

Need for a social contract

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NOTWITHSTANDING 20 plus years of experience with democratic governance, the present political impasse suggests that Bangladesh still has a long way to go to attain mature democratic traditions. Quick solutions are unlikely.

In the meanwhile, the development agenda continues to gather steam. The changing aspirations and challenges of an economy in transition from a primarily agrarian production mode towards one that is dominated by a modern manufacturing and services activities require far more agile and thoughtful policy making than in the past.

So, irrespective of how the political impasse gets resolved and who wins and who loses, citizens would greatly benefit from a broad political consensus that guarantees that whoever governs must respect some minimum norms of behaviour when it comes to economic and social policy making.

This is not an impossible task. The development experience of Bangladesh suggests that there are areas of policy making where consensus has emerged and despite many changes in government, there has been a broad continuity of policies and programmes in those areas, particularly since the advent of democratic governance in the early 1990s.

The most fundamental area of consensus is a commitment to poverty reduction and human development. This has been the flagship of economic and social policy making for all governments since independence. The underlying strategies and policies have been broadly consistent across all governments. The approach to programmes or emphasis on certain policies has differed, but more or less the political commitment has stayed.

Thus, for example, all governments have emphasised economic growth as the main instrument of job creation and poverty reduction. Related to this, the focus on rice and agricultural productivity has prevailed; the push for labour-intensive exports has continued; and the commitment to sound macroeconomic management has by and large prevailed.

When deviations have happened, as in the conduct of monetary policy during FY10-12, they have been subsequently corrected.

The result of this continuity in policy has been highly positive. Savings and investment rates and export as a share of GDP have all grown remarkably, contributing to an impressive increase in total and per capita GDP,



People show the photographs of their relatives, who were missing after the Rana Plaza collapse in Savar in April.

STAR/FILE

especially since the 1990s. Fiscal deficits have been kept within manageable limits, the average inflation rate has been restricted to single digit and the balance of payments has remained comfortable.

On the human development side, successive governments have emphasised the importance of education, especially at the primary and secondary level; programmes to eliminate mass communicable diseases; programmes to lower fertility; and programmes to improve child health and nutrition. The resultant progress with improvement in social indicators, including gender imbalances, has drawn international attention with public appreciation from Nobel Laureate Prof Amartya Sen.

GDP growth and human development in turn have helped Bangladesh achieve a solid progress with poverty reduction.

These positive experiences suggest that even in an environment of political immaturity it is possible to reach consensus on some key areas of economic and social policy making irrespective of who governs the country.

However, a critical area where economic and social policy making has made least progress owing to the lack of political maturity concerns the absence of sound institutions. Events such as the stockmarket crash of 2010, the Hallmark scandal, the Padma bridge debacle and the Rana Plaza tragedy are all indicative of the weakness of economic institutions in Bangladesh.

The stockmarket crash of 2010 was not caused by a slump in domestic or international economic activity but by pure greed and wrong doing of certain market players who took advantage of the weaknesses of the Bangladesh Securities and Exchange

Commission and in the conduct of monetary policy. The Hallmark scandal happened because of poor management and oversight of the state-owned Sonali Bank.

The Padma bridge debacle resulted from weakness in public procurement policy. The Rana Plaza tragedy happened because of inadequate regulatory policies and poor implementation owing to the weaknesses of the underlying institutions.

Quite apart from the serious negative effects of each individual event, they are symptomatic of emerging development constraints that, if left alone, could easily gain strength and prevent progress with economic and social development. For example, available evidence from the performance of the state-owned banking sector shows that the amount of infected portfolio (non-performing loans or NPLs) has now reached a massive proportion equivalent to \$4.1

billion owing to either Hallmark type scandals or politically-motivated lending decisions. The prospect for recovering much of these infected loans is highly uncertain. The government is being pushed to divert scarce public resources away from infrastructure, human development and social protection to fill the holes left by corrupt and inefficient lending decisions of the underlying public banks.

The proper management of the public banks is a huge policy issue where a consensus is needed. Irrespective of who is in power, there must be a commitment that these banks will not be used as an instrument of corruption and favour dispensation.

Otherwise, the cost to the stability of the financial sector and to the economy can be substantial that could have severe downside effects on development prospects. Options include privatisation, conversion to narrow banks by taking away their lending functions other than dealing with treasury financing, and true commercialisation with professional management based on sound banking principles and norms.

