

NATIONAL BUDGETS AND PUBLIC SPENDING PATTERNS IN BANGLADESH: A POLITICAL ECONOMY PERSPECTIVE

Wahiduddin Mahmud

ABSTRACT

This exploratory study looks at the factors shaping the formulation and implementation of national budgets in Bangladesh with an emphasis on the determinants of public social spending. By considering the actual budgetary outcomes as the "revealed" public choice, the deviations from the stated economic policy objectives are examined. While few generalisations can be made, the study highlights the complex interactions of economic, political and bureaucratic incentives and institutions underlying the budgetary processes. One finding is that, given the weaknesses of the democratic institutions in Bangladesh, there seem to be at work some non-institutional mechanisms for ensuring public accountability, such as through civic activism, a free press and widespread political awareness among the people at large. This probably explains why, in spite of many perverse political incentives embedded in the system, there has been considerable progress in many areas of social development in Bangladesh and the budgetary process portrays, at least in pretence, a "benevolent social guardian role" of the government.

Introduction

National budgets are the most potent instrument of the government's economic management and can thus have a profound effect on the well being of the people. Both the methods of revenue collection and patterns of expenditure adopted in the budget go a long way in determining the growth and distribution of income in the economy. This is particularly true when one considers the cumulative effects of budgetary policies pursued over a period of time. There are of course many important areas of economic policymaking that lie outside the purview of the budget - for example, monetary and exchange rate policies, labour market policies, and a whole range of policies and institution-building activities that are intended to regulate and facilitate the functioning of a market economy. But these policies largely complement and get reflected in the budgetary processes in one way or another.

The scope of budgetary policies in a poor developing country like Bangladesh is, however, closely related with what developmental role is envisaged for the government vis-à-vis the private sector. On this, development thinking has undergone profound changes over time and is still evolving, with no clear-cut consensus (the so-called 'Washington consensus' itself being continuously modified by its own proponents). This debate, while relevant, is not the major concern for the present study. Public policy discussions are usually about what *ought to be* done, rather than what *actually is* done. The former is about the economic arguments regarding policy choices, while the latter is concerned with the economic-political-institutional interactions that shape the actual formulation and implementation of policies. This study is mainly concerned with analysing those interactions and their outcomes - what may preferably be called 'public choice' involved in budgetary decisions.

Why does a government conduct its budgetary policies (or, for that matter, the entire economic management) in the way it does? There is not much guidance available from the economics or public administration literature on this issue. Many authors have discussed the political economy aspects of implementing market-oriented liberalising policy reforms in developing countries, but the discussions hardly cover the government's behaviour regarding public finance (excepting certain issues that are directly relevant to those reforms, such as the elimination of subsidies or cuts in import tariffs).¹ On the other hand, the so-called "public choice" school of economics founded by James Buchanan and Gordon Tullock among others, does provide a framework for analysing the determination and efficiency of public policies, including budget-making processes (Buchanan and Tullock 1962, Downs 1957). Following their work, there has now emerged a sizeable literature attempting to explain economic policymaking by democratic governments; but there is yet little consensus on empirical evidence or on modes of analysis (Mueller 1997, Persson and Tabellini 2002). Moreover, this literature deals with only Western industrialised economies having mature democratic systems, and has, therefore, very limited applicability to developing countries.² As such, this paper makes only some occasional reference to this literature

The point of departure for this paper will be to see how far there exists a coherent stated economic policy framework for the budget, particularly regarding the priorities of public spending and their envisaged contribution towards social well-being. If the actual budgetary outcomes are considered as the "revealed" public choice, one can then examine how far these deviate from the stated policy framework.³ The deviations may occur when the budget is proposed as well as at the implementation stage. Some of the deviations may be due to lack of analytical and administrative capacities in the formulation and

implementation of the budget, but more important in explaining the deviations are likely to be the political compulsions. It need not, however, be assumed that the stated policy framework is conceived in a political vacuum on the basis of economic rationale alone, as in the so-called "benevolent social guardian" model of governmental objectives and decision making. Such a model implicitly underlies most public policy discussions. In reality, economic policy making is likely to incorporate political responses and feedback, thus making a full circle of political-economic interactions.

The empirical analysis will be based on the fiscal policies pursued during the decades of the 1980s and the 1990s, with more emphasis on the later years. The analyses of the fiscal trends during this period can be enriched by capturing the effects of several factors relevant for this study:

- large-scale fiscal adjustment taking place as part of macroeconomic reforms initiated in the mid-1980s, mostly under donor conditionalities (thus showing donor influence as well as changes that were more than 'incremental');
- increased reliance on domestic financing of public development spending in the face of declining foreign aid availability, thus providing more scope for the government to 'reveal' its own priorities;
- transition to parliamentary democracy in the beginning of the 1990s.

On the last point, it may be noted that the 1980s saw the semi-autocratic rule of General Ershad, starting with a martial law regime, followed by a semblance of presidential form of democracy with a multi-party parliament. The government failed to gain credibility as a representative one because of its repressive measures and rigged elections. Parliamentary democracy was introduced in the beginning of the 1990s, after the Ershad regime had fallen through a mass movement. Since then, the elections held under the neutral caretaker governments (for which, provision has been made under the constitution) have been widely acclaimed as free and fair. However, none of the elected parliaments could function effectively because of frequent boycotts by whichever parties were in the opposition.

The empirical analyses presented in this paper are mainly based on official data relating to the government's fiscal operations. In order to assess the actual outcomes of the stated budgetary policies, it also draws upon the results of various studies on the evaluation of public service delivery mechanisms and implementation of development projects. The findings of some recent studies on economic policy reforms, conducted with a 'participatory' approach, are also

found helpful in understanding the perceptions of stakeholders, and thereby, the political economy of the budgetary process.

Budgetary Trends and Strategies: What Do They Reveal?

The Economic Policy Framework

Achieving equitable economic growth for poverty alleviation is generally accepted to be the overriding goal of the government's developmental efforts in Bangladesh. In this context, poverty alleviation is broadly defined to include social development, particularly in terms of improvements in health and education indicators. The policy statements regarding the budgetary measures, in order to have political legitimacy, must conform to these broad welfare objectives. While these statements may have a populist stance to an extent (e.g. well justified measures for increased tax coverage are underplayed, while not-so-justified writing-off of agricultural loans is highlighted), at least they show the compulsion on the part of the government to portray the so-called 'benevolent social guardian' image. In other words, any deviant political motives or compulsions have to remain as a hidden agenda.

These policy statements, which are made in the Finance Minister's budget speech and come as a preamble to the main budget documents, can hardly be said to provide a well-articulated policy framework for the budget. While some policy justifications are given for the budgetary measures representing only 'incremental' changes in a year, it is not made clear how they fit into a coherent strategy evolving over time. Moreover, the important trade-offs in resource allocations, which lie at the heart of budgetary decision making, is rarely spelt out. Nevertheless, certain yardsticks for judging the merits of the budget proposals are now generally accepted in Bangladesh. One such yardstick, for example, is whether there is enough fiscal prudence to contain inflation and ensure economic stabilisation. Raising higher revenue and containing the growth of administrative expenditures, so as to generate more domestic resources for development spending, are regarded as a broad goal of budgetary measures. Within development spending, the higher is the benefit going to the poor, the better. And there seems to be a compulsion for the Finance Minister to show (even with some jugglery of data, if needed) that the allocations to education are larger than the defense budget.

Like most developing countries, Bangladesh embarked on a program of macroeconomic stabilisation and structural adjustment during the early to mid-1980s along the standard guidelines of the IMF and the World Bank. These reforms, which were undertaken under rigid aid conditionality arrangements and were more

vigorously pursued in the early 1990s, were primarily aimed at reducing the fiscal and external deficits to a sustainable level in the face of declining foreign aid availability. The accompanying market-oriented liberalizing policy reforms involved a redefining of the developmental role of the government and the priorities of public expenditures. The fiscal measures included reduction or elimination of agricultural and food subsidies during the late 1980s, introduction of value-added tax (VAT) in the early 1990s and a gradual withdrawal of direct public investment in productive sectors. The envisaged developmental role of the government was mainly defined in terms of the provision of such public goods as education, healthcare, public utilities and physical infrastructure. In addition, this role also included the implementation of cost-effective poverty-alleviating programs to provide 'safety nets' for the poor.

This broad policy framework, even if generally agreed, is far from being an adequate basis for making the actual decisions regarding public development spending. Unlike in the case of investments in directly productive activities, the technique of social cost-benefit analysis is difficult to apply in evaluating social sector projects, because of deficient data and many conceptual problems. One such problem concerns the so-called "externalities" arising from interdependent outcomes.⁴ For example, in improving the health indicators, there are known to be important synergies among interventions in healthcare, environmental sanitation, family food supplementation, female education and income generation for the poor. Even from the point of view of strict economic theory, not enough is known about these synergies in quantitative terms to devise an optimal allocation of resources.⁵ A more practicable method is to devise sectoral development strategies and targets along with cost-effective programs to achieve those targets. While this can help to determine priorities within the broad sectors, the rationale of resource allocation among those broad sectors still remains wanting.

The appropriate state-market mix remains another grey area of budgetary policy-making. While most proponents of the so-called "Washington consensus" now agree that the resolution of this problem should be based not on ideology, but on evidence regarding market failure vis-à-vis government failure, there is much less agreement about what that evidence is. Again, market-oriented policy reforms are no substitute for having an appropriate development strategy that is needed, say, to guide public investments in infrastructure or other policy measures towards supporting private sector development. These gaps in the policy framework can create ambiguities and controversies regarding how far the budgets actually adhere to their stated policies (or, in other words, whether the government acts according to what it publicly commits to).

The Budgetary Trends

The annual budget has two components: (a) the current or revenue budget that is meant to meet the regular expenditures on public administration and defense as well as the recurrent expenditures in social sectors like health and education, and (b) Annual Development Plan (ADP) that includes project-wise allocations for development spending. These development projects are supposed to be approved through an elaborate inter-ministerial process of scrutiny under the guidance of the Planning Commission, but many projects are given a go ahead without a formal approval. While the larger part of expenditure under ADP can be called public investment (in the strict economic definition of physical investment, i.e. construction and installation of equipment), it also includes expenditures that are more in the nature of public consumption. The demands for current budget are matched against revenue income, and any surplus is available for financing the ADP. The ADP expenditure, net of this revenue surplus, shows the overall budgetary deficit, which is financed by net foreign aid.⁶ Any remaining deficit is met by the government's domestic borrowing, consisting of bank borrowing and sale proceeds of government saving certificates and bonds.

One serious problem in analyzing the budgetary trends is that the realized expenditures and earnings may be substantially different from the figures given in the original budget documents or even in the "revised" budgets prepared at the end of the financial year. A comparison of the actual and the original budget figures shows a typical pattern: that there is some shortfall in revenue collection and in foreign aid disbursements, and an excess in revenue expenditure. The effect of this is borne by a downsizing of the ADP (in some years, substantially) and by an unanticipated extent of domestic borrowing. The government thus has a tendency to set budgetary targets that are too ambitious compared to what it can actually achieve. A certain amount of optimism in setting the targets may help to inspire the relevant government agencies into action. A less generous interpretation is that the government may deliberately try to make the budget look politically more acceptable, at least at the time of announcing the budget when it is more in the public eye.⁷ Nevertheless, it shows that there is a political compulsion on the government to increase development spending and restrain the growth of current expenditure (or, at last, to be *seen* to do so).

