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Impact of Iraq War on Bangladesh Economy

Paper 29

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The Centre for Policy Dialogue (CPD), established in 1993, is a civil society initiative to promote an ongoing dialogue between the principal partners in the decision-making and implementing process. The dialogues are designed to address important policy issues and to seek constructive solutions to these problems. The Centre has already organised a series of such dialogues at local, regional and national levels. The CPD has also organised a number of South Asian bilateral and regional dialogues as well as some international dialogues. These dialogues have brought together ministers, opposition frontbenchers, MPs, business leaders, NGOs, donors, professionals and other functional groups in civil society within a non-confrontational environment to promote focused discussions. The CPD seeks to create a national policy consciousness where members of civil society will be made aware of critical policy issues affecting their lives and will come together in support of particular policy agendas which they feel are conducive to the well being of the country.

In support of the dialogue process the Centre is engaged in research programmes which are both serviced by and are intended to serve as inputs for particular dialogues organised by the Centre throughout the year. Some of the major research programmes of CPD include *The Independent Review of Bangladesh's Development (IRBD)*, *Governance and Development*, *Population and Sustainable Development*, *Trade Policy Analysis and Multilateral Trading System and Leadership Programme for the Youth*. The CPD also carries out periodic public perception surveys on policy issues and developmental concerns.

Dissemination of information and knowledge on critical developmental issues continues to remain an important component of CPD's activities. Pursuant to this CPD maintains an active publication programme, both in Bangla and in English. As part of its dissemination programme, CPD has decided to bring out **CPD Occasional Paper Series** on a regular basis. Dialogue background papers, investigative reports and results of perception surveys which relate to issues of high public interest will be published under its cover. The Occasional Paper Series will also include draft research papers and reports, which may be subsequently published by the CPD.

The present paper *titled Impact of Iraq War on Bangladesh Economy* has been prepared jointly by *Dr Debapriya Bhattacharya*, Executive Director, CPD, *Professor Mustafizur Rahman*, Research Director, CPD and *Dr Ananya Raihan*, Research Fellow, CPD. The paper was presented at the dialogue on *The War in Iraq and Economic Implications for Bangladesh* organised by CPD held on Thursday, April 10, 2003 at CIRDAP Auditorium, Dhaka, Bangladesh.

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Impact of Iraq War on Bangladesh Economy

Introduction

At present Bangladesh economy is more sensitive to external factors compared to early 1990s when the first Gulf War took place. It is true that the impact of the 1991 Gulf war on the Bangladesh economy, particularly on the export sector, was not significant. As a matter of fact, external sector performance indicators such as export and remittance in that particular year posted robust growth when the entire year is considered. However, one important difference with 1991 is that at present the degree of openness of the Bangladesh economy is much higher than it was in early the 1990s. The current economic indicators dictate that about 40percent of Bangladesh's GDP is directly related to the global economy. This enhanced integration is manifested through an increasingly close link of the Bangladesh economy with the global markets for goods, services, labour and capital markets. Any major disruption in the external sector is likely to have more impact on the economy, both in terms of extent and severity. Thus, the Iraq war generated significant concern among the stakeholders in Bangladesh.

The impact of Iraq invasion was critically dependent on the duration of the war and, on whether the war spills over to other countries, how the war affects the Middle East economies, how the post-war reconstruction is organized, and what are the likely impact of the war on global financial and commodity markets.

An early assessment of the anticipated consequences of Iraq war was necessary for Bangladesh economy for taking appropriate measures to address the consequences and finalisation of aid negotiation with the World Bank and the IMF and the Bangladesh Development Forum in May, 2003. The assessment would also facilitate preparation for the global trade negotiations, particularly setting up the tone of declaration of the LDC Ministers at the LDC Ministerial to be held in Dhaka on May 31-June 02, 2003. The impact assessment was also important to identify necessary measures by reflecting in the upcoming national budget for FY 04.

This note deals with three questions: the dimensions of the impact of Iraq occupation, the depth of the fallouts, short-term, and medium-to-long term impact of the war.

Impact of Iraq War: The Transmission Channels

Two major channels of impact of Iraq war on the Bangladesh economy have been identified: the *Direct or National Impact*, and the *Indirect or Global Impact*. It is anticipated that the impact should also have time dimensions: short term impact (e.g. immediate dislocations), and medium-to-long term impact (e.g. post-war changes).

