Independent University **Bangladesh (IUB)**

IUB Academic Repository

Independent Business Review Volume: 14, No: 1, June-2025

2025-06

Dollar crises, import structure and economic development: some preliminary findings on Bangladesh

Mahmood, Raisul Awal

School of Business and Entrepreneurship, Independent University, Bangladesh

https://ar.iub.edu.bd/handle/11348/1381

Downloaded from IUB Academic Repository

DOLLAR CRISES, IMPORT STRUCTURE AND ECONOMIC DEVELOPMENT: SOME PRELIMINARY FINDINGS ON BANGLADESH

Raisul Awal Mahmood*, Hanif Mahtab, Safayet Rahman, Tarannum Azim

Department of International Business
School of Business and Entrepreneurship
Independent University, Bangladesh (IUB)

Introduction

Perspective

The dollar crisis – labeled also as the foreign exchange crisis, the balance of payment deficit, shortage in the supply of foreign exchange, etc. has been one of the most talked about issues in Bangladesh during the past couple of years reaching its zenith in recent months. Rooted in the country's various experiences the dollar crisis underlines the current shortages in the country's foreign exchange supplies vis-à-vis its overall needs – both current and prospective future. Related also are macro-economic policies pursued over the past decades, political uncertainties prevailing in the country, the undertaking of mega development projects based on external funding, capital flights, money laundering, hoarding foreign exchange, and lack of fiscal accountability.

This all underlines an increase in demand for foreign exchange, a decline in respective supplies and/or a combination of both. For instance, the rise in the international price of goods and services in recent years coupled with devaluation in currency value require greater foreign exchange to import the same volume of goods and services; similarly, a decline in export trade, leakage in remittance inflows, lesser inflow of foreign grants, aids and loans underline a reduced flow of foreign exchange. Consequently, pressure could be exerted on the foreign exchange reserve of the country to meet import needs.

Given the country's dependence on the import of such essential items as energy, food, edible oil, industrial raw materials and spare parts,

* Corresponding author: Raisul Awal Mahmood, Email: raisul@iub.edu.bd

machinery and equipment, crises overseas caused increased demand for foreign exchange. The cost of services such as transportation, insurance, etc. - boosted by global crises, added further to the foreign exchange needs. Topped further are the country's external obligations towards debt repayment which has been increasing all along due to the undertaking of various mega projects.

The effect of all these dynamics is an ever-increasing gap between a country's foreign exchange earnings and respective needs; dwindling foreign exchange reserves causing to look for assistance from international organizations such as World Bank, IMF, ADB, JICA, and major donor countries wherever possible. An ever-widening gap between demand and supply has caused the exchange rate to spiral out astronomically with the Taka/$ rate deteriorating officially from 84 to 110 – going up above 125 in the open market.

The immediate concern of the policymakers to alleviate the dollar crisis has been to harness the inflow of imports into the country – besides efforts to increase the foreign exchange earnings from exports, overseas remittances, and, not least, the inflow of aid and loans from international organizations like the IMF. Discouraging or restricting imports through various means such as increasing the LC margin - a prerequisite for any import and having variations for different import items has been a policy priority. LC margin was raised to a minimum of 75% for such goods as motor cars, home appliances, electrical and electronic products.

The result of all this has been rising prices of imported goods in the market. Prices of basic consumption goods such as food, edible oil, sugar and petroleum products soared up not only to the extent of the currency devaluation but more so due to various market imperfections like control by interest groups locally termed syndicates. Secondly, a significant increase in the cost of imported raw materials including energy led to cost inflation, and, in the case of export-oriented industries like the RMG, a decline in the country's competitive advantage. Many industries reported a decline in output. Costs of energy and frequent power failures added further nails.

Finally, high-cost inflation, lower sectoral output and uncertainties about the future are expected to have demeaning effects on the country's future growth. Already, the RMG sector recorded a 7.5% decline compared to last year; and the ADB predicts that Bangladesh's growth would slow down to 6.6% from its forecasted value of 7.1%. The dollar crisis with its

adverse impact on price, output and growth rate could be spiraling into the future.

Purpose and Scope of Study

The purpose of the current exercise is to explore possible links between the Dollar crisis and the country's future development, therefore, highlighting respective implications for future policy planning. Based on the experiences of Bangladesh with the dollar crisis and its impact on the nature and composition of imports, the focus of the exercise is what implications the observed experience has for the country's future development.

Specifically, it investigates (a) the experience of Bangladesh with the Dollar crisis; (b) the impact on the composition of imports flowing into the country; and respective (c) implications for the future development of the country. The underlying assumption of the exercise is that the dollar crisis would influence the composition of the country's current import basket given demand elasticities for different imported products – classified broadly as consumer goods, intermediate goods, and capital goods, with negative implications for the level and rate of future growth.

The goal of the exercise is to come up with policy suggestions towards redeeming the adverse effects of the dollar crisis and maintaining the development momentum Bangladesh experienced in the recent decade. It will underline the costs and benefits of import-oriented production and development, and alternatives to imports based on cash payments.

The current exercise is qualitative and descriptive in nature. It utilizes secondary information available from various sources to provide a clear understanding of the major issues of particular focus of the exercise. Four issues of focus here are: (a) Dollar crisis, (b) costs of imports, (c) composition of imports, and (d) implications for development. The depth of analysis of the issues is limited by the very purpose of the exercise which basically is exploratory in nature.

Organization and limitations

The report has been organized into six sections including the present one. This section highlights the analytical framework for the current exercise. Section 3 provides an overview of the dollar crisis in Bangladesh – nature, sources, and trends. Section 4 explores the impacts of the dollar

crisis on the level, trend and composition of imports flowing into the country. Section 5 underscores the possible implications of changing import structures for a country's development. Section 6 draws major conclusions based on the exercise.

Notably, the present exercise is very much exploratory - highlighting and understanding the major issues underlying the dollar crisis in the context of Bangladesh. This is expected to provide a basis for a rigorous study on the subject planned to be conducted moving forward, therefore, should be taken in that spirit.

Analytical Framework and Methodology

The following diagram underlines the issue of the dollar crisis - variously defined as a balance of trade deficit, shortage in foreign exchange, in terms of a discrepancy between the demand for and supply of foreign exchange available at a given point in time. Let S_{FX} and D_{FX} refer respectively to the aggregate supply of and demand for foreign exchange in the country; Q_{FX} and E refer to the initial demand for and supply of foreign exchange in the country and ER_1 as the initial exchange rate.

