2006, a total of about US\$ 53.93 billion of foreign assistance was committed of which about US \$ 44.83 billion of aid was disbursed. 44.74 percent of the disbursed aid was grants and 55.26 percent was loans. In 2007, Bangladesh received \$1631 million as foreign economic assistance of which \$1040 was loan while the amount of grant was \$590, almost half of the amount received as loan. Aid is received from both multilateral and bilateral sources. The multilateral sources include World Bank (WB), Asian Development Bank (ADB), United Nations Development Programs (UNDP) and other UN organizations. The bilateral donors include individual countries[2]. Interestingly, with the passage of time, there has been a significant change in the composition of aid to Bangladesh over the years. The key features demonstrate the fact that the share of grants has been decreasing steadily over the past few decades. The share of grants which was 89 percent in 1971/73 has reduced to only 31.9 percent in 2006. The declining volume of grants resulted in a larger share of loans in the total aid package. Bilateral aid has shown a declining trend whereas multilateral aid has increased positively over the years. Bilateral aid that was 75.4 percent of total aid in 1973/78 has declined to about 43.8 percent in 2005. Multilateral aid, on the other hand, has grown from 24.6 percent to about 56.2 percent in 2005. The flow of food aid and commodity aid has shown a declining trend while project aid has increased sharply from 1.3 percent of total aid in 1971-72 to 93.8 percent in 2006.

2 – Reasons for the Shift

The shrinking contribution of foreign aid in the economic wellbeing of the country stemmed from three principle sources: (i) strengthening of the internal revenue management system of the country by means of widening the tax-net (both direct and indirect; in different proportions), (ii) balancing the external payments mechanism with trade and remittances, and (iii) with the changing policy paradigm of the development partners with regards to the conditionalities attached to the aid disbursed.

With the installation of a democratic form of governance in the early nineties, the economic wellbeing of the country took an upswing. Since the establishment of a civilian government in 1991, the economic impetus of Bangladesh has been: (i) to diversify its economy – by adding new means of income generation, (ii) to reform its agricultural sector – coupled with land reforms, (iii) to expand its industrial sector, (iv) to liberalize the trade regime, and (v) to institute a social safety net based on employment generation through the private and informal sector.

2.1 – Internal Factors

In the early 1990s, while Bangladesh was struggling to solve its economic difficulties and eliminate poverty, it achieved impressive growth in many of the constituent areas, including manufacturing and agriculture. With much difficulty, the government was tried to implement recommendations for conducting structural adjustments, which included (i) relinquishing its socialist orientation and state control over the economy, (ii) decentralization of economic management, and (iii) privatization (of the economy). With structural adjustments and enhancement of the tax-net – especially after introduction of the Value Added Tax (VAT), the Government's potential for revenue generation from internal sources was greatly augmented. Early nineties was the time since when Bangladesh started to develop a fresh impetus to draw

its strengths from internal resources – rather than depending on the stringent constituency of foreign aid. The situation alleviated to a great extent with the take-off by the RMG sector as a major source of foreign exchange earnings and the influx of remittance from expatriate Bangladesh nationals.

2.2 – External Factors

Added, the political economy of foreign aid, its focus, magnitude, composition and operational modalities has also undergone important changes over the last decades. Over the last two decades, especially. The range of policy conditionalities imposed is now being extended to areas far beyond the traditional structural adjustment policies derived from the so-called Washington Consensus. Studies suggest that among the new areas of interest to donors, as either preconditions for or as corollaries to aid, are the growing emphasis: (i) on dealing with the non-government sector, (ii) on upholding human rights, promoting democracy, and (iii) on emphasizing good governance. This reconstruction of the aid agenda was incorporated into the design of the PRSP (Poverty Reduction Strategy Paper) by the Government, where aid recipients were expected to assume ownership over this conduit between the Washington Consensus with the newer aid priorities of the Development Partners.

From a different view point, it is also true that while the flow of foreign aid is on the wane in Bangladesh, the absorptive capacity of foreign aid is also a serious concern for the country. A low aid absorption capacity often leads to a vicious cycle of “low absorption-low development-low aid”. While it has been suggested time and again that the government should not look at aid as a source for overcoming weaknesses in fiscal management, and rather it should be seen as a source for enhancing investments, it remains true that (i) multiple controls, (ii) ad hoc procedures, (iii) divergence between development and revenue budgets, and (iv) undefined ministerial jurisdiction are the major factors contributing to the weak implementation of aid financed development programs inside the country.

3 – The Future

We must bear in mind that the role of aid is primarily two fold: (i) meeting immediate needs for poverty alleviation, and (ii) capacity building for self-sufficiency in localized administrative paradigms. It has been argued that Bangladesh is now evolving from an aid to a trade dependent economy. The fact of growing regional export concentration during the 1990s in the markets of the EU and the USA, with a single product, namely the readymade garments (RMG), is now playing a more important role in defining Bangladesh’s foreign policy than its need for aid. While in the 1980s Bangladesh’s foreign policy was targeted to ensure an uninterrupted flow of foreign aid, today, Bangladesh’s aid dependence is focused on the international and regional financial institutions. Only a few bilateral development partners, such as Japan, are largely delinked from Bangladesh’s trade relations whilst remaining an important source of FDI. In contrast, the EU, which is Bangladesh’s principal trading partner, lets its individual members develop their own bilateral aid relation with Bangladesh, whilst their role as an individual aid donor is much less significant.

Low levels of association between aid flow and poverty has been underscored by experts and administrators alike. Based on a disaggregated analysis of aid flows during the two previous decades, one can trace the dynamics of the aid and foreign exchange gap in Bangladesh, and the diminishing but critical role of aid in government finances. While food aid is not an important element of the aid flow, it is still critically important towards improving human development indicators as part of the global commitment of Bangladesh to attain the Millennium Development Goals (MDGs). An Inter-sectoral Analysis by the Center for Policy Dialogue shows that over the past decade there is continuing erosion in the importance of aid for public investment in Bangladesh – but it has remained important for the MDG-related sectors (e.g., health and education) as well as for rural income and employment supportive sectors (e.g. transport and communications).

[1] Since independence, Bangladesh has received highest amount of bilateral aid from Japan in terms of cumulative disbursement followed by USA. International Development Association (IDA) is the largest amongst the multilateral development institutions followed by the Asian Development Bank. IDA contributed 26.68% of the total aid disbursed between 2001-2007 – closely followed by ADB.

[2] Common agendas of International Financial Institutions (IFIs) are:

- Dismantling public institutions and public enterprises that deprives people but give immense authority to big business
- Removing all supports and protection for local industries and agriculture by liberalizing imports
- Supporting export oriented activities to meet the needs of western market by supplying cheap product at the expense of economy and environment

- Withdrawing state's responsibility of providing basic services such as health care and education for the people
- Raising prices of fuel, gas, electricity, raising fees of education and healthcare to create good business opportunities of the global companies.

Reference: Bangladesh Bureau of Statistics (BBS)

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