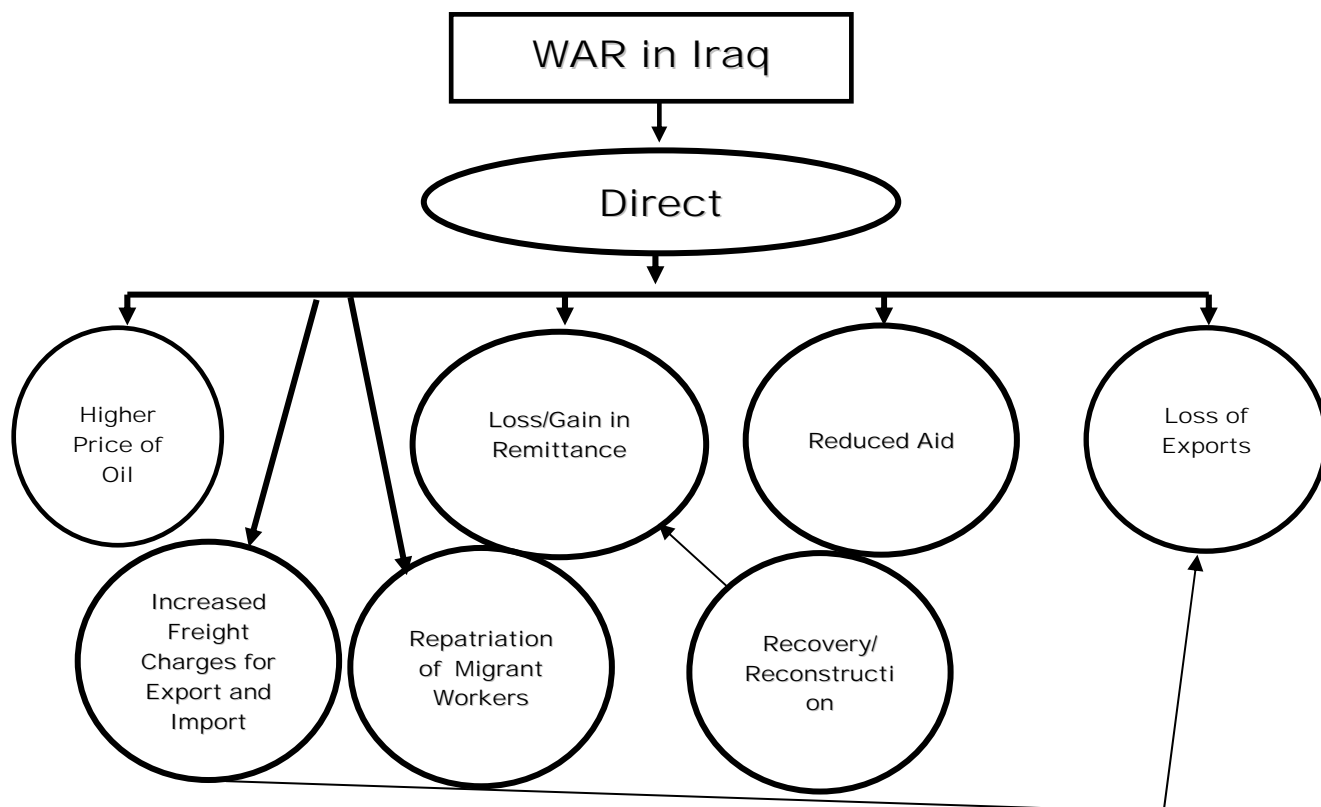
The possible channels of direct impact, identified by the CPD were as follows:

- Change in Price of Oil
- Loss/Gain in Remittance
- Change in Aid Flow
- Loss of Exports
- Increased Freight Charges for Export and Import
- Repatriation of Migrant Workers
- Recovery/ Reconstruction

The indirect impact which might affect Bangladesh economy through global changes had been identified as follows:

- Long-term Impact on Global Economy (Recession or Boom?)
- US Budget Deficit
- Oil Production and Price
- Exchange Rate (Dollar Weakens?)
- Loss of Consumer Confidence, Job Loss, Possible Recessionary Trend
- US Trade Deficit
- Loss of Income
- Changes in Global Priorities (Cancun, MDG)
- Reconstruction in Iraq

Figure 1
Direct Impact of Iraq War: Possible Channels
 Global Priorities May Change (Cancun, MDG)



The Fallouts of Global Impacts

Initially CPD developed three possible scenarios depending on the length of the war and possible Iraqi resistance against the US-UK forces: Benign case, Intermediate case, and Worse case. The anticipated benign case depended on whether the war would continue for more than two months. The worse case was perceived as the war might continue for more than a year, the damage of US-UK war machineries would be huge in terms of human casualties and physical damage within Iraq and across the border. The Intermediate case has been perceived as in between the benign case and the worse case. The world observed that the war in Iraq was short, less than a month. Although the civilian casualties and damage of infrastructure in Iraq had been devastating, the US-UK joint forces captured the country according to the anticipation of the benign case – without significant loss. Various US sources forecasted that the direct cost of war would be limited [see Table 1]. The Pentagon study forecasted that the cost of war would be limited within USD 50 billion, or 0.55 percent of their Gross National Product (GNP); the estimate excluded the reconstruction cost. The US congressional Budget Office

(CBO) projected a cost of USD 50 – 60 billion for a shorter war. The President of the US submitted a budget to the US Congress for the war, which is estimated to be USD 74.7 billion.