Now assume that for some reason or the other, the aggregate demand for foreign exchange in the country shifts to D_{FX1}. With the supply of foreign exchange remaining the same as before, a change in aggregate demand will cause the exchange rate to move up to ER_2, and demand for foreign exchange going up to Q_{FX2}. This will create a gap between available supply and demand. Unable to bridge the gap between the two over a period will have adverse effects on different macro variables through a higher exchange

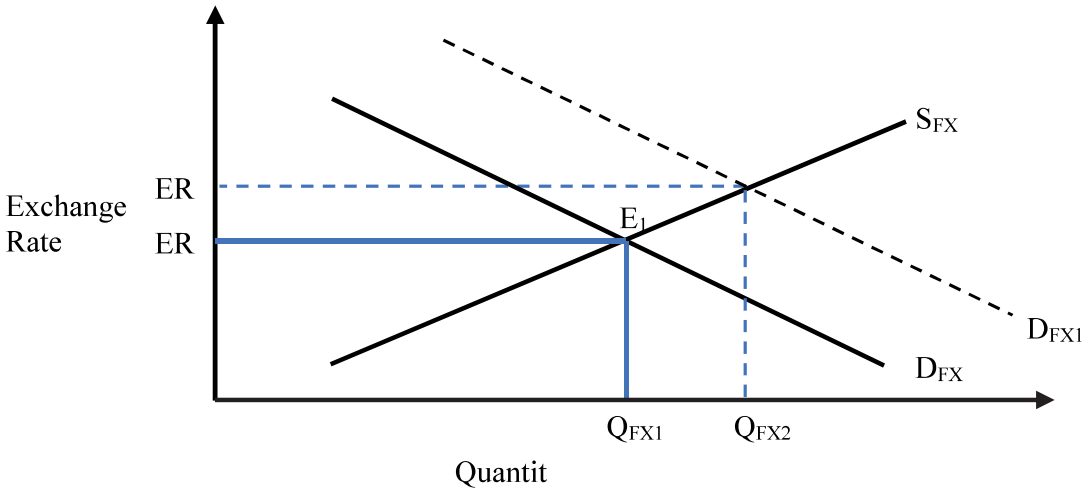


Figure 1.1: Demand, Supply and Exchange Rate

rate and the rising price of import items. The higher the gap and longer the time, severe the crisis will be.

Demand for foreign exchange is underlined by the country's external payments as due to: (a) import payments for goods and services, (b) the country's external obligations like debt repayments – interests on loans, or payment of principals, (c) financing of development projects based on external resources, and (d) miscellaneous other payments in foreign currency.

Availability of foreign exchange, on the other hand, is accounted by (a) export earnings, (b) foreign direct investment (FDI), (c) overseas remittances from nationals working abroad, (d) inflow of foreign aids, loans and grants from various bilateral or multilateral sources, and (f) drawing down on country's foreign reserves.

The persistence of a prolonged gap between the demand for and supply of foreign exchange may become critical for the immediate functioning of the economy underscoring country's future development. Possible links between any existing crisis and its impact on the domestic economy can be depicted by the following schematic diagram.

The diagram highlights four critical issues pertaining to possible links between the dollar crisis and the country's development. First, it points to different indices of a dollar crisis as prevailing in the country. Secondly, one immediate impact of the dollar crisis is depreciation in domestic currency value raising the costs of imports as compared to prior to the emergence of the crisis. Thirdly, the rising cost of imports will underline the level and composition of imports flowing into the country.

Critical here would be the relative elasticities of different imported goods as well as the policy paradigm pursued by the country. Inflation control and relative incidence on different socio-economic groups could be important policy options. Priorities between immediate social needs and long-term development would seem very important. Particularly, given shortages, distribution of foreign exchange across consumption, intermediate and capital goods may seem critical, therefore, having implications for the country's future development.

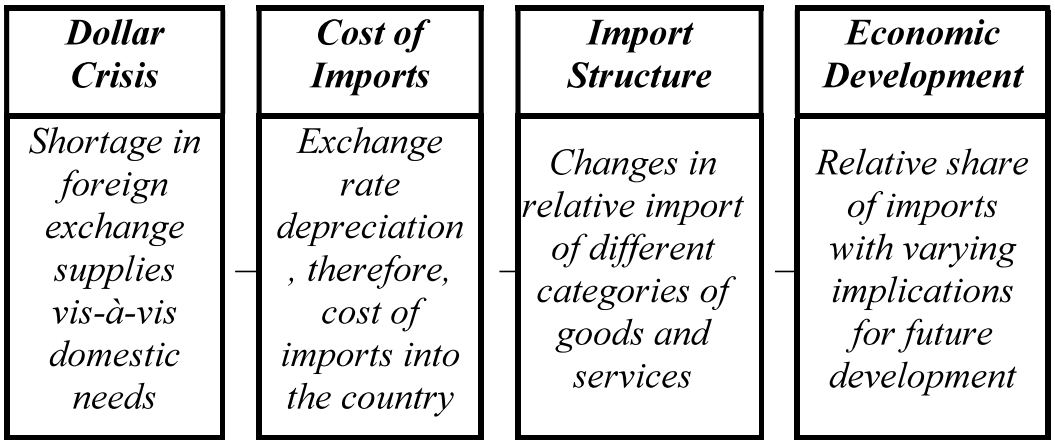


Figure 1.2: Schematic Dynamics Showing Links Between Dollar Crisis, Import Structure & Development

The basic hypothesis in this exercise is that higher costs of imports - due to currency depreciation and/or external factors, demand elasticities, alongside policy towards inflation control through increased supply of basic needs of the population – food, basic consumption items, and industrial raw material and spare parts, the quest for future growth of the economy may be put on the back burner for the time being at least.

Literature Review

In an increasingly globalized business environment – integration and interdependence of economies and incensement of financial flows - foreign exchange crisis or balance of payment deficit, has been common across regions, countries, and time periods. Variations experienced, however, relate to the nature, magnitude, location, major drivers, degree of contagiousness, and impact on domestic economies.

Historically, major foreign exchange or balance of payment crises include that of India 1990-91, Latin America 1993-1994, Thailand, 1997, Mexico 1994, Russia 1998, Global financial crisis 2008, Sri Lanka 2022, Nigeria 2023 (Oleksandr Chernyaka 2013; World Bank 2022; kilanko 2023). Foreign exchange or balance of payment crisis is the inability of a country to meet its external obligations temporarily or on a sustained basis (Nakhoda, 2023). Foreign exchange or balance of payment crisis is rooted in a multitude of factors both internal and external to the country. Three theoretical models of the balance of payments crisis exist: each of the next model rests on the previous one.

The First Generation Models emerged based on the experience of the Latin American Debt crisis beginning in the 1980s. These models were based on the hypothesis that a fixed exchange rate leads to the loss of international reserves and faces speculative attack because of a chronic deficit of the payment balance. Models suggest that the period preceding the balance of payment crisis is characterized by a persistent decline in the country's foreign exchange reserve. In a fixed exchange rate regime –what prevailed at that time in most of the Latin American countries, when agents change the composition of their portfolio from domestic to foreign currency, for example, on the suspicion of an impending currency devaluation, foreign exchange reserve will no longer be enough to defend its currency.

The Second Generation Models is based on the hypothesis that the effects of a speculative attack or just a decrease in expectations can lead to a balance of payment crisis even without changes in fundamental macroeconomic indicators (Obstfeld, Ozkan and Sutherland). The system of indicators that could be used for alarming currency crisis could include, for example, domestic interest rate, public debt, central bank credit to banks, number of credits, political variables, etc.

The Third Generation Models evolved out of the Asian and Latin American crisis during mid 1990 shifted interest from sound economic fundamentals to incompetent financial structure and further incorporated the notion of 'contagion' – that the mere occurrence of a crisis increases the likelihood of a similar crisis elsewhere (Radelet and Sachs, 1998; Masson 1998). Three related scenarios to represent contagion include: monsoonal effects, spillover effects, and pure contagion effects. Added to this was 'information cascade' – correlation between currency crisis and banking crisis provided local banks have debts denominated in foreign currency (Chang and Velasco, 2001). Following this Third Generation Models external liquidity is a crucial factor in financial and currency crises (Mckinnon and Pil, 1996).