The issue of establishing sound public procurement cannot be over-emphasised. The loss of Padma bridge financing is illustrative of the serious development costs of weak public procurement. More broadly, there is now a consensus among development practitioners that infrastructure is the most important constraint to manufacturing sector and overall GDP growth in Bangladesh.

There is a large volume of foreign aid potentially available to help finance critical infrastructure in electricity, primary energy and transport network. The fear of corruption in public procurement is a serious bottleneck to their effective use.

It will be unrealistic to expect that all public procurement will be made corruption free in Bangladesh. However, it is not unreasonable to ask for a consensus that all donor funded infrastructure projects will be done on a turn-key basis to safeguard the implementation of projects of fundamental development importance, such as Padma bridge or a mega power station.

A third critical area where a social contract is essential is related to the prevention of Rana Plaza tragedy type incidents. The event reflects both the absence of prudential regulations related to land procurement, building construction and occupancy norms and their sound implementation.

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India's central bank chief prescribes bitter pill

REUTERS, Mumbai

RESERVE Bank of India (RBI) Governor Raghuram Rajan may raise policy rates again after shocking markets by increasing them in only his first meeting, signalling he is willing to risk prolonging what is already the lowest economic growth in years in order to quash persistent inflation.

Raising the repo rate by 25 basis points to 7.50 percent as India stumbles through its worst economic crisis since 1991 puts pressure on New Delhi to relieve supply-side bottlenecks in the economy, such as poor infrastructure, that keep inflation high even when demand is soft.

That is a big ask for a weak coalition government, which also faces a general election by May.

Rajan is expected by many in the market to shift the RBI's main inflation gauge to consumer prices from wholesale prices, putting India in line with most big economies but pushing up near-term rate expectations. Consumer price inflation was 9.5 percent for August, meaning the cost of living is rising faster than interest rates. The wholesale price index rose 6.1 percent.

"If he goes ahead and hikes further, which I think he might, then it might affect growth. But ultimately, if you have to bring down inflation, there is no other option," said A Prasanna, economist at ICICI Securities Primary Dealership Ltd in Mumbai.

A prominent former IMF chief economist who famously predicted the global financial crisis, Rajan took office earlier this month amid much media fanfare and high expectations that he could engineer a turnaround for the sluggish economy and rescue a currency that had fallen as much as 20 percent this year.

A flurry of measures by Rajan's predecessor and fresh moves on his first day in office have helped lift the rupee off its record low. Rajan rolled back part of the



Raghuram Rajan

sharp increase in the marginal standing facility (MSF), an overnight rate, reassuring some in financial markets that the rupee measures are temporary. But in raising the repo rate, traditionally the policy interest rate, Rajan showed the central bank's priority had shifted from defending the rupee to fighting inflation.

"It should bring down inflation expectations and help correct India's macroeconomic imbalances. However, this means severe growth pain in the coming year," Nomura analysts wrote.

Nomura now expects the RBI to raise the repo rate by another 50 bps in the fiscal year ending in March to take it to 8.00 percent, followed by a lengthy pause.

It had previously expected no further rate move this fiscal year followed by 75 bps of cuts in the next fiscal year. It also said there are downward risks to its GDP forecast of 4.2 percent, which would be the lowest in a decade, and 5.1 percent for this fiscal year and next, respectively.

Edelweiss Securities, which had expected 50 bps of rate cuts by the end of March, now expects rates to stay unchanged.

While the US Federal Reserve's

decision on Wednesday not to begin unwinding its monetary stimulus fuelled expectations that the RBI would begin cutting the MSF back to its earlier level, not a single analyst in a Reuters poll had predicted that Rajan would increase the repo rate.

Lifting rates may compel Indian households to shift more of their savings towards banks and away from real estate and gold, addressing a trend that has pushed down deposit growth.

"I think it's an interesting experiment," said Rahul Bajoria, an economist at Barclays Capital in Singapore.

"I am not saying whether I know it will work or not, but I think it sort of shows the RBI's hand in the sense that they really want to focus more on the inflation side of things than on growth at this point," he said.

