Floating Exchange Rates in the Developing World: The Bangladesh Context

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Abstract

We find that independent floating is not a viable option for least developed countries. During the last one decade, the number of countries with independently floating exchange rate declined significantly. However, developed countries, such as the USA, Canada, UK, Japan etc. have been consistent floaters. Many least developed countries went for independent floating, but failed to stick. Some also suffered damages in the process. Bangladesh belongs to managed floaters' group. However, Bangladesh's floating behaviour looks like an independent one. The result has been unpleasant. Our opinion is that Bangladesh's move toward floating has not been timely. To continue with floating, Bangladesh will have to exercise total independence at managing the float on the one hand and devote to developing such complimentary factors as are essential for floating to work.

Exchange rates are theoretically divided into two categories, namely, fixed and flexible exchange rates. There are, however, quite many variants of each of these categories. The fixed exchange system has about as many variants as has the variable system. Edwards and Savastano (1999) list as many as nine different exchange rate systems that prevailed in the world until 1999. According to IMF Annual Report 2005, the total number of variants [1] is eight. *Exchange rate arrangement with no separate legal tender*, and *independent floating* appear respectively in the first and last places of both the lists. Coexistence of many systems has, among others, turned the task of estimating their relative merits

Since Edwards and Savastano (1999) and the IMF use distinct terms to describe various systems we cannot determine if fonner details any particular system or some particular system vanished during the interval.

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problematic. *The profusion of exchange rate systems and the blurred boundaries between many of them makes any attempt to empirically determine the merits of alternative regimes extremely difficult*—(Edwards and Savastano 1999, p.5).

Between 1988 and 1998, the number of countries having floating– a variant of the flexible exchange system— rose from just 38 to 101. The rush seems to have waned since. According to IMF Annual Report 2005, 86 countries out of a total of 187, were pursuing floating as of end April, 2005. Of them 52 were using *managed floating* and the rest pursued *independent floating*. At the other extreme, the number of countries with no *separate legal tender* is also on the rise. Between 1999 and 2004, the number of countries under the latter, in turn a variant of the fixed exchange rate system, rose from 37 to 41. The fact that an overwhelming majority of the world's countries, 127 out of 187 now belong to either extreme has also led some experts (e.g., Eichengreen and Hausmann, 1999; Fisher, 2001) to predict that the intermediate regimes will vanish, and as between the corner solutions, floating will dominate.

The bipolar view has been refuted by Velasco (2000), OECD (2001), and Williamson (1999). Velasco (2000) points out that, except for some extreme cases, neither currency boards nor a clean float of currencies seem appropriate for developing countries. Williamson (1999), for instance, sees equally admissible the possibility of countries reverting to intermediate regimes. Recent statistics too seem to provide credence to this possibility. The number of independent floaters, for instance, fell from 50 in 1999 to 34 in 2005. This might also go some way to dispel the IMF's foresight. It is the bipolar view that might rather fade away. Table-1 in the appendix shows how rapidly the numbers of countries affiliated to the various variants are fluctuating. There are instances of countries *hiring and firing* certain system in a span of just one year. Exchange rate system of the world, particularly, the developing one is seemingly passing the most turbulent of episodes ever.

This article is organized in the following manner. In section two, we prepare a short note on the prospect of floating by developing countries. In section three, there appears a perspective account of Bangladesh's move toward floating. Section four points out Bangladesh's problems and prospects with floating. Concluding remarks appear in the last section.

2. Floating by the Developing Countries

The job of determination of the relative advantage of floating exchange for the developing countries is complicated due to the very nature of the problem. As

Frankel (2003) notes, *The advantages and disadvantages of various exchange rate regimes – fixed* versus floating as well as various other places along the spectrum — are far too numerous to be readily captured and added up in a single model. Studies on floating by developing countries so far have remained almost confined with addressing the broad issue: whether a developing country should float or fix. Opinions, as usual, are divided. While the IMF is almost the sole advocate for floating by developing countries, other experts differ and seriously object to applicability of floating for them.

2.1 The IMF's Point

No single exchange rate regime is best for all countries in all circumstances (IMF, 2000). *Member countries continue to have scope to choose the type of exchange rate regime that best suits their needs, always with the proviso that the chosen regime must be credibly supported by policies consistent with the choice. ...While increased capital mobility has been leading an increasing number of countries to either end of the spectrum between firmly fixed rates (or monetary unification) and free floating, intermediate regimes are likely to remain viable and appropriate in many cases (IMF 2000, op. cit.).*

In the contemporary world, however, the IMF, in not quite keeping with this position, is found to put pressure upon those developing countries, which seek its help to switch to floating exchange system. To the sheer disregard for the arguments that highlight inappropriateness of floating system for the developing countries, more and more countries are allured to introduce it. "Fixed exchange rates pose significant challenges because they require much greater reliance on fiscal, monetary and structural policies to provide the flexibility needed in the economy" declares Anne Krueger, the managing director of the IMF (Krueger 2005).

Floating exchange system, thus, is supposed to overcome the necessity of excessive reliance by developing countries with fixed exchange system on fiscal monetary and structural policies for economic flexibility. Unfortunately, we will see soon how experts refer to the same fiscal, monetary, and structural matters to express reservations about appropriateness of floating for developing countries.

2.2 The Counterpoint

Number of countries belonging to independent floating declined from 50 in 1999 to 34 in 2005. Although, a few least developed countries, such as, Somalia,

Uganda, Sierra Leone, Papua New Guinea, Madagascar, continued to be in the independent floating group until 2005, they too may be expected to follow suit considering the observed trend. Ecuador, finding itself in ruins, abandoned floating after experimenting with it less than one year. Of the 50 countries, which belonged to independent floating group in 2000, only 24 remained in the same group in 2005. They are mostly the developed countries, e.g., the US, U.K., Canada, Japan, Australia etc. Floating exchange system initially evolved in those countries. That is, independent floating suits the developed countries.