Notorious combinations of high debt, low foreign exchange reserves, falling government revenue, rising expectations of devaluation, and domestic borrowing constraints could lead to a currency crisis. Four sets of factors underscore the onset and magnitude of a currency crisis: domestic and private, expectations, financial market vulnerability to pegged exchange rate, and magnitude and success of speculative attack (Rahman and Hasan, 2014).

The foreign exchange crisis in Bangladesh turned into a crisis scenario when Bangladesh's currency value vis-à-vis US $ - to which it has been tied or pegged ever since getting out of the Pound Sterling, suddenly shot up to TK. 110 by December 2023 as compared to TK. 85 in July 2021; and TK 94 in the next year; continuing to increase further and further. The latest official change rate stands at TK. 117 in May 2024 (Bangladesh Bank, 2024). This drastic fall in the exchange rate is closely linked to a significant downturn in the country's foreign exchange reserves. Country's foreign exchange reserve which reached a record level of US$46 billion in FY20-21 dropped down to US$31 billion by FY22-23 (Bangladesh Bank 2024). This rapid decline in foreign exchange reserve is underlined by a sudden and significant increase in the country's balance of payment deficit which was quite unusual for Bangladesh historically. The deficit reached a peak of US18.7 billion in FY2022 (Rahman 2023).

Ballooning of balance of payment deficits underscores the dual effects of rising costs of imports and falling or stagnancy in the country's external receipts (Sajid Amin 2024, Hyder 2024, Islam 2024). Depreciation in the exchange rate – from 86 to 117 in TK:$, rising global prices of commodities such as food, fuel and fertilizers owing to external events such as the Covid-19 pandemic, Russian invasion of Ukraine 2022, Gaza Crisis 2023 and the latest escalation in shipping costs due to emergence of Heutis insurgence, increased import bill by more than 30% due to exchange rate depreciation alone (Rahman 2023).

Meanwhile, earnings from overseas remittances remained almost stagnant despite an increasing outflow of nationals on employment. On top, the country's external payments due to debt servicing increased compared to previously as many mega development projects based on external financing got into the repayment stage. Not the least, the issues of capital flight emerged significantly estimated at an annual rate of around US$ 10 billion per annum (Hayder 2024).

Policy measures undertaken by Bangladesh towards redeeming the exchange crisis and balance of payment deficit have been multi-pronged. An immediate response was to harness demand for imported goods and services by various restrictive measures alike increasing LC margins for imports, attuning of exchange rate with market conditions – managed depreciation in exchange rate, curtailment of public expenditures for such purposes as travel of government officials, treatment, education, and

slowing down of expenditures for various mega development projects. Towards augmentation of the falling foreign exchange reserve, including greater support and cooperation from external sources, the Bangladesh government approached and successfully obtained US$ 4.5 billion loan from the IMF. It also obtained budget support from the ADB, and disbursement on account of different development projects.

The implications of the foreign exchange crisis - and balance of payments deficits have been far-reaching. It underlined the significance of external forces in affecting the domestic economy as well as the implications of macro-mismanagement in creating future crisis.

Foreign Exchange Crisis

A foreign exchange crisis is said to exist if the sovereign nation is unable to "pay for its imports and meet its current foreign debt payments as well as other foreign obligations" with its foreign exchange earnings and reserves (Ayittey, 1984). A foreign exchange crisis – or currency crisis – is known to be associated with "severe falls in economic activity" (Terra, 2015); is also called the "balance-of-payments" crisis resulting from a severe present or future imbalance in payment under prevailing exchange rates (Willett & Wihlborg, 2013). This type of crisis is often associated with other types of financial crises, such as banking crises, sudden halt of foreign capital inflow, a sharp rise in capital outflows and defaulting debt payments (Glick & Hutchison, 2013).

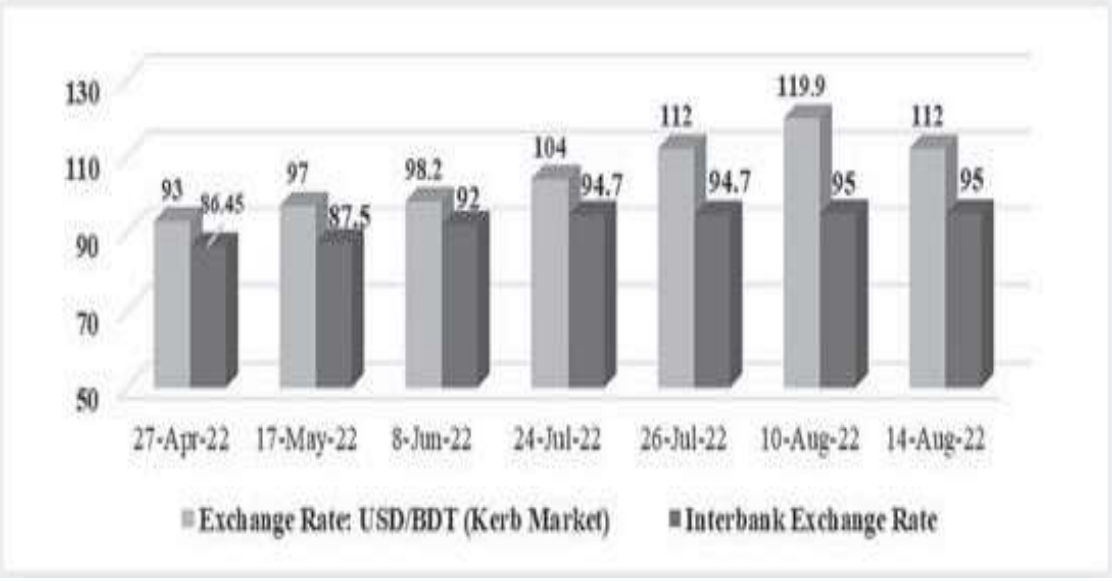


Figure 2.1: Interbank and Kerb Market Exchange Rates (Amit & Kafy, 2024)

Amit and Kafy (2024), in a recent systematic review of 90 articles (published between 2020 and 2023) assessed the Foreign Exchange Reserve (FER) to investigate the "dollar crisis" of Bangladesh. They identified both external and internal factors as the trigger points for the crisis, leading to inflation, as well as disruptions in supply chain, healthcare, and numerous other services.

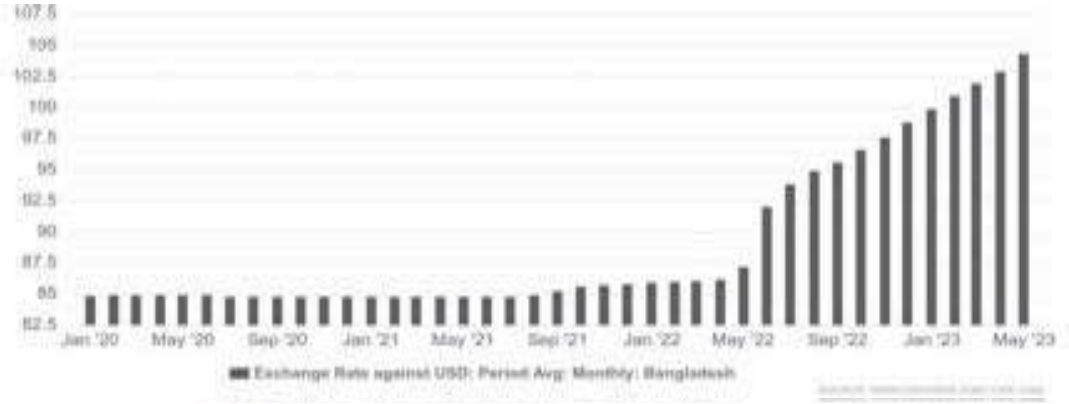


Figure 2.2: Exchange Rate Against USD

It is noticed that, prior to the COVID-19 pandemic, the exchange rate of the US dollar was around Tk. 84, but the kerb market rate hit its highest at Tk. 127 on November 9, 2023 (Islam, 2023). The FER in December 2023 came down to $20 billion from its peak of $48 billion in August 2021 (New Age, 2024), which is one-third of the projected $60 billion using 2009 trends, according to Dr. Birupaksha Paul (Paul, 2023).