Figure 2
Indirect Impact of Iraq War: Possible Channels

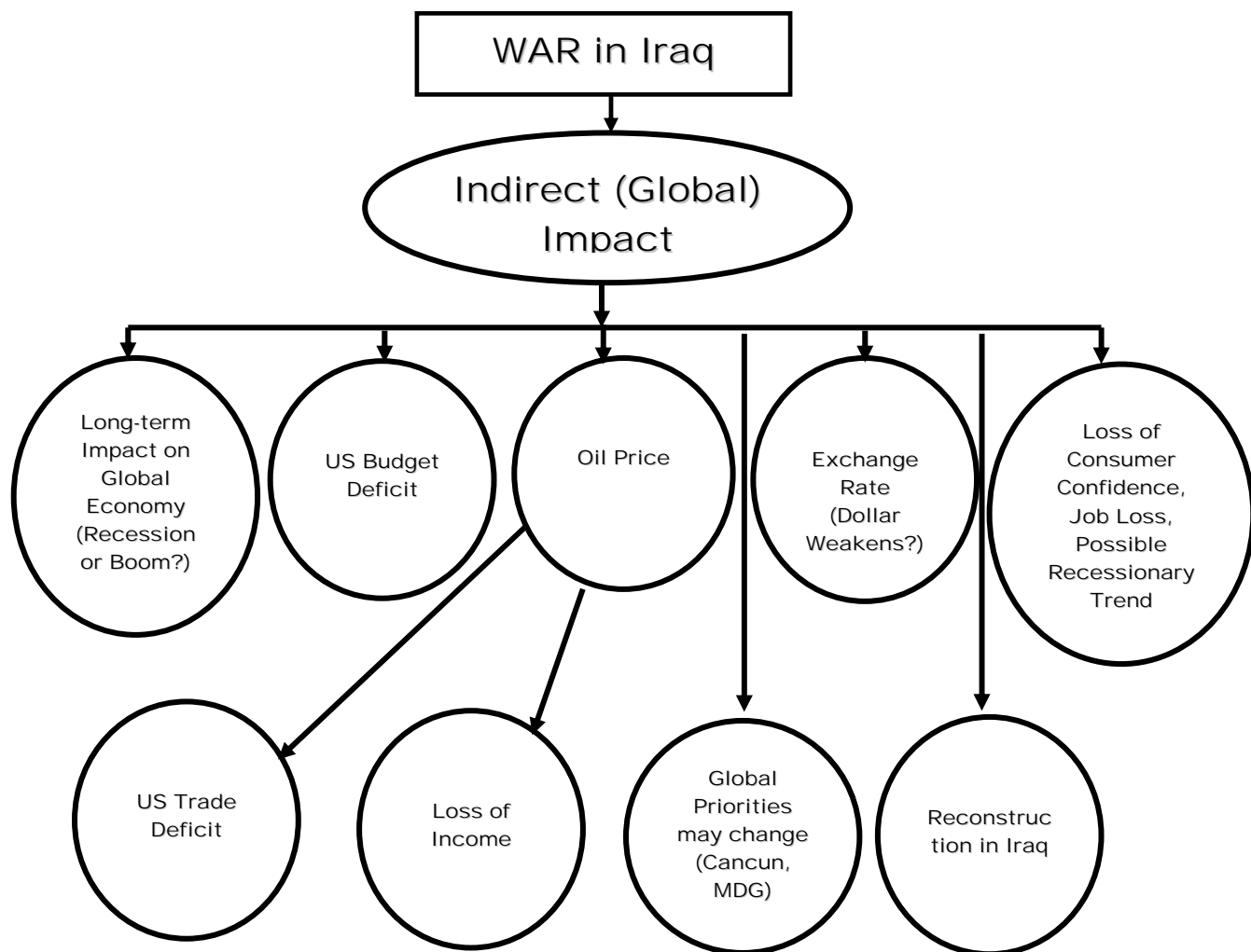


Table 1. The Cost of Iraq War: Forecast of American Administration

Source	Projected cost of war
Estimate of President Bush sent to Congress	\$74.7 billion
Pentagon Study	\$50 billion, 0.55percent of Gross National Product (excluding reconstruction costs)
US Congressional Budget Office (CBO) Study	\$50 billion - \$60 billion (for a short war)

The Academic and Business think-tanks' forecasts included both immediate and medium to long term cost of war [Table 2]. For example, Yale University Study (by William Nordhaus) forecasted the direct cost of war \$48 billion - \$60 billion (excluding interest) in case of short war, around \$140 billion in case of a year long war. The study projected cost of occupation and peacekeeping force in Iraq \$17 billion - \$45 billion per year. Per capita cost of reconstruction and nation-building by Iraq, forecasted in the study was USD 800. The Financial Times forecasted the cost of war between USD 156 billion to USD 755 billion over the next decade. Assuming a certain degree of military difficulty the US Economic Adviser Lawrence Lindsey forecasted the cost of war between USD 100 billion and USD 200 billion. There had been other forecasts made by various institutions, some of which are presented in the Table 2.

Table 2. The Cost of Iraq War: Projection of American Think Tank

Source	Projected Cost of War			
Yale University Study (by William Nordhaus)	\$48 billion - \$60 billion (excluding interest in case of short war) around \$140 billion (in case of a year long war)	Occupation and Peacekeeping force in Iraq	\$17 billion - \$45 billion per year	\$100 billion - \$600 billion over the next decade
		Reconstruction and Nation-building cost by Iraq	\$800 per capita	
		Humanitarian Assistance	\$1 billion – \$10 billion	
		Additional oil cost to the US	Up to \$500 billion for a difficult war	
		Further economic costs to the US	Up to \$345 billion	
The Financial Times (Martin Wolf)	Costs of the war between \$156 billion and \$755 billion over the next decade.			
US Economic Adviser Lawrence Lindsay	\$100 billion - \$200 billion (assuming a certain degree of military difficulty)			
Estimate by Royal United Services Institute (by Keith Hartley)	\$1.4 billion - \$5 billion (purely short term military cost)			
Oxford Economic Forecast (07-Feb-2003)	US Government Spending			
	Benign Case		\$53 billion	
	Intermediate Case		\$90 billion	
	Worse Case		\$124 billion	

The history provides us with the information on economic impact of various wars and shocks on the world economy and economy of the countries involved in them [Table 3]. The Korean war experience was initially positive for both the US and UK, starting with boom, followed by a bust and ultimately the economy recovered. However, the Suez conflict did not bring any happy memory for the UK economy, which caused a Sterling crisis and ended up with a mild recession in the UK economy. The prolonged Vietnam war stimulated growth in the US economy, however, the outcome was mixed due the inflationary pressure. The UK experienced a positive impact on the economy as a result of the Falklands war. The first Gulf War brought a mixed outcome for the US and UK economy. While the American economy experienced a recession followed by a strong recovery, the ERM dominated in the world currency market against the US dollar.

