The foreign exchange troika

A credible and long lasting political stability combined with the presence of skilled workers would certainly help the investment climate. These cannot be built overnight, but while our businesses and policymakers look for quick solutions, decades slip by and Bangladesh's only industrial workers continue to walk home in colourful groups every evening.

FARIDA C. KHAN

BANGLADESH has three primary sources of foreign exchange -- aid, worker remittances, and ready-made garment (RMG) exports. My comments on these three relates to an editorial written by Dr. Anis Chowdhury (DS, Feb 10).

Remittances have indeed been very high for Bangladesh. They have been increasing at 24% for the past two years, 2005-2007. But export earnings have also increased at high rates (about 17% on average for those same two years). And when compared, knitwear and woven garments, the two main items in the ready-made garments category, earned one a half times more foreign exchange than remittances contributed.

One might consider the point that much of the remittances are not brought in through official channels and the $6 billion estimate for 2007 is an underestimate of the actual amounts that are available for spending through hundi exchanges, cash inflows, and various other forms of unreported financial transactions.

Nonetheless, as far as we know, the RMG sector yields more foreign exchange than remittances do.

Why bother with this comparison? Both point to the importance of the labour intensive comparative advantage of Bangladesh. The country is competitive in exporting labour-intensive products or exporting labour itself.

On the other hand, aid as a source of financing for global development spending has fallen substantially in the last two decades. Official Development Assistance, the main source of funds for the developing world in the 1960s and still of importance in the 1970s, has fallen to insignificant levels. Instead, the significant sources of financing are now direct investment and portfolio flows.

These capital flows in the form of new companies, stock purchases, or bond purchases have been regionally skewed. Most of these have gone to East Asia, Latin America, and Eastern Europe. Or they have gone to large countries -- in fact, BRIC (Brazil, Russia, India, and China) account for the majority share of financial flows going to the developed world.

Why are countries like Bangladesh left out? The story of world economic success rests in the notion of economies of scale nowadays, not on "small is beautiful." Small is set up for failure -- how do you diversify risks, spread out shocks to one sector by relying on another, produce large enough quantities to realize scale efficiencies that global technology now provides? The predicament is worse when the country in question does not have a critical pool of skilled labour -- flexible skilled labour that can move seamlessly between administration in manufacturing, high tech hardware and software, and service sectors in finance, health, and even education.

Let's face it -- isn't that why Bangladesh is still reliant on RMG exports, remittances, and (fading fast but still present in least developed countries) foreign aid?

Can we compare the three in terms of their merits and demerits? Let's start with aid. Dr. Chowdhury has already pointed out that one only has to read "The White Man's Burden" by William Easterly to understand why aid is dismissed as useless in development. This is affirmed by many studies undertaken on aid effectiveness such as those by Paul Moseley or Peter Boone who find that aid mostly ends up as unproductive public expenditure.

On the other hand, one has to only look around Dhaka to see the cobweb of dependence on donor funding -- whether it be through NGO loans and jobs, ADB projects, UN-Millenium Development Goals cash for clean water. How did this Bangladesh come about? Decades of foreign aid and donor funding? Years of colonisation? Centuries of patronage systems that perpetuate dependencies? Has donor assistance entrenched the feudal mindset that still anchors Bangladeshi society?

I will leave that for someone else to work out, and move on to the more simple point that I set out to make.

Remittances are pay checks that people bring back home as opposed to exports of RMG, which is a single sector project and one that allow us to recreate the origins of the industrial revolution in Britain. Increases in remittances can be spent on all goods and services produced in Bangladesh or outside the country without necessarily causing any changes in the price of one item compared to another. RMG is more complicated. With the incentives given for RMG exports and the plethora of profitable companies in this industry, there has been deindustrialisation in other sectors. We do not see any other job creating sector coming up as a potential exporter or domestic producer. For 25 years or more, Bangladesh's growth has been tied to its garment exports. Little has occurred in the way of import substitution.

If anything, the Dutch Disease argument -- which originates in the phenomenon of deindustrialisation in the Netherlands when oil exports led to an appreciation of the Dutch guilder -- can only at best be applied to the RMG case. The removal of all incentives on import substitution industries and the excessive focus on RMG in the 1980s is probably the most important factor for a lack of investment in other sectors in Bangladesh.