Enhanced cost of import

Due to the rising prices of fuel due to the Russia-Ukraine war, the import cost through Chittagong port had fallen 9% year-upon-year in the first

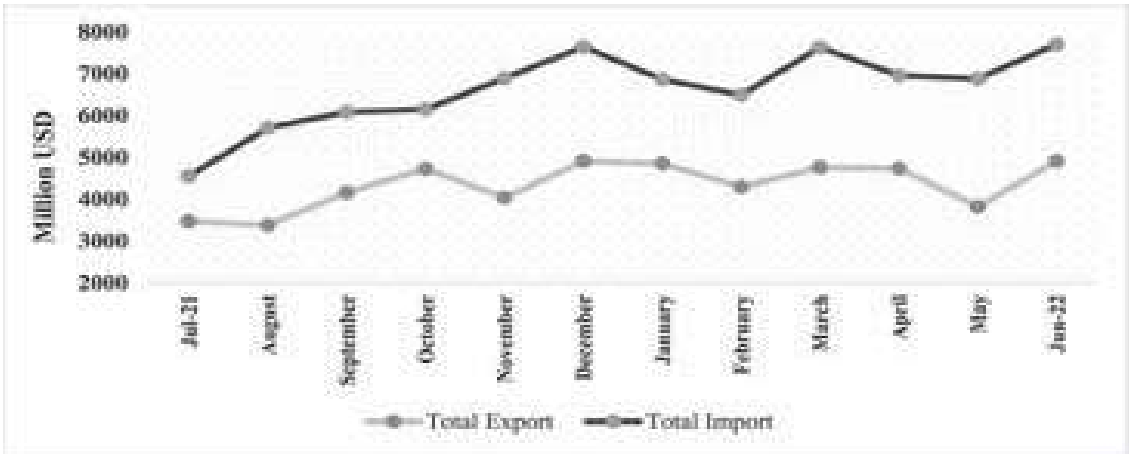


Figure 2.3: Bangladesh's Exports and Imports in Fiscal Year 2021-22 (Amit & Kafy,

quarter of Fiscal Year 2023-24 (Chowdhury, 2023), despite the government's post-COVID-19 liberalization of import regulation and broader duty-free import policies (Amit & Kafy, 2024).

Restriction on import volume

According to Ayittey (1984), when faced with a foreign exchange crisis least developed countries abruptly restrict imports, which leads to "serious dislocations" in the economy – development rates suffer, food and agricultural input imports become difficult, hunger and starvation rise, and political situations unstabilize.

The imports dropped sharply as LC opening by public and private institutes fell by 26% year-on-year in fiscal 2022-23 (News Desk, 2023). Chittagong port – which handles 92% of import-export in Bangladesh – saw imports of 20 types of products decline between 12% and 97% during July-September, 2023, compared to the same period the previous year, leading to 793,493 tonnes fewer imports of products like oil, steel, structures and parts, chemicals, cables, electronic equipment and cable, etc. (Chowdhury, 2023)

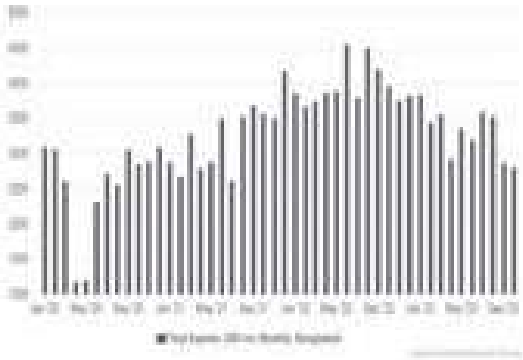


Figure 2.4

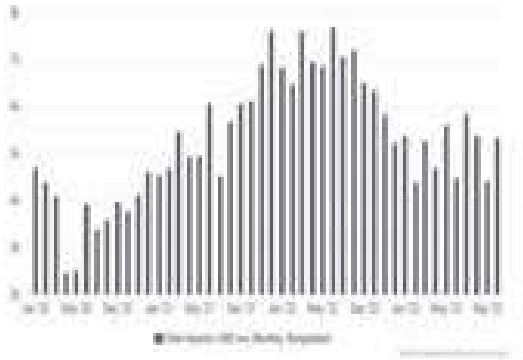


Figure 2.5

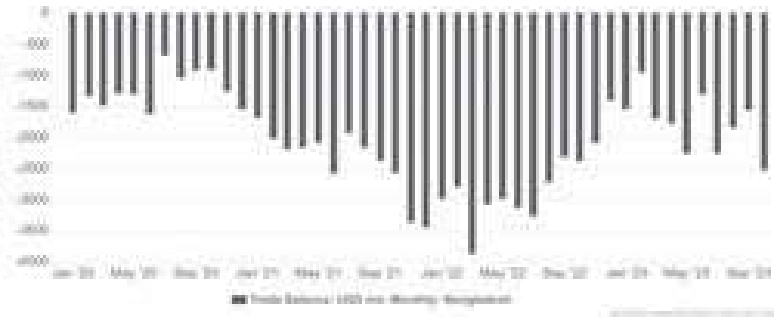


Figure 2.6

Figure 2.4, 2.5 and 2.6: Export, Import and Trade Balance, Jan 2020 – October

Problems meeting international obligations

In the last 15 years, Russia, India and China have emerged as the main lenders for Bangladesh (Byron, 2024) but, during the first half of fiscal 2023-24, they have not made any new aid commitments (Kabir, 2024).Bangladesh's foreign debt repayment is expected to rise as much as 63% by the fiscal year 2025-2026 (Byron, 2024), as a surge in disbursement of foreign loans and interest payments against them is pushing up the debt-servicing requirement. In recent times, the foreign debt service rose to $1.56 billion in July-December, 2023, which is further squeezing the country's withered foreign-exchange reserves (Kabir, 2024). The country's external debt has increased by 322% since 2009, from $23.5 billion in June 2009 to $99 billion in June 2023 (New Age, 2024). Bangladesh owes 59% of its loans to multilateral creditors such as the World Bank and the Asian Development Bank, while the rest is owed to bilateral lenders (Byron, 2024).

Financing existing development projects and undertaking new one

Over the past three terms, Bangladesh has witnessed a remarkable transformation under the leadership of Prime Minister Sheikh Hasina (National Desk, 2023). Her party's latest manifesto with the slogan "Smart Bangladesh where development shines accelerating employment" states that mega projects are crucial for achieving high growth rates. The development projects involve investing heavily in infrastructure projects by building and upgrading roads, bridges, ports, and railways, notably projects such as the Padma Bridge, Cox's Bazar Railway Station, Elevated Expressway, Metrorail, etc. However, such development projects take a heavy toll on FER.