The trends in the overall budgetary balances from 1983-84 to 1996-97 are shown in Table 1. All the estimates are shown as a proportion of GDP at current market prices. While Bangladesh has recently switched to a new revised series of national income estimates, the estimates in Table 1 are derived from the old series. The new national income estimates, which are available in published form from 1990-91 onward, show an upward

revision over the earlier ones ranging between 26 to 30 percent for various years, but the estimated year to year real GDP growth rates are not much changed. The estimates in Table 1 should not, therefore, be much affected by these revisions in terms of their trends, although their *level* in each year will be considerably lower. Since the old national income series is available up to the fiscal year 1996/97, this is taken as the terminal year in Table 1, as also in some of the subsequent tables.

One important feature of Bangladesh's fiscal scenario is that the revenue-GDP ratio is low even by the standard of developing countries. This will appear to be even more so with the new national income estimates, in which case this ratio would be about 9 percent instead of about 12 percent during the late 1990s as shown in Table 1. There was some increase in this ratio in the early 1990s, mainly due to the introduction of VAT, but the increase proved to be a once and for all phenomenon. Evasion of taxes, particularly of income tax, is extremely high, so that direct taxes currently contribute only 15 percent of total tax revenue. An analysis of the trends in tax yields in Bangladesh suggests that the tax system is income-inelastic, so that the rate of growth of tax revenue tends to fall behind that of GDP unless 'discretionary' measures are taken for enhancing the rate structure and (or) expanding the tax base. A large and increasing degree of tax evasion is alleged to be the major factor behind this tax inelasticity (Mahmud 2001).⁸

Enforcing strict tax compliance has a political cost for the government, so that it has to weigh this cost against the 'marginal' benefit (political and economic) to be derived from development spending. It is a fair assumption that development spending, being the more flexible part of the budget expenditures, bears the major burden of any public resource shortfall. While better enforcement of income taxes goes against the interest of the rich, a drive for collecting more indirect taxes (mostly VAT) by increasing their coverage is unpopular among the middle income class, on whom the incidence of these taxes is the highest. A drive for better enforcement of indirect taxes annoys the business community, who often can get away without paying the taxes. Since at least a part of development spending is likely to be pro-poor (see later discussions), the poor seem to have got a rather bad deal so far as there is a trade-off between higher revenue and higher pro-poor spending.⁹

One redeeming feature is that the level of current expenditure as a proportion of GDP is also low relative to many developing countries. It is noteworthy that this proportion increased steadily in the 1980s (which was the tenure of the semi-autocratic regime of General Ershad), but has been kept from rising since then. Partly

because of this, the size of the development budget as a proportion of GDP fell during the 1980s, but subsequently recovered to some extent in the 1990s. The transition to a democratic regime thus seems to have resulted in increased accountability in respect of restraining the government's current expenditures, thereby, mobilising more resources for development spending. There was a significant steady decline throughout this period in the availability of net foreign aid, which declined from 10 to 8 percent of GDP in the early 1980s to 3 to 4 percent in the late 1990s. There are many factors behind this decline in foreign aid, and one of those is how the government values the benefit of increased-aid financed development spending against the political cost of complying with the aid conditionalities. More on this will be discussed later.

Besides the revenue budget's surplus and net foreign aid, the government's domestic borrowing can be the other source of financing the development budget. However, such borrowing has the risk of increasing the rate of inflation through excessive credit expansion or 'crowding out' the private sector from the credit market. The experience of the 1990s suggests that the two successive political regimes resorted to higher and unsustainable levels of domestic borrowing towards the end of their respective tenures. This conforms to the hypothesis of the so-called 'political business cycle' discussed in the literature on public choice theory - that an elected government will court popularity by cutting taxes or increasing expenditures (and thereby running higher budget deficits) before an election.¹⁰ Overall, however, no serious threat to macroeconomic stabilisation arose out of such government borrowing; instead, the rate of annual average inflation rate was lowered from above 10 percent in the 1980s to around 5 percent in the 1990s.

The trends in the sectoral allocations in the revenue and development budgets are shown in Table 2 and Table 3. As expected, the allocations in the revenue budget do not show any marked or systematic changes. This is to be expected, given the fact that the economic reforms in Bangladesh have not involved any significant restructuring of the regular functionaries of the government, such as a major downsizing of the administration. This also shows that the revenue budget, in particular, is prepared on the basis of incremental changes over the previous year's budget. The subsidies on food distribution and on the distribution of agricultural inputs had already been greatly reduced by the mid-1980s, and this is not therefore reflected in these estimates.¹¹ The only significant trend is the steady increase in the interest payments on the government's domestic and foreign debts (shown as debt service).

Table 1: Income and Expenditure of the Central Government (Actual)

(Percent of GDP at current market prices)

	1983/84	1985/86	1987/88	1989/90	1991/92	1993/94	1995/96	1996/97
Total revenue	8.1	9.1	8.9	9.3	10.9	12.2	11.5	11.8
Total expenditure ^a	17.1	16.6	16.1	17.2	16.8	18.1	17.1	17.4
Current expenditure ^b	6.5	7.5	8.1	8.8	8.3	8.9	8.7	8.8
Development budget ^c	8.5	7.8	6.4	6.4	6.3	8.4	7.4	7.7
Overall budget deficit	9.0	7.5	7.1	7.9	5.9	6.0	5.7	5.4
Net foreign financing ^d	7.8	6.4	6.9	6.6	4.9	4.9	3.6	3.5
Net domestic financing ^e	1.2	1.5	0.2	1.3	1.0	1.1	2.2	1.9

a. Includes food account balance and capital expenditures and net lending not included in the development budget.

b. Excludes food subsidies

c. Expenditure under Annual Development Plan (ADP).

d. Includes grants and conventional loans net of amortisation

e. Includes borrowing from the banking system and sales proceeds of savings certificates.

Note: Based on the estimated *actual* figures, not the budget figures. The estimates correspond to July-June fiscal year; they are based on the old national income series which is available up to 1996/97.

Sources: Official fiscal statistics and data compiled in the World Bank's Annual Country memorandum, various issues.

The sectoral allocation pattern of development spending has, however, undergone some significant changes, reflecting the changing developmental role of the government under the economic reforms. Allocations to manufacturing industries have been reduced to almost an insignificant proportion, showing that the government has virtually withdrawn from investment in setting up new industries. With the rapid expansion of tube-well irrigation in the private sector, the proportion of allocations to water resource development has also declined. Also, the decline in investment in energy reflects increased reliance on private companies for the generation of electricity and for the exploration activities. The reverse of this structural changes in development spending is the increased proportional allocations to rural development and to social sectors, especially education.

Broadly speaking, one thus finds a close concordance between the accepted development strategy and the patterns and trends in public expenditures. That human development and poverty alleviation are given due importance is supported by increased budget allocations to rural development and social sectors.¹² Two points, however, may be made at this stage regarding the above restructuring of development spending. First, how far higher allocations to the social sectors will lead to an improvement in social development indicators will depend very much on the quality and effectiveness of the spending. The *a priori* rationale and the actual effectiveness of public expenditures are two separate

aspects. There is also the broader question of whether the redefining of the government's role, as reflected in the budget, will result in the envisaged private-sector-led growth that is also pro-poor. (This study does not go deep into this latter question.). Second, the structural shift in the budget towards larger social spending has come about from a redefining of the role of the government and is, therefore, of a once-and-for-all nature. In future, higher allocations to social sectors will require more difficult reforms, for example, in respect of preventing tax evasion or downsizing the government.

Lastly, it should be mentioned that the budgetary estimates discussed here do not fully reflect the drain on public resources due to the loss-making state-owned enterprises, including public commercial banks. Not only past investments in these enterprises have not given returns to the public exchequer, but also some of the state-owned enterprises cannot even cover their operating costs. These losses are covered partly by direct loans from the budget, and partly by occasional capital replenishments of the public commercial banks through issuance of government bonds. If these losses are fully accounted for in the budget, then the full-deficit of the government's financial operations will be much larger.

Foreign Aid and Donor Influence

As mentioned earlier, macroeconomic reforms including fiscal adjustment in Bangladesh were implemented under rigid aid conditionality.¹³ The

articulation of the rationale for such reforms and their evaluation have come almost entirely from the donor side and very little from the side of the government. The indigenous support or critique has come mainly from the local media and experts outside the

government. The government's position is only occasionally stated in public utterances of political leaders, and to some extent, in the annual budget speeches of the Finance Ministers.¹⁴ It is, therefore, difficult to assess how much of the

Table 2: Current Budget (Revised Budget) Expenditures; Proportion of Sectoral Expenditure to Total

Sector	1986/87	1989/90	1991/92	1993/94	1995/96	1996/97
General Services	0.43	0.38	0.37	0.42	0.40	0.41
Social Services	0.36	0.31	0.30	0.33	0.32	0.32
(Education)	(0.19)	(0.16)	(0.17)	(0.19)	(0.18)	(0.18)
(Health & population planning)	(0.07)	(0.05)	(0.05)	(0.07)	(0.06)	(0.06)
(Social welfare)	(0.10)	(0.09)	(0.07)	(0.07)	(0.08)	(0.08)
Economic Services	0.08	0.07	0.07	0.08	0.09	0.08
(Agriculture)	(0.04)	(0.04)	(0.04)	(0.04)	(0.05)	(0.04)
(Others)	(0.03)	(0.03)	(0.03)	(0.04)	(0.04)	(0.04)
Debt Service	0.11	0.10	0.14	0.12	0.15	0.14
Food Subsidy ^a	0.01	0.09	0.04	0.02	0.03	0.03
Other Subsidy ^a	0.01	0.05	0.03	0.01	0.01	0.02
Contingency	0.00	0.00	0.04	0.02	0.00	0.00
Total Current Expenditures ^b	1.00	1.00	1.00	1.00	1.00	1.00
(in billion taka)	(47.2)	(62.4)	(89.0)	(122.8)	(155.1)	(171.5)

a. There has been a change in the definition of subsidy, especially during 1992-93.

b. Government's budgetary definition, differs from IMF definition.

Note: Based on the figures given in the *revised* budgets.

Sources: Official fiscal statistics and data compiled in the World Bank's Annual Country memorandum, various issues.