Table 3. Impact of War: Some Historical Facts

Source	Period	US Economy	UK Economy
Korea	1950 – 53	Boom, bust, recovery	Boom, bust, recovery
Suez	1956	--	Sterling crisis, mild recession
Vietnam War	(1966 – 72)	Growth Inflation	--
1st Oil Shock	1973	Inflation & Recession	Inflation & Recession
2nd Oil Shock	1979/80	Inflation & Recession	Recession (Sterling Rise)
Falklands	1983	--	Growth
Gulf War	1990/91	Recession, then strong recovery	ERM dominates

National Impact

As the War was played out, the immediate adverse impact on Bangladesh economy, as of today, seems to be limited. Although it was anticipated that there would be a large scale repatriation of Bangladesh's migrant workers due to war, in reality there had been little evidence that such massive repatriation took place during the war or before. The latest data shows that the remittance flow appears to be steady. However, some signs of

immediate export dislocation and loss had been evident. There was a rise in petroleum and petroleum products related import costs.

Importance of Middle East

As is known, at present the flow of remittance play a crucial role in the context of Bangladesh's import payment capacity, balance of payments position and reserve situation. As Table-4 shows, at present remittance flow from Middle East (\$1911.5 mln in FY2002) is equivalent to 31.9percent of Bangladesh's global export and 22.3percent of her global import. In case of adverse effects of the war on the economy of Kuwait and Saudi Arabia, it would have depressing effect on demand for migrant workers; as a result, inflow of remittance to Bangladesh would be severely affected. The price of oil, an import item of critical importance to Bangladesh, had already surged in January-February, 2003, in anticipation of the war, and further rise may lead to cost-push inflation.

Table 4: Importance of Remittance from the Middle East

	Indicator	FY1991	FY2002
(a)	Total Export (in million USD)	1697.0	5986.3
(b)	Total Import (in million USD)	3510.0	8592.0
(c)	Remittance from Middle East (in million USD)	476.0	1911.5
(d)	(c) as percent of (a)	28.1	31.9
(e)	(c) as percent of (b)	13.6	22.3

Source: Compiled from Bangladesh Economic Survey (various issues).

Table 5: Importance of Middle East as Trade Partner

	Indicator	FY1991	FY2002
(a)	Export to Middle East (in million USD)	88.5	224.1
(b)	Import from Middle East (in million USD)	-	466.1
(c)	(a) as percent of Bangladesh's Total Export	5.2	3.4
(d)	(b) as percent of Bangladesh's Total Import	-	5.3

Source: Compiled from Bangladesh Bank (various issues).

The importance of Middle East countries as import source and export destination is not of high significance to Bangladesh. From Table-5, it is evident that the Middle East countries account for only 5.3 percent of total imports to Bangladesh (FY2002), whilst

the corresponding share in the country's export is 3.5 percent. However, the Middle East market is important for such exportables as vegetables (75 percent of total export) jute yarn (22 percent), jute goods (30 percent), textiles fabrics (30 percent) and tea (10 percent). 25 percent of all petroleum imports are from the Middle East countries, mainly Saudi Arabia. Any subsequent slump in the US and the global economy was likely to have negative impact on the demand for goods and services exported by Bangladesh. Early signs were that RMG exports were already facing some difficulty and some of the orders were being deferred. War surcharge and other related charges pushed the ship freight (of a 20TEU ship) by about \$250 in some of the routes (Karachi, Gulf states).

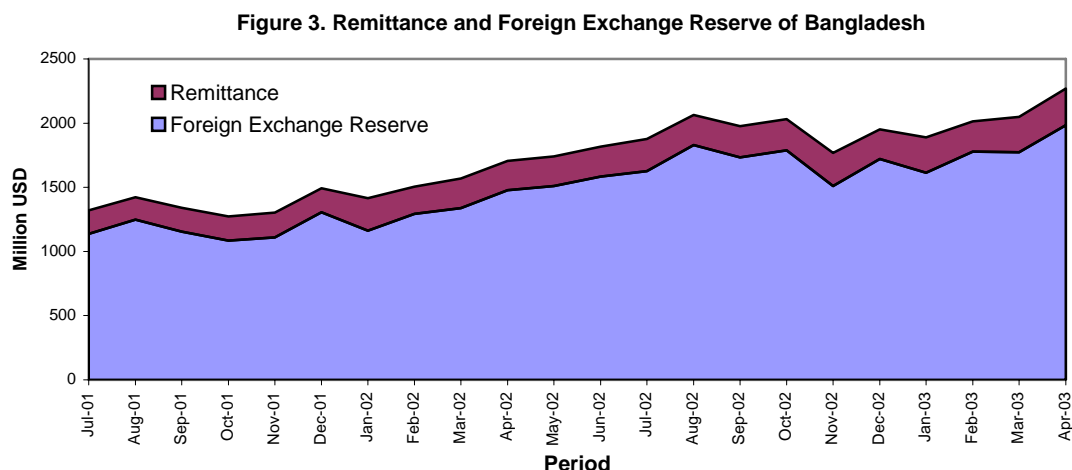
Possible Repatriation of Workers and Remittance Situation

Although the number of Bangladeshis working in Iraq is negligible, Bangladesh has a large contingent of migrant workers in the neighbouring countries of Iraq, such as Kuwait, Qatar, Bahrain and Saudi Arabia. Before the war, manpower export of the country in February, 2003 came down from 22000 of the previous month to 13100. The decline was mainly because of the difficulties faced by the Middle East bound Bangladeshi workers. This created a bit panic among the concerned sectors. However, it appeared that such decline was temporary.