If we consider India and China along with the myriad smaller economies in Southeast and East Asia, all of whom have seen currency appreciation in the recent year, we do not see this single sector expansion and deindustrialisation -- and cannot conclude that remittances and other types of capital inflow lead to a Dutch disease.

The price of food and transportation in Bangladesh has blown through the roof -- further currency depreciation would worsen this but would it lead to the rise of any potential manufacturing products?


STRINGER/DRIK NEWS
Garment workers in the streets after work.

Given the perverse incentives that invite imports, a dependent mindset that encourages relying on donor funds, the scapegoat for an absence of investment can hardly be hard earned remittances of toiling Bangladeshis in the Middle East and all over the world.

I heartily agree with Dr. Chowdhury's suggestions that the government of Bangladesh provide incentive schemes such that these funds are productively used within the country.

The task of the government should indeed be to encourage the channel of these funds to employment generating enterprises that are identified by local and diasporic partnerships, but not to select any specific sectors and create a complex set of incentives/disincentives that merely lead to quick returns.

A credible and long lasting political stability combined with the presence of skilled workers would certainly help the investment climate. These cannot be built overnight, but while our businesses and policymakers look for quick solutions, decades slip by and Bangladesh's only industrial workers continue to walk home in colourful groups every evening.

Farida C. Khan is Professor of Economics University of Wisconsin-Parkside.

Good for the Jews?

The few mainstream Jewish and Israeli figures who criticise Obama focus on his apparent willingness as president to talk to the Iranian regime. Danny Ayalon, Israel's former D.C. ambassador, says Iran would exploit Obama's gullibility and race ahead with a nuclear program. Hillary Clinton seems eager to remind voters of that argument.

MICHAEL HIRSH *and* DAN EPHRON

THE comment seemed like a casual aside. Ann Lewis, a senior adviser to Hillary Clinton, was touting the New York senator's strong support for Israel during a conference call in January with leaders of major American Jewish organisations. During the call, Lewis energetically contrasted Clinton's pro-Israel credentials with those of Barack Obama. To make her point, she said that Obama's "chief foreign-policy adviser" is Zbigniew Brzezinski, says one participant who would talk about the call only if he were not identified.

Brzezinski -- the former national-security adviser to Jimmy Carter -- is not Obama's "chief foreign-policy adviser." That is the job of a triumvirate who once worked for Bill Clinton: Anthony Lake, Susan Rice and Greg Craig. But Brzezinski, who tells NEWSWEEK he has advised Obama "only on occasion," has a reputation that is close to toxic in the American Jewish community.


NEWSWEEK
Obama with former Israeli Foreign Minister Silvan Shalom.

"When Brzezinski's name appears on an advisory list, that's a red flag right away," says an influential American Jewish leader who did not want to sour relations with the Obama campaign. Many American Jews mistrust Brzezinski because he endorsed a 2006 article, later a book, called "The Israel Lobby," which blames many US foreign-policy problems on Washington's ties to Israel.

Lewis's aside is not an isolated incident. (She did not respond to a request for comment.) As the race between Clinton and Obama has sharpened in recent months, other Clinton campaign operatives have sent around negative material about Obama's relations with Israel, according to e-mails obtained by NEWSWEEK.

In addition to Brzezinski, the e-mails attack Obama advisers such as Rob Malley, a former Clinton negotiator at the 2000 Camp David talks who has since written articles sympathetic to the Palestinian point of view, and they raise questions about Obama's relationship with the Rev. Jeremiah Wright, the former pastor at Obama's Trinity Church in Chicago.

Wright has criticised Israel, and Trumpet, a publication run by his daughter, gave an award for "greatness" to Nation of Islam leader Louis Farrakhan, who once called Judaism a "bloodsucking religion." (Obama disagreed with bestowing the award.)

Aides to Obama say they have little evidence of an organized Clinton plan to turn Jewish voters away from him. (Clinton spokesman Howard Wolfson says he has no comment.) Some members of the Jewish community say the e-mails began with Christian evangelicals who are supportive of Israel.

Regardless, one senior Obama adviser, who would talk only anonymously because the campaign's response involved internal discussions, says the timing is suspicious: "There's an increased number of these attack e-mails going around in direct correlation to Barack's strength in the primaries and caucuses." (He has beaten her among Jewish voters in California, Connecticut and Massachusetts; she's won in New York, New Jersey and Maryland.)