In the absence of hard data on the outcome of floating in the developing countries authors until now concentrate on its theoretical aspects. These include issues on regional blocks, competition for world market for similar range of products, difficulty of defining floating proper for a developing country, likely volatility of exchange rate, uncertainty, and loss of confidence, fiscal and monetary weaknesses, adverse implications of combination of floating and international capital flows, potential negative impact on investment and debt service, etc.

Bénassy-Quéré and Coeuré (2000) have stressed upon the regional dimension of the debate on corner solutions. They argue that both pure floating and hard pegs make future regional cooperation more difficult. This is important in a world of regional trade blocs, which look for ways to intensify cooperation. A float is an inherently unstable regime for countries competing on world markets for a similar range of products and hence sets incentives for beggar-thy-neighbor competitive devaluation. Floating induces non-cooperative strategies, especially when the competing neighbors face a common shock

In the similar vein, Cooper (1999) points out prescriptions regularly extended to developing countries by the international community, including the IMF and the US Treasury, namely to move toward greater exchange rate flexibility and to liberalize international capital movements, may be in deep tension, even deep contradiction. *It is an open question whether a broad, diversified financial market based on the domestic currency can develop under floating exchange rates,* says Cooper (op. cit.), who also argues that jumping asset prices and absence of hedging instruments in underdeveloped countries could trouble lives under floating exchange system by hampering well-being and investment. Cooper concludes by noting that,

> *as time goes on flexible exchange rates will gradually evolve from being mainly a useful shock absorber for real shocks into being mainly a disturbing transmitter of financial shocks, increasingly troublesome for*

> *productive economic activity. Thus a cost-benefit calculation for flexible versus fixed exchange rates will gradually alter the balance against flexibility, even for large countries.*

This conclusion will look justified empirically since the number of independent floaters declined from 50 to 34 between 1999 and 2005 (see table-1). Table-1 also shows that number of managed floaters has almost doubled to 52 between 1999 and 2005. Edwards and Savastano (1999) asks if it is at all possible to distinguish fixed and flexible exchange rates in the context of the developing countries. To quote the authors,

> *to our knowledge, there have been no serious attempts at establishing an economically-based divide between a "flexible" and a "floating" exchange rate in developing countries. Moreover, given the dearth of episodes with floating exchange rates in those economies, it is not entirely clear whether such a distinction is even possible and, therefore, what countries or experiences outside the developing world should provide the yardstick for evaluating this* option. …

This argument notwithstanding, Edwards and Savastano (op. cit.), conclude,

> *Mexico's experience after the 1994 peso crisis provides an opportunity to gain some insights on behavior of floating exchange rates in emerging economies. Of course, it is not possible to extract general conclusions from a single episode, but in the absence of other experiences with anything that resembles a floating rate, analyses of Mexico's foray with exchange rate flexibility should prove very useful. ... Although preliminary, and based on only a few months of the floating exchange rate experiment, these results suggest that middle-income countries can have a reasonably well functioning floating exchange rate system.*

Likely volatility and uncertainty has been highlighted by Standard and Poors (Feb 15, 2002), which notes that in Mexico, foreign exchange rate dropped 24 percent in a week in Venezuela after the announcement of floating and that interest rates on commercial loans peaked near 100 percent.

> *"The high uncertainty prevailing in the economy and the loss of confidence are likely to drive the fx (foreign exchange) rate well over VB1000 per US dollar. While the sharp increase in interest rates should benefit intermediation margins, with banks able to get spreads as wide as 40 percentage points, the negative effect on asset quality will be more*

> *significant given the weak loan portfolios. High interest rates will curb customers' capacity to service their debts, driving problem loan ratios in the system up from the 7.1% (including restructured loans) reported at year-end 2001"* (see, Standard and Poors Feb 15, 2002).

OECD (2001) argues that corner solutions are not as crisis-free as is often maintained. The prospect of regional integration invalidates corner solutions as non-cooperative (float) and costly to exit (hard pegs), but it revives the intermediate exchange-rate regime (OECD, op. cit.)

Similar fate befell Guinea, which introduced floating on 1 March 2005. Guinean Franc has free-fallen, losing 38 percent of its value against currencies like the dollar, according to the IMF. Informal money-changers reportedly hawk on the streets of Conakry Guinean Franc.

About floating by least developed countries one can thus expect to witness repeating of similar events. It should be so because a host of fundamental issues remain unresolved in those countries. These, according to a list made by Joshi (2003), include

(1) Floating needs inflation targeting – a task quite beyond the capability a typical least developed country to handle successfully, due to, among others, dominance of fiscal policy there.

(2) These countries lack the financial infrastructure that is appropriate for floating exchange rates. Their financial and foreign exchange markets lack depth. This may amplify exchange rate fluctuations to enormous social costs. These thin markets are potentially subject to manipulation by hedge funds.

(3) Weak or fragile financial credibility of developing countries can arouse market fears of likely irresponsibility on the part of financial authority. This limits heavily flexibility of monetary policy, which, in turn is the main advantage claimed for a floating exchange rate.

(4) Developing countries cannot undertake local-currency-denominated foreign borrowing. Since domestic bond markets are also undeveloped, debt structure becomes over-dependent on unhedged external borrowing. This makes the national balance sheet vulnerable to large exchange rate changes.

Thus, even if floating can be useful for middle- and high-income countries, it might prove be highly volatile and destabilising in countries with underdeveloped financial markets, especially, in those whose banking sectors are weak. Also, in the absence of hedging instruments local companies would be exposed to

exchange rate risk and the already financially troubled state-owned enterprise sector might collapse. *Freely floating exchange rates are particularly harmful to developing countries with underdeveloped financial markets and highly open economies. Compared with the industrial countries, their exchange rates would be more volatile and the availability of financial instruments for hedging against exchange risks would be limited* (Kwan, 2000). The classic objection against floating is that it leaves the system bereft of nominal anchor. A new critique of floating rate is that the latter is volatile in the short term and thus potentially may inhibit trade flows (see, Bernanke, 2004). Bernanke (op. cit.) also note that historically, floating exchange rates emerged in countries where there existed no less worse alternatives.