Since the beginning of the war on March 20, a total of about 3000 Bangladeshis came home from Kuwait and UAE; however, most of them appear to have come home on leave. Thus, the fear of massive repatriation of workers appeared to be a false alarm.

Remittance from Middle East has become a crucial component of forex earnings for Bangladesh. In 2002 remittance from Middle East (\$1911.5 million or 76.4 percent of total remittance) was equivalent to 31.9 percent of export earnings and 22.3 percent of import payments. Remittance during first 4 months of 2003, at \$1071 million, was 15.93 percent higher than the corresponding period of 2002. The growth rate appears to have slowed down: during the preceding six months (July-December, 2002) the growth rate was 31.1 percent compared to the corresponding period of the previous year.

The increase in remittance during the war month boosted further the foreign exchange reserves, which stood at USD 1.98 billion in early May, which was the highest since the government took over. Thus, the remittance did not affect Bangladesh economy due to the Iraq war.



Export Market

As was mentioned earlier, Bangladesh trade is not much dependent on the Middle East. As a result the direct impact of the war could not be huge due to the war. However, the sectors which concentrate their business in the region, suffered much. As the export data are processed with a time lag, it was not possible to estimate exact volume of trade loss. CPD investigation found that mainly export of fruits, vegetables and allied products, jute and jute products had been suffered due to the war [see Box 1]. Export of perishable items, which are mostly exported to the Middle Eastern region, discontinued for a week as a consequence of the war.

The RMG sector was not affected much in the short run as the major destinations of the supply are Europe and the US. Some RMG orders placed earlier have been deferred. Iraq was one of the major importers of jute and jute products from Bangladesh. Thus, export of the jute and jute products had been hindered immediately before the war and during the war. The war pushed the transaction cost of export up through increase of freight and insurance cost. The cancellation of cargo flights hampered export of perishable items to the region. The weak dollar also affected the price of perishable exports from Bangladesh. Bangladesh Biman has withdrawn the facility of subsidized rate for carriage of perishable items to the Gulf region [Box 1].

It was confirmed from various sources that the immediate negative impact of the war was very short. Thus, the export disruptions were largely a short run phenomenon. However, such disruptions accentuate the ongoing erosion of competitive strength of Bangladesh's export sector. As a result, any compensatory packages need to address long-term structural issues.

It is worthy to mention that the US imposed new stringent regime of security compliance for the Bangladeshi exporters during the Iraq war, which is going to be a permanent rule. The new security regime will definitely increase cost of production for the Bangladeshi exporters and thus far reduce the competitiveness of the products from Bangladesh.

**BOX 1: IMMEDIATE IMPACT ON EXPORT PERFORMANCES OF IRAQ WAR:
A SNAP SHOT**

Jute Goods: Impact of Iraq War was immediately felt on jute and jute products. Some specific information was possible to collect from the Bangladesh Jute Goods Association. Bangladesh had to stop production and shipment of 100,000 bales of raw jute with a value of Taka 300 million that had been sold to Iraq. Another shipment of jute carpet had been cancelled, which was also bound to Iraq. The value of the shipment was Taka 190 million. Two other shipments had been also halted, which was due for shipment under the “Food for Oil” Programme of the United Nations.

It should be mentioned that Middle East, specifically Iran, UAE, Turkey, Egypt and Iraq, are the major importers of the jute goods from Bangladesh, about 60 percent of export of jute and jute goods are concentrated in the Middle East.

Many jute mills had to hold ready stocks due to cancellation of orders or delay in shipments.

Vegetables and Food Export: The air communication had been stopped almost for one week between Dhaka and Kuwait from March 20, 2003. The foreign airlines reduced the frequency of cargo flights for more than one month period. As a result the export of the perishable goods to the Middle East had been suffered. The exact volume of damage to export of these items will be known after two months due to the data compilation process. The individual banks do not have also up-to-date information processing system. The Vegetable’s Exporters Association reported deferment of 20 orders destined to Kuwait, Bahrain and Qatar. The payment of earlier shipment had been stopped due to the outbreak of war. There was no incidence of loss of order however; the volume of export had been reduced during the war time.

It should be mentioned that Bangladesh exports annually 200, 000 MT of vegetables and fruits to Middle East, Europe and USA. Before the war, due to the lack of cargo space and infrequent cargo flight Bangladesh could service only 50 percent demand in the South sector (Jeddah-Riyadh) of Middle East market. In the North sector (Dubai-Abu Dhabi) this rate is only 20 percent. Due to the sluggish demand 20 – 25 exporters closed their business, which is around 10 percent of total exporters.