Table 3: Annual Development Program: Proportion of Sectoral Allocation to Total

Sector	1986/87	1989/90	1991/92	1993/94	1995/96	1996/97
Agriculture	0.04	0.06	0.06	0.05	0.04	0.04
Rural Development	0.02	0.03	0.04	0.04	0.06	0.07
Water Resources	0.1	0.17	0.07	0.05	0.05	0.07
Industry	0.16	0.07	0.02	0.01	0.01	0.01
Energy	0.26	0.17	0.14	0.14	0.15	0.14
Transport	0.09	0.13	0.11	0.14	0.16	0.16
Communication	0.01	0.03	0.02	0.05	0.02	0.02
Physical Planning	0.03	0.05	0.04	0.03	0.04	0.05
Education	0.05	0.04	0.04	0.09	0.11	0.11
Health & Family Planning	0.04	0.06	0.06	0.06	0.06	0.07
Social Welfare	0.00	0.01	0.00	0.00	0.01	0.01
Others	0.18	0.09	0.29	0.16	0.13	0.05
Total ADP	1.00	1.00	1.00	1.00	1.00	1.00
(in billion taka)	(44.4)	(47.2)	(57.0)	(87.1)	(96.0)	(115.5)

Note: Base on estimated *actual* expenditures.

Sources: Official fiscal statistics and data compiled in the World Bank's Annual Country memorandum, various issues.

reforms were actually "owned" by the government, and how much were imposed by the exercise of external aid leverage. It is a fair assumption that the later factor was the dominant one. The World Bank, in particular, has been involved in Bangladesh's economic development in an all-encompassing role of policy advice, lending and donor co-ordination.

Although generalisations are difficult, there seems to be a good record of compliance with aid conditionality in respect of some politically difficult policy reforms, whose economic rationale was beyond controversy. For example, under donor guidelines, the public food distribution system was successfully transformed in the 1980s to make it more cost-effective and targeted to the poor. The system of urban food rationing was gradually, but entirely abolished, although it hurt the politically influential urban middle class, who had been the main beneficiary of the system. On the other hand, the withdrawal of subsidies on fertiliser distribution was resisted by the government, and after the initial major reductions in these subsidies in the 1980s, they were reintroduced to some extent from time to time. In theory, some amount of agricultural input subsidies can be justified on both equity and efficiency grounds, if there are sub-optimal levels of fertiliser use, particularly by poorer farmers exposed to an imperfect credit market. In this situation, a case for subsidy withdrawal usually rests on the argument that the money thus saved may be better used for rural infrastructure that could help farmers to get better product prices. But

this leads to the more complicated behavioural question about the government's "marginal" expenditure propensities (and the resulting marginal social value of such expenditures).¹⁵

The above examples are given to show that aid conditionalities are not always resisted because of vested interests of powerful political elite; sometimes it may be out of a genuine concern about the validity of the rationale of the proposed reforms. This does not mean that those concerns are always justified.¹⁶ But in many other cases of reforms, particularly the institutional reforms aimed at improving the quality of governance, aid conditionalities are resented precisely because their implementation will hurt the rent-seeking opportunities of the political elite. Since these types of reforms have an important bearing on the availability of resources for social spending and on the quality of such spending, there will be more discussion on this later in this paper.

While aid conditionalities are mainly regarding economic policy reforms, donors try to influence the budgetary allocations through project aid, which is the predominant form of foreign aid received by Bangladesh. Table 4 shows the proportion of sectoral ADP funded by project aid as estimated from *original* budget documents and shown as five-year averages since the late 1970s. (The corresponding actual or realized figures, which are not available, will be admittedly somewhat different.) For any period, the sectoral variations in these proportions show how donor

Table 4: Ratio of Sectoral Project Aid to Sectoral ADP

Sectors	Average 1976-81	Average 1984-90	Average 1991-95	Average 1995-00	Recent 2000-01
1. Agriculture	0.20	0.52	0.56	0.52	0.52
2. Rural Development	0.26	0.84	0.62	0.49	0.39
3. Flood Control & Water Resource	0.23	0.61	0.47	0.55	0.44
4. Industry	0.53	0.61	0.20	0.23	0.42
5. Power	0.40	0.75	0.48	0.33	0.38
6. Natural Resources	0.37	0.55	0.58	0.49	0.51
7. Transport	0.37	0.55	0.58	0.49	0.53
8. Communication	0.24	0.48	0.31	0.27	0.42
9. Physical Planning & Housing	0.24	0.43	0.40	0.39	0.45
10. Education & Training	0.14	0.60	0.47	0.30	0.27
11. Health and Family Planning	0.35	0.61	0.60	0.63	0.71
12. Social Welfare ^a	0.13	0.31	0.30	0.24	0.14
13. Others	0.17	0.30	0.25	0.25	0.01

a. Includes Women's Affairs and Youth Development.

Source: Compiled from the data in original budget documents; see Ahmed (2001).

priorities vary from those of the government regarding development spending; and the variations over time show how their respective priorities have changed since the late 1970s.

The sectoral proportions of donor funding show a general declining trend because of the overall decline in the foreign funding of ADP. Health and population control seems to get the highest donor priority; moreover, the level of donor funding in this sector has not declined. The aid share in agriculture has also been maintained. The previously high donor support for public investments in industry and power has drastically fallen, reflecting the policy shift in favour of private sector. In both rural development and education, the sharp decline in the proportion of donor funding is mainly because of the government's increased allocations to these sectors as reflected in the trends in overall sectoral ADP allocations (Table 3). Apparently, the government's enthusiasm to increase allocations to these sectors was not shared by the donors, perhaps because of the latter's scepticism regarding the quality and effectiveness of additional spending in these sectors.

It is well recognized that the targeting of aid to priority areas may not produce the intended results, since local funds may be diverted to less-priority areas in response to the availability of foreign funds (the so-called *fungibility* problem). One common donor reaction to this problem is to impose additional conditions beyond the project level to ensure the *additionality* of resources at the sector level. An example is provided by Bangladesh's Health and Population Sector Project (HPSP) for 1998-2003, which was designed to provide integrated healthcare including population services along the guidelines adopted at the UN's International Conference on Population and Development (ICPD) held in Cairo in 1994. The program stipulates for a five-year period the amounts of both local and foreign funding as well as the minimum levels of allocations to the priority areas like primary health care. So far, the arrangement has proved unworkable because of its lack of flexibility and unreliable projections of resource availability.¹⁷ There seems to be little alternative for donors but to encourage the government, through concerted efforts, to devise its own plans and strategies for efficient public spending.¹⁸

The "fungibility" problem in aid utilization is also overcome to some extent when aid is spread over a large number of projects to meet only the foreign exchange component of those projects, thus requiring the government to commit local resources. In fact, too many of Bangladesh's development projects and programs have been donor-driven. The syndrome of 'donor-dependence' is manifest in the absence of sustainable institutional capacities (or their rise and fall with donor-funded project cycles). The aid donors have

been of late emphasizing the need for reforms towards improving institutional sustainability and the quality of project implementation by incorporating mechanisms for accountability, beneficiary participation and people's empowerment. The incorporation of these ideas can definitely improve the design of projects. However, institutional innovations of these kinds have to be based on intimate knowledge of ground realities; these can hardly be transplanted from outside, less so through the leverage of aid conditionality. Donors could perhaps make more use of local expertise in determining what works and what does not; and in the process, they could also reduce their own excessive delivery costs.¹⁹

Budgetary Processes and Political-Bureaucratic Incentives

Problems of Project Design and Implementation

While the broad pattern of sectoral allocation of development expenditures may appear promising, investigations at the micro-levels of project implementation may give a different picture. It is like looking at the forest from a high point while missing the details at the levels of the trees. The low quality of implementation of development projects has been a persistent problem in Bangladesh. The government evaluation and monitoring of projects is usually limited to verifying how far the expenditure targets are met, without looking into the actual benefits derived from such projects.²⁰ It is generally recognized that there has been a huge wastage of public resources due to poor project implementation and allegedly large leakage of funds. To cite an example, the World Bank's Operation Evaluation Department (OED) evaluated a sample of 63 projects executed in Bangladesh during 1980-96: of this, 24 projects or 38 percent were rated as "unsatisfactory" compared to a Bank-wide rating of 33 percent for countries receiving IDA project assistance.²¹ While some of the deficiencies in public development spending are discussed below, one also needs to keep in mind the considerable contributions made by such spending in many areas of social and economic development.

One fundamental problem is that the budget lacks a strategic framework, so that the measures taken are piecemeal and fragmented and the links between policy, planning and budgeting are weak. As a result, budgets are prepared mechanically by making incremental changes to the previous year's allocations and any new measures mostly represent short-term response to appeals of interest groups (often involving a compromise of opposing appeals). The government produces a Five-Year Plan that sets out, in considerable detail, the medium-term objectives and strategies and makes indicative allocations of development spending. However, these sectoral strategies are so broad that almost any project proposal can pass the test. This not

only undermines the rationale of project selection, but also results in including too many new projects in the annual development budget in disregard to their multi-year recurrent cost implications. This inevitably leads to project implementation delays, thus reducing the economic returns from such projects. Lack of strategic planning also results in such anomalies as health clinics being set up without the provision of doctors and medical supplies, or new roads being constructed while the existing ones go in disrepair.

Budget monitoring is generally not effective because of the weakness of the accounting and auditing procedures and delays in expenditure reporting. The approval of additional expenditures has to wait until the end of the year when the revised budget is presented, which is contrary to the spirit of the constitutional provision requiring prior, and not *post facto* approval of the Parliament. Consequently, the accountability and transparency of the government's budgetary management are greatly undermined. An institutional arrangement for ensuring such accountability in parliamentary democracy is provided by the Public Accounts Committee of the Parliament. Such a committee has hardly functioned in Bangladesh with any degree of effectiveness. Even if the committee were made effective, it would have to depend on government audit reports that refer to financial irregularities committed 5 to 8 years back, given the current state of the country's public auditing system. Thus, the committee could at best attempt to ensure the accountability of the previous regime or of the regime before.

A centralized technocratic approach without local participation is a major impediment to making the project outcomes beneficial to local communities. An example is provided by the schemes for flood management, drainage improvement and erosion control undertaken by the Bangladesh Water Development Board (BWDB). In theory, these schemes can greatly help rural development and poverty alleviation through increased agricultural production and protection from floods.²² In reality, BWDB's performance has been poor mainly because its operational approach is utterly centralized and technocratic. The agency has little interaction with local people at stages of project design and implementation. The projects, therefore, miss even some micro-technical considerations, let alone the ways of involving local participation. Moreover, once a structural facility is created, its operation and maintenance become dependent on allocations from the revenue budget, which is not always available. These projects do not charge any fees from the supposed beneficiaries. Such user fees would have brought accountability to BWDB while at the same time providing resources for maintenance. A recent evaluation on rehabilitation of some of these projects show that the original purpose of the projects were vindicated by more than 80 percent of

the people in the respective localities, but only one out of the 35 projects could be successfully rehabilitated. Among many problems, neglect of the details of local circumstances was found to be the main cause of failure (Ahmed 2001).

The Political Economy of Budgetary Failures

It needs to be emphasized that the basic reasons for the weaknesses in the budget formulation and implementation are political rather than technocratic. It will be a mistake to suppose that these weaknesses arise simply out of managerial problems and hence can be solved by administrative reforms alone; they are essentially problems of political governance. If government agencies are to work in a transparent and accountable way, if authority is to be decentralized, if officials are to be judged by well-defined yardstick of performance or tasks accomplished, then the legislators, political power-brokers and ministers will have to often act against their perceived self-interests. This is so because of the structure of Bangladesh society and the nature of its polity.