IMF Annual Report 2005 shows that level of development plays no role at countries' becoming managed or independent floaters. Thus while countries like Somalia and Malawi are having independent floating systems, Singapore, Russia, and Czech Republic are managed floaters. Wickremasinghe (2004) refutes the validity of PPP hypothesis for Sri Lanka. Qayyum et al. (2004), find *a substantial undervaluation of the Pak-rupee vis-à-vis the US dollar* under the managed floating system that it introduced in 2000.

India did revert to managed-floating from independent floating in 2000. Sri Lanka belongs to independent floating regime, under which its economy has not done well. Inappropriateness of independent floating for underdeveloped countries has also been witnessed other countries too. Ecuador lost its sovereignty over a legal tender of its own; it has dollarized. Ghana, Guinea, Guyana, Mauritius, Mongolia, Angola, Indonesia, Zambia abandoned independent floating and moved to managed floating in 2001. Ghana qualified for debt relief amounting to $3,5bn under the heavily indebted poor countries initiative. It also recorded strong growth in foreign investment from $65,37m in 2002 to $88,6m in 2003. Congo and Eritrea abandoned independent floating and moved to some pegged systems.

According to IMF classification, Bangladesh belongs the group of countries whose currencies are subject to *managed* floating. This group is the largest one with, according to 2005 data, as many as 52 members. Its size rose from as low as 27 in 1999.

3. Bangladesh Floats Exchange Rate

On May 31, 2003 Bangladesh replaced its fixed peg arrangement against a single currency (see, IMF Annual Report, 2003) by floating exchange system.

Bangladesh now belongs to the 7th group in the IMF's categorization of countries into groups according to exchange rates in place. The system used by this group is called Managed Floating with no predetermined path for the exchange rate. On May 31, 2003, inter-bank market trading in foreign currency began in Bangladesh. Under the new system "the monetary authority attempts to influence the exchange rate without having a specific exchange rate path or target. Indicators for managing the rate are broadly judgmental (for example, balance of payments position, international reserves, parallel market developments), and adjustments may not be automatic. Intervention may be direct or indirect" (IMF Annual Report 2005).

Bangladesh's move to floating exchange rate system was not warranted by economic condition as such; it was one of the conditions that the IMF wanted GOB to meet in order for her to be able to borrow under PRGF. On May 31, 2003 Bangladesh introduced floating exchange rate. And in June 2003 the IMF's Executive Board approved Bangladesh's request for a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF). In order to qualify for funds under the PRGF the government had to prepare an Interim Poverty Reduction Strategy Paper (I-PRSP). While the latter was on progress the government also had to undertake a series of "belt-tightening" measures in the macro economy in order to qualify for loans under PRGF. *The government launched in June 2003 a comprehensive reform program based on a poverty reduction and growth strategy as set out in our Interim Poverty Reduction Strategy (I-PRSP). Monetary policy was tightened in the second half of FY03 to facilitate the transition to the float* (GOB, 2003).

Thus the development programs of the government were selectively shelved or curtailed to save foreign exchange and boost international reserves. The current account of the BOP was going negative for a couple years preceding the austerity phase; it began to show surplus during the years that followed. International reserves rose close to two billion US dollars. The government had to make fresh promises to the IMF about, among others, privatization of SOEs. The Adamjee Jute Mills was closed. International trade was liberalized further (see, Nag and Salimullah, 2005). Despite all these developments and an I-PRSP ready by April 2003, the IMF did approve loan under PRGF only after Bangladesh switched to floating exchange rate system on May 31, 2003. "The government has been negotiating with the IMF for a multi-million dollar *poverty reduction credit programme*, but the agency said it would only consider the request if the authorities floated the taka by June" (BBC news, May 29, 2003).

Floating system has not been a welcome phenomenon in Bangladesh; arguments opposed to the measure look both substantive and overwhelming. Interestingly, the finance minister himself has been quoted, prior to floating, as saying, "I do not have any rigid stand but the current exchange rate policy is serving us better at least for the time being … The depth and strength of our money market does not suggest that we should opt for a policy which we cannot handle and would create problem for us." *The Daily Star, January 03, 2003.* But it took the minister only a couple of months to change his stand. On April 22nd, 2003, - he said that the government was planning to introduce floating currency exchange rate shortly to promote export against the backdrop of "anti-export atmosphere" in the international arena. "We need it to support our export, which can't be done through subsidy anymore," he told reporters after a meeting with a visiting International Monetary Fund (IMF) mission at his secretariat office here (BSS, April 22, 2003).

A synthesis of the finance minister's statements will only reveal the government abandoned the exchange rate policy that was "serving us better" only because the IMF asked for it. Nothing untoward happened in the said couple of months to transform the international arena into an "anti-export atmosphere". Experts (e.g., Islam, 2003) opposed to Bangladesh's floating emphasize upon such factors as non availability of credible nominal anchor, absence of central bank's independence necessary for, among others, controlling fiscal deficits, absence of competent professionals necessary for predetermining inflation targets, absence of deep and competitive foreign exchange market, absence of sound banking system, low level of international reserves, etc. The government seemingly was not in a position to pay heed to such suggestions.

In June 2003, the IMF approved a loan to Bangladesh of over half a billion US dollars. The IMF got Taka floating; and the government got IMF money.