In one case, Daphna Ziman, a longtime friend of Hillary Clinton's who has co-chaired several events for her, forwarded an e-mail from the Republican Jewish Coalition, a grass-roots GOP group, criticising Obama for proposing a Muslim summit.

In a Jan. 31 interview with Paris Match, Obama said he wanted "an honest discussion about ways to bridge the gap that grows between Muslims and the West." Ziman, in her Feb. 2 e-mail, responded, "I am horrified at Mr. Obama's point of view."

Her e-mail, sent to a group including Mike Medavoy, a Hollywood producer who supports Obama, contained a press release from RJC executive director Matt Brooks. "Nowhere in the Paris Match article does Senator Obama affirm Israel's right to exist," Brooks wrote. (Ziman says "the campaign had nothing to do with" her e-mail.)

In an e-mail sent Feb. 4 -- a day before Super Tuesday -- Clinton finance official Annie Totah passed along a critical essay by Ed Lasky, a conservative blogger whose own anti-Obama e-mails have circulated in the US Jewish community.

Totah wrote: "Please read the attached important and very disturbing article on Barak Obama. Please vote wisely in the Primaries." (She didn't respond to a request for comment.)

The Obama-ites have counterattacked, rounding up endorsements from stalwarts in the Jewish community. Almost unanimously, American Jewish leaders say Obama's voting record and public pronouncements paint him squarely as an Israel supporter.

"Senators Clinton, Obama, McCain and Governor Huckabee have demonstrated their support for a strong US-Israel relationship," AIPAC president Howard Friedman wrote to NEWSWEEK. (AIPAC says all three senators have strong congressional voting records on issues important to the US-Israel relationship.)

The few mainstream Jewish and Israeli figures who criticise Obama focus on his apparent willingness as president to talk to the Iranian regime. Danny Ayalon, Israel's former D.C. ambassador, says Iran would exploit Obama's gullibility and race ahead with a nuclear program. Hillary Clinton seems eager to remind voters of that argument.

View from Tokyo

It should be noted that Japan has expressed keen interest on the planned election in Bangladesh and is willing to see the smooth transaction of power to the elected representatives within the time-frame declared by the caretaker government. Tokyo is also willing offer assistance in organizing the polls, including providing transparent ballot boxes. Japan has provided such ballot boxes for the recent election in Pakistan and is also sending the supply to Nepal.

MONZURUL HUQ

THE adviser for foreign affairs of the caretaker government of Bangladesh, Iftekhar Ahmed Chowdhury, was recently in Tokyo on a three-day official visit at the invitation of the Japanese Foreign Minister Masahiko Koumura. This was the first foreign ministerial visit level visit to Japan from Bangladesh in five years and the first official visit to the country by any member of the caretaker administration of Dr. Fakhruddin Ahmed.

After arriving Tokyo on February 24, Dr. Chowdhury held a number of meetings with high-level Japanese officials, addressed a press conference at the National Press Club, and also gave a speech at the United Nations University in Tokyo. On Monday the Bangladesh foreign adviser met the Japanese foreign minister and at the meeting the two sides signed an agreement extending Japanese financial support to Bangladesh. Japan will provide a loan of $64 million to Bangladesh to help the country rebuild the damages caused by floods and cyclone last year. The Japanese loan will be used to reconstruct damaged roads and barrages. Japan will also offer $14.8 million grant aid to Bangladesh for housing reconstruction.

After the meeting, Mr. Koumura said the Japanese government will set up a 10 billion dollar fund to help developing nations reduce greenhouse gas emissions and offer financial aid to nations that have been seriously affected by climate change. Dr. Chowdhury noted that Bangladesh is susceptible to global warming and he would like to see the problem seriously dealt with through meaningful co-operation of the international community.

Speaking at a dinner hosted by the Bangladesh ambassador in Japan, Ashraf-ud-Doula, on February 26, the foreign adviser praised the role being played by Japan in international politics, by saying that Japan leads an emerging Asia and Bangladesh would like to see Japan continuing performing this responsibility that would bring benefits to the whole region. The dinner was attended by parliamentarians, high officials of Japanese foreign ministry and aid agencies, journalists, and academics.