The fund release for mega projects such as the Dhaka Metro Rail, the Matarbari Coal Power Plant, and the Rooppur Nuclear Power Plant has increased in recent times as their implementation has entered the final phase (Byron, 2024). With such massive fund releases, the country faces a significant backlog of nearly $48 billion in foreign loans as of December 2023 (Report, 2024). However, the Prime Minister on January 24, 2024, met with a high-powered committee to find ways to reduce waste in government projects, as the major portion of government expenditure is on implementing development projects (Byron, 2024).

Risks and uncertainties associated – current and future

The government has recently decided to form another high-level committee (headed by the Prime Minister's principal secretary) to speed up foreign-funded projects to expedite the disbursement of foreign loans from development partners.

According to officials from the Economic Relations Department (ERD) and the Planning Commission, delays in development projects occur due to:

- Inadequate feasibility studies, complications in land acquisition, delays in utility shifting, frequent changes in project director, delays in the tender process, and delays in the revised project proposal process especially by implementing agencies and development cooperation agencies.
- Development partners impose specific conditions on their projects throughout the implementation process, which are time-consuming.
- Absence of regional offices of development cooperation organizations, such as the Asian Infrastructure Investment Bank (AIIB).

In the revised Annual Development Programme (ADP) foreign aid allocation is decreasing every fiscal year due to challenges in expenditure – in the fiscal 2023-24, a cut has been proposed from Tk94,000 crore to Tk73,500 crore (Report, 2024). For example, the health sector, which was initially projected to receive an allocation of 11.1% in the 8th Five Year Plan 2020-2025, has been allocated 6.16%, the agriculture sector from 11.5% to 4.07%, the rural development sector from 12.1% to 7.18%. This inconsistency in funding raises uncertainties regarding the attainment of the targets outlined in the five-year plan.

Impact on Import Structure

The impact of the foreign exchange crisis has a multifaceted impact and the compounding effect of the impact is felt in every sector and brunches of an economy. Bangladesh's current foreign exchange crisis is no doubt a consequence of prolonged mismanagement of the economy, high import payments, low remittance, and export receipts and not to mention the Covid-19 pandemic over the last few years. We noticed earlier that the two major foreign currency sources for our country (exports and remittances) plunged

in early 2023. This indicates that the economy is in severe problem as this will expedite multiple challenges including the dollar crisis, aggravated import costs and further declining reserves. Even though there was an increase in the number of migrant workers in 2022, remittances sent by these migrant workers dropped 16.2 percent to $1.68 billion according to a report by Daily Star in 2023.

Recent reports from Daily Star highlighted Bangladesh's position at a moderately risky stage in its Balance of Payment among its neighboring countries Pakistan and Sri Lanka as there is a significant decline in the foreign currency reserves. This decline has some serious negative impacts on the country's economy, severely hampering businesses' imports of raw materials and intermediate goods necessary for production which, in turn, is compelling foreign lenders to circumvent their investments. Bangladesh is heavily dependent on imports. Businesses in every sector are facing challenges due to a lack of strategies to mitigate this crisis. Increased raw material prices are minimizing profit margins. Letter of Credit (LC) is a mandatory financial contract issued by an importer's bank but recently importers have been denied by the banks due to a crisis of dollars. LC settlements have severely dropped from 15 percent to $3.13 billion in the last few months (Parvez & Ullah, 2023). Companies are paying huge amounts of shipping demurrage because ships are getting stuck in the port due to the bank's failure to settle the payment. Since banks are unable to provide the necessary dollars which means that the clients have an additional burden of managing dollars themselves. While dollars are scarce in banks, they are more or less available in the informal market at a considerably higher price than the official exchange rate. Thus, increasing the cost of import and a rise in the commodity price.

The major industries that were hit the hardest were the textile, packaging, and garments industries, followed by jute and pharmaceuticals. The garment industry is the largest contributor to the nation's GDP along with airlines and shipping companies. Moreover, students moving abroad for higher studies are hardly able to pay their tuition fees and patients going for treatment are excruciating to secure adequate dollars. The decline in imports also poses challenges to employment opportunities in the country. Moreover, multinational companies have been facing challenges in remitting dividends and technical assistance fees for the past year. Political uncertainty, compounded by money laundering and hundi activities, has further worsened the crisis, contributing to the multifaceted challenges

faced by the country. Businesses are becoming more cautious in financing purchases causing a continued declining trend in the country's import of capital machinery. Imports of capital machinery are on a steady decline as banks are more cautious in financing any kind of purchase. Additionally, entrepreneurs are equally reluctant to expand their businesses amid slowing domestic and export sales.

For a long time, the value of the Taka was kept artificially high even though countries such as China, Cambodia, India, and Vietnam had depreciated their respective currencies. A strong currency was helpful for importers, but not desirable to exporters. However, despite the depreciation of the Taka against the US dollar, export sector performance was not impressive in FY2023. With payments made by RMG makers being in dollars, the weakening of the Taka means the cost of purchasing raw materials using US dollars has increased. This nullifies the advantage of Taka depreciation against the US dollar and increases the cost of export. In addition, depressed demand in importing countries due to the economic downturn has been another main reason behind low export income. Restrictions on import of capital machinery and intermediate goods has jeopardized the future production and export opportunities which will have a long-term impact on the export growth in the country. As mentioned earlier, in the RMG sector, not only production has been hampered by the dollar crisis, but also it is impacting RMG workers via inflation. The growing cost of imports has increased the demand for domestic products, and this has potentially placed upward pressure on local prices. Therefore, low-income RMG workers faced the impact of inflation from the very beginning.

Several government initiatives to tackle the declining reserves have created further barriers for importers, not just making imports of raw materials, capital machineries and intermediate goods, but also the imports of necessary consumer goods. The dollar crisis has forced consumers to pay more for essentials even though there is a declining trend in the price of essentials in the international markets according to a Daily Star report in 2023. Essential goods such as soybean oil, palm oil and lentils along with meat and fish cost a lot more in our domestic markets than in international markets. Flour prices have stayed consistent internally but have risen by 35 percent in Bangladesh in just 10 months, onion prices have reduced by 25 percent in the international market but again have gone up in the domestic market. Prices of domestically produced commodities are continuously

rising despite ample local production. Market manipulators are taking the advantage of global economic crisis and creating a supply crisis in the market and the inability of policymakers to take necessary measures against them has left common people suffering since wages have not increased as inflation has.

High energy prices are another important source of inflation in Bangladesh. Power generation companies that consume heavy fuel oil (HFO) have been severely affected by to dollar crisis in the economy. This eventually impacted the cost of raw materials to go up significantly. Power generation companies' profits dropped in 2022-23 and many of them incurred massive losses as the value of the taka depreciated against the US dollar resulting in increasing costs for these companies. The power generation firms had opened LCs to import furnace oil, which was around Tk 86 at that time, however, had to pay the dollar by spending Tk 105 to Tk 115. Although the input costs increased, their revenue did not as these organizations had to submit their invoices on the basis of the price of the dollar during the letter of credit (LC) opening period. The companies had to take in the loss as a consequence. United Power Generation and Distribution Ltd which is the largest power generation company in terms of its capacity and revenue had witnessed a 17.7 percent drop in its profit to Tk 840 crore. Other companies such as Khulna Power Company Ltd had to face a loss of Tk 81 crore and Doreen Power Generations and Systems Limited incurred severe loss as well.