In Bangladesh, social interactions at the community, market and state levels often reflect patron-client relationships and are determined by kinship, social hierarchy, gender, economic status and regional identity. In such an environment, no institutions can guarantee impersonal and impartial conduct of public affairs. Spoils and privileges are parcelled out among different clientele as an essential tool of political management. The absence of strong participatory local government and the concentration of power at the top result in delayed and ill-informed decisions and create incentives for corruption at all levels. While these characteristics apply generally to the functioning of the entire political-bureaucratic system, they also largely explain the weak governance of development spending.

In this environment, it is difficult to obtain a confluence between political self-interest and the public good. One can also easily understand the reason for the political opposition to reforms that are aimed at making the budgetary processes more transparent and accountable or making the processes more decentralized for ensuring community participation and empowerment. The control over the delivery of public services is viewed as a means of fostering patron-client relationships and creating vote banks. The Members of Parliament, instead of being concerned with lawmaking and national policies, become lobbyists for procuring projects for their respective constituencies - by no means a healthy process of selection of development projects. Much of the wastage in public resource management at the local level, such as the alleged leakage of resources in the rural works program, is the result of the above system. It also partly explains many weaknesses in the implementation of local development

projects. For example, as noted earlier, disproportionately more funds are allocated for constructing new local roads rather than for the maintenance of the existing ones; the former is perceived as public service rendered by the local Member of Parliament, the latter as only the routine work of the concerned government agencies.

As discussed earlier, the availability of funds for public development and social spending largely depends on what happens in other areas of budgetary and economic management. Large-scale tax evasion, maintaining an unproductive large bureaucracy, or the need to meet the losses of state-owned enterprises - all these have adverse impact on the availability of budgetary resources. It is noteworthy that the implementation of market-oriented liberalising policy reforms in Bangladesh has not been matched by progress in institutional reforms such as administrative, legal and financial sector reforms. These reforms are needed essentially to deal with economic crimes that generate huge illegal incomes, whether from the wilful default of bank loans, corruption in tax administration, leakage in public development expenditure, or illegal financial deals in the running of state-owned enterprises. It is most likely that effective policy measures involving institutional and legal restraints on such rent-seeking activities will meet with strong popular support, except from the few beneficiaries of the system; yet resistance to such reforms has apparently proved quite insurmountable. In contrast, there was no serious political resistance to the earlier policy reforms many of which could have adversely affected large sections of the people, such as the withdrawal or reduction of subsidies on agricultural inputs, abolition of urban food rations or a lowering of industrial protection through import liberalization. Thus, the seemingly vote-losing reforms are not necessarily the politically blocked ones.

There have been recently some studies on the impact of economic reforms in Bangladesh, carried out through a participatory approach involving dialogues with various stakeholders.²³ One of the insights gained from these studies is that common people do not have unreasonable demands or expectations regarding the government's economic policies. It is the electoral competition among political parties that gives rise to economic populism. Farmers do not expect their agricultural loans to be written off. They do not think it realistic that the high rates of subsidies on agricultural inputs that were prevalent until the early to mid-1980s could be reintroduced. This does not require them to be aware of the arithmetic that subsidies at those rates would now simply eat up a large portion of the government's development budget (given the huge increase in the use of modern agricultural inputs since then). But they do expect the government to provide enough help in terms of price support, provision of credit and adequate supply of inputs at 'reasonable' prices, particularly at times of distress.

Economic populism needs to be distinguished from people's 'voice' being heard in the government's economic policymaking. The former is a cause of fiscal imprudence, while the latter can lead to a better use of public resources for the welfare of the common people. The government's budgetary processes are seen as too inaccessible and distant, both physically and psychologically, for the common people to be able to voice their grievances. There is some public outcry only when the burden of resource wastage is seen to be *directly* borne by the people, such as when the power tariffs are raised to cover the cost of electricity pilferage. People are found more resentful about their local conditions, such as regarding the poor quality of public service delivery in their communities. But, in the absence of strong representative local government, there are not much institutional mechanisms for ensuring accountability.

One of the positive ways in which political incentives have worked in Bangladesh in recent times is in coping with natural disasters and avoiding famine-like situations. In 1998, Bangladesh suffered the most devastating floods in the history of the region. Gloomy forecasts were made in international media about the likelihood of a famine and widespread death in the wake of the floods. The government took extraordinary measures to mobilise funds for relief and rehabilitation. Massive agricultural credit was distributed for early planting of the next dry-season rice crop. The NGOs also played an important role by expanding their micro-credit programs and by rescheduling the repayment of loans. In the end, the economy that year fared well with no marked decline in the growth of GDP and rice production, and there were no reports of unusual starvation-related deaths. This all-out effort on the part of the government to avert a famine-like situation contrasts with a far lesser degree of commitment when it comes to alleviating endemic poverty and human deprivation. This fits well with Amartya Sen's hypothesis that the incentives in a democracy are more potent in averting major economic disasters than addressing the problem of persistent poverty (Sen 1983). As Bardhan (1999) puts it succinctly: ".. in a democracy it seems easier to focus political attention to dramatic disturbances in a low level equilibrium, than to the lowness of the equilibrium itself".

Choice of Development Projects: Some More Insights

Looking at some specific development projects undertaken in recent years may provide further insights into the nature of political and bureaucratic incentives. Improved physical infrastructure for rural areas, particularly the provision of road networks, is rightly viewed as a main contributor to rural and agricultural development. For some time now, an agency called Local Government Engineering Department (LGED) has been entrusted with the responsibility of developing

rural infrastructure (rural roads and markets), mostly under foreign aid-funded projects. The Roads and Highways Department (RHD), on the other hand is responsible for the development projects involving the construction and improvement of national and regional highways. Recently, three massive umbrella projects worth 73 billion taka (or US \$1.7 billion at the official exchange rate in 1997) have been initiated under the RHD, which are aimed at improving the so-called 'feeder' roads, and to some extent, rural roads proper.²⁴ There are 800 subprojects under these schemes and the annual allocations for these small projects are very small - typically about 2 to 3 percent of their project cost (implying that, with these low levels of funding, it would take about 30 to 50 years to complete these projects!). At this rate, this will mean that only small segments of the roads will be constructed every year, and consequently, project benefits will be largely deferred far into the future. In addition, a serious concern is that the choice of the roads has not been based on feasibility studies or on the basis of a prioritised investment plan.

The above example shows several aspects of political and bureaucratic incentives in project choice. First, the project gives an appearance of the government's commitment to rural development, which may be in part genuine, and in part populist in nature. Second, the choice of the project reflects a kind of turf battle among government agencies, which have their vested interests in enlarging their respective domains. Third, and more important, the design of the project is such that it allows *ad hoc* decisions, thereby making room for taking up low priority politically-mandated projects, particularly at the insistence of the Members of Parliament belonging to the political party in power.

The LGED, mentioned above, emerged into a leadership role in the 1990s in the provision of most of rural infrastructure. It appeared to be an efficient and dynamic organization and attracted strong donor support. The funding decisions may thus be determined to a great extent by the quality of the executing agencies. But this may distort the expenditure priorities. Bangladesh has already one of the highest road densities in the world, although the bulk of the roads are of extremely low quality. Maintaining the existing network of roads in workable condition should be the central focus of public spending in this sector, but this objective is compromised by the rapid growth of the road network. This leads to several problems. First, many of these roads are hastily planned and have overlapping population catchments, whose communities can ill-afford to lose the valuable farmland from road construction. Second, the problem of inadequate funding for the maintenance of the existing roads is compounded. Third, given the ad hoc nature of project selection, scarce funds are spent on low priority roads on political considerations.

Another well-intentioned project, the implementation of which went wrong, is the Teesta Barrage Project, which was undertaken entirely with local funds and expertise. The project has claimed a large share of the water sector's investment budget for many years, the cumulative spending so far being about taka 10 billion. By the time the project was nearing completion, tube-well irrigation under private initiative had already become widespread in the project area, making the project somewhat redundant. Moreover, the technical design of the project proved to be faulty. Meanwhile, given the sunk cost, additional investment is needed to realize any possible net benefits. This was a 'prestige' project of the erstwhile regime of General Ershad, undertaken with a misplaced faith in the technical capability of local expertise and with an intention to show the General's commitment to rural development in his own electoral constituency in north-eastern Bangladesh.

In the area of physical planning, there are several large projects for providing residential accommodation for government employees in metropolitan and urban locations. The rationale for such projects has been questioned on grounds of both efficiency (since the private sector can perhaps do a better job in meeting the housing needs) and equity (given the urban middle-class bias of the project).²⁵ Even when projects are proposed to benefit the urban poor, such as a project called Multi-storied Housing for Slum Dwellers of Dhaka, the project design is found to be rather ill conceived. Given the large number of poor slum-dwellers in Dhaka (estimated to be almost a third of the city's population of nearly one million), government construction of public housing is not a cost-effective, sustainable and feasible approach. More realistic approaches have been proposed to facilitate self-help housing, with the support of the government and NGOs in the development of sites and services and in the provision of credit facilities. But such enterprises require the kinds of initiatives and vision that are usually lacking in the government planning bodies.

In the area of secondary education, three large projects have recently been prepared, costing together about 12 billion taka, for reconstruction and expansion of non-government secondary schools. These are sequels to a similar project implemented earlier at a cost of about 3 billion taka. As will be discussed later in the context of educational spending, these projects are not conceived within the context of an overall strategy for development of secondary stage schooling. Under these projects, budgetary grants are to be provided without linkage to any performance indicator. In principle, grants are more effective when these are provided to match funds mobilised locally, so that there is a demonstration of local commitment to these institutions. Since the identification of educational institutions to be covered under the projects is not done on the basis of any transparent criteria, political

considerations will almost certainly be a major determining factor.

Spending on Education and Healthcare: Achievements, Inefficiencies, and Biases

Over the last three decades since its independence, Bangladesh has achieved considerable progress in human development indicators, particularly those related to health and education. The progress has been particularly marked in the 1990s. Between 1975 and 1997, the infant mortality rate (per 1000 live births) fell from 148 to 81, life expectancy at birth rose from 44.2 to 58.1 and total fertility rate dropped from 6.8 to 3.1 (BIDS 2001, p.11, Table 1.1). The gross primary school enrolment rate increased from 76 to 92 percent between 1991 and 1996, with gender differential entirely eliminated, and there has also been impressive progress in the adult literacy rate. The progress in poverty alleviation has been more modest. Between 1983-84 and 1995-96, the proportion of population below the poverty line is estimated to have declined from about 54 to 51 percent in rural areas and from 41 to 26 percent in urban areas. Although human development indicators in Bangladesh have improved faster in relation to income growth, it may largely reflect a "catching up" process. In the *Human Development Report 2000* of UNDP, Bangladesh was ranked 146th, among 174 countries, in terms of both HDI and GDP per capita (adjusted for purchasing power parity of domestic currency with dollar). In other words, Bangladesh's level of human development is not only still quite low, but also it is no better than what would be normally expected at the given level of GDP per capita. There are also many inequities and inefficiencies in the healthcare and education systems in Bangladesh, which reduces the social benefit of public spending in these sectors.

