

Corruption, budget deficit and price instability

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INFLATION is a result of "too much money chasing too few goods." Nobel Laureate economist Milton Friedman argued, "Inflation is always and everywhere a monetary phenomenon." Friedman contended that to restrain inflation, the central bank should allow the money supply to grow at the same rate as that of real GDP growth. Otherwise, the imbalances in aggregate demand and aggregate supply would induce price inflation. Although the microeconomic settings of firms and businesses in Bangladesh may not conform to many of the assumptions of western free market models, its macroeconomic goals and expected policy outcomes, however, are the same as those of industrialised countries and hence Friedman's money-inflation paradigm is not a misnomer.

Principles of economics text taught us that a sustained increase in the price level is caused by a sustained increase in aggregate demand (AD) which is an algebraic sum of the demand for consumer goods, investment goods (equipment and structure), government purchases, and net exports (= exports(X) - imports (IM)). That is, $AD = C + I + G + (X - IM)$. Now what factors can cause a sustained increase in the four components of AD?

Economists widely believe that the money supply is the only predisposed factor that can continually increase and add stimulus to a sustained growth in all the four components of AD. One might ponder, "Can't government purchases continually increase and cause sustained increase in the price level?" This scenario is unlikely for two reasons. First, there are both real and political limits beyond which government purchases are untenable. The real limit is perceived to be 100 percent of GDP and the political limit, although unknown, is likely to be less than 100 percent of GDP. Second, government purchases that are not financed with newly created money may crowd out one of the three remaining components of total expenditures. Thus, increases in government purchases are not a guaranteed precursor to increased total expenditures because such an increase may be obliterated by a concomitant fall in private consumption expenditures. Thus a continued increase in the money supply can be the only lubricant to a sustained increase in the price level.

Budget Deficits, Money Growth and Inflation: The Central Bank of most free market economies conducts of monetary policy to achieve a target level of output growth, price stability and unemployment rate. Consistent with these policy goals, the authority sets an interest rate target and constantly adjusts money and credit growth to maintain that rate. However, in the process some exogenous factors may permeate into the authority's policy parameters. A government budget deficit is among the most common culprits. As budget deficits are monetised by the central bank,

the money supply increases. The deficits monetisation by the monetary authority is triggered when interest deviates from its target range. This is because, as government issues new bonds to finance revenue shortfalls, supply of bond increases which causes bond prices to fall and interest rate rise. The central bank intervenes through open market operations to buy back some of the bonds to keep bond prices high in an effort to restore interest rate at the desired level. However, our central bank, the Bangladesh Bank (BB) acts as a service institution of the government

The third channel works through transfer of funds in hard currencies to foreign countries to buy real estate or other investments, or travel to neighbouring countries to shop for luxuries. Thus hard earned foreign currencies (mostly US \$) are lost. This leaves domestic currencies weaker and depreciated in value through increasing its supply in the currency exchange market. As a result, foreign goods, especially high-tech machines, equipment and spare parts, become prohibitively expensive impeding business expansion, and or repair and

demand.

Hartals, Natural Disasters, and Inflation: Unlike corruption, which is essentially a demand side factor, hartals and natural disasters act as supply side shocks and affect the economy the same way energy price or labour boycott affect production, and distribution of goods and services? Natural disasters add to the already burgeoning budget deficits, money growth increases and funds for private investments are drawn dry. However, natural disasters must be accepted as *fait accompli*. On the other hand, hartals are mostly brought upon by politicians who failed to hold on to power.

Government Interventions and Price Control: DS editorial on March 22 forcefully argued that authorities should enforce punitive and disciplinary measures against non-price competition such as hoarding, price gauging, and market manipulations. Government intervention does not bring solution, instead impedes solution, and breeds corruption. These anti-competitive acts cannot cause a sustained increase in prices. They are essentially outliers, and can cause a short term price spike. The real solution is to allow competition and the forces of supply and demand, free of any externalities such as government interventions, to work their way into increased production and supplies of substitute products.

