Friendly fire

Though the intensity of "friendly fire" is increasing in rural finance in Bangladesh, there has been virtually no significant new initiative from the government in recent years. From the government's perspective, the maintenance of the status quo seems to be the easiest option. The losses resulting from unsustainable credit operations in government-owned specialised banks are hidden in the balance sheet of the central bank, and the government is not required to make explicit budgetary allocations for the losses of state-owned banks in rural finance. Furthermore, governance reforms in the agricultural banks are likely to be opposed by the employees who benefit from the status quo.

AKBAR ALI KHAN

THE term "friendly fire," a popular term in the military jargon in the US army, refers to the bizarre situation where an army attacks its own elements, either accidentally or erroneously, owing to mistaken identity. The outcome of friendly fire is diametrically opposite of what is intended.

Friendly fire is, therefore, more disturbing than enemy fire. According to Amartya Sen, "friendly fire" is not confined to military operations; it also exists in economic and social spheres *(The Argumentative Indian)*. There are, indeed, many apparently benign public policies whose upshots turn out to be perverse, and they rightly deserve the epithet of "friendly fire."

A case in point is the government policy on rural finance in Bangladesh. Since independence, the government has consistently supported the policies to provide cheap credit to small and medium farmers and SMEs in rural areas. Despite these sympathetic policies, the crisis of rural finance in Bangladesh did not ease. On the contrary, the outcome of these policies had been the perennial inadequacy of rural finance that contributed to rent-seeking, crowding out of the poor, and large hidden losses of state owned banks that destabilise the entire banking system of the country. The major components of these policies and their effects are as follows:

Acute scarcity of rural credit despite government intervention

According to a World Bank estimate, institutional sources can barely cater to 40 percent of total requirement of rural finance for the "missing middle" (total supply Tk. 310 billion and unmet demand Tk. 483 million). Market forces do not drive the supply of rural credit from banks in Bangladesh; rather it is determined exclusively by directed credit of the government.

Because of the preoccupation with targets set for state-owned banks, there is no sensitivity to the concerns of other likely players in the rural sector. The artificial low interest rate in government run agricultural credit programs and occasional decisions of unilateral debt forgiveness scare away private institutions from rural finance. As a result, one million small and medium enterprises and 4.3 million small and medium farmers do not have access to institutional credit.

Rent-seeking in government run agricultural credit programs

According to a TIB report, 61 percent of bank borrowers from state-owned banks have to pay bribes; the corresponding figure for private banks is 15 percent. The opportunities for rent in government-owned banks arise from artificially low interest rate. The transaction costs vary inversely with the economic status of the borrower.

According to a survey, the average transaction cost of credit from landless is 42.8 percent; for small farmers, 14.48 per cent; for medium farmers, 9.52 percent and for large farmers, 7.7 percent. As a result, many small farmers are unwilling to borrow from programs that are designed by the government in the name of the poor. 40 percent of likely borrowers who avoid state-owned banks cited high transaction cost for not borrowing from state-owned banks.