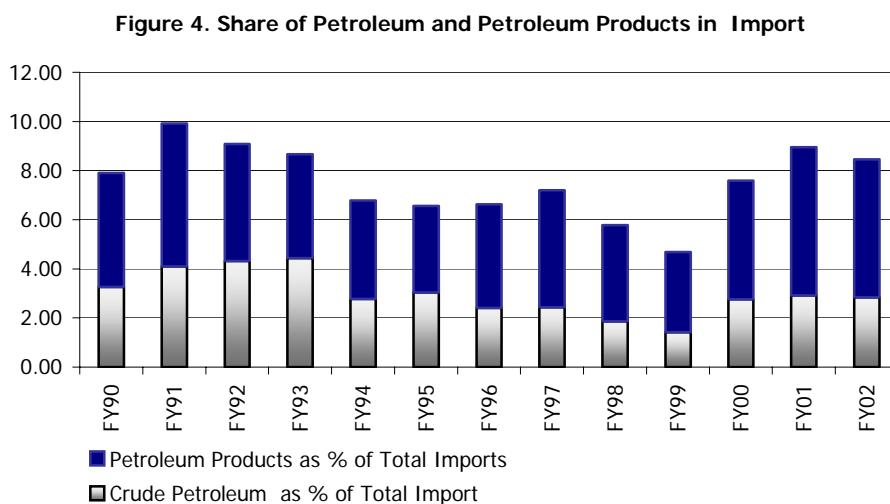
RMG: Talking to the RMG exporters and bank executives, who deal with the RMG export and import LCs, it was felt that Iraq war did not touch the RMG sector in a significant way. No estimate was possible to make on the basis of the available data. However, information about deferment of shipment had been received from one Nationalized commercial Bank. One shipment of RMG products bound to USA was deferred by two weeks, from March 15, 2003 to March 30, 2003 [final date of shipment] which was worth USD 65,785. Another shipment, worth USD 81310, heading to the USA was also stopped until further notice. On April 10, 2003, the supplier got the notification about the deferment of shipment and extended date of shipment. Some RMG exporters had to change the meeting with the buyer from Dhaka to Bangkok due to the war.

Cost of Export: All shipping lines increased the freight through General Rate Increase (GRI) by USD 100 to USD 250 per container effective from April 20, 2003. The rate was not withdrawn till the moment of writing the paper. The war risk premium had also been added to the cost of export. However, no reliable figure was possible to trace in this regard.

Source: Bangladesh Jute Goods Association, Bangladesh Fruits, Vegetables and Allied Products Exporters’ Association, and CPD Investigation

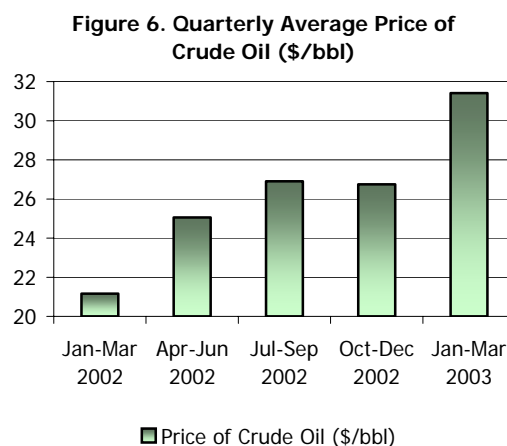
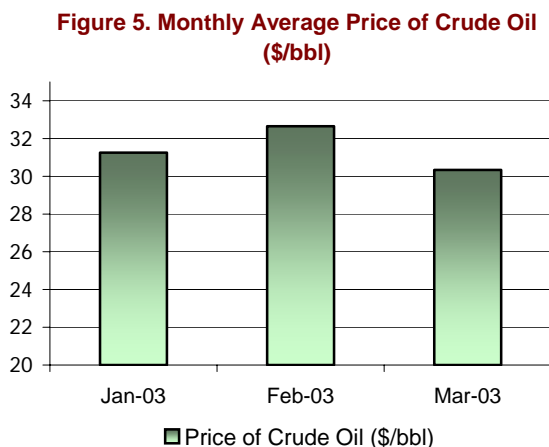
Price of Oil

It was anticipated that the Iraq war would influence the world oil price; as a result, the national market would be adversely affected. It should be mentioned that imports of



petroleum and petroleum products constitutes about 10 percent of Bangladesh’s total imports [Figure 4]. About a quarter of it comes from the Middle East.

It was observed that the L/Cs opened for imports of petroleum and petroleum products

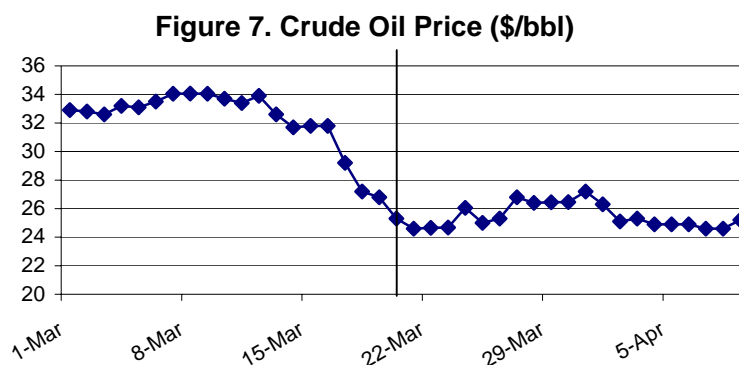


had been increased by more than 30 percent (in \$ term) during January – February ’03 compared to January – February ’02. It was mostly due to war anticipated purchase, however, the increased price for petroleum was also a reason for the rise. For L/C settlement the increase was more than 38percent and accounted for about 9 percent of total settled L/C.

In FY91, share of petroleum and petroleum products in Bangladesh’s total import rose to 10percent from 8percent (FY90); it was estimated that, if the post-Gulf war-I trend repeats itself, Bangladesh would have to take an extra import burden of around \$170 million. The rise in price of war might trigger a series of macro-economic problems. For example, product price also might increase as the increased oil price would likely to push the production cost. There was a fear that the push on oil price may strengthen inflationary pressure also.

It was observed that the oil producing countries were very careful in maintaining the price of oil. The short span of war also allowed the oil producing countries to keep the price within tolerable limit. Bangladesh government took emergency measures by arranging oil reserve in the Far East. That decision also helped in Bangladesh to contain domestic price of petroleum and petroleum products.