The Economics of Healthcare System

Table 5 shows the trends in public expenditure on health and family planning as percent of GDP and of total budget expenditure (development and revenue budgets combined) as well as in constant per capita taka and US dollar terms. While the proportion of budgetary allocations to this sector shows a mild upward trend, per capita spending in real terms more than doubled in real terms since the mid-1980s to the late 1990s. Even so, the level of spending remains pitifully low - only US \$ 3.33 per capita in 1997 (at constant 1987 prices). This is a reminder of the fact that the scarcity of resources, arising from the low levels of per capita income and of public spending generally, is a major limiting factor in achieving population and health targets in Bangladesh.

Table 6 attempts to provide a macro view of the flow of resources in the health and family planning activities, including public, private and NGO sectors. By piecing together information from various sources, the table

provides a mid-1990s scenario regarding the source of funding and the various channels of service delivery. The picture that emerges is helpful for illuminating many policy issues. Combined public and private spending on health and family planning in 1994-95 is estimated to be about US \$876 million, equivalent to US \$7.3 per capita, or 3.2 of GDP at market prices.²⁶ This compares poorly even with other South Asian countries. For example, per capita health expenditure in India, Sri Lanka and Pakistan in 1990 was US \$21, US \$18 and US \$12 respectively (Mahmud and Mahmud 2000).

Table 6 shows that households provided the largest source of funding, 46 percent, whereas the government provided 28 percent (from local resources) and donors a further 25 percent. Donor funding is heavily concentrated on project aid for the funding of family planning activities. In terms of delivery of services, the public sector's share is nearly a half, with a slightly lower share for the private sector providers (45 percent), whereas the NGO sector's share appears quite small (only 6 percent), though often it is highly effective. The overwhelming share of household expenditure (97 percent) is directed toward the private sector, which shows the extremely low level of cost recovery in the public sector (less than 4 percent according to the estimates of Table 6). Cost recovery in the case of NGOs seems to be somewhat higher, about 11 percent. The estimates support the findings from various surveys that there is a high propensity of households to seek the services of unqualified doctors in the private sector, more so among poorer income groups. Survey findings also show that the distribution of household health expenditures is highly skewed among income groups, more so than household income distribution. For example, the top 25 percent income bracket is found to account for 60 percent of household expenditure on health (HEU 1997). Thus, for funding a basic package of health services, it would be desirable to find mechanisms to protect the poor, even though an expansion of user fees is feasible, and may be necessary.

Some findings are available about the incidence of benefit from public health expenditures from an on-going study, which combines the official household survey data regarding the use of health facilities and the estimated unit costs of providing various public health services.²⁷ These findings show that the government's overall health expenditures were not pro-poor *per se*, but only weakly pro-poor in the sense that these expenditures were more equitably distributed compared to the distribution of household income or expenditure in the economy. In other words, public health spending helps to *reduce* the overall inequality in the economy, although it is itself skewed against the poorer households. It is, however, important to note that one particular component of health spending, namely, child healthcare within the so-called essential services

package (ESP) is found to be *strongly* pro-poor (that is, skewed in favour of the poor).²⁸

Why do the poor not have better access to public health resources? As mentioned above, Bangladeshis generally seek infrequent curative health care in government health facilities.²⁹ The resulting utilisation rates of government facilities are quite low, representing wastage of scarce resources. Although fees charged in

government facilities are low, the informal fees required, particularly to get quality services, can be a burden for the poor. Government doctors routinely engage in private practices, where they charge fees that are affordable only by the relatively rich households. This not only adversely affects the quality of public health services, but also diverts the services of government doctors (including publicly financed medical equipment and other supplies) away from the

Table 5: Public Expenditure (Recurrent and Development) on Health and Family Planning, 1984-1997^a

	1983/84	1985/86	1987/88	1989/90	1991/92	1993/94	1995/96	1996/97
As % of budget expenditure	4.8	3.4	5.5	5.5	5.8	7.0	6.4	7.3
As % of GDP	0.8	0.9	0.9	0.9	0.9	1.3	1.1	1.3
Per capita in 1987 taka ^a	72.0	50.9	80.7	85.3	86.9	125.7	120.8	142.4
(in 1987 US.\$ ^b)	(1.69)	(1.19)	(1.89)	(2.00)	(2.04)	(2.94)	(2.83)	(3.33)

Source: Official fiscal statistics and data compiled in the annual Country Economic Memorandum of the World Bank, various years.

Notes: The estimates are based on *actual* income and expenditure of the central government and not on budget figures.

a. At 1987 constant taka prices derived by using the consumer price index.

b. Constant taka prices are converted to U.S. dollars at the 1987 exchange rate: U.S.\$1.00= Tk. 42.7.

Table 6: Flow of Funds and Expenditure Patterns in Health and Population Activities, 1994/95
(Million US dollar)

Providers	Sources of Funding						Total
	Government's Local Resources	Food and Commodity Aid ^a	Project Aid	Total Foreign Aid	Households	NGOs	
Public Sector	246	40	135	174	7		428 (48.9%)
Hospital	61	10	7	18	2		80
PHC	78	14	14	28	3		109
FP/MCH	61	11	96	107	2		170
Other	47	4	17	21	1		69
NGOs	2			46	6	2	56 (6.4%)
Private for Profit					391		391 (44.6%)
Medicine					319		319
Qualified doctors					24		24
Unqualified doctors					48		48
Grand Total	249 (28.4%)				404 (46.1%)	2	876 (100%)

Source: Based on revised budget estimates, official data on NGO funding, and survey data on household health expenditure; see HEU (1997).

Notes: Due to rounding, rows and columns may not sum exactly to totals.

^aEarmarked revenue generated from food and commodity aid.

intended beneficiaries. If this effect were taken into account, the incidence of the distribution of benefit of public health spending would be worse than found in the above studies. The social benefit from public health spending is thus greatly compromised by poor governance of the public health facilities.

Public Spending on Education: Benefit Incidence and Biases

With considerable progress made in primary education in Bangladesh, the enrolment gap between rich and poor has been considerably narrowed and the gender gap has been eliminated. In fact, female enrolment is as high or higher than male at all levels of education below the higher secondary, which is a truly remarkable achievement. The rich-poor gap, however, widens rapidly from the junior secondary level and upward. Also, while there are no significant rural-urban disparities in enrolment at the primary level, these disparities do exist against rural areas at the secondary level and above.

The implication of this enrolment pattern is that the public expenditure on primary education is found somewhat pro-poor, primarily because of the demographic of poor households tending to have more children.³⁰ The pro-poor bias reverses sharply at higher levels of education. Still, as in the case of public health expenditures, the overall public education system in Bangladesh reduces inequality - that is, its benefit is distributed less unequally compared to the overall income inequality.

Bangladesh has a centralized system of financing education through the revenue and development allocations in the national budget. The government finances all primary schools including the non-government ones, but parents are required to contribute towards construction of school facilities and maintenance activities.³¹ The primary school teachers are paid out of the national budgets and are not accountable to any local representative bodies; as such, they constitute in effect a multitude of centrally supervised permanent functionaries of the government. Although most of the secondary schools are privately managed, they depend on the government for most part of their operating and capital expenditures. All higher and tertiary education is primarily run through government grants, although the private sector's participation has been on the increase in recent years.

Public education expenditures have increased rapidly, claiming an increasing share of GDP and the total budget expenditures. The later share, for example, averaged about 9 percent in the first five year of independence in the early 1970s and increased to above 16 percent in the late 1990s. The level of expenditure still remains low at around 2.2 percent of GDP,

compared to above 3.5 percent in both India and Sri Lanka. Most government expenditure is directed to primary and secondary education which currently claims about 85 percent of the total education budget (recurrent and development expenditures combined).³² The expenditure priorities thus seem to be broadly consistent with the equity criteria and the objective of achieving basic literacy among the population and the labour force.

However, the broad pattern of educational expenditure conceals some major inefficiencies of the education system. One major concern pertains to the government's apparent preference for expanding the physical facilities and enrolment at all levels at the cost of sacrificing the quality of education. In spite of a remarkable success in increasing primary level enrolment and in achieving gender parity, the quality of education is alleged to have sharply fallen. In this situation, the government has opted for extending primary education from five to eight years in defining the goal of universal primary education. This is a wasteful but easier option than taking steps for improving the quality of the existing primary education system. The latter would require putting in place mechanisms for making the primary school teachers accountable and for disciplining them for deviant behaviour (e.g. frequent abstention and negligence of duty). But these teachers, being under a centralized administrative structure, constitute a powerful and influential constituency, which no government would like to antagonize.

In higher education, maximum expansion has taken place in colleges that used to be primarily responsible for two-year higher secondary education, but nearly all of which have been gradually elevated to preparing students for degrees under affiliation with some universities. These degrees include two to three-year Bachelor's degree, and in some colleges (called university colleges), an additional one- to two-year Master's degree. This rapid expansion of generalist higher education has perhaps been of very little social benefit, given the extremely inadequate teaching and other facilities and the consequent low quality of output (Mahmud 1994).³³ The higher degrees, whatever their worth, are used as a "credential" for securing higher-paying white-collar jobs. This characteristic of the white-collar job market, combined with demographic pressure and cultural preferences, results in heavy social demand for publicly subsidised higher education.

There are other aspects of the higher education strategy that involve inefficiencies, inequities and an urban-middle-class bias. The public funding of higher education benefits a narrow segment of the population, mostly the sons and to a lesser extent the daughters of the urban middle class. There is no economic rationale to provide higher education virtually free of cost in colleges and universities, particularly for non-technical

education. Such education has very little "public good" characteristics and students predominantly come from non-poor families. Ideally, there should be a scholarship program for higher education on equity ground. Such a financial support program, particularly at the university level, will not be very expensive in the near future, since very few of the poor can navigate their way up to the university stage. This would release resources for improving the quality of higher education and for funding some areas of higher learning, such as research, that are more in the nature of "public goods" (that is, having non-private social benefit). However, the successive governments have been politically constrained to deal with such sensitive issues as raising university tuition fees, restricting the growth of colleges, and "depoliticising" the higher education institutions. The organizations of both students and faculty at these institutions are closely linked with the major political parties, which is one major factor contributing to a general deterioration of that academic environment.

In spite of these inefficiencies and biases, some aspects of educational funding are not only well motivated, but also innovative. For example, to promote primary schooling among children of poor families, the so-called food for education (FFE) program was introduced in 1993 and was expanded rapidly during the rest of the decade. Under the program, eligible households receive a quota of rice rations per month per children subject to a minimum rate of school attendance. Early evaluation of the program showed promising results in terms of promoting enrolment and reducing dropout rates (Ahmed 2000). Also, the level of leakage was found to be low (7 percent). However, since the program is now claiming a very large share (above 40 percent) of funding for primary education under the development budget, questions have been raised about the priorities of resource needs in this sector. A more recent study suggests that the cost of income transfer under the program may have increased and the targeting may have deteriorated with the expansion of its coverage (World Bank 1997, p.51). Moreover, there are additional implicit costs in terms of teachers' time and logistic support. The challenge for policymakers now lies in their capability to monitor the performance of this program and take corrective actions, keeping in mind the priorities of primary education expenditures and of targeted food distribution programs. In the past, so far as food distribution programs were concerned, the government was willing to modify or close down underperforming programs, such as urban and rural food rationing. But, there was less success in tightening the management of the remaining programs that were on the whole considered worth continuing, such as the food for work program.