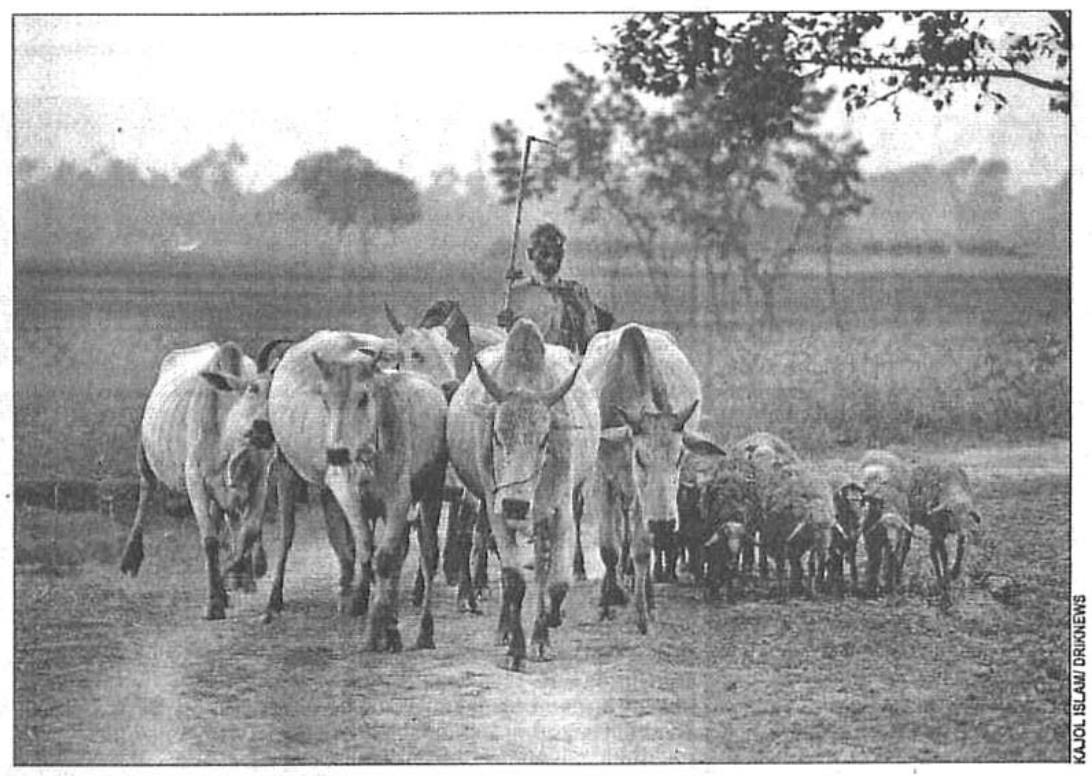
Unsustainable losses

The uninterrupted continuance of directed credit in rural areas without governance reforms in state-owned banks has created an unsustainable financial situation that poses a serious threat to the viability of the banking system in Bangladesh. The percentage of overdue in agricultural credit varied between 52 to 60 percent in the period 2001 to 2006.

Total losses of BKB are estimated at Tk. 51-61 billion while its total advances stood at Tk. 65.6 billion. Rakub's total losses are likely to be in the range of Tk. 12-16 billion while its total loans are estimated at Tk. 21 billion. Both these institutions are entirely dependent on the central bank refinance for their liquidity. Total borrowings from the central bank by BKB and Rakub are estimated at Tk. 48.9 billion.

Unless the government owns the losses of BKB and Rakub, the viability of the Bangladesh Bank is likely to be compromised. Furthermore, total deposits in BKB and Rakub stood at Tk. 72.9 billion in 2005 -- about 4 percent of total bank deposits in Bangladesh. Given the existing weaknesses of BKB and Rakub, the possibility of liquidity crisis in these banks cannot be ruled out.

Such an eventuality may trigger panic in the entire financial sector in Bangladesh. Thus, the wisdom of continuing the existing rural finance policies of the government should be immediately revisited.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Though the intensity of "friendly fire" is increasing in rural finance in Bangladesh, there has been virtually no significant new initiative from the government in recent years. From the government's perspective, the maintenance of the status quo seems to be the easiest option. The losses resulting from unsustainable credit operations in government-owned specialised banks are hidden in the balance sheet of the central bank, and the government is not required to make explicit budgetary allocations for the losses of state-owned banks in rural finance. Furthermore, governance reforms in the agricultural banks are likely to be opposed by the employees who benefit from the status quo.

This also gives an opportunity to the government to postpone difficult decisions like reviewing the practice of directed credit and interest rate. It is also felt that agricultural credit in a country like Bangladesh, where most borrowers are small, is not likely to be commercially viable. It is, therefore, argued that the government should accept losses in agricultural credit as an inescapable cost of its social responsibility to poor people.

Despite these obvious advantages of "business as usual" in rural finance, it is no longer a viable option. Because of the mounting losses of huge non-performing loans in BKB and Rakub, the cost of Tk. 100 loan is estimated at Tk. 122. Delay in restructuring the agricultural banks is increasing the cost.

Between 2004 and 2005, the reported capital shortfall for BKB and Rakub increased from TK. 23.9 billion to Tk. 28.26 billion, and the actual losses of the banks are believed to be in the range of Tk. 63 billion to Tk. 77 billion. Furthermore, the existing policies are fostering rent-seeking and denying access of small and medium farmers and SMEs to credit.

Against this backdrop, immediate steps are needed for restructuring BKB and Rakub, and for improving the policy environment for increasing more opportunities for rural finance.

