income, with flow on effects on consumption. In the medium term, slowdown in investment, particularly foreign direct investment, will hurt industrialisation, technology transfer, and productivity growth -- all very important factors for poverty alleviation through sustained economic growth.

The second channel through which a worse-than-expected slowdown could affect Bangladesh is exports. About a quarter of Bangladesh's exports are to the US, with Germany, the United Kingdom, France, and Italy accounting for another third.

If the US recession is worse than anticipated, or if one or more of the major European countries enter a recession, exports will suffer. A sharp slowdown in exports will have additional impacts on investment, employment, and household income.

Remittances will also suffer, especially if the credit squeeze worsens. This is because most non-resident Bangladeshis, particularly those living in the developed economies, will have to pay higher interest payments in their house mortgage, credit card debt, or personal loans. Remittances have shored up household income and boosted consumption in recent years. If remittances were to start drying up, consumption will hurt, and the service sectors such as financial services, property, and telecommunications will suffer.

Macro-economic policy options

The task of macro-economic policy-maker in Bangladesh is never easy. But it is a particularly difficult balancing act to stimulate a flagging economy at a time of inflationary pressures. This is just as true for our Ministry of Finance and the Bangladesh Bank as it is for the US Treasury or the Federal Reserve. As long as inflation, particularly food price inflation, remains at the current highs, the government will come under pressure to subsidise foodgrains and/or widen social safety nets.

Some possible policies -- food for work programs, greater government investment in rural infrastructure projects to generate rural employment -- are worthwhile in their own right, regardless of the inflation situation. However, to the extent that they cost money, their implementation is problematic, as the government's coffers are already in the red. The ADB forecasts a budget deficit of 4.8 per cent of GDP in the 2008 financial year.

If the worst should happen -- a protracted global slowdown with continued inflation -- we could be looking at the worst economic crisis since the 1970s.

The Economist puts the number at 5 per cent. Unless the food subsidies and related programs were financed by external assistance, the government will have to make some difficult choices. Other policy options -- liberalisation of foreign investment regimes to encourage new energy projects, or policies aimed at improving agricultural productivity -- may not require much government expenditure, but will not yield results immediately.

And in an environment of 40 taka per kg of rice, calls for subsidies that assist the poor here and now will be very difficult to ignore for the government. If significant external assistance is not forthcoming, the government will have to either cut expenditure elsewhere and/or raise taxes, or finance the widening deficit somehow. The former option presents obvious political difficulties. The latter presents significant macro-economic risks. In an already tight global credit market, government borrowing to finance widening budget deficit will crowd out private investment. Alternatively, if the Bangladesh Bank were to finance the deficit by printing money, we would be taking the first steps to hyper-inflation.

Even the most optimistic scenario -- one of a very mild US recession and a quick global recovery -- still leaves our macro-economic policymakers with little wiggle room. As long as inflation remains high, our policymakers will have to balance difficult policy trade offs. If the worst should happen -- a protracted global slowdown with continued inflation -- we could be looking at the worst economic crisis since the 1970s.

This is indeed a very bleak outlook, with no good policy options. It is in this environment that the budget will be brought down. And quite possibly, the newly elected government will inherit a more challenging set of tasks than any of its predecessors in decades. No matter what happens in the political arena, it is important that this grim situation is understood.

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1. See here: *http://www.thedailystar.net/forum/2008/February/food.htm*
2. Full details of the ADB's outlook for Bangladesh are available here: *http://www.adb.org/documents/Books/ADO/2008/BAN.pdf*

Jyoti Rahman *is an applied macroeconomist and a member of Drishtipat Writers' Collective. He can be contacted at dpwriters@drishtipat.org.*