Concluding Remarks

The findings of this exploratory study are difficult to

summarise, since very few generalisations can be made. The various programs and policies relating to the budgetary processes have evolved under various mixes of economic, political and bureaucratic institutions and incentives. There is the "benevolent social guardian" role of the government - sometimes genuine, but at other times, only in pretence or public posture. The political incentives may work in terms of creating vote banks among particular constituencies at the national or the local level³⁴, or in distributing spoils and privileges among the political elite, or in placating militant groups who can create considerable disruption in spite of their limited voting power (e.g. trade unions in state-owned enterprises or nation-wide unions of primary school teachers). Political leaders may forge alliances with vested interest groups to create and distribute rents as a tool of political management. Political incentives should, however, be distinguished from any predatory behaviour, that is, when politicians in office appropriate public resources for personal wealth creation, which is also widely prevalent in Bangladesh.

The extent of deviations of budgetary practices from the stated goals has varied at different levels of budget implementation. So far as macroeconomic stabilisation is concerned, the government has, on the whole, pursued reasonably prudent fiscal policies (although, in the 1980s, such stabilisation in the face of declining foreign aid was achieved by curtailing only development spending, and, in the 1990s, there were some signs of political budgetary cycles). The broad sectoral allocations of development spending have also been largely in conformity with the government's stated objectives of emphasizing social development along with infrastructure and rural development. Political biases and the resulting distortions can be detected mostly in the selection of individual projects and in the quality of project implementation.

Budgetary policies in Bangladesh have been dictated to a large extent by the priorities of aid donors, but those priorities themselves have changed considerably over time with changes in aid ideas. The most recent changes in these aid ideas are towards more emphasis on the quality of aid utilisation and on poverty alleviation. While this shift of emphasis is welcome, a narrow interpretation of this approach may lead to a kind of "aid populism". There is a legitimate concern of the taxpayers in donor countries to see that the benefit of foreign aid goes to the poor *within* the poor countries. However, this new poverty concern has sometimes led donors to chase the same projects, namely, those directly targeted to the poor. Surely, the government needs assistance to be able to provide safety nets and essential social services to the poor. But, in a pro-poor growth strategy, there are many legitimate areas of development spending besides directly poverty-alleviating activities. Adaptive research for increasing crop yields, for example, has the potential to benefit the poor much more than many directly poverty alleviating

programs possibly can. Incidentally, agricultural research is one of the most under-funded budgetary heads in Bangladesh.³⁵

While political competition may give rise to populist budgetary policies (which at the end benefits none), it is also important to distinguish between macroeconomic populism and incorporating popular 'voice' into the budget-making process. The veil of obscurity and secrecy that surrounds the budgetary process no doubt stifles public accountability; but how far it is the result of an archaic system of budget preparation and how far it is a deliberate ploy is hard to ascertain. Making the budget more accessible can greatly help initiate healthy public debates on the budgetary policies and, thereby, promote accountability.³⁶ While the common people remain distanced from the budget-making process, both geographically and psychologically, they can obviously be much more involved at the level of implementation. Promoting strong representative local government can go a long way in helping this process.

In the absence of such representative local government, the control over the delivery of public services is used as a means of political patronage and for creating vote banks. Much of the wastage and inefficiencies in public resource management, both in the central allocations of funds and in the use of funds at the local level, result from this political culture. The remedy lies in building institutions that can be made responsive to the felt needs of the common people through greater community participation, representation and empowerment. Political leaders will then not be seen to be distributing spoils and privileges among their respective clientele. People will demand services as a matter of right - through their participation, say, in parents' associations or healthcare users' committees. This demand will be all the more credible if there is some cost sharing by the community through local taxes, so that the local people will like to know how well their money is utilized. This will require considerable decentralization of the budgetary process. While such an arrangement will obviously help in improving the quality of service delivery, it will not be to the liking of political leaders who derive their power through patron-client relationships or to the central government functionaries who benefit from lack of public accountability.

In conclusion, given the complex nature of political incentives and institutional arrangements surrounding the budgetary processes in Bangladesh, it is difficult to explain them by one or more hypotheses or analytical approaches as discussed in the literature.³⁷ The view that budgets are prepared by making only "incremental" changes to the previous year's allocations is largely true, but it begs the question of how budgetary policies evolve during, say, a medium term period. Again, it may be true in general terms that the budgeting decisions reflect the balance of political power among

groups or classes in society. But, as can be seen from the analyses presented in this paper, it is not easy to clearly identify any such class biases, except, say, some instances of an urban middle-class bias.³⁸ The technocratic aspects of budget-making are also important, such as the centralized bureaucratic approach followed in Bangladesh; but, as has been pointed out, the basic reasons for any weaknesses in the budgetary processes are political, not technocratic. Lastly, following the public choice approach, it may be useful to ponder how far the electorate acts as the "principal" and the government as its "agent" to carry out the electoral mandate regarding fiscal policies. Given the weaknesses of the democratic institutions, it is difficult to apply such a principal-agent approach in explaining fiscal policies in Bangladesh. Elections are not fought on clearly articulated economic policy issues, and there is hardly any effective parliamentary oversight mechanism for ensuring the accountability of the government's fiscal operations. Instead, there seem to be at work some non-institutional mechanisms for ensuring public accountability, such as through civic activism, a free press and widespread political awareness among the people at large. This probably explains why, in spite of many perverse political incentives embedded in the system, there has been considerable progress in many areas of social development in Bangladesh and the budgetary process portrays, at least in pretence, a "benevolent social guardian role" of the government.

References

- Ahmed, Akhter, U. (2000), "Targeted distribution", in Ahmed, R., S. Haggblade, and T. Chowdhury (eds.), *Out of the Shadow of Famine: Evolving Food Markets and Food Policy in Bangladesh*, Baltimore: Johns Hopkins University Press.
- Ahmed, Raisuddin (2001), "Rural development", Background paper prepared for *Bangladesh: Public Expenditure Review*, Paper presented at a workshop organised by the World Bank and the Asian Development Bank, Dhaka, November 13, 2001..
- Bardhan, P. (1999), "Democracy and development: a complex relationship", in Shapiro, I. and C. Hacker-Cordon (eds.), *Democracy's Value*, Cambridge: Cambridge University Press.
- Bhattacharya, Debapriya and R. A. M. Titumir (2001), eds., *Stakeholders' Perceptions: Reforms and Consequences*, Dhaka: Shraban Prakashani for SAPRI, Bangladesh.
- BIDS (2001), *Fighting Human Poverty: Bangladesh Human Development Report 2000*, Dhaka: Bangladesh Institute of Development Studies.
- Buchanan, J.M. and G. Tullock (1962), *The Calculus of Consent*, Ann Arbor: University of Michigan Press.

Buchholz, T. G. (1999), *New Ideas from Dead Economists: An Introduction to Modern Economic Thought*, New York: Penguin Putnam Inc. (Plume paperback edition).

Dasgupta, Partha (1993), *An Enquiry into Well-Being and Destitution*, Oxford: Clarendon Press.

Downs, A. (1957), *An Economic Theory of Democracy*, New York: Harper & Row.

Haggard, S. and R. R. Kaufman (1992), eds., *The Politics of Economic Adjustment*, Princeton, N.J.: Princeton University Press.

HEU (1997), "An assessment of the flow of funds in the health and population sector in Bangladesh", Research Paper 5, Dhaka: Health Economics Unit, Ministry (HEU) of Health and family Welfare.

Krueger, A. O. (1993), *Political Economy of Policy Reform in Developing Countries*, Cambridge, Mass.: The MIT Press.

Mahmud, W. (1981), "Rate of return on higher education in Bangladesh", in ILO, *Manpower Planning in Bangladesh*, Bangkok: ILO-ARTEP.

Mahmud, W. (1994), Chapter on South Asia, in *Teaching Economics in Developing and Other Countries*, special issue of *Journal of Development Planning*, No. 24, New York: United Nations.

Mahmud, W. (2001), *Adjustment and Beyond: the Reform Experience in South Asia*, Basingstoke, U.K. and New York: Palgrave-Macmillan in association with International Economic Association.

Mahmud, W. (2002), *Popular Economics: Unpopular Essays*, Dhaka: University Press Ltd.

Mahmud, W. (2002), "National budgets, social spending and public choice: the case of Bangladesh", Institute of Development Studies, University of Sussex: IDS Working Paper 162.

Mahmud, S. and W. Mahmud (2000), Chapter on Bangladesh, in Forman, S. and R. Ghosh (eds.), *Promoting Reproductive Health: Investing in Health for Development*, Boulder: Lyne Rienner Publishers.

Mueller, D. C. (1997), ed., *Perspectives on Public Choice: A Handbook*, New York: Cambridge University Press.

Osmani, S. R. (2002), "Expanding voice and accountability through the budgetary process", *Journal of Human Development* (forthcoming).

Persson, T. and G. Tabellini (2000), *Political Economics: Explaining Economic Policy*, Cambridge, Mass.: MIT Press.

Rahman, A. and W. Mahmud (1988), "Rice market interventions in Bangladesh", in Asian Development Bank, *Evaluating Rice Market Intervention Policies - Some Asian Experience*, Manila: Asian Development Bank, 1988.

Self, P. (1993), *Government by the Market? The Politics of Public Choice*, Basingstoke, UK: Macmillan.

Sen, A. (1983), "Development: which way now?", *The Economic Journal*, Vol. 93, pp.745-62.

World Bank (1997), *Public Expenditure Review: 1997 Update*, Washington, DC: South Asia Region, The World Bank, 1997.

World Bank (2001), World Bank, "Benefit incidence analysis, education and health sectors", Paper presented at a workshop on "Bangladesh: public expenditure review" organised by the World Bank and the Asian Development Bank, Dhaka, November 13, 2001.

World Bank (2002), *Bangladesh: Public Expenditure Review*, Washington, DC: World Bank (South Asia Region), Draft, May 29, 2002.

Endnotes

¹ See, for example, Krueger (1993); Haggard and Kaufman (1992).

² Public choice theories challenged the Keynesian welfare-state ideas to substitute a much more critical view of the capacities and integrity of the democratic governments. These theories have been criticised for their narrow interpretation of political motivation and their ideological bias for excessively restricting the scope of public sector responsibilities. However, these theories do provide some useful insights and help to understand political behaviour in some limited contexts; see, for example, Self (1993). Also, for a discussion in a developing country context, see Mahmud (2002), Chapter 17.

³ The term "public choice" is used here in preference to, say, public policy or public action, in order to better convey the idea of public decision-making as discussed in this paper.

⁴ Any criterion of "marginal social benefit" is even more difficult to conceptualise in the case of the government's non-development expenditures, say, on defense or public administration.

⁵ See Dasgupta (1993), p.542.