4. Float Starts to Bite

As mentioned, Bangladesh is a *managed* floater. Under the system Bangladesh can influence the exchange rate, considering such factors as balance of payments position, international reserves, parallel market developments etc. It may be noted that under managed floating system India managed her exchange rate so heavily that the system may be best described as *a "dirty crawl" (see Joshi, op. cit.).* Indian rupee-dollar exchange rate *has exhibited longish periods of stability, punctuated* by crawling depreciations in order to keep the real effective exchange rate roughly constant. A question thus arises as to whether Bangladesh has done

its *managing* right. Available data indicate that the economic agents –consumers and producers— almost did not feel any pinching of the new system until end calendar year 2004. Nominal exchange rate against US dollar showed a small depreciation. It rose from 57.9 to 60.3 between May 31 2003 and December 2004. The monetary authority even would claim credits to the effect that the very shift to floating had *stabilized* the exchange rate.

Since the beginning of the calendar year 2005 nominal exchange rate began to depreciate rapidly. In June 2005 nominal exchange rate rose to about 64; by December was above 66. Early months of the year 2006 saw further erosion of the exchange rate. Business people of late complain that they buy/sell US dollar for Taka 72 to as high as Tk. 74. Monetary authority no longer highlights its ***efficacy*** of having stabilized the exchange rate through moving to floating. Instead, they can now be found to preach that u3nder floating exchange system the government cannot control import prices via intervention in the foreign exchange market. They can also be found to glorify the ongoing depreciation of Taka by attributing to it larger export earnings and foreign remittances.

Neither of the claims, however, seems to be authentic. To quote the Government of Bangladesh, *Monetary policy was tightened in the second half of FY03 to facilitate the transition to the float. Treasury bill rates were raised and reserve money rose by only 4 percent, below program. Nonetheless, private sector credit remained robust, growing by 13 percent in FY03 and the exchange rate has been stable. Given this favorable environment, Bangladesh Bank (BB) began to ease monetary conditions in the first quarter of FY04 to better support growth … With a substantial increase in external assistance, gross official reserves rose by about $1 billion from June 2002 to $2.4 billion (worth three months of imports) by end-November 2003, well above our target* (GOB, 2003). Thus it was *the tightened monetary policy to facilitate the transition to float* and *a substantial increase in external assistance* ***not the movement to floating itself*** that helped the exchange rate to *stabilize* during the months that followed May 2003.

Available data also do not support the monetary authority's claim that the rising exchange rate helped Bangladesh to receive larger export earnings and higher foreign remittances. Table-2 shows that monthly average rate of growth of remittance declined from 2.76 in the pre float period to 2.42 in the post float period despite growth rate of number of persons going abroad rose from 2.42 to 2.55 in the same period. Table-3 shows that export growth rate went negative in 2002, to be followed by a positive single digit rate. During the latest year, 2005, export growth showed a decline. Although the most recent months of the current

fiscal year remittances grew considerably, experts wonder as to what could have caused it.

Course of events reversed during the years since the beginning of calendar year 2004. The Bangladesh Bank eased the monetary policy in the interest of growth as mentioned above. Growth of narrow money M1 and broad money M2, which were respectively 8 percent and 13 percent in 2002, rose to respectively 16.5 and 16.8 percent in 2005 (Table – 4). The government borrowed heavily from the central bank. During fiscal 2005, the government borrowed Taka 3500 from the central bank as against only Tk. 64 crore in preceding year. At the same time inflow of foreign aid fell. According to reports, during the current year Bangladesh received only US $ 500 million in foreign against the committed US $1.5 billion. Bangladesh received a total of US$ 488 million in foreign aid during July-December period of fiscal 2005-06, down from $ 815 million during the same period of the previous year Aid flow is declining gradually due to the government's failure to carry out the conditions imposed by the donors," (Financial Express, Mar 12, 2006). Naturally, floating had to bite. That is, exchange rate's depreciation has been but a consequence of the above events.

Unfortunately, the course of events would look very familiar among concerned observers. Internally, the public exchequer was having hard time consequent upon oil price shock. Administered price of oil has been raised on several occasions of late to public misery. The government wants to take time to raise oil price further. But the donors are stubborn.

It may be remembered that during the structural adjustment era the IMF would keep pressing the government to devalue Taka. Presently, by having compelled the government to go to floating exchange system it has secured one objective seemingly permanently. Devaluation is no longer its headache. The donors reportedly also opine that if the installments of loans are disbursed the government might abuse in the months prior to election. We wonder what else can be a more silly reasoning. The fact of the matter we believe is that even if the government fulfills all the conditions attached to foreign aid, the donors would in one or another pretext refuse to disburse committed funds timely. There are also instances of similar behaviours of donors. In another occasion, during early 1980s the IMF refused to disburse funds committed to Bangladesh despite Bangladesh fulfilled all the conditions attached (see, Matin, 1986). Studies (e.g., Nag and Salimullah, 2005) show that the poverty reduction strategy presently pursued by the government is only nominally different from the previous structural adjustment policies.

Although Bangladesh is entitled under the system of exchange rate policy it is pursuing to intervene according to the economy's priority, as mentioned, she is made to behave as if she belongs the so called independent floater's group. Had the donors disbursed timely the committed funds the country's external reserves, with other things remaining the same, could stand near four billion US dollars, in turn worth nearly five months import. Bangladesh could then be able to intervene properly in the foreign exchange market to the greatest interest of the country.

The ongoing episode, on the other hand, involves all the perils that one could imagine.

The hefty devaluation of the exchange rate will, theoretically, reduce output, employment through both supply and demand sides of the economy (see, Nag, 1990.) Real tax revenue will also tend to decline (see, Nag, 1999).

Aside from these, the de facto independent floating like behaviour of the country's currency will also cost the economy in terms of volatility of macro variables. Volatile exchange rates make international trade and investment decisions more difficult because volatility increases exchange rate risk. According to a study on small island developing countries (SIDS) (Vella, 2005) volatility of the macro economic variables showed considerably higher variations in those countries which floated exchange rates compared to those who did not float. In the appendix we quote from Vella (op. cit.) (Table-5) to compare volatilities of a set of macro variables (measured in terms of standard deviation) with those of the ones in Bangladesh economy. Table-2 compares the pre-float and post-float standard deviation of a number of macro variables of Bangladesh. We see that post-float standard deviations are consistently higher that the pre-float standard deviations.