There are three major options for restructuring the BKB and Rakub.

- Privatisation and increased role of NGOs.
- One-shot recapitalisation.
- Performance-based recapitalisation and governance reforms.

The main attraction of privatization of BKB and Rakub is that it can put an end to continuous hemorrhage from the government and the central bank. The private agricultural banks and NGOs can also provide better service and new products in rural finance.

In this connection, the example of Khan Bank of Mongolia is often cited. In 2003, the state-owned Agricultural Bank of Mongolia was sold to Khan Bank of Mongolia, which was owned by a Japanese investment group. 90 percent of the Bank's lending is in rural areas, and the default rate is below two percent.

It is, however, doubtful whether Khan Bank's success can be easily replicated in Bangladesh. The scale of operations of BKB and Rakub, which include 1316 branches and more than fifteen thousand employees, is much larger than the Bank of Mongolia. These banks cannot be privatised without prior recapitalisation and restructuring. In the transition period, there may be dislocation in rural finance.

Furthermore, it will be difficult to get genuine investors for a risky business like agricultural credit. Even if they are privatised, it is doubtful whether new owners will focus on risky rural finance, and they may opt to concentrate on normal commercial operations. Thus, privatisation may adversely affect the flow of rural finance.

It is also unlikely that NGOs would expand agricultural credit significantly even if the government provides concessional resources to them. Women, who constitute 97 percent of NGO members, are the driving force of NGOs. The overwhelming majority of small and medium farmers are men. As a result, the experience of NGOs in agricultural credit, although increasing, is still limited and least encouraging. The option of privatising specialised agricultural banks and encouraging NGOs to expand agricultural credit may achieve the desired outcome, but will take a long time.

The second option is the one-shot recapitalisation of BKB and Rakub. This is essential for protecting the interests of depositors in these banks. However, one-shot recapitalisation without significant governance reform may turn out to be counterproductive.

The World Bank assisted first financial sector reform in Bangladesh is a case in point. In this project, NCBs were recapitalised without any major governance reforms. New capital evaporated very quickly as the inefficient management squandered the additional resources through creation of more non-performing loans.

The third option is performance-based recapitalisation. In this scenario, prior improvement in governance is a precondition for infusion of new capital. The package of minimum governance reforms should include nomination of a truly independent and professionally competent Board of Directors who will be insulated from outside pressure, efficient management, and the institution of a system of punishment and reward for the employees.

Such option is difficult to implement as vested interest groups may impede the implementation of reforms. In such an eventuality, the depositors of these banks may remain exposed to risk for a long time. The performance-based recapitalisation should, therefore, include both reward (additional capital for attaining benchmarks) and punishment (restrictions on deposits and operations for non-fulfillment of benchmarks). Given the deep insolvency of BKB and Rakub, performance-based recapitalisation of these institutions appears to be inescapable.

The restoration of financial viability of BKB and Rakub is not enough to meet the escalating unmet demand of rural finance. The following policy areas also need immediate attention:

- Development of appropriate insurance products to transfer commercially viable risk, and the implementation of a reformed secured transaction regime.
- **Attracting private financial institutions and NGOs to rural finance by ensuring level playing field:** The average interest for agricultural credit in BKB and Rakub is 8 percent, whereas the average weighted average cost of deposit is over 7 percent in many private banks.
  In fact, 8 percent interest rate is not viable for BKB and Rakub, which are incurring significant losses. There is an inverse relationship between interest rate and supply of rural finance. The artificially low interest rate is likely to reduce the supply of agricultural credit.
- **Predictability in government response in case of natural disasters:** In the past, the government response in the event of natural disasters had been erratic. In one case, both principal and interest for small loans below TK. 5000 were forgiven; in some cases, only interest was written off, and in other cases, defaulting loans were rescheduled on the basis of government directives.

However, the banks are never fully compensated for such government interventions. A national policy on the coping strategies in rural finance in the face of natural disasters should be formulated, and a national fund should be established to compensate the banks for relief provided to small farmers and entrepreneurs adversely hit by natural disasters.

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NGOs need to think about themselves

If we find one NGO which is engaged in any kind of corruption or misgoverance we have to think about it seriously, and we have to take initiatives to stop those misdeeds entirely as we beg money for the sake of helping the poor. We cannot misuse that money.