The monthly world average price of crude oil was below USD 33 in January and February 2003. However, there was a hike in the crude oil price during the last three quarters of 2002 [Figure 6]. The quarterly average price of crude oil increased from USD 21. 16 in Q1 to USD 26.76 in Q3 of 2002. The quarterly average price raised further in the first quarter of 2003, to a high of USD 31.4. The recent peak in the oil price was in



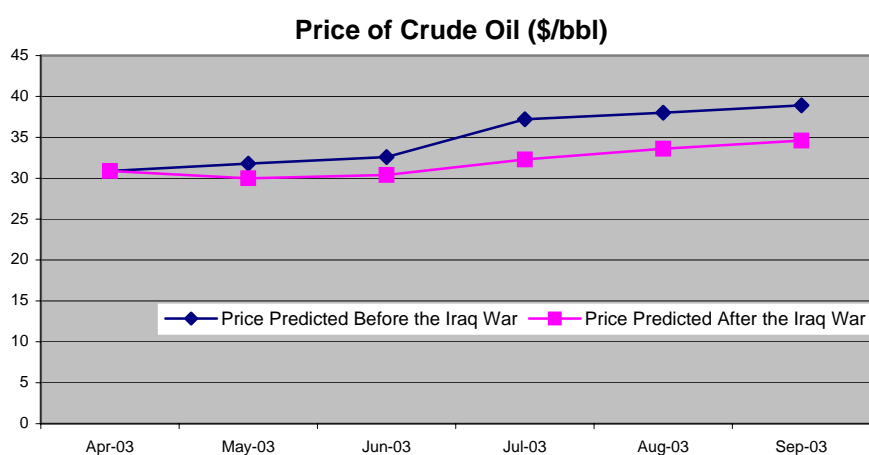
February 27, 2003, when the price of crude oil went up to high USD 39.9 per barrel. However, the price of the crude oil in the last day of the war, when the US force captured Baghdad, stood at USD 25.19 per barrel. Figure 7 shows that the price of oil got a declining trend from the second week of March, 2003. Thus, it can be argued that the change in the oil price preceded the war time period and there was no direct impact of war the oil price.

Global Impact

Global Price of Petroleum

The Gulf War in 1991 saw prices rise by 90 per cent, only to fall subsequently. It was feared that the war in Iraq would throw the world into another oil crisis. It was anticipated that the oil price rises will also affect the price of other energy sources such as coal and natural gas. The experts projected that with crude price once again exceeding \$30 per barrel the world would experience a mild fourth oil shock [see Figure 8].

Figure 8: Forecast of Oil Price in West Texas (Before and After the Iraq War)



As the war was short, the forecast was not realised. It is expected that in the coming months the price will rise, but at a lower pace than anticipated before war. Figure 8 shows that the post-war forecasts of price have been corrected with the new reality.

It should be mentioned that Iraq's oil reserves are the second largest in the world, after Saudi Arabia. Production level is at present way below the capacity, and represents around 2 million barrels per day (2 to 2.5 percent of current world oil demand). The future of production and sales of Iraqi oil as well as continuation of UN "Food for Oil" Programme in Iraq will have some impact on the global oil price. It is expected that in the medium term Bangladesh economy will not face any pressure on the foreign reserve due to the fluctuation of the oil price.

The State of the Global and US Economy

The world economy started to experience a sharp downturn in the last quarter of 2000 which subsequently continued, sustained and deepened in 2001 with no perceptible improvement in 2002. Although there are some early signs of recovery in US in 2003, there is no confidence in sustainability of those improvements.¹

US economy is currently recovering from the 2001 slump which was deepened after the September 11 Terrorist Attack. Current US unemployment rate, at 6percent in April, is the highest in 2003, is more than the average for the recent years. US economy suffered about half a million job loss in the months of February and March, 2003 alone (460 thousand to be precise).

Trade Deficit

USA is running the largest current account deficit ever experienced by any country. The US trade gap has surged in December 2002 to a record \$44.2bn. Trade gap stood at \$462 billion or about 4.7 percent of GDP in the third quarter of 2002 and hit the 5 percent mark in early 2003. Keeping budget deficits under control is the most important task the U.S. could do to limit expansion of the current account deficit. Some economists are forecasting that the U.S. budget deficit could climb to \$500 billion this fiscal year, which may put global financial stability at a high risk.

Iraq Reconstruction and Economic Boom

The quick end of war and the forthcoming reconstruction activities with large participation of the US companies are expected to boost the US economy. However, the boom of the US economy will largely depend on the source of financing of the Iraq reconstruction. The global economy is vulnerable to any sharp correction in the US economy. The strong US economy will have a positive impact on the Bangladesh economy, as the US is the second largest trade partner of the country.