Bangladesh and the developing countries in the sample in question have considerable amount characteristic similarities. All are price takers in the world economy and have very small share of world trade. Susceptibility to fluctuations of terms of trade is high for both SIDS and Bangladesh. Both have small market sizes and large numbers of small firms. These small firms do not enjoy any economy of scale, so any variability in exchange rate translates into costs. Lack of hedging instruments limits firms' potential efforts to insulate themselves from damages originating from exchange rate fluctuations.

Contents of tables 2, 3, and 4, can be compared with those of table-6 to have a guess about rates of growth in the pre-float and post float periods.

It may be observed standard deviations of interest rate, international reserves, exchange rate, price are higher under floating, reflecting higher volatility of the

variables. The implication is that the economy had to bear the costs. For example, there is a negative relationship between volatility of prices and GDP growth (see, Vella op. cit.). Exchange rate volatility hampers trade flows and thus overall economic activities. Now, the question remains whether the country deserved all these.

5. Concluding Remarks

Floating exchange system is truly a developed country's profligacy. Least developed countries are not viable floaters as of now. Total number of countries practising floating exchange rate has declined during the current decade. However, number of managed floaters has increased considerably. Bangladesh is a managed floater. But it has behaved like one with independent floating. The reason, we argue, is the IMF's influence over the country's economic policy. The consequence has been damaging. We are afraid, unless the country can exercise independence at management of it exchange rate system only more damages await it.

One question, of course, remains as to whether it has been wise to abandon the previous regime that, in turn, was serving the country better according the finance minister himself. Empirical data do not indicate any final location for any particular country, particularly a least developed one. Things at best are changing continuously. None can challenge a possibility of countries returning once again toward intermediate regimes – regimes that have shown signs of being vanished. Bangladesh, it may be remembered was having an intermediate regime prior to the present and also doing better.

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Appendix

Table 1 : Number of Countries under different Exchange Rate Regimes

Exchange Rate Regimes	April 30 1999	Dec 31 1999	March 31 2001	Dec 31 2001	April 30 2003	April 30 2004	April 30 2005.
Exchange arrangements with no separate Legal Tender	37	37	39	40	41	41	41
Currency Board Arrangements	8	8	8	8	7	7	7
Other Conventional fixed-peg arrangements	44	45	44	41	42	41	42
Pegged exchange rates within horizontal bands	8	6	6	5	5	4	5
Crawling Pegs	6	5	4	4	5	5	5
Exchange rates within crawling bands	9	7	5	6	5	5	1
Managed floating with no pre-determined path for the exchange rate	25	27	33	42	46	49	52
Independently floating	48	50	47	40	36	36	34

Source: IMF Annual Reports, various years.

Table 2 : Mean and Standard Deviations of Macro Variables

Variables	Mean		Standard Deviation	
	Pre-float	Post-float	Pre-float	Post-float
Money (M1) (n=32)	231.61	314.35	15.01	40.00
Money (M2) (n=32)	935.35	1356.04	97.16	159.79
Domestic Credit Growth (n=31)	7.31	6.15	3.99	3.95
Forex Reserves (n=32)	1418.02	2750.88	241.48	262.03
Exchange Rate (Tk/USD)(n=32)	56.75	61.17	1.60	2.88
Exchange Rate (Tk/Pound) (n=32)	84.54	109.378	5.50	8.14
Exchange Rate (Tk/Yen) (n=32)	0.47	0.55	0.02	0.03
Exchange Rate (Tk/Euro) (n=32)	53.45	74.92	5.30	5.19
Export Earnings (Taka) (n=29)	2924.62	4010.68	384.80	820.15
Import Payments (Taka) (n=29)	3860.45	5561.83	657.57	1149.97
Export Earnings (USD) (n=32)	518.18	710.23	65.10	121.36
Import Payments (USD) (n=32)	684.06	934.27	111.98	143.18
Price Level (CPI) (n=23)	105.62	114.24	2.63	3.87
Interest rate on Commercial Lending (n=32)	12.59	10.82	0.55	0.64
Current Account Balance (n=19)	44.08	5.11	156.78	140.31
Remittances	209.70	314.69	43.82	50.37
Growth rate of Remittances	2.76	2.42	- -	
Growth rate of persons left for abroad	2.42	2.55	- -	
Call money rate	13.82	16.51	7.39	12.04

Source: Calculated by the authors' based on monthly data obtained from Economic Trends, Bangladesh Bank and International Financial Statistics (IFS).

Table 3 : Export Growth

Year	Export (Million USD)	Annual Growth
1998	5161.2	16.81
1999	5312.8	2.94
2000	5752.2	8.27
2001	6467.3	12.43
2002	5986.1	-7.44
2003	6548.4	9.39
2004	7603.0	16.10
2005	8654.5	13.83

Source: Bangladesh Bank.

Table 4 : Growth of money supply

Year	Money Supply (M1)		Money Supply (M2)	
	In Crore Taka	Growth	In Crore Taka	Growth
2000-01	22347.4	12.40	87174.1	16.60
2001-02	24161.1	8.12	98616.0	13.13
2002-03	26743.4	10.69	113994.5	15.59
2003-04	30500.2	14.05	129773.8	13.84
2004-05	35546.1	16.54	151588.5	16.81
2005-06	36559.6	15.39	158722.5	16.93

Source: Economic Trends, Bangladesh Bank. For 2005-06, M1 and M2 figures are seven months' (July to January) average and have been compared with the previous year's seven months' average to calculate the growth rates.