SADIKA AKHTER

A strong storm is blowing over the country. The storm is the report of TIB on "Problems in good governance in the NGO sector: The way forward." High officials of the NGOs do not agree with it. They, however, have their own strong logic for not supporting the report. On the other hand, the workers in the lower positions, many of whom are deprived and exploited by the organisations, are fully at one with the report.

The NGOs have many policies such as gender policy, vehicle policy, human resource policy, child protection policy etc. The list goes on. The lower level staff who work for the organisations from dawn to dusk, often with no benefits except the pay-check at the end of the month, are largely content with report.

Those who work year after year under contractual service agreement and, in many cases, do not get salaries according to the commitment (something I am a victim of, too) are happy with the report.

Research has limitations; one research cannot answer all the questions. TIB has done a great job with the research, though the sample is small. They were able to create a debate among the NGO workers, and it is now the duty of the NGOs to think about their own shortcomings.

Nothing is perfect in the world. Neither a human being nor an organisation can be perfect. Undoubtedly, NGOs are doing the most challenging task. They are working with the poor, uneducated, unaware people in remote areas. Working with these communities is very difficult, and bringing changes among them is not possible overnight.

Many people of the remote areas of Bangladesh now know how to prepare saline, and how to deal with a child when she gets diarrhea. Though the number is small, many pregnant mothers go for ANC, PNC check-up, offer colostrum to their children right after birth, and continue exclusive breast feeding for six months.

If we go to where the NGOs are working to set up latrines, we see that people are changing their habit and using toilets. Open defecation was a curse for the community. It was impossible to walk on the roads for this unhygienic practice. But changes are taking place. Still, people have queries about the NGOs' contributions.

People also say that NGOs are not doing anything for the country. Why do the people ask this? Where is the gap? Why is the miscommunication between NGO and general people as bad as the relation between politics and the common people?

Let's talk about Rehana. She worked for an international research organisation for four years as a contractual employee. She would not get any benefits except the salary. Her contract was renewed every three months. Rehana could not take any leave, and if she did she had to compensate for it on Saturday.

Rehana wants a baby, but thinking of getting pregnant is a nightmare for her as she will not get any maternity leave. If she gets leave without pay, and if she takes leave for two months, she may lose her job as her contract is for three months.

The organisation has a gender policy, and the gender expert gets a huge salary, but many daily wage-earners and CSA holder staff who work in such a poor environment. Is this not misgovernanace? Is this not unfair behaviour towards the staff? Is this not exploitation of labour and taking advantage of unemployment?

I was in the field in Gazipur, working with a woman who was pregnant. She works for an NGO, which is a sister concern of a world famous organisation. She said: "It is very difficult to drive a motorcycle during pregnancy and I am also so huge now." I asked her, why she wasn't using a rickshaw during pregnancy. She replied: "It is not in the policy." My office will pay for motorcycle fuel but not the rickshaw fare."

The list of such cases, and even worse, can go on. Many NGOs supposedly have "gender policy." It would be nice to see its application for a change.

I also want to share another story of a reputed NGO. The NGO is now located on prime real estate in the capital, so we can imagine the price of the land of the office. How did the organisation manage that price for the land? They allegedly took money from the salary of the staff. The staff were forced to pay the money from their salary without any documents.

I conducted many assessments of different NGOs, and I know how they put money in their own pocket. There are lots of people who very frequently talk on television about the rights of the children and women, but if you visit their organisations you will find the discrepancy between their words and practice.

There are lots of organisations, which are one-man show organisations, and the staff works according to the instructions of the "executive director." They work to make the donors happy. They work to pocket the funds.

I cannot define corruption and misgovernance, but I know that those who work to establish the rights of human beings cannot indulge in such malpractices. If we do anything against the rights of a human being, and exploit him in the name of development, then that is also one kind of corruption.

Because NGOs claim that they are humanitarian, non-profitable organisations, which serve the people, they have to be more transparent and accountable towards the community and the country. If we find one NGO which is engaged in any kind of corruption or misgoverance we have to think about it seriously, and we have to take initiatives to stop those misdeeds entirely as we beg money for the sake of helping the poor. We cannot misuse that money.

I cannot say that my organisation is necessarily better than the rest. But why should I be considered compromised for working for an NGO? We have to fight against the compromised organisations, whichever ones they are, to preserve our reputation and to keep ourselves out of the debate.