Addressing the gathering, the former foreign minister of Japan, Taro Aso, said he was expecting the election in Bangladesh to be held at the end of this year and he would like to visit the country early next year to welcome the new elected government. Mr. Aso has recently been elected president of the Japan-Bangladesh Parliamentary League, replacing Shin Sakurai, who lost the upper house election last summer and that left the post vacant since then.

Talking to the Star correspondent at the dinner, the foreign adviser termed his visit as very fruitful. He said the visit has further strengthened the friendly ties between Japan and Bangladesh and it also helped the Japanese side to realise the possibilities that Bangladesh offers. According to Dr. Chowdhury, everyone on the Japanese side now has a better understanding of the potentiality of Bangladesh.

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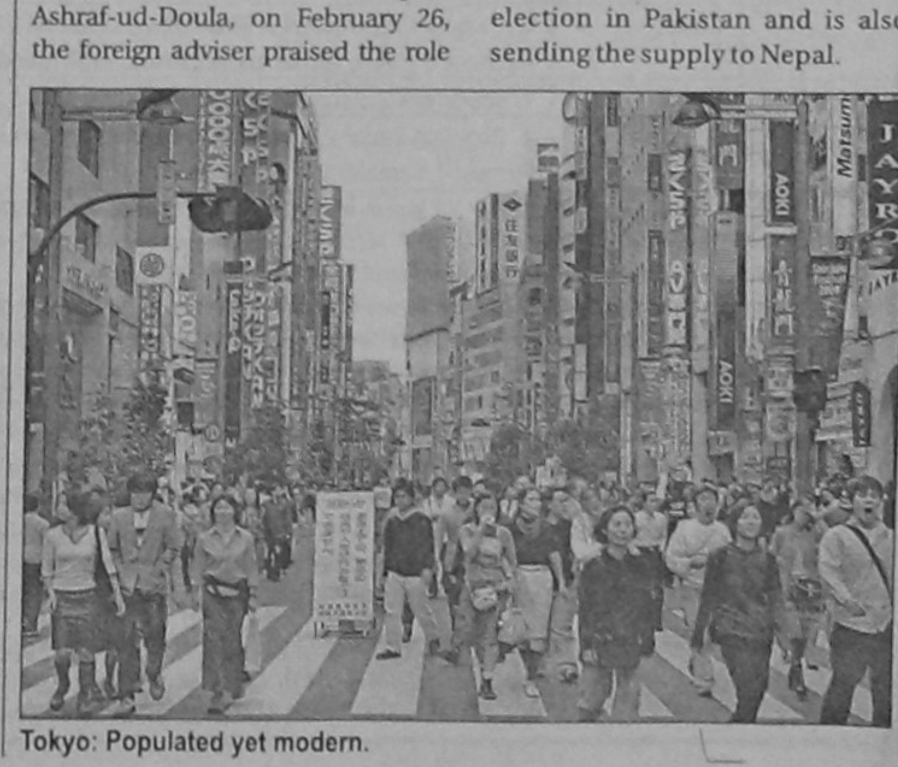
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What to do with Rupali Bank?

Nevertheless, several groups attempted to respond to the PC's offer. There was a bar of gold in this confusion. This bar of gold was the opportunity to gain control of most of the remittance flows from the Middle East. These flows, at the end of 2007, amounted to almost $4 billion per annum.

FORREST COOKSON

BANGLADESH Bank has made real progress towards selling Oriental Bank to the ICB Financial Group. I am confident the central bank will complete this sale. But the Rupali Bank case remains unresolved more than one year after the award to a Saudi prince. The saga of Rupali Bank resembles a cancer patient slowly dying while doctors and family dither about surgery, chemotherapy, or assisted suicide! The two years of drift have hurt the bank, driving it ever deeper into insolvency.