Table 5 : Indicators of Volatility (Standard Deviation)

	Hard Pegs	Soft Pegs	Floating
Terms of Trade	7.5	9.8	14.0
GDP growth rate	4.8	3.4	3.4
Export Growth rate	10.5	11.5	11.7
CPI	13.4	16.5	24.9
NEER	9.7	9.1	24.1
REER	5.2	4.1	9.4
Reserves	16.4	25.4	56.5

Source: Vella (2005)

Table 6 : Average Macroeconomic Performance (%) (1990 - 2002)

	Hard Pegs	Soft Pegs	Floating
GDP growth rate	2.3	3.0	3.1
Export Growth rate	5.1	5.7	3.1
FDI/GDP	9.2	3.0	5.3
Fiscal Performance/GDP	2.0	0.5	-4.2
Inflation rate	2.5	4.0	10.9
Money Growth rate	8.3	10.2	18.2
Interest rate	7.7	6.6	16.1
Unemployment rate	11.0	9.5	9.9
Current Account/GDP	-15.6	-5.1	-2.6
External Debt growth rate	11.0	7.0	3.0

Source: Vella (2005)

Export of Port Services and Private Port in Chittagong

Abul Kalam Azad*

During the days of Adam Smith, David Ricardo and Karl Marx, services were viewed as unproductive and the mention of trade in services was hardly found in economic literature. But those days are gone now. Things have changed dramatically since then. At present, services are recognized to constitute an important sector of the economy no less than agriculture or industry. Not only do services contribute significantly towards GDP and employment in both the developed and developing countries, the use of new technologies has made many services storable, transportable and consequently, tradable. Lately, a large proportion of the world economic transactions is taking place in the service trade[1].

Again, services may be divided into those consumed directly and those used as intermediate inputs. These input services play a much more complex and important role in the development process than is suggested by their direct contribution to GDP and employment-creation. This is reflected in the inter-linkages between services and the rest of the economy[2]. Production and export in agriculture, industry and services sectors require many infra-structural services like port, transport and storage, utilities, telecommunication besides banking and insurance. The lack of access to adequate and efficient services is considered as an impediment to economic development of the developing countries. National efficiency and international competitiveness of a country depend on the availability of adequate infrastructure services. This makes the efficient supply of services important in any economy. The efficient supply of services, in turn, is linked to production of and investment in services by government and private enterprises, both local and foreign. In this paper, we look at the importance of port services and of the Chittagong Port in the economy of Bangladesh; the latter's current and prospective uses; the organization of production and the cost of supply of port services in the Chittagong Port along with its impact on the economy and finally we suggest ways to improve the situation. We, however, begin with a brief historic profile of the Chittagong Port.

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A Brief Historical Account of the Chittagong Port

It is difficult to say exactly how old the Chittagong port is. But it can be said without doubt that this port is as old as the land is. It is learnt from the writings of the Roman, Greek and Arab sailors and geographers that the Chittagong port was established about two thousand years ago. History testifies the fact that by age and prosperity, this port was one of the oldest elite ports of the world. Historians unanimously admit that since 200 B.C., the pre-Islamic Arabs of Yemen and Babylon dominated and conducted the international trade between Arab, Abisinnya (Ethiopia), Yemen, Assyria (Syria, Iraq, Iran) Greece and Rome in the West and China in the east through ports like Ceylone, Malabar, Kalikot, Java, Sumatra etc. including Chittagong. This domination of the Arabs on the sea route continued till the arrival of Portuguese in 1500 A.D. in Chittagong[3].

The Portuguese and the Arakanese established supremacy over Chittagong for some time before the conquest of Chittagong by the Mughals in 1666. The English East India Company made a failed attempt to capture Chittagong in 1685 when they were beaten back by the Mughal army. The English instead settled at Sutanati—the present Calcutta. They were however back to Chittagong in 1761 when it was conceded to them by Nawab Mir Quasim. Although Chittagong was the biggest port of Bengal, the English had invested a lot of time and resources by then in building Calcutta that was to become the capital of British India later on. In the following 200 years of English rule, the East India Company/British Royal Government favored Calcutta over Chittagong and the latter was developed, if at all, only as a 'second fiddle'. It was only after the partition of India in 1947 that the Chittagong Port was rebuilt and developed as the principal port of this country.

The short historical background of the Chittagong Port has been described above just to remind ourselves the fact that this port, more than two thousand years old, once enjoyed the status of an important international seaport linking the West and the East. It is a matter of great regret that the port that once served as the 'entreport' for the whole region now-a-days cannot even serve this country efficiently.

Importance of the Port Services and the Chittagong Port

Port or harbor services are directly related with the export and import trade of the country. Presently almost 99% percent of our export trade and more than 90% of our import trade are carried out by sea route and hence depend on port services[4].

Again, the trade-intensity index of our economy, given by the ratio of volume of trade vis-a-vis total GDP, increased over the years. This index was about 31%in the year 1999- 2000. This means that the port services are directly related with an amount of out put as large as almost the one third of our national output.

The Chittagong port, as the largest seaport of Bangladesh, handles 80% our import trade and 75% of our export trade[5]. Besides, the volume of cargo-handling in the Chittagong port shows a direct and positive correlation with the growth of GDP of the country. Between 1992-93 and 2001-2002, average annual growth of our real GDP was roughly 5% and average annual growth of cargo handling in the Chittagong Port during the same period was about 10% (Table I). This means that cargo-handling in the Chittagong Port grew twice the growth rate of GDP. So in the future, our drive to achieve higher growth rate will necessarily require larger and larger capacity of cargo handling in the Chittagong Port.

Thus we see that the port service plays an overwhelming role in our economy and the Chittagong Port plays the largest role in that act.