Inflation Expectations: An important factor that fuels inflation and price instability is the so called expected inflation. We know that inflation feeds into itself and breeds a spectre that fuels further inflation. People come to realise that as soon as their pocket gets emptied; even before buying daily essentials less than what they wanted. The result is a growing fear of a runaway inflation for an unknown period into the future. This expectation of inflation is self-fulfilling and in an effort to beat tomorrow's price increases people buy up goods today to hoard them aggravating the already vicious price spiral. Unless inflationary expectations are curbed by immediate monetary and fiscal restraints and increased supply of goods whose prices run away faster, price instability would be a nightmare.

Conclusions: The confluence of both demand and supply shocks have become so corrosive and contagious that only an irresponsible and self-indulging government can be oblivious to its consequences. With nearly 35 percent unemployment rate, slow use of available energy resources (natural gas), slow adaptation of digital techniques of production, lack of technically skilled workers, the economy's real GDP must be well below its potential. Government's claim of a 5 percent GDP growth, even if believable, accompanied by the scourge of inflation is showing signs of a dreaded prospect of topless price spirals. The presence of a large unrecognised body of "un- or under-employed" worsens the spectre of price spiral. Within the private sector, slow growth, corruption and hartals discourage businesses to expand plant and equipment investments, driving the elusive prosperity further into out of reach and sight. Fiery slogans with promises of affluence and prosperity by political parties in power or those in opposition are simply unattainable if growth deterrent factors and high unemployment continue unabated. It is a miracle that an economy which is continually subjected to so many anti-growth externalities (e.g. corruptions, hartals and natural disasters) have come a long way to avoiding an episode of a hyper inflation or an economic depression during its nearly 34 years of existence. Questions that crop up in my mind are, how can a country go on like this? Who runs it? Adam Smith would have said, "Stupid! Have you forgotten about the *Invisible Hand*?" I would have replied, "Sorry sir, I certainly did."

replacement of worn out capital equipment. Thus corruption drags down productivity of both capital and labour causing price hikes and an economy wide inflationary pressure.

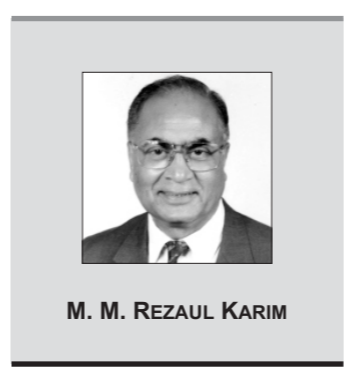
The fourth channel exerts upward pressure on prices through cutting future profit potential of investments. In an environment of rampant corruption, cost of business investment and operations are high. Real estate developers, property owners, retail stores, and all other entrepreneurs who pay bribes for quick approval of permits, licenses etc. must raise prices of their products to recoup costs and raise profits.

The fifth channel can drive up prices through loss of foreign direct investment (FDI) which are discouraged if potential investments are delayed and investors are hagglers for underhand dealings. Any loss of FDI due to unfavourable business environment (such as corruptions and hartals) retards future growth potential. Such losses of investment potential affect future output, prices and employment and depress prospective domestic investments as well. Bangladesh offers the cheapest labour, but its per capita share of nearly \$5,000 trillion of global outsourcing is probably the lowest among the South Asian countries.

There is yet a sixth channel, the banking sector. This sector suffers from the dual mishaps of adverse selection and moral hazard when it extends business loans under political pressure and or bribes driven greed of the bankers. Inexperienced and unscrupulous borrowers mismanage funds, businesses fail and loans end up in default. The government takes the heat and the economy ends up with unproductive excess money supply which transforms into increased aggregate

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Saddam's security apparatus and a state visit



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WHILE the deposed Iraqi President Saddam Hussain is awaiting trial in a jail in the country which he ruled ruthlessly for 24 long years, one may naturally wonder how he could last so long as head of state without what is claimed to be popular support. Elections were, no doubt, held during his time. There was always one presidential candidate, who won securing 99 percent of the votes cast. He killed thousands of Kurds and Shias and made the country a police state. This was the secret of his success and survival till his fall two years ago. The Americans, supported by the British, came in and saved the people, mostly Shias and Kurds, from the rule of the tyrannical dictator, in a bid to transplant democracy into a widely divided country.