The Privatisation Commission (PC) struggled through piecing together a portfolio of Rupali Bank's condition, that was characterised by:

- A statutory audit that followed the loan classification rules of Bangladesh Bank, or at least one version of those, significantly under-counting the non-performing loans.
- A special audit of loans conducted according to "international standards": This special audit revealed that behind the statutory audit, and the brave face it presented of Rupali's condition, was a horrific collection of uncollectible loans not recognised as non-performing. Some information on this was presented to potential buyers who were left to their own devices to assess the true condition of the loan portfolio. The volume of non-performing loans increased by more than 100% once these loans were recognised.
- Changed tax regulations: The NBR announced (independently of the privatisation of Rupali) a change in the tax regulations on loan provisions that imperiled the privatisation. The change undermined any serious effort to purchase Rupali Bank and rebuild it into a decent financial institution. Indeed, the changed tax treatment of provisions makes it very difficult to deal with the large volume of bad loans. The central bank may require classification of these loans at any time, resulting in the buyer becoming subject to continuing large capital injections.
- A program to reduce staff by paying reasonable benefits to those leaving the service of the bank. Implementation of this program promised to be very difficult, particularly for a foreign owner potentially exposed to all kinds of political pressure.
- Overview of Rupali Bank: Altogether, Rupali was presented as a bankrupt financial institution that could only trade because Bangladesh Bank allowed it to do so. Its market value rested on its bank license and its extensive branch network, combined with the future profits that can be generated. All bidders pandered to the PC's biases by promising to retain all staff.

Nevertheless, several groups attempted to respond to the PC's offer. There was a bar of gold in this confusion. This bar of gold was the opportunity to gain control of most of the remittance flows from the Middle East. These flows, at the end of 2007, amounted to almost $4 billion per annum. Controlling 50% and earning a fee of 2% might prove feasible with a well-positioned owner from the Middle East.

If one could carry out this strategy then it may pay to purchase Rupali Bank despite its appalling financial condition. Running the bank at zero profit, investing $350 million to buy the bank, and earning $40 million, increasing at 10% per annum, from remittances gives a return of 24% on the investment.

Since one can take these profits in the Middle East through the local companies collecting the remittances, rather than in Bangladesh, one can avoid Bangladesh income tax. Buying Rupali is a good deal if you have the determination and contracts to organise the collection of remittance flows. This is, I think, the basis for the Saudi Arabian prince's interest.

But this deal seems to have vanished. It is unlikely that the government will allow the winning bidder to reduce his bid. The Privatisation Commission provided the data needed to grasp the real condition of Rupali. If the prince has a problem, it is with his analysts who assessed the bank. Since the key point -- handling the remittances -- is unchanged, why has this deal failed? Perhaps the taxation aspects finally dawned.

Unfortunately, the long delay has undermined the Rupali privatisation program. The audits are out of date. To assess the bank, one needs up-to-date accounts and another review of the loan portfolio. It is hard to see how the prince can buy Rupali Bank with the dated information available; it is hard to see how the government can accept a lower price.

I believe the government now has four choices:

- Forget the whole thing; allow the bank to continue its losing ways.
- Allow the bank to continue operating but forbid any increase in lending; Rupali can lend what has been recovered, but nothing more. Let the bank slowly wither away.
- Go through the same process as the Privatisation Commission went through in 2006, preparing to solicit new bids in a few months after revised audits are complete.
- Divide Rupali Bank into units and sell off, say, two modest size banks. This process is well known, and will result in two new banks leaving the residual of Rupali. This residual of Rupali Bank can be eventually closed down.

The first and second throw away the good part of Rupali and destroy the whole bank; the third is unlikely to be more successful than it was the first time. Selling off the good banks will be simpler as it will be possible for local businessman to participate.

Two final points

Bangladesh Bank certainly monitors the remittance in-flows. While there is much concern with money laundering, the shift of fee earnings out of the country by "transfer pricing" is much more serious. It is important to check the profitability of these remittance flows to the commercial banks; arrangements where profits are taken in the originating or an intermediate country should be examined. In the financial environment that exists, one should insure that a reasonable share of the remittance fees are profits taken within Bangladesh and not in external financial institutions.

For banks that are privatised, or restructured the way chosen by the Privatisation Commission, the tax rules on expensing provisions should be re-examined. Indeed, no one would make an offer for Rupali bank if he expected to recognise the "hidden" bad loans and to follow the tax rules.

The buyer is in a tight spot: if forced to classify these "hidden" bad loans, the cost of provision must come after taxes are paid. The bank will not make money for years. The buyer is also unable to follow good banking practices and classify or write off these "hidden" bad loans as the owners continue to misrepresent the condition of the bank. The buyer is thus forced to find a way to avoid the required tax payments.

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