Present and Prospective use of the Chittagong Port

Presently the Chittagong Port and its services are used for handling our exports and imports only. While the service content of the Chittagong Port in our imports

Table 1 : Growth of Cargo in the Chittagong Port and GDP

Year	Volume of Cargo (Thousand M. Tons)	Year-to Year Growth	GDP (Million	Year-to-Year Growth
1992-93	7616	8.23	1455680	4.57
1993-94	7897	3.69	1515140	4.08
1994-95	10278	30.15	1589760	4.93
1995-96	10301	0.22	1663240	4.62
1996-97	10554	2.46	1752850	5.39
1997-98	11087	5.05	1844480	5.23
1998-99	13903	25.40	1934290	4.87
1999-00	15141	8.90	2049280	5.94
2000-01	16907	11.66	2155060	5.16
2001-02	17748	4.97	2258480	4.80

Source: Bangladesh Economic Survey 2002, Min. of Finance, GOB.

may beregarded as our domestic consumption, the same content in our exports may be viewed as our export, that is, export of port services.

But we can export this service of the Chittagong Port in at least two more ways:

Presently, we export this port service embodied in our exported commodities. But we can also allow other countries like Nepal, Bhutan, India, (particularly, landlocked seven sisters of north-east India) to use our port facilities on payment of service charges.

Alternatively, we can import commodities from other countries using our port facilities and re-export them to a different set of countries. In this way also we can export our port services in embodied form in commodities that are neither produced nor consumed by us[6].

But the use of port services in general and that of the Chittagong Port, in particular, for both domestic consumption and export purpose depends on the efficiency of service supply in the Chittagong Port.

Efficiency of Service supply in the Chittagong Port

If we look at the increase of revenue, expenditure and cargo volume, we find that all of them increased at roughly the same average rate per annum (revenue increased by 11.3%, expenditure increased by 11.2% and the volume of cargo increased by 10.1%) between 1992-93 and 2001-2002 (Table 2). Consequently, the staggering high operating cost/revenue ratio, instead of showing any declining trend as expected by some people, maintained an almost constant ratio. This is further reflected by the fact that the cost of handling per ton of cargo remained almost the same between 1992-93 and 2001-2002 (Tk. 188 per ton in 1992-93 and Tk. 184 in). To be more specific, the operating cost/revenue ratio never declined below 63% and went up as high as 77% between 1992-93 and 2001-2002. In input-output terms, this means that most of the value of port services was used up as costs of production of output.

However, from the national point of view, the cost of output of the Chittagong Port is even larger than what is actually incurred by the port. According to a study by Hossain, the illegal rent-seeking in the Chittagong Port was as high as 1.7 times the revenue earned by the Chittagong Port in the year 1999-2000[7]. In nominal monetary terms this means that the nation had to spend about Tk. 11352 million for producing an output of only Tk. 4204 million.

Table 2 : Revenue, Expenditure and Volume of Cargo

Year	Revenue (Million Taka)	Expenditure (Million Taka)	Volume of Cargo (Thousand M. Tons)
1992-93	1875.8	1434.4	7616
1993-94	2055.6	1571.3	7897
1994-95	2604.0	1963.2	10278
1995-96	3158.6	2234.6	10301
1996-97	3243.1	2133.3	10554
1997-98	3452.2	2427.2	11087
1998-99	3745.1	2621.7	13903
1999-00	4204.3	2983.5	15141
2000-01	4770.0	3022.8	16907
2001-02	4795.2	3258.9	17748

Source: Bangladesh Economic Survey 2002, Min. of Finance, GOB.

The Lost Production in the Chittagong Port

The principal activity of a port is connected with the 'loading' and 'unloading' of cargo from the ships carrying goods in and out of the country. It has been estimated that the average turn-around time for every ship visiting the Chittagong Port is at least 6 days which should be normally no more than 2 days. This means that if the port operation was run efficiently, the Chittagong Port could handle 3 times larger amount of cargo than what it handles presently.

Since, at present, the yearly output of the Chittagong Port is about Tk. 5000 million, so the lost output of the port due to higher turn-around time may be given as 5000X2 = 10000 million taka. The rent-seeking by the unscrupulous employees and workers has been estimated to be about 10000 million taka. So the total production loss of the Chittagong Port stands to be (10000 + 10000=) 20000 million taka annually.

If we add the total annual production-loss with the cost incurred by the Port Authority (4204 million taka in 1999-2000), the total national costs of output (services) of the Chittagong Port stands to be 20000 + 4204 = 24204 million taka. The total production-loss is paid, directly and indirectly, by all the users of the port. The total value of export and import in 1999-2000 was about 620000 million Taka. The national cost of port services for handling the total volume of export

and import was about 24204 million taka which is about 4% of the total value of export and import. So we can conclude that the price of both our exports and imports increases by at least 4% because of inefficiency in the Chittagong Port.

The exorbitantly high operating cost incurred in running the operation of the Chittagong Port (Table 3) naturally leaves very small net surplus. Table IV shows the amount of profit deposited in the Government treasury on the account of Chittagong Port in various years. Leaving all other investment on infrastructure aside, if we consider only the value of the total land area of the Chittagong port, the rate of return will be very insignificant. Simple bamboo-huts built on this land would have fetched more revenue as rent for the Government/country!

The reason for inefficiency of the Chittagong Port in terms of input-output, cost-structure and asset-return ratio may be looked into the organizational structure of the Chittagong Port as an individual production unit.

An Analysis of the Chittagong port as an individual Production Unit

Table 3 : Revenue, Expenditure and Operating Costs

Year	Revenue (Million Taka)	Expenditure (Million Taka)	Operating Cost Ratio
1992-93	1875.82	1434.40	.77
1993-94	2055.63	1571.30	.76
1994-95	2604.00	1963.20	.75
1995-96	3158.63	2234.60	.71
1996-97	3243.10	2133.30	.66
1997-98	3452.22	2427.20	.70
1998-99	3745.08	2621.70	.70
1999-00	4204.30	2983.50	.71
2000-01	4770.00	3022.80	.63
2001-02	4795.20	3258.90	.68

Table 4 : Profits Deposited by the Chittagong Port in the Govt. Treasury (million Taka)

Year	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02
Profit	50	200	200	200	350	400	-	00	500

Source: Bangladesh Economic Survey 2002, Min. of Finance, GOB.