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Targeting China?

MIAO YINGCHUN, *China Daily*

ON September 14, China requested the World Trade Organisation (WTO) to settle its dispute with the United States over Chinese coated paper after negotiations with the US failed. China was seeking WTO help following a preliminary decision by the US Department of Commerce to impose duties on coated paper imported from China.

It was the first time that China has filed a case in WTO against the US since the country's entry into the world trade body in 2001.

The frequent usage of trade protective tools, like anti-dumping, anti-subsidy duties, guarantee measures and special guarantee measures, has become a source of trade conflicts between China and the US.

According to WTO statistics, China is the most targeted country in US anti-dumping investigations. Since the first anti-dumping case involving menthol produced in China in 1980, Chinese exports have been subject to 10.2 percent of all anti-dumping cases investigated in the US. The antidumping cases involving Chinese exports have significant values, some more than $100 million.

On March 30 this year, the US Department of Commerce decided to impose an anti-subsidy tax on coated paper produced in China. This was a significant change in the US anti-subsidy tax policy. Before that, this tax was only imposed on products from market economies, and China had always been treated as a "non-market economy" by the US authorities in nearly all trade-related issues.

The Chinese products involved in the anti-dumping cases are mostly in the light and chemical industries, and machinery and electronic products such as bicycles, colour TV sets and steel pipes.

The products have helped China gain a considerable position in global trade, and have led to more jobs in the country. A conservative calculation shows that the light and textile industries employ 50 million people a year.

In the anti-dumping cases initiated by the US, China is the victim of a high proportion of confirmed dumping. Between 1980 and 2006, the US International Trade Committee (ITC), the institute authorised to give decisions on the anti-dumping litigations, concluded that 70 out of 111 Chinese commodities had been dumped. This rate is much higher than that of other trade partners of the US.

The US authorities are also using more diversified means to protect its domestic market from Chinese products after China became a WTO member. The frequent use of antidumping measures toward Chinese exports by the US is primarily due to economic pressure.

With its huge trade deficit, the US has undergone an industrial restructuring. The government has to protect its domestic industries from foreign competitors. As one of the biggest trade partners of the US, China has not only increased its export volume to the US but has also added value to its commodities in recent years thanks to the development of Chinese manufacturing.

Thus, competition between Chinese exports and US domestic products has become more intensive. It is, therefore, natural for US authorities to resort to antidumping measures to protect their domestic industries.

Another motive is the strategic interests of the US. Researchers from the US National Bureau of Economic Research, Thomas J. Prusa and Susan Skeath, found that US antidumping cases were often driven by political pressure, national security interests, and historical economic relations. And these considerations are sometimes more important than economic interests.


AFP

Theoretically, anti-dumping is meant to fight unfair competition. However, if used to obstruct free trade and protect incompetent industries, it would cause serious damage to global trade.

It affects the commercial interests of exporters, especially those in developing countries.

The abuse of anti-dumping measures has made it a non-tariff trade barrier to protect a country's market from imported products and services. Thus, consumers have to pay much more for goods or services than they should in an open market.

Low-priced Chinese exports have helped ease inflation in the US, and have benefited the country's consumers. The use of trade protective tools is detrimental to US consumers interests and does nothing to help the less vigorous industries.

President George W. Bush decided not to provide import relief for the US pedestal actuator industry in 2003 when the ITC believed the industry was threatened by Chinese exports. He argued "the import relief would have an adverse impact on the United States economy clearly greater than the benefits of such action."

His explanation could be applied to other Chinese exports to the US market. And hopefully, Sino-US trade disputes could be reduced if this was accepted by others concerned.

Bush said: "Imposing the ITC's recommended quota would not likely benefit the domestic producing industry and, instead, would cause imports to shift from China to other offshore sources.

Even if the quota were to benefit the primary domestic producer, the cost of the quota to consumers, both the downstream purchasing industry and users of the downstream products, would substantially outweigh any benefit to producers' income.

In addition, downstream industries are already under pressure to migrate production offshore to compete with lower-cost imports of finished products. Higher component costs resulting from import relief would add to this pressure.

"Given the significantly larger number of workers in the downstream purchasing industry when compared with the domestic pedestal actuator industry, I find that imposing import restrictions would do more economic harm than good."

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