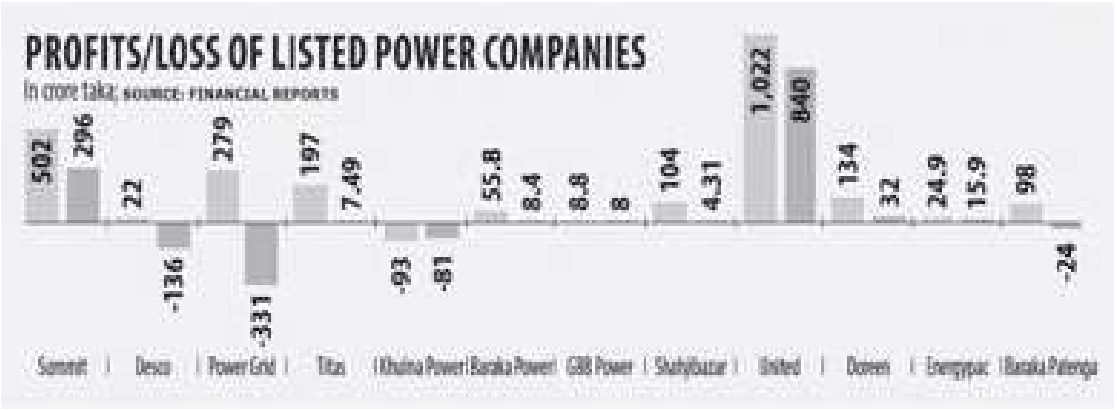


Figure 3.1: Profits/Loss of listed power companies (Source: Daily Star, 2023)

On the other hand, Titas Gas Transmission and Distribution Company's profit plunged 96 percent year-on-year to Tk 7.49 crore. Meanwhile, its revenue increased 26 percent to Tk 17,097 crore. The Power Grid Company of Bangladesh, a state-run listed power transmission company, incurred a

loss of Tk 331 crore whereas it had logged a profit of Tk 279 crore in the same period of the previous year. The company incurred losses mainly due to the depreciation of the value of the take against the US dollar and the increase in financing costs. Its foreign exchange losses stood at Tk 911 crore whereas it was Tk 74 crore in the previous year. Many companies profited in that period however was not in line with higher expenses arising from the foreign exchange loss.

Delays in dollar payments to foreign counterparts have caused an image crisis as well. Bankers and economists fear that the failure to comply with payment deadlines, which are usually 180 days, will put Bangladesh at risk of a credit rating downgrade. if the country's rating ultimately goes down, import costs for banks will significantly go up because they will have to pay commissions to third parties to get letters of credit confirmation.

Future Development Prospect

The world economy has not recovered yet. Liquidity pressure is still prevailing due to the foreign exchange crisis. Efficient management of foreign exchange and inflation would ensure the future growth of foreign trade and economy overall. Policies adopted by developed countries to control their inflation have been showing positive results. However, political instability and a possible breakout of regional war in the Middle East region could alter the way towards a stable global economy. In the middle of all this chaos, Bangladesh will have to cross a thin line towards economic stability.

The gov has started to pay the installment for foreign loans given by the development partners therefore increasing the pressure on the foreign reserve. This is an added pressure in the midst of already depleting foreign exchange reserves, low remittance earnings and decreased export income. This might create more negative pressure on future foreign trade in the country. However, there is a glimmer of hope on the horizon. Imports of capital machinery for garment, packaging and other industries have increased over the past six months compared to a year ago. Political uncertainty regarding the parliamentary election affected the investment sentiment earlier. Since the election is over, investors are injecting fresh money on a go-slow basis.

To reduce inflation, increasing the interest rate has been one of the popular mechanisms used by governments. If this policy is adopted in

Bangladesh, then it might bring inflation down in the short term, however, it will lead to reduced entrepreneurial activities within the country. Apart from taking monetary policies, the government should enact measures to repel market manipulators. Resolving a fake supply crisis, orchestrated by syndicates, would make consumer goods available at a fair price in the market and reduce inflation. Recently Prime Minister Sheikh Hasina has directed authorities to cut import duties on necessary commodities for the upcoming Ramadan month, however, if syndicates remain active then all these actions to reduce inflation will be in vain.

New sources of natural gas should be explored within the country. It will reduce the purchasing pressure from foreign countries and save foreign reserves. If the energy supply can be managed from its own sources for the next 10-12 years, it will stabilize the economy within this period and the development of renewable energy sources by this time, such as solar and wind power, could take the lead afterward.

To increase export earnings, developing new markets should be initiated. Africa, South America, and Middle East markets can be tapped more for increased exporting opportunities. Though our share of exports in Japanese and Australian markets has increased over the years, however, export of diversified products to these markets can jump up the export earnings substantially. Exporting of products where Bangladesh has a comparative advantage such as leather, seafood and pharmaceuticals could grab major market share in other countries. Opportunities to sign up for bilateral or multilateral agreements with new markets to reduce tariffs should be explored for future growth of export earnings.

Since the COVID-19 pandemic, remittance flow has been a volatile trend. Political uncertainties regarding the election also impacted the remittance flow into the country. Moreover, complex and time-consuming government remittance channels in Bangladesh discourage people from using legal mediums. Simplified legal remittance channels and skilled migration of workers in diversified countries have the potential to boost the foreign exchange reserves of the country.

The use of multiple currencies to settle international payments could help absorb the dollar crisis shock and ensure financial stability. Bangladesh mostly trades with China and India and has a good trading relationship with them. At least partial payment can be thought of as a payment mechanism for payment which will reduce the foreign exchange volatility.

Conclusions and Policy Recommendations

Bangladesh witnessed a significant dollar crisis in recent periods. Emanating from an increased demand for foreign exchange caused primarily by rising price of imports due to global crises, stagnancy in export earnings and overseas remittances including external resources, mismanagement of macroeconomic policies, draining domestic resources due to capital flights, and speculative efforts to privately hold foreign exchange domestically. The end results are curtailment of imports, significant currency depreciation, high inflationary pressures, rising costs of production, demeaning country's international competitive edge, potential loss of export markets and import composition changes with adverse implications for future development.

Rooted in shortage of foreign exchange vis-à-vis needs, dollar crises underline dynamics of all various factors associated with the demand for and supply of foreign exchange available to the country and determinants thereof. Enhanced demand for foreign exchange is at the core of the crisis though, overcoming the crisis contemporarily involves optimizing alternative uses of available supplies. Both qualitative and quantitative control of imports may seem appropriate depending on the demand elasticities of different import types.

The ensuing dollar crisis and subsequent balance of payments deficits point to susceptibility of Bangladesh's economy to various global crises given its dependence on exports and imports. Our dependence on a few export items - RGM in particular, as also limited export destinations like the USA and European Union, makes the country vulnerable to any adverse politico-economic changes in these regions. Similarly, import dependence for three key items – fuel, fertilizers and food, makes imports highly inelastic.

Even import dependence for basic consumption items like onion, green chili and eggs, makes the economy vulnerable to the whims of external market conditions. Increasingly recognized, import components of mega-development projects significantly underlines demand for foreign exchange. So long as these continue, the country shall remain vulnerable to any such future crisis. Current exchange and balance of payment crises should therefore be a wakeup call for the policy makes and academicians alike.