Also, one of the biggest drivers of inflation in India, the rising cost of food, is generally not sensitive to rates, meaning the net effect of Rajan's policy tightening may be on managing inflation expectations as much as inflation itself.

If Rajan raises rates further, he might not do so dramatically. On

Friday, he noted that a weak economy can provide a "cushion in terms of disinflationary processes at work but also will give us an incentive to then perhaps look to putting greater emphasis on reviving the growth of the economy."

India grew at 4.4 percent in the June quarter, its worst pace in four years.

Indian markets took the policy badly, with bonds and stocks plunging and dragging the rupee down with them only a day after a Fed-fuelled rally. Still, in recent weeks the rupee has recovered some of its losses and the sense of crisis surrounding the currency has eased for now.

Traders said the 10-year government bond yield—which jumped 39 basis points on Friday—could rise close to 20 basis points this week, partly as the market factors in higher policy rates.

Some Indian companies worried the higher rates could prove damaging. Many companies are struggling after the central bank's rupee measures supported the currency but dried up credit.

"Industry is truly concerned about the policy rate hikes and their adverse impact on the investment sentiment," Srei Infrastructure Finance Ltd said in a statement.

Finance Minister P Chidambaram, who has in the past pushed for pro-growth monetary policy, did not make any public comment on Friday, although several ministry insiders said they were understanding of the challenge Rajan faces.

At his first-day press conference earlier this month, Rajan, 50, impressed RBI-watchers with a multi-pronged action plan to bolster the rupee and strengthen financial markets but also warned that he would have to make unpopular decisions, that his job was not to accumulate "likes" on Facebook.

"This is possibly the part where the new RBI governor pre-empted that the course of action by the central bank was not to accumulate "likes", said Radhika Rao, economist at DBS in Singapore.

Chinese tourists, diplomats make a splash in Maldives



AFP

Hotel guides wait for Chinese tourists as they walk out of the international arrivals hall at the Male International Airport in Maldives.

AFP, Male, Maldives

THE travellers pouring off flight LV199 from Shanghai into the international airport of the Maldives, many dressed in designer labels, are an unmissable sign of China's interest in the far-flung archipelago.

Their arrival -- Chinese visitors are now the biggest group of tourists to the Indian Ocean islands -- has been accompanied by greater diplomatic engagement in the Maldives by Beijing, which is investing widely around South Asia.

Recently married Chen Hui and Fang Ye, 20-something business executives from near Shanghai, are returning for their second trip and heading to a resort by speed boat where over-the-water bungalows start at \$500 a night.

"Most of our friends come here on their honeymoon," Fang told AFP, who said they were looking forward to doing some fishing and posing for photos on the sun-kissed white sands that draw nearly a million visitors a year.

The Maldives has been promoted as a destination in the Chinese media, she said, with the Islamic republic benefiting from its status as an "approved destination" by the Communist Party government.

Chinese now comprise nearly a quarter of all tourists annually, triggering a recruitment race for Mandarin-speaking hosts, waiters and diving instructors at five-star hotels.

Across the water from the airport island lies the cramped capital Male, where Chinese aid paid for the foreign ministry, a waterfront building built in the shape of

sails that evoke the nation's sea-faring character.

In the Sultan Park neighbourhood stands the two-storey national museum, another gift from China that opened in 2010. It hit the headlines two years later when Islamist rioters broke in and smashed invaluable Buddhist artefacts.

Around the same time, Beijing opened an embassy, giving it a permanent diplomatic presence -- and better access to the frequent Chinese swimming casualties who underestimate the dangers of the country's turquoise waters.

"I think we will do our best to develop our friendship and cooperate in the economic field," Chinese ambassador in Male, Yu Hongyao, told AFP in an interview when asked about Beijing's vision for relations.

"Gradually we will give aid to Maldives," he added.

He said that bilateral trade volumes remain "very small" but that talks were on for future joint projects, including possible road construction and education schemes.

China's interest in the Maldives fits a pattern of investments around the Indian Ocean, referred to by some analysts as a "string of pearls" strategy to contain India's rise.

The Maldives consists of more than 1,100 islands scattered across the equator, which sit aside the world's most important shipping channel on which goods from the East travel to markets in the West.

Its strategic location was appreciated by former colonial master Britain, which ran a military base here until 1976, and China was once rumoured to be eyeing an uninhabited atoll as a submarine base.