⁶ Foreign aid net of amortisation; payments of interest on foreign concessional loans are included in the revenue budget.

⁷ True, the revised budget is presented at the time of announcing the next year's budget, but the new budget dominates the political debates at that time. Also, the estimate of the revised budget usually differs from the actual in the same pattern mentioned above. The actual budget figures are, in fact, never publicly presented.

⁸ See Mahmud, W., "Bangladesh: structural adjustment and beyond", in Mahmud (2001), Chapter 3.

⁹ The trade-off will, however, depend on the 'marginal expenditure propensities' of the government, which cannot be easily ascertained.

¹⁰ For evidence on this in Bangladesh's context, see Mahmud, W., "How to assess the budget: comments on budget 2000-01, in Mahmud (2002).

¹¹ There are also many ambiguities regarding the budgetary definitions of these subsidies.

¹² The food for work program, which is a major poverty-alleviating program in Bangladesh, is not included in the Development Plan and is not therefore shown in Table 3. In spite of declining volume of food aid, the government has continued, and even expanded this program.

¹³ The major aid conditionality agreements regarding macroeconomic reforms included IMF's Structural Adjustment Facility (1986-89) and Extended SAF (1990-93) and agreements under Import Program Credit and Industrial Sector Credit of the World Bank's IDA during the 1980s.

¹⁴ The Five-Year Plan documents, except for the Fifth Plan (1997-2002) did not go far in explicitly dealing with macroeconomic policy reforms.

¹⁵ For a discussion on these points in Bangladesh's context, see Rahman and Mahmud (1988).

¹⁶ In fact, the government's recent handling of fertiliser distribution policies is an example of muddled economic thinking at the highest levels of policymaking. In Bangladesh, government is the monopoly producer and supplier of urea fertilisers; but the government's policy often ignores the fact that, as a monopolist, it cannot determine both the price and the quantity demanded of fertilisers. Thus, a well-intentioned policy of supplying fertilisers to farmers at a certain 'fair' price will fail if it is not backed by adequate supply to meet the demand at that price; it will only create scope for reaping extra profits by traders and middlemen; see Mahmud (2002), Chapter 1.

¹⁷ Incidentally, such a fate for HPSP was predicted by many well in advance; see Mahmud and Mahmud (2000).

¹⁸ In fact, one major weakness in pursuing global goals is that too little attention has been given to national-level follow-up actions and to adapting global goals to the situations of different countries.

¹⁹ The HPSP in Bangladesh, mentioned above, is a good example of what can happen when an otherwise well-designed project lacks ownership and knowledge of ground realities. The proposed wide-ranging organizational restructuring has proved difficult to implement; one result is that the family planning visitors have been withdrawn before the alternative system of reproductive healthcare could be put in place.

²⁰ The government agency entrusted with this responsibility is the Implementation, Monitoring and Evaluation Division (IMED) of the Planning Commission.

²¹ Cited in Bhattacharya and Titumir (2001), p.106.

²² Studies on flood damage show that the poorer households suffer more from floods in terms of proportionate losses in income and assets.

²³ See, for example, Debapriya and Titumir (2001).

²⁴ The three umbrella projects are *Thana Connecting Road Project, Construction of Public Priority Roads and Bridges Projects Phase I and Phase II*; see World Bank (1997), p.46.

²⁵ For details, see World Bank (1997), pp.48-49.

²⁶ This latter proportion will be even lower with the new revised national income estimates.

²⁷ The study is part of a larger exercise on public expenditure review undertaken by the World Bank (2002).

²⁸ According to these estimates, the poorest 20 percent of the population claim about 16 percent of the public spending on health (and 10 percent of curative health spending), and the poorest 50 percent get an estimated 45 percent. The position of the poor may be actually worse, since these estimates do not take into account the possibility that the poorer people get lower quality services and may have to pay higher extra charges. These estimated targeting outcomes fall in the middle of the recorded outcomes in other developing countries; better than Ghana and Vietnam, similar to India and worse than Malaysia; see World bank (2001).

²⁹ The survey mentioned above, carried out as part of the official Household Expenditure Survey, found that only 16 percent of all health visits of the urban poor are to government providers (11 percent for the non-poor); the corresponding figure for the rural poor is only 8 percent (and for non-poor, 12 percent); cited in World bank (2001).

³⁰ The bottom 50 percent of the population is estimated to get 56 percent of public spending on primary education. However, at the secondary level, this share of the poor comes down to about 25 percent. These estimates of incidence are made by combining enrolment rates obtained from a special round of the official Household Expenditure Survey with the estimated public spending per student at different levels.

³¹ Only the non-registered private primary schools, including community and satellite schools and some religious schools are not publicly financed.

³² The allocations for primary education are slightly higher than those for secondary education.

³³ The rate of return from general college education, even when estimated in terms of *private* benefit from increased income prospects, are found to be quite low in Bangladesh - lower than 10 percent; see Mahmud (1981). Given the low quality of such education, the social benefit in terms of contributing to increase in productivity, would be even lower.

³⁴ Examples of such political incentives underlying public spending decisions abound in the Western developed democracies as well. For example, the 200 billion highway bill signed by President Clinton in 1998

was alleged to be not only highly wasteful but also aimed at promoting the political careers of congressmen, who "bragged about bringing their districts new funds for bridges, tunnels, ferries, and bicycle paths... Five months after passing the bill, 98 percent of incumbent congressmen won reelection" (Buchholz 1999, p.259).

³⁵ This is not evident from the broad sectoral budgetary expenditures discussed earlier. Bangladesh spends an extremely tiny proportion of its agricultural GDP on agricultural research, which was 0.38 percent during 1995-2000. This is far below the recommended 2 percent target for developing countries.

³⁶ See Osmani (2002).

³⁷ As mentioned in the beginning, these hypotheses, mostly based on the public choice approach, have been mainly developed in the context of western mature democracies.

³⁸ Of course, the budget is seen to serve the interest of the politically influential groups, but they can hardly be considered as a distinct socio-economic class in the conventional sense.

Wahiduddin Mahmud
Professor of Economics
University of Dhaka
Dhaka 1000, Bangladesh
wmahmud@bangla.net

Commentary

Frederick T. Temple, Country Director for Bangladesh, and Zahid Hussain, Senior Economist, World Bank

Professor Mahmud's article is an insightful contribution to the analysis of public expenditure in Bangladesh – an invaluable “must read” addition to the literature on the subject. The article provides an excellent description of the dynamics underlying budgetary processes in Bangladesh and demonstrates that an appreciation of political economy factors is essential to understand the performance of public economic functions. The analysis improves our understanding of both the pattern of budgetary allocations and the expenditure outcomes that we observe in Bangladesh.

Mahmud tries to explain a paradox. Bangladesh's formal budgetary processes and institutions exhibit very little transparency, accountability and stakeholder participation, the politicians who run the government are not renowned for their vision and integrity, and there are many perverse political incentives embedded in the system. Yet the composition of public expenditures and development outcomes demonstrate many positive features, which seems to suggest that the budgetary process reflects a “benevolent social guardian role” played by the government. The paradox is to explain the positive outcomes in a public expenditure management system replete with numerous dysfunctional features.

Mahmud's explanation of this paradox is stated most clearly in the abstract and the concluding remarks to the article. The abstract says, “given the weaknesses of the democratic institutions in Bangladesh, there seem to be at work some non-institutional mechanisms for public accountability, such as through civic activism, a free press and widespread political awareness among the people at large. This probably explains why, in spite of many perverse political incentives embedded in the system, there has been considerable progress in many areas of social development in Bangladesh and the budgetary process portrays, at least in pretense, a ‘benevolent social guardian role’ of the government.”

Mahmud has posed a critically important question that has certainly vexed the World Bank and other donors in designing appropriate assistance strategies for Bangladesh – why has the country done (relatively) well despite its perverse political economy? While the article provides many rich insights about this paradox, there are limitations to its analyses on both sides of the equation. The explanation for the successes that have been achieved isn't adequately supported, and the successes are less than portrayed.

Mahmud credits civic society, the press and popular political awareness for holding the politicians in check. As appealing as this argument is, alas the analysis in the

article doesn't support it. It remains a plausible assertion, unsupported by evidence. There are many alternative hypotheses – such as that the need to be re-elected has created an incentive structure in which politicians try to respond to popular sentiments in order to win re-election while still pursuing their own objectives (especially recovering their investments in winning the last election). Mahmud is a keen observer. Hopefully he will push his political economy analysis further in future studies to help us understand how the factors he cites lead to the observed outcomes.

Based on his review of budget allocations, Mahmud concludes that “So far as macroeconomic stabilization is concerned, the government has, on the whole, pursued reasonably prudent fiscal policies...The broad sectoral allocations of development spending have also been largely in conformity with the government's stated objectives of emphasizing social development along with infrastructure and rural development.” The recent *Bangladesh Public Expenditure Review* conducted jointly by the Asian Development Bank and the World Bank reached essentially the same conclusion: “Public expenditures and policies have important positive attributes, especially their impact on human development and poverty at Bangladesh's level of development. No major expenditure reallocations among sectors appear necessary at this stage.”

However, in focusing on the maintenance of macroeconomic stability and the sectoral distribution of budgetary allocations, Mahmud has chosen too narrow criteria on which to base a judgment whether the government performs a “benevolent social guardian role”. His paper is full of observations about the limitations on the government's social benevolence despite its well distributed budgetary allocations. We believe three of these limitations, all recognized by Mahmud, are particularly important.

First, the quality of the services the public gets from these expenditures is generally very low, largely due to poor governance and outright theft. Mahmud refers to “economic crimes that generate huge illegal incomes, whether the willful default of bank loans, corruption in tax administration, leakage in public development expenditure, or illegal financial deals in running the state-owned enterprises.” Social expenditures are also subject to poor governance and theft, exemplified by leakage in the food distribution programs, teacher and doctor absenteeism from their public jobs while they sell their services privately, and illegal sales of public drugs and textbooks. The World Bank has estimated that 10-15% of public procurement is subject to corruption; if so, Tk 30-45 crore is siphoned off this way. Thus public expenditures can be analyzed as income opportunities for corrupt politicians and bureaucrats as well as potential benefits for the public. Second, as Mahmud recognizes, his focus on central government expenditures excludes the state owned

enterprises (SOEs) and public banks. During the last two years, the World Bank estimates that the annual ADP-financed SOE deficits were equivalent to 1.8-2.5% of GDP. The SOEs are an important source of perquisites and patronage for bureaucrats and politicians, which largely accounts for the slow pace of the closure or privatization of even hopelessly losing enterprises. The SOEs' over-employment is maintained at wage levels typically higher than for similar jobs in the private sector, creating a public sector labor aristocracy. SOE procurement is as vulnerable to corruption as central government procurement, and corrupt SOE employees, politicians and customers collude to share the benefits of theft and under-billing from public energy operations. The nationalized commercial banks (NCBs) have long been prone to politically directed lending and default, which has created huge contingent public liabilities as well as pushed domestic interest rates to very high levels. Thus a meaningful analysis of the government's "benevolent social guardian role" can't ignore the SOEs and NCBs.