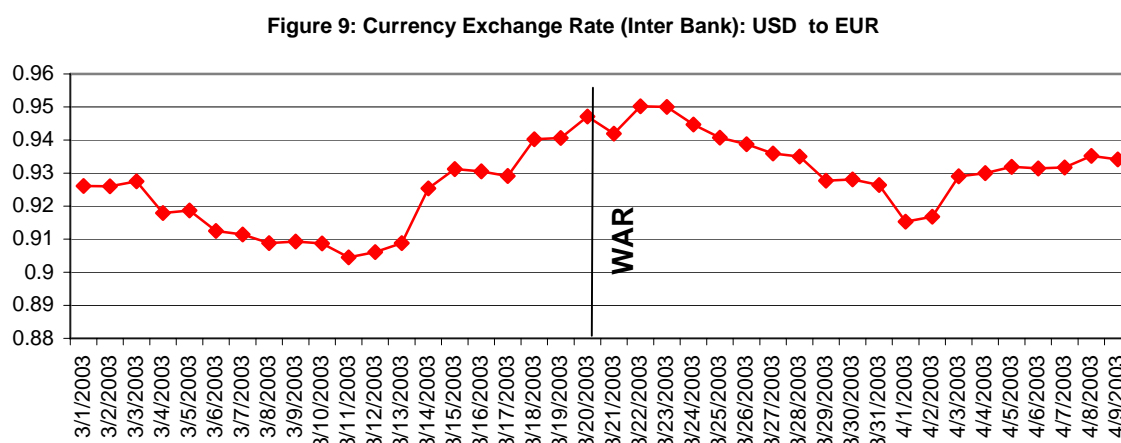
¹ The unemployment rate in the US was still in rise, in January the rate was 5.7percent, which was set at high 6percent in April, 2003. One month change in CPI was 0.3percent in March, 2003, which was 0.6percent in February, 2003. www.bls.gov

Inflation

The wholesale inflation in USA, which has been virtually non-existent, jumped by 1.6percent in January 2003, its biggest increase in 13 years, according to figures from the US Labour Department.

Value of Dollar

The US currency has become weak compared to the EURO in the pre-war week and with a fluctuation of the relation between the US dollar and EURO remained in favour of the EURO at the end of the war [Figure 9].



The strong EURO and Pound Sterling acted against the Bangladeshi export in the European market. A recovery of the US dollar against the EURO will have some positive impact for the Bangladeshi exporters.

US Economy and Bangladesh’s Vulnerability

The US is an important development partner of Bangladesh. US accounts for 38.7percent of Bangladesh’s global export of goods. The state of US economy after the Iraq war will impact on Bangladesh’s export performance. US is a major source of FDI in Bangladesh (25.2percent in FY01 and 22.8percent in FY02). US’s share (bilateral) in disbursed aid to Bangladesh is low, at less than 3percent (\$40 million, 2001), but it is a major player in global financial and development institutions. Any immediate slowdown of the US economy is likely to affect Bangladesh through the following channels:

- Trade – Stagnancy in export demand;

- Aid – Lower disbursement due to diversion of scarce resources;
- FDI – Reduced availability as equity risk increases; and
- Global Support for LDCs – Further weakening of commitment.

Among the channels only trade channel is expected to provide some hope due to recovery prospect of the US economy in the short run, because there are some long run concerns, which are related to MFA phase out under the ATC.

The US contribution to the LDC Support Programme has been weakening since some time. The Iraq war and US foreign policy has a clear indication that the commitment of the US will further weaken due to the competing priority in the other regions of the world.

It is still not clear what will be the mid-term impact of the Iraq war on the global economy – *a recession, recovery or a boom*. The growth rate projections for USA, UK and Euro Zone have been toned down for 2003, but 2004 may see good recovery. Bangladesh has to brace itself for possible global recessionary trends in rest of the 2003 and prepare for the expected recovery in 2004.

In the medium-term rise in oil price, increased trade-facilitation charges, possible economic slowdown in the US, UK and Euro Zone countries may aggravate the ongoing vulnerabilities of Bangladesh's export sector. Prospect of participation of Bangladeshi workers in post-war reconstruction activities may get affected because of alleged discriminatory recruitment practices. If dollar weakens, it is going to affect Bangladesh's export earnings. This may be marginally compensated by fall in import cost. Bangladesh's access to concessional overseas resources may suffer as development priorities may get significantly undermined due to changed paradigm and resource diversion. Uncertainties in the global economy may deepen leading to increased arbitrary treatment of trade partners in distribution of trade preferences. In the process, Bangladesh may get sidelined.

The cost of war would, in all probability, have negative impact on the availability of global aid funds for the developing countries and LDCs and may push the cause of supply side capacity building and financial assistance to these countries further down in the priority list of the developed countries. Developed country initiatives and interest for

achievements of such targets as the Millennium Developed Goals (MDGs) may also suffer setback.

Macro-Economic Policy Response

As there is on firm confidence in the recovery of the global as well Bangladesh economy, the need to pursue moderately expansionary policy through enhanced public expenditure and accelerated domestic credit expansion to the private sector for the rest of the year have become more imperative.

Recent developments manifested in weakening of the export sector, import pick-up, enhanced petroleum import cost, low off-take of foreign aid, and tapering off of FDI may create incremental pressure on the balance of payment. The GOB will be well advised to negotiate with the IFIs some quick disbursement of balance of payment support.

Conclusion

It was feared that the early signs of Bangladesh export sector's recovery in FY2003 might be seriously undermined by the negative consequences emerging out of the war in Iraq. Thanks to the short duration of the war. The immediate negative impact on the economy of Bangladesh was also limited in extent and duration. Thus, the export disruptions were largely a short run phenomenon. However, such disruptions accentuated the ongoing erosion of competitive strength of Bangladesh's export sector. As a result, any compensatory package needs to address long-term structural issues as well.

It is expected that the post war economic scenario in the US will improve towards a recovery. If so, Bangladesh economic recovery will be more stable, this is evident in the early months of the FY 2003.

The Iraq war rang the bell to streamline and diversify our export once again. The vulnerable merchandise export demands intervention in many areas, including reduction of transaction cost and time for business. The vulnerability of remittance flow was exposed once again due to the Iraq war. The government should also think of policies to put in place mechanisms for up-gradation of skill of the expatriate workers, which might help diversify the destinations of the workers that would help reduce the risk of economic loss due to economic shocks and extraordinary events.