

Overcoming middle-income trap hinges on innovation

ECONOMY - BANGLADESH

TBS REPORT

A lack of appropriate policy, infrastructure deficit, a shortage of skills, the absence of real time data and uneven distribution of growth, all these have got in the way of achieving two aspirational goals – uplifting Bangladesh to the higher income level by next 10 years and higher income country by 2041, say economists and leaders of private entrepreneurs.

The government should now come up with policy support to spend more on inno-

vation to increase productivity and reduce costs of products and services to overcome the tentative middle-income trap, they noted at a roundtable of the closing session of the Annual Development Conference on Friday.

The Bangladesh Institute of Development Studies (BIDS) organised the discussion titled “Turning Points in 2020s: Analytical and Policy Changes”. Some 27 research papers and 13 keynotes were presented by economists from home and abroad at the three-day event that began on Wednesday.

But government

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Dr Mustafizur Rahman, distinguished fellow at the Centre for Policy Dialogue, stressed regional trade and signing effective free trade agreements with potential countries to meet the challenges that will arise after the LDC graduation.

They highlighted the government's initiatives to ensure alternative sources of funding for development and other reforms initiatives.

Sayed Akhtar Mahmood, former lead economist at the World Bank, said the goals of becoming a middle-income country by next 10 years and a higher income country by 2041 is highly aspirational.

Every country has such aspirations but a few of them succeed. Argentina became a middle-income country 100 years ago, but the country is now facing a middle-income trap, he noted.

Identifying a lack of investment in innovation as the major reason for such a trap, he said an investment in innovation, process and product development reduces cost and increases productivity.

The private sector is responsible for investment for innovation and the government is required to provide incentives in these fields, he added.

Reducing dependence on the readymade garment sector, he emphasised diversifying exports and identifying potential on the electronics sector.

The government declared the "Made-in-Bangladesh" strategy in the last budget and provided some protection for the domestic market, the economist pointed out.

Some Bangladeshi factories are exporting a full unit of electronics goods, which is a matter of pride, and the industry has potential to export parts of electronic items.

India imports products worth \$41 billion per year, but Bangladesh's exports to the country amount to only \$1.25 billion. China imports \$2,000 billion worth of goods but less than \$1 billion from Bangladesh, he also said.

The regional trade of Bangladesh was 10% of total exports a decade ago and the rate is still only 12%. The ratio is not sufficient to be beneficial from the upcoming Asian century, Dr Mustafizur noted.

Asif Saleh, executive director at Brac, said benefits of economic growth should reach the last mile of the country to uplift it to the next level of development.

Growth benefits are being distributed unequally owing to a lack of skills among the country's labour force, he also said, urging investments for health and education to upgrade the human capital.

Termining the first two decades after independence "lost decades" as the country had a highly protectionist trade policy that highlighted import substitutions, Zaidi Sattar, chairman at Policy Research Institute, advocated for more leveraging of trade to boost exports and GDP.

Bangladesh's GDP size increased by a remarkable level with per capita income, food production, external trade and others. But the economy started boosting in the 1990's when it became more liberal.

He also said the country's garment sector is generating about 85%

of export earnings and the sector should not be underestimated in the name of export diversification.

Bangladesh is exporting only 6.5% of the global demand for apparels. Investors have potential to boost their earnings manifolds through grabbing a 20% or more share of the global demand, he noted.

While presenting a keynote at the event, eminent economist Dr Wahiduddin Mahmud urged attention on a more concrete pathway to attain two inspirational goals.

Rapid growth among developing countries rarely sustains. And, even if it sustains, uplifting the status of a country is not guaranteed owing to high inequality, he also said.

Termining the LDC graduation an immediate concern for Bangladesh, he stressed starting preparation regarding negotiation in the global economic order without the preferential treatment that the country has been enjoying.

State Minister for planning Dr Shamsul Alam at the event said the government has a commitment and concrete plan to achieve the middle-income status by 2021 and higher-income status by 2041.

Highlighting the government's perspective plan, he said double digit economic growth is projected by next 10 years.

The eighth Five Year Plan, the perspective plan, Delta Plan 2100, National Social Security Strategy and other policies are adopted by the government to ensure desired sustainable and inclusive growth.

Ahmed Kaikaus, principal secretary to the prime minister, said predictions of economists seldom come true as, according to him, most of

the projections are based on flawed methodologies.

Mentioning that the Bangladesh Bureau of Statistics (BBS) had identified 10 poorest upazilas where the rate of poverty was found to be higher – up to 80%, he said the Prime Minister's Office (PMO) sent a team to take proper initiatives to reduce poverty in those areas but they found that the poverty rate was much lower than what the BBS claimed.