Understanding and preparedness is fundamental to harness any such crisis in the future, and it should be a lesson learned for policy makers and practitioners alike. Whilst predictions about occurrence of various global events may not be feasible, knowledge of past experiences, and policies to counter any unforeseen circumstances is part of professional expertise that should be endowed. The upending of crisis has long been simmering missed tally missed by those responsible until the ball got dropped.

Redeeming adverse consequences of an ongoing foreign exchange and balance of payment crisis could focus on three prong policy recommendations: immediate, short-term, and long-term. Immediate policy measures should include drastic control of external payments with little or no socio-economic consequences coupled with public advocacy measures. Distinction could be made between imported goods with high income elasticity and lowprice elasticity. Import of goods with close local substitutes - should be discouraged strongly– for instance, imported fruits and vegetables; price hike controlled not so much my external supplies rather by restricting market controls by syndicates. Public advocacy to reduce market demand through lesser or no use temporarily could counter market syndicate. Similarly, given income and price inelasticity, imposition of quota on certain imports could prove effective over raising import duties. On the same note, restrictions should be imposed on demand for various external needs – foreign tourism, treatment, international meetings and seminars, etc. Lastly, debt repayments falling due could be rescheduled for the near future, relieving current pressures.

During the short-term period – ranging from 6 to 12 months period, policy objective should be preparing the ground for a longer term policy. Short-term policy measures should note of the success or otherwise of immediate policy measure on putting a check on import control, and assessing possible consequences, including possible continuation of such measure moving forward. It should bring in lessons for a longer term period. For instance, what happens if import of local substitutes should be discontinued, and possible incidence of such a decision; How public advocacy measures plays a positive role in price control? How effective could a quota system vis-à-vis import duty? Could there be differences in commodity types responding more to tariff as compared to quota?

Long-term policy options to currency or balance of payment crises relate to identification and implementation of policy measures having

cushioning effects for any future crisis. Human capital development to analyze, forecast, and design crises management plans and program should be amongst the top lessons of the current crisis. Development of expertise in such areas of crisis management is fundamental to effective participation in the global economy. Academic and professional institutions should be encouraged and patronaged to focus on such areas of expertise in terms of teaching, research and guidance facilities.

Policies should particularly focus on certain aspects of Bangladesh economy which has proved to be vulnerable to various international crisis. These include composition and destination country's major exports, issues of exports based on imported materials, development projects based on imported inputs, import liberalization for basic consumption products. All this, however, underlines the visions and wisdom of a country's policy makers.

Uncertainties and inappropriateness of macro-economic policy measures emerged prominently in the ongoing foreign exchange crisis. Mismanagement of the exchange rate has been a serious issue as reflected in current crisis. Adherence to a managed exchange rate with little reflection of the real market conditions is blamed for exchange crisis. An objective basis for exchange rate determination is fundamental which, however, is missing in the country. With the exchange rate fixed at TK. 117 could reflect the real market conditions.

Most serious, macro-economic uncertainties - policy and politics both, seriously underline the ongoing exchange and balance of payment crisis. This is reflected in capital flight from the country – totaling around US$ 10 billion a year, a significant proportion of the ensuing balance of payment deficits, and poor expectations about investment opportunities in the country. Dollar crisis further reflect uncertainties about the future exchange rate encouraging private buying and hoarding in significant volume by those who have excess cash in hand. Hoarding foreign exchange, say in $, is easier to accomplish, and could yield returns higher than other available alternatives available. Easing these two elements of crisis is critical to harness any such even in the future.

References

Ahmed, K. A. (2024, January 3). *Bangladesh enters 2024 with volatile forex.* Retrieved from Dhaka Tribune: https://www.dhakatribune.com/business/banks/335655/bangladesh-enters-2024-with-volatile-forex-market

Amit, S., & Kafy, A. A. (2024). Addressing the dollar crisis by investigating underlying causes, effects, and strategic solutions in emerging economies. *Research in Globalization*, *8*, 100187.

Ayittey, G. B. N. (1984). Foreign Exchange Crisis in the Third World: Real, Artificial or Imaginary? *Foreign Trade Review*, *19*(2), 329-346.

Bangladesh govt moves to speed up foreign-funded projects. (2023). *The Business Standard*. https://www.tbsnews.net/economy/govt-moves-speed-foreign-funded-projects-781006.

Bangladeshis paying way more for essentials. (2023). *The Daily Star*. https://www.thedailystar.net/opinion/editorial/news/bangladeshis-paying-way-more-essentials-3279511.

Bensaid, B., & Jeanne, O. (1997). The instability of fixed exchange rate systems when raising the nominal interest rate is costly. European Economic Review, vol. 41, pp. 1461-1478.

Burnside, C., Eichenbaum, M., & Rebelo, S. (2004). Government guaranties and self-fulfilling speculative attacks. Journal of Economic Theory, vol. 119 (1), pp. 31-63.

Byron, R. K. (2024). PM calls task force to cut project waste. *The Daily Star*. https://www.thedailystar.net/business/news/pm-calls-task-force-cut-project-waste-3525771.

Chang, R., & Velasco, A. (2001). A model of financial crises in emerging markets. The Quarterly Journal of Economics, vol. 116 (2), pp. 489-517.

Chiodo, A. J., & Owyang, M. J. (2002). A case study of a currency crisis: The Russian default of 1998. Journal of Federal Reserve Bank of St. Louis, pp. 7-8.

Chowdhury, S. H. (2023). Import cost at Ctg port falls 9% in Q1 of FY24 *The Business Standard*. https://www.tbsnews.net/economy/import-cost-ctg-port-falls-9-q1-fy24-728770.

The Daily Star. (2023, November 23). *Time to set realistic.* Retrieved from The Daily Star: https://www.thedailystar.net/opinion/editorial/news/time-set-realistic-dollar-exchange-rates-3476216

de Macedo, J.B., Pereira L.B., and A.M. Reis (2009). "Comparing Exchange Market Pressure across Five African Countries," Open Economic Review, Vol. 20, pp. 645-682.

Eichengreen, B., Rose, A. K., & Wyplosz, C. (1995). Exchange market mayhem: The antecedents and aftermath of speculative attacks. Economic Policy, vol. 21, pp. 249-312. [41] Komulainen, T., &

Glick, R., & Hutchison, M. M. (2013). Models of Currency Crises. In G. Caprio, T. Beck, S. Claessens, & S. L. Schmukler (Eds.), *The Evidence and Impact of Financial Globalization* (pp. 485-497).

Habib, A. (2023). Power companies' profits fall amid dollar crises. *The Daily Star* https://www.thedailystar.net/business/economy/news/power-companies-profits-fall-amid-dollar-crisis-3312941.

Hayder, K. M. (2024, February 1). *Bangladesh's Dollar Crisis : What Went Wrong?* Retrieved from The Confluence: https://theconfluence.blog/bangladeshs-dollar-crisis-what-went-wrong/

Hunt, A. I. (2023, March 8). *Forex crisis: Countries with the largest fall in reserves since Covid-19.* Retrieved from The Financial Times: https://www.fdiintelligence.com/content/data-trends/forex-crisis-countries-with-the-largest-fall-in-reserves-since-covid19-82182

Islam, S. (2024, January 20). *Forex crisis forces power cos to seek govt dollar bailout.* Retrieved from The Financial Express: https://thefinancialexpress.com.bd/economy/forex-crisis-forces-power-cos-to-seek-govt-dollar-bailout

Islam, M. (2023). Is taka most devalued currency in region over past year? No. *Daily Sun*. https://www.daily-sun.com/post/721925.