Simple microeconomics says that an individual business firm producing goods/services will try to maximize its profits. Chittagong Port catering port services will be no exception to it. In a competitive situation, a firm not only tries to reduce costs of production by technical innovation and restructuring, it also resists any move by labors to raise wages and, thereby, costs. Again a firm can try to maximize its profits by raising price of its products/services or by reducing costs of production or by both. When a firm sells in a competitive market, its scope for raising the price of its product is limited because if it raises price, it risks losing customers. In such cases, the option left to the firm for maximizing profit is to reduce costs of production. And this is good for the producer as well as the consumers and the nation. The producer benefits from the increased margin of profit, the consumers benefit from the reduced price and the nation benefits from lesser use of resources for producing a given amount of goods/services.

But in the case of monopoly, the firm does not have to be afraid of losing customers. So it can go for raising prices if it wants to maximize profits. Not only to maximize profits but to avoid any erosion in profit margin also, the firm will raise price in response to any wage increase by the workers and employees.

This is how Scitovsky tried to explain inflation in his Market Power Theory[8]. According to him, producers with dominance or monopoly power in market find it more convenient to raise the price of product instead of resisting demand from workers for higher wages. Consequently, instead of traditional antagonism between the producers and workers (because of conflicting interest), we see an "unholy alliance" of the producers and workers who use their monopoly power to exploit the consumers and the nation.

And this is exactly what has happened in the case of Chittagong Port. But that is not enough. The situation, here, is even worse. In the case of private monopoly, the monopolist producer at least tries to maintain his own profit margin. But, since the Chittagong Port is a state monopoly, here the government does not prefer to raise the price of services supplied, instead it concedes its own share to the workers and employees. This is what reflected in the very little contribution made by the Chittagong Port to the national exchequer. Though the government as the owner of the port does not go for raising the price of port services, the workers and employees do not stop. They do not mind going after the users of the port for illegal rent seeking, taking advantage of the monopoly position of the Chittagong Port.

But, is the Chittagong Port a Perfect Monopoly?

No, it is not. Though the Chittagong Port has got some captive users, a lot of potential users are barred from using the port services because of its direct and indirect, legal and illegal high costs of services. Not only that, it may even lose some of its present users to its competitors, if things change. Who are the competitors of the Chittagong Port? We can think of at least two—-one within our border and another outside the border. Mongla Port in the south-west of our country could be a potential competitor for the Chittagong Port. But its small size and inefficient organizational structure (same as that of the Chittagong Port) prevent it from becoming a real competitor of the Chittagong port. The other rival of the Chittagong Port is the Calcutta Port. Chittagong Port could provide port services to producers and consumers of the nearly land-locked seven sisters of northeast India. Barring the government policies of India and Bangladesh, the factor that keeps the port-users of this region locked to the Calcutta Port is the inefficiency of the Chittagong port. And this may not be the end, things may turn even worse. If mismanagement, inefficiencies continue to rule the operation of the Chittagong Port and if the Indian government decides to seize the opportunity of allowing transshipment of cargo to Bangladesh through Calcutta Port, Chittagong Port may even lose many of its present users. And, no one will deny that it will spell disaster for our country.

The Way Out

In order to avoid the possibility of such disaster and undesired consequences, we need to reorganize the supply of port services and the present system and scope of operation of the Chittagong Port in order to increase its efficiency. The reorganization of the supply of port services in Bangladesh should be such that the Government should not be the sole supplier of this service. Both private and public sectors should supply port services. Next, the Chittagong Port should be allowed to cater the needs of not only the users from Bangladesh but also users from the entire region in the neighbourhood of Bangladesh.

The first measure to involve private sector in the supply of port services will be to encourage private investors to set up private ports in Chittagong at suitable locations (and also in Khulna). Besides, Mongla Port may be leased out to the private sector on a free, transparent and open auction basis. Next, while keeping the management of a number ‘jetties’/ terminals reserved exclusively for the Chittagong Port Authority (CPA), others may be leased out to private agencies. This will create an atmosphere of healthy competition between the private and

public suppliers, thereby increasing the efficiency of supply of the port services.

As for allowing the Chittagong Port to serve the users from outside the national boundary of Bangladesh, we may at least adopt the trading arrangement suggested by the present author in another article [6] if direct transit or transshipment of goods to and from other countries in the region through Chittagong Port is not desired. We should not for get the age-old adage of the international trade theory that 'some trade is better than no trade'.

It may be recalled here that when Chittagong was a 'porte Grande', Sutanati—-the present day Calcutta was mere a fishing village. The persisting inefficiency of the Chittagong Port goes only to the advantage of its competitor in Calcutta. Those who want to save the Chittagong Port by stalling the introduction of private port services in Chittagong should better realize that their actions help only perpetuate the inefficiency of the Chittagong Port and, thereby, will ruin it ultimately. Instead of trying to save the Chttagong port, they should rather be eager to ensure the uninterrupted and efficient production and supply port services in Chittagong for domestic users as well as users from the neighbouring countries. In the end, only will this make Chittagong the real 'porte Grande.The perpetuation of inefficiency in the Chittagong Port will only help its 'arch rival' in Calcutta.

So, we may conclude by saying that those who discover the 'Cronies of Clive'[9] among the supporters of private port in Chttagong should better be watching for the 'Chellahs' of Yagat Shett[10] among their ranks and files.

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9. Unfortunately, the patriotic zeal and emotion on this controversial issue sometimes run so high that people opposing the privatization of Chittagong port even do not hesitate to compare the supporters of privatization scheme with the collaborators of British East India Company and its Commander Colonel Clive who engineered the demise of Independent Bengal in 1757.
10. Yagat Shett was one of the most infamous architect of the Plassey conspiracy that saw the sowing of seed of the British colonial rule in Bengal (later on in entire India) in 1757.