Finally, Mahmud's insightful observations on the very low level of public resource mobilization in Bangladesh, pervasive tax evasion and the implications for the ADP highlight another limitation on the conclusion that the government is a benevolent social guardian. Although the *distribution* of budgetary allocations may be generally appropriate, the *levels of expenditure* on important services are low. For example, Bangladesh's government spent \$11-12 per capita a year on education and health during 1997-2002, while Sri Lanka spent \$32-37, India \$15-21, and Pakistan \$12-15. Revenues and thus expenditure levels are low, Mahmud notes, because "Evasion of taxes, particularly of income tax is extremely high...A large and increasing degree of tax evasion is alleged to be the major factor behind this tax elasticity. Enforcing strict tax compliance has a political cost for the government" so it constrains development expenditures instead.

These factors – all discussed by Mahmud – should temper his conclusion that the government performs a "a benevolent social guardian role" through public expenditures in Bangladesh.

Politicians in Bangladesh pursue a wide range of objectives -- such as recovering election expenses and enriching themselves, building and maintaining constituencies to enable them to stay in power in the next election, distributing spoils and privileges to supporters and cronies, and enhancing their power bases – as well as promoting socio-economic development and poverty reduction. In addition to focusing primarily on whether budgetary allocations are socially beneficial, examining how politicians use public expenditures, legitimately and illegitimately, to pursue these various objectives could provide a deeper understanding of their role in Bangladesh's political economy. Mahmud's rich analysis provides many

insights in this regard, and we hope that he and others will pursue these issues further in the future.

We would like to conclude by offering some observations on Mahmud's comments about foreign aid. Mahmud contends that the macroeconomic stabilization and structural adjustment reforms pursued in Bangladesh, especially during the early to mid-1980s and early 1990s, "were undertaken under rigid aid conditionality arrangements." In retrospect it is clear that many of these reforms were initiated with limited ownership. It is therefore not surprising that the reform programs under the IDA-financed Public Resource Management (FY92), 2nd Industrial Sector Adjustment (FY93) and Jute Sector Adjustment (FY94) operations were not completed, resulting in the cancellation of about \$300 million of the \$500 million committed for these programs. Mahmud argues that some of the reforms were not implemented due to "a genuine concern about the validity of the rationale of the proposed reforms," although he notes that "This does not mean that those concerns are always justified." He also observes that "in many other cases of reforms, particularly institutional reforms aimed at improving the quality of governance, aid conditionalities are resented precisely because their implementation will hurt the rent-seeking opportunities of the political elite."

IDA (and other donors) have learned from this experience. We now look for clear indications of Government ownership of reform programs proposed for support from adjustment credits, and IDA is now more likely to support single-tranche credits that recognize prior actions rather than multi-tranche operations under which tranche releases depend on the fulfillment of commitments.

Mahmud notes an "overall decline in the foreign funding of ADP" and observes that "The aid donors have been of late emphasizing the need for reforms towards improving institutional sustainability and the quality of project implementation by incorporating mechanisms for accountability, beneficiary and people's empowerment."

While these are important trends, we believe that the most significant factor affecting the availability of aid to Bangladesh is the donors' shift toward performance-based rather than need-based allocations of development assistance, both across and within countries. In the past, aid allocations tended to favor countries (like Bangladesh) with high assessed need in terms of poverty, poor nutrition and health, low education, etc. Recently aid allocation decisions have begun to be made more on the basis of a country's progress in policy and institutional reforms that increase the likelihood that development assistance will be used productively. The relative stagnation in levels of Bangladesh's level of development assistance during the last decade can be attributed primarily to the slow

pace of economic reform, especially the failure to improve governance. The political economy perspective adopted by Mahmud is thus particularly relevant to forecasting future trends in aid flows, because it is Bangladesh's political economy that is likely to be the prime determinant of how rapidly the country will reform.

Commentary

A.M.A. Muhith, Former Finance Minister and presently Member, Advisory Council, Awami League

The paper of Prof. W Mahmud is very well-structured and he has successfully belaboured the point about the benevolent social guardian role of the Bangladesh Government. It gives a good and easily intelligible account of the budgeting process and brings up the major points on political contents of the process. The paper makes the following broad points on economic policy and budget trends:

1. The budget speeches of Ministers give statements on economic policies and direction of the economy but they do not get reflected in actual budgetary measures.
2. The budget does not provide a discernible linkage between policy, planning and budgeting.
3. Budget preparation is done essentially on an incremental basis, particularly for the larger revenue budget.
4. In the development budget sectoral allocation reflects development policy such as emphasis on social expenditure, infrastructure development, or diminution in public spending in directly productive sectors. In fact, the changes in allocations reflect the changing development role of the government.
5. Budgetary policy-making only marginally impact on the distribution of roles between state and market.
6. The revenue GDP ratio is very low and tax compliance is very lax.
7. Budget monitoring is virtually non-existent and resource gap is met either by unplanned domestic borrowing or cutting down ADP size.

These findings are generally beyond question and they represent the real state of affairs on economic policy and budget making in Bangladesh. But there are exceptions. I am not sure if the budget speech of Saifur Rahman in 1991-92 (and not 2002-03) and that of Shamsul Kibria in 1996-97 did not provide a direction on economic policy of the respective governments. I believe the broad policies announced in these two speeches greatly influenced the subsequent budgets drawn up by the BNP and Awami League governments. In particular in defining the commitment of Awami League to open market and limited economic role of the

government the budget speech of 1996-97 was absolutely crucial. The incremental changes in budget is a reality mainly because there has not been a structural change in the roles of government agencies consequent to policy change in favor of open market and limited economic role of government. No changes have also taken place in government operations as a result of devolution of powers or decentralization of operations. At any time such restructuring occurs the changes I believe will cease to be incremental. The introduction of the Upazila system, for example, introduced budget assignments for Upazila activities from both revenue and development budgets. The point about policy, planning and budget linkage is assuming new meaning as the role of the government is changing from investing for development to investing for enabling development. While detailed planning of five-year plans may be unnecessary, the vision for a medium term seems to be urgent for the ship of state so that it does not turn out to be rudderless. Medium term fiscal plans to me is crucial to gauge a periodic resource envelop as well as to present proposals for fiscal measures to the electorate. Budget revision is a totally undemocratic process and possibly violates the constitutional obligations. The only feasible way it can be changed is by instituting a mid-term review of the budget by parliament. Until recently actual expenditure statements could be found in budget documents, of course after a lapse of two years or so. But this practice seems to have been discontinued and deserves to be reintroduced.

As expected, the role of foreign aid and donor influence feature prominently in the paper. We know that Bangladesh has been a good student of the Bretton Woods twins and it has generally honored the policy prescriptions of donors. The economic reforms program has actually been a manifestation of donor conditionality. The point that is missing is why even then growth is a distant dream and poverty alleviation is not so robust. We began the reform program so long ago (nearly two decades) but the progress made is rather limited. I believe it is because it was started by a regime without popular support and hence its execution was half-hearted and halting. And this half-hearted commitment got ingrained for all time. The actions of subsequent popular governments, of course, had political overtones. The declining trend of aid is acknowledged but why this is so is not explained. It is certainly not due to a fall in global aid flow nor due to a slackening of demand in Bangladesh. Whether it is a right policy to reduce aid flow seems questionable to me. What is important is reduction of dependence and that is achieved by increasing domestically financed portion of the budget; it does not call for reducing the volume of aid received. The author very rightly does not see much virtue in targeting aid to priority areas, as it is not really enforceable. He is concerned about improving institutional sustainability and the quality of project implementation. A good project works as long

as there is support from aid but it is not internalized when the aid flow stops. The suggestion that use of local expertise should be made to assess what works and what does not and thus find sustainable institutions is, indeed, so appropriate. I must point out that donor influence at times is acknowledged by our practitioners and researchers very easily even where the original initiatives have been essentially indigenous and donors take pains to claim authorship where they moved in later and perhaps refined the policy framework. Imports with wage-earners funds that began the first liberalization policy in the 1970s or the initiative on trade and industrial policy in early 1980s that was started to rationalize export incentives or some of the initiatives in environmental protection and improvement in 1990s were entirely indigenous in origin. At the early stage of working on such initiatives even limited foreign financing was difficult to find for their implementation.

In the paper three subjects have been discussed at some length viz. rural infrastructure development, healthcare expenditure and investment in education.

- ❖ In considering rural infrastructure building the author refers to the turf war between government agencies, highlighting the need for coordination and indirectly for local level planning. He finds that commitment to addition to capital stock is a veritable vice as maintenance of existing stock is neglected and capacity utilization is impeded.
- ❖ The discussion on healthcare covers financing of healthcare services by households, government and aid including through NGOs. It considers the question of excess to public healthcare services hinting that emphasis on curative aspect in public investment is wasteful. It finds that healthcare expenditure is not pro-poor *per se* but more equitably distributed in the economy. The author also severely criticizes the famous Health and Population Sector Program (HPSP). The lack of flexibility and unreliable projections of resource availability in the program are deplored. The lack of ownership of the program and its neglect of ground realities are held guilty for the failure of an otherwise well-designed program.
- ❖ Turning to educational investment he extols efforts at primary level that have virtually eliminated enrolment gap between rich and poor and between male and female students. He laments the urge for expanding physical facilities and neglect of quality improvement.

He faults centralized management for this failing. He finds education at higher levels i.e. secondary and higher levels to discriminate against the poor. At the college level, the expansion has been utterly wasteful and it also reflects inequities and urban as well as class bias. On the whole he is pleased with increase in educational investment and emphasis on basic education. He welcomes the food for education program and recommends better monitoring of program performance.

These are very important elements of the national budget now. There are two issues that appear to be very relevant here. First, planning and execution of these activities would be better and more productive if they were devolved to institutions of local government. Possibly such an arrangement would also eliminate turf war, reduce waste, mitigate delay in implementation and set the right priorities. From this point of view the finalization of a system of local government demanded by the Constitution and urged by the Supreme Court assumes great urgency. I am disappointed that budgetary analysis does not bring out the importance of transfer of functions to local level and does not dwell on how budgetary process would be affected by such a transfer. The other issue is the practice of preparing two budgets instead of one comprehensive budget. The artificial division of the budget into revenue and development was done mainly to attract donor support in the 1950s and 1960s when all aid was on project basis. This is no longer justified since public investment has been limited mainly to social and infrastructure sectors where distinction between operation and maintenance and capital addition can be highly inefficient and wasteful. If one budget covers maintenance and operation as well as investment of public funds, it is likely that a lot of distortions impeding capacity utilization and causing depreciation of assets can be held in check. For example, under one budget new schools are not likely to be built when existing schools do not have teachers.

I have three additional comments. HPSP in my view is excellent in concept as it looks at the entire program (under both revenue and development budget) of the sector and provides for annual finalization of program within the broad five-year framework. The real problem is with the ownership of the Program; lack of commitment has frustrated it more than anything else. Second, it may be noted that a part of the Food for Works Program is being incorporated in the budget (ADP) since 1997/98. Third, the way the integrity of the electoral process has been destroyed in 2001, we have to strive to restore it by systemic changes because a government without popular support is dangerous for the state.