"The government emphasises the foreign direct investment (FDI) to meet future challenges. It is creating an environment for every entity to realise their own potential," he said.

Dr Mashiur Rahman, economic affairs adviser to the prime minister, said Bangladesh was enjoying stable growth in GDP and per capita income with relatively more equitable distribution among people compared with countries with the same level of growth.

Mentioning that the rate of employment generation in the country was lower compared to investments over the years, he stressed moving towards higher-technology industries as the country is facing a dearth of land.

Jashim Uddin, president of the Federation of Bangladesh Chambers of Commerce and Industry (FBCCI) told the event that the private sector requires more support in terms of policy and infrastructure development.

He, however, mentioned that the government is implementing a good number of mega projects to facilitate trade and attract investment. The private sector is also working to develop infrastructure in the Public Private Partnership (PPP) method.

Planning Secretary Pradip Ranjan Chakraborty said there were no threats or traps on the way to elevate the country to the next stage of development.

The ongoing eight fast track mega projects will help the economy get a growth momentum, he mentioned, adding the government had brought a set of reforms in the administration to overcome all types of traps.

Finance Secretary Abdur Rouf Talukder said as the tax-to-GDP ratio of Bangladesh is lowest among the developing countries, the government is trying to manage alternative sources of funding to implement the development programme.

He found two challenges in the economy for the current and next fiscal year – subsidy and inflation.

The government has a provision of subsidy to the tune of 1.7% of the GDP while 1% of the GDP for fertilizer, gas, and electricity, he said.

One kilogram of urea fertiliser is selling for Tk30 at the retail level, although the government is purchasing it at Tk100 a kg, he noted, adding these three sectors – fertiliser, gas, and power – would require about 2% of the GDP in the current fiscal year.

He also said the US economy is currently facing the highest inflation in the last 31 years, while manufacturing inflation in India is 12.5%. That is why, inflation in Bangladesh is likely to go up in the upcoming months, he added.

Fazle Kabir, governor of the Bangladesh Bank, said inflation in Bangladesh is highly dependent on prices of food products, as food places the highest weight of the consumer price index.

Food prices are on the rise in the

global market, which implies that the rate of inflation would increase further, he added.

He also said the government was trying to buy a significant amount of rice as the country saw a bumper yield of Boro paddy this year.

The government has a target to increase the food stock to a level from where it can manage the inflation pressure, he added.

Responding to a question he said managing non-performing loans (NPLs) is a very short-time target. The gross NPL in the country's financial sector was 8.18% of the total outstanding loans on the last day of October.

NPL rate is lower in private-sector banks as the main goal of such banks is to maximise profit, he pointed out, adding specialised banks are formulated to provide special types of services with special goals, which is why the NPL rate is high – over 10% – in such banks. He, however, said no bank should have any NPL.

Barrister Nihad Kabir, president of the Metropolitan Chamber of Commerce and Industry, said Bangladesh would face many problems in terms of policies and data to meet the status of an upper middle-income and higher-income country.

The private sector does not have sufficient access to data and has no capacity to analyse the data being provided by the government, she claimed.

She also observed that the ternary industry has been relocated from Hazaribagh to Savar but it did not bring any fundamental change. "The River Buriganga has got relief from pollution in exchange for pollution in the River Dhaleshwari."

Women earnings potential largely untapped yet: BIDS

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Despite women's participation in the labour market on the rise in the country, their earnings potential has remained untapped yet, Economists and researchers have said.

"Bangladesh has an opportunity to substantially raise the total amount of earnings by women, but the potential remains largely untapped," said Maria Eugenia Genoni, a foreign researcher, at a programme organised by the Bangladesh Institute of Development Studies (BIDS) in the capital Friday.

Titled "Income and Employment Diagnostics and Drivers," the event in the three-day annual conference of the BIDS discussed different aspects of the country's employment situations.

"Of the working women, around 60% are contributing to the agricultural sector, with a large proportion taking care of livestock or engaged in unpaid agricultural activities," she added. The economist said the western part of the country was mostly dependent on agriculture. However, increasing off-farm manufacturing activities around Dhaka and Chittagong influences rural income opportunities country-wide, she believes. Maria put five recommendations for raising rural incomes – bringing an overhaul in agricultural policies, improving water management, increasing quality of electricity, and road accessibility, making the rural markets work better, addressing gender norms and expanding the quality of skills and extension services.

Gladys Lopez-Acevedo, another researcher who attended the conference, believes increasing access to education for the female workers, raising the number of female supervisors in different sectors particularly in RMG, promoting women participation in export-oriented

and manufacturing sectors would improve the situation.

The researchers also identified three barriers to career development in Bangladesh – low demand for services, low educational level, and low female employment.