But on the second anniversary of the commencement of the US invasion of Iraq, the people took to the streets in large numbers to protest against the presence of foreign troops and US occupation of their land. They compared Saddam's atrocities and repression with the death, devastation, and colossal human indignity perpetrated by the US troops during the past two years. The demonstrations were staged mostly by the Shites, who represented the vast majority of the population. ÉHeightening their aspiration to eventually rule the country, in partnership with the Sunnis and the Kurds or not, following the recently held country-wide election.

In my long diplomatic career, I had the opportunity of arranging a number of state visits of heads of state and governments of my country as head of mission. Though they were all successful, rewarding, and enjoyable, the visit to Iraq in the year 1984, when the then president of Bangladesh, Hussain Muhammad Ershad, paid a state visit to Iraq, was an extraordinary one for various reasons.

Bangladesh and Iraq developed cordial and beneficial relations from the day the latter recognized Bangladesh as a sovereign nation in August 1972. Iraq was the first country in the Arab world to do so. Soon thereafter, Iraq received a delegation to negotiate for supply of crude oil to a desperately oil-hungry Bangladesh. I was a party and witness to the desperation of that delegation. Besides, a large number of Bangladeshi expatriates and construction firms were working as development partners of Iraq. Pilgrimage of Bangladeshis to Iraq adds to the dimension of our interest to promote bilateral relations.

Iraq was perhaps one of the few countries in the Arab world where Bangladeshis are not called as "miskins" -- the Arabic word for poor. On the contrary, many of them, specially engineers, doctors, and other professional and skilled personnel, endeared themselves to the Iraqis with their wisdom, skill, and manners. That is why President Saddam Hussain finally complied with my request to send the Bangladeshi expatriates back home last (of foreign personnel). The compelling need for conserving foreign exchange during the war with Iran was cited as the primary reason for sending expatriates back to their respective countries.

Anyway, the most important aspect of the state visit of the Bangladesh president which made it

almost unique was the nature and extent of the security measures undertaken during the visit. Saddam Hussain's ascendancy to power may have been the normal step by step affair, but his retention of power was a different question. For this, Saddam introduced a severe, omnipresent, and all-pervasive security network throughout the country. The only other country, which may come close to Iraq in this matter was North Korea, about which I already had some personal experience as ambassador concur-

since I had earlier discussed in detail all these requirements with the chief of protocol. He had assured me all these would be duly complied with. I found the chief of protocol at a distance, veering towards me. I was sad, though determined to give him a piece of mind. Before I opened my mouth, he told me that the venue for reception to the president of Bangladesh had been changed to a small military airfield away from the capital. In a low voice, he added it was done due to security precautions (for

other paraphernalia of a state visit observed. Ershad became happy. Saddam was delighted to welcome the head of a Muslim state in the midst of his war against a fellow Muslim country, Iran. He even drove the limousine himself, making the visiting president sit beside him, on his way to the presidential palace. There was an element of security consideration there, too. The security measures taken for Saddam were so rigid that none would know about his whereabouts until the very last moment.

Another incident of similar nature took place in the same visit. The Bangladeshi president, his wife, and son, along with the president's personal staff, were lodged in a separate palace within the compound of the grand presidential palace of Baghdad. The Foreign Minister and the rest of the presidential entourage had their accommodation in the Al-Rashid Hotel, specially built for the aborted non-aligned summit in 1982. On the day of arrival a welcoming banquet was hosted by the Iraqi president at the grand palace. The Bangladeshi foreign minister and his party duly set out in a motorcade from the hotel towards the venue of the banquet. On the way, coming close to the palace, the motorcade was stopped by the elite Presidential Revolutionary Guard. They claimed they had instructions not to allow anyone to approach the presidential palace.