Jeanne, O. (2000). Currency crises: A perspective on recent theoretical developments, Special papers in International Economics No. 20, International Finance Section, Princeton University.

Jeisman, S. (2004). "Exchange Market Pressure in Australia," Discussion Paper No 183, Queensland University of Technology.

Kabir, F. H. M. H. (2024). Soaring foreign-debt servicing further sinks forex reserves. *The Financial Express*. https://today.thefinancialexpress.com.bd/first-page/soaring-foreign-debt-servicing-further-sinks-forex-reserves-1706032166.

Kaminsky, G., & Reinhart, C. M. (1996). The twin crises: The causes of banking and balance of payments problems. International Finance Discussion Paper No. 544 presented to the Board of Governors of the Federal Reserve System, Washington.

Kilanko, V. (2023). Nigeria's Balance of Payment Crisis: Causes . *Global Journals Inc.*, 8.

Krugman, P. (1979). A model of Balance-of-Payments crises. Journal of Money, Credit and Banking, vol. 11, pp. 311-325.

Lukkarila, J. (2003). What drives financial crises in emerging markets. Emerging Markets Review, vol. 4

Mahmud, F. (2023). Severe dollar crisis hobbles Bangladesh businesses. *Business and Economy.* https://www.aljazeera.com/economy /2023/2/23/severe-dollar-crisis-hobbles-bangladesh-businesses.

Masson, P. (1998). Contagion: Monsoonal effects, spillovers, and jumps between multiple equilibria. IMF Working Paper No. 98/142.

McKinnon, R., & Pill, H. (1996). Credible liberalizations and international capital flows: The over borrowing syndrome. In T. Ito, & A. Krueger (Eds.), Financial Deregulation and Integration in East Asia. Chicago: University of Chicago Press.

Nakhoda, A. (2023, April 19). *Explaining Pakistan's balance of payments crisis: A comparative analysis.* Retrieved from Dawn: https://www.dawn.com/news/1745350/explaining-pakistans-balance-of-payments-crisis-a-comparative-analysis

National Desk, S. (2023). Bangladesh's remarkable development journey under Sheikh Hasina. *Somoy Full News*. https://en.somoynews.tv/news/2023-11-11/bangladesh-s-remarkable-development-journey-under-sheikh-hasina.

News Desk, F. F. (2023). LC opening in Bangladesh down by 26% YoY in FY23. *Fibre2Fashion*.

Obstfeld, M., & Rogoff, K. (1995). The mirage of fixed exchange rates. Journal of Economic Perspectives, vol. 9, pp. 73-16.

Oleksandr Chernyaka, V. K. (2013). The Main Triggers of the Balance of Payment Crisis in the Eastern . *Procedia Technology*, 4.

Paul, B. (2023). Correcting the dollar's price is the only medicine we need. *The Daily Star*.

Paul, B. (2022, July 1). *What made the dollar crisis worse?* Retrieved from The Daily Star: https://www.thedailystar.net/opinion/views/open-sky/news/what-made-the-dollar-crisis-worse-3060891

Rahman, D. M. (2023, October 4). *How to restore balance of payment stability for Bangladesh.* Retrieved from The Business Standard: https://www.tbsnews.net/thoughts/how-restore-balance-payment-stability-bangladesh-711982

Rahman, D. M. (2023, November 27). *Resolving Balance of Payment (BoP) Crisis in.* Retrieved from ICAB Publications: https://www.icab.org.bd/publication/news/4/1117/Resolving-Balance-of-Payment-(BoP)-Crisis-in-Bangladesh

Rahman, A. A. (2020, May 4). *Currency Crisis in Bangladesh Economy: Some Insights.* Retrieved from ResearchGate: https://www.researchgate.net/publication/270608281_Currency_Crisis_in_Bangladesh_Economy_Some_Insights

Rahman, D. M. (2023, October 4). *How to restore balance of payment stability for Bangladesh.* Retrieved from The Business Standard: https://www.tbsnews.net/thoughts/how-restore-balance-payment-stability-bangladesh-711982

Rahman, D. M. (2023, November 27). *Resolving Balance of Payment (BoP) Crisis in.* Retrieved from ICAB Publications: https://www.icab.org.bd/publication/news/4/1117/Resolving-Balance-of-Payment-(BoP)-Crisis-in-Bangladesh

Refayet Ullah Mirdha, A. Z. U. (2023). Economic pressure deepens as Export, remittance dip. *The Daily Star.* https://www.thedailystar.net/business/economy/news/economic-pressure-deepens-export-remittance-dip-3309756.

Repayment to rise 63pc in three years. (January 17, 2024). https://www.thedailystar.net/tags/foreign-debt-repayment.

Radelet, S. & Sachs, J. (1998). The East Asian financial crisis: Diagnosis, remedies, prospects. Harvard Institute for Development.

Sachs, J., D., Tornell, A., & Velasco, A. (1996). Financial crises in emerging markets: The lessons from 1995. Brookings Papers on Economic Activity: 1, Brookings Institution, pp. 147-215.

Sajid Amit, A.-A. K. (2024). Addressing the dollar crisis by investigating underlying causes, effects, and . *ELSEVIER*, 11.

Sohel Parvez, R. U. M. (2023). Capital Machinery Imports Keep falling. *The Daily Star.* https://www.thedailystar.net/business/economy/news/capital-machinery-imports-keep-falling-3299516.

Sussangkarn, C. (2012, June). *Prevention and Resolution of Foreign Exchange Crises in East Asia. Tokyo: Asian Development Bank Institute.* Retrieved from ADBInstitute: http://www.adbi.org/working-paper/2012/06/25/5099.resolution.foreign.exchange.crises.east.asia/

TBS Report. (2023, December 7). *What are the factors contributing to the crisis?* Retrieved from The Business Standard:

https://www.tbsnews.net/economy/deepening-dollar-crisis-unveiling-causes-and-solutions-75304

Terra, C. (2015). Currency Crises. In C. Terra (Ed.), *Principles of International Finance and Open Economy Macroeconomics* (pp. 229-263). Academic Press.

Tanner, E., (2001). "Exchange Market Pressure and Monetary Policy: Asia and Latin America in the 1990s," IMF Staff Papers, International Monetary Fund, Vol. 47: 3.

What is causing dollar crisis in Bangladesh. (2023). *The Business Standard.* https://www.tbsnews.net/economy/deepening-dollar-crisis-unveiling-causes-and-solutions-753042.

Willett, T. D., & Wihlborg, C. (2013). Varieties of European Crises. In G. Caprio, P. Bacchetta, J. R. Barth, T. Hoshi, P. R. Lane, D. G. Mayes, A. R. Mian, & M. Taylor (Eds.), *Handbook of Safeguarding.*

The World Bank. (2022, October 6). *The World Bank in Sri Lanka.* Retrieved from The World Bank: https://www.worldbank.org/en/country/srilanka/overview

Yueh, L. (2023, October 6). *Lessons from history from three generations of currency crises.* Retrieved from VOXEU: https://cepr.org/voxeu/columns/lessons-history-three-generations-currency-crises