CURRENTS AND CROSSCURRENTS

On the stipulated day, we all from the embassy went to Baghdad International Airport. On reaching there, I did not see any red carpet, children with bouquets, and contingent of troops for presenting guard of honour. I found the chief of protocol at a distance, veering towards me. I was sad, though determined to give him a piece of mind. Before I opened my mouth, he told me that the venue for reception to the president of Bangladesh had been changed to a small military airfield away from the capital. In a low voice, he added it was done due to security precautions (for Saddam).

rently accredited from Beijing. What contributed largely to Saddam's success in this sphere was his unparalleled cruelty and total lack of trust in people, even though they were his near and dear ones.

His father-in-law General Khairullah, the Defense Minister, and son-in-law Husain Kemal, looking after Iraq's chemical and nuclear programs, and many other relatives had to pay with their lives due to Saddam's suspicion and alleged breach of trust. When I rejoined our Embassy in Iraq in 1982, I heard a widely spread rumour about the Health Minister, who once whispered in the ears of one of his colleagues suggesting that the "Jaish" or leader could step down from office, as per condition of Ayatollah Khomeini to end the war with Iraq. After the war ended, the Jaish would be brought back to office, he added. These words did not take time to reach the ears of the Jaish, and since then the Health Minister was nowhere to be found. After 24 days, Saddam appeared on the TV and declared that the Health Minister, under whose authority a drug had been imported resulting in the death of a few patients, had no right to live. In other words, he was liquidated. There are similar other stories.

Let us now come back to our state visit. On the stipulated day, we all from the embassy went to Baghdad International Airport. On reaching there, I did not see any red carpet, children with bouquets, and contingent of troops for presenting guard of honour. I was surprised, shocked, and dismayed at this gross and unpardonable faux pas,

Saddam). Saddam was never to be found at the exact time and in the exact place of his scheduled visit.

My friend and colleague, Foreign Secretary Faruq Ahmed Choudhury, who was in the Presidential entourage, later told me of the feelings on board the plane on landing at the Baghdad International Airport. The president was baffled and deeply annoyed not to see through the aircraft window any welcoming party, musical band, or the host president on the tarmac. Faruq thought there could have been some administrative mistake on his part about the date of the visit. If that became the case, the Foreign Office and foreign secretary were to blame, and the outcome would be an unpalatable uncertainty. On the other hand, if the Bangladeshi ambassador had made any gross mistake, that would surely herald the end of his diplomatic career. He felt pity for me.

However, the Biman Bangladesh plane carrying the president duly landed at the Baghdad International Airport. The Iraqi chief of protocol and I went up inside the aircraft and, as expected, found a stern look in the face of the president. After the situation was fully explained, the presidential face relaxed into its normal composure. The entire party disembarked and boarded four military helicopters. Within a short time we were at the small airfield. President Saddam Hussain, some of his ministers and senior officials came forward to welcome the president of Bangladesh on the red carpet. Bouquets of flowers were offered, national anthems played, guard of honour presented, and all

It was clear that a communication gap between the Guard and protocol had taken place, giving rise to the misunderstanding. The protocol officers accompanying the motorcade approached the guards and insisted on allowing the visiting foreign minister and members of the Bangladesh delegation to attend the presidential banquet. But to no avail. The elite Presidential Guards would not budge from their stand. Then I went to the guard commander, and after introducing myself and showing my identity card, pleaded with him to allow passage of the motorcade. The commander was courteous, but politely and firmly declined my request. Faruq was enjoying the scene of interlock with great interest, again feeling pity for me, thinking this time I had no escape. Finally, I insisted on speaking with their superior at the presidential palace and explained to him the situation as well as I could in my imperfect Arabic. The chief asked me to wait and after about ten agonizing never-ending minutes finally gave the clearance. We all heaved a sigh of relief. I stopped sweating and received another lease of diplomatic life.

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