Presenting a paper titled "How selling online is affecting informal firms in South Asia", researcher Maurizio Bussolo said, "When an organisation joins an online platform its sale expands as online selling can access more customers.

It learns to adopt new or improved business practices and technologies, for better access to finance and flexibility in balancing home and work life."

He said, "Digital technologies affect economic activity, reducing costs and barriers related to search, replication, transportation, tracking, and verification. It also reduces matching and verification costs and facilitates the implementation of management practices."

Presenting a research paper styled "Women's employment and safety perceptions: Evidence from low-income neighbourhoods of Dhaka", World Bank's researcher Tanima Ahmed said, "In areas of Dhaka city where low-income people live, 31% women feel unsafe outside their homes while the remaining 69% women feel safe. In the same area, 98% of men feel safe outside the home." Their study found that women of all ages feel insecure outside the home. But as they get older, they start to feel safe.

Their research shows that 61% of economically active women feel safe outside the home. But among the women who work in garments, only 19% feel safe. In doing this research, we have seen that only highly educated women in society report harassment.

Session Chair SR Osmani, professor of Development Economics of the University of Ulster in the United Kingdom, said all these issues are related to education; so, we need to ensure the quality of education and the access to education for all, especially for the women.

Creating enabling environment for economic growth: Some country contexts for Bangladesh

Wahiduddin Mahmud

Economist

According to the official plans, our eyes are set on becoming an upper-middle income country by another ten years, and a developed country by another 20 years. Those are inspirational goals, but we need to concentrate more attention to exactly the pathways that might lead us to those goals. The economic growth studies show that episodes of rapid growth are quite common among the developing countries, but the growth is rarely sustained: that is why we need to be watchful. The other day, in a BIDS public lecture, I mentioned that the development discourses have perhaps spent too much efforts on how to imitate the success stories of the so-called East Asian tigers, which reminds one of the famous 1965 song by the



rock band called Beach Boys: “I wish they could all be California girls” (translate: I wish they could all be East Asian Tigers).

I may add that, in contrast, the contemporary development literature has given relatively less importance to the example of Japan which had about the same per capita income as Argentina around 1900, and look at them now! As for China, it has seen one of the highest increases in income inequality along with high economic growth since its embracing of the market economy, and is only now clamping down on big businesses; but Japanese growth has been remarkably equitable. Japan followed its business model tied to workers’ welfare and loyalty – the so-called “Japanese ethos”. And it may not have occurred to many as to why Japan has many rich people, but few billionaires (only 25 as against America’s 675 and India’s 153). Notice that

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Bangladesh is also now cited as a country producing billionaires, which means we are achieving high economic growth, but it also means that growth has become increasingly unequal.

All success stories, of course, have some common element like providing an enabling environment for fostering economic entrepreneurship that is also compatible to creating a welfare society; what that enabling environment may mean will depend on the specific country context. What are those elements of specific country context for Bangladesh?

An immediate concern is the challenges to be faced in the post-LDC era. We have to start preparing ourselves regarding how we shall negotiate our way around the global economic order without the preferential treatment that we have been enjoying. Most of our trade competitors have already become part of one or more regional free trade arrangements (FTAs). Negotiations of FTAs take a long time and a lot of expertise. Governments often make the mistake of relying too much on the business leaders assuming rightly that they have the first-hand insights on trade potentials. But any beneficial FTA involves some losers and some gainers among the existing businesses; when an FTA proposal gets whole-hearted support from the entire business communities, economic theory of FTA tells us that it is a non-starter. A possible research agenda for BIDS could be to help the government identify the post-LDC challenges.

Another important country context for Bangladesh is its extreme land scarcity; the proportion of total

land area that is not already used for habitation and production activities is the lowest among all countries (forget the island states like Singapore). That makes it extremely difficult to have urbanization and industrialization without encroaching on agricultural land or whatever environmental resources like forests and water bodies we are left with. If we become even a high-middle income country, we shall have to imagine an environmentally sustainable configuration of land use where we shall be producing GDP per square kilometre that will be higher than most of today's industrialised countries. That could be another research agenda for the BIDS.

In one of the sessions yesterday, Ahamad Ahsan emphasised the costs of Dhaka city's overgrowth and rightly so. A megacity like Dhaka has the advantage of agglomeration of economic activities nested together supporting one another, but it has the disadvantage of congestion that pollutes the environment and requires the provision of costly urban civic facilities. In Dhaka's case, the disadvantage of congestion has far out-weighted the advantage of agglomeration. Simply put, Bangladesh can hardly afford to have one of the ten largest megacities in the world, population-wise, given the income of the general city-dwellers which permit very little cost recovery in the provision of the required civic amenities. For example, the maintenance costs of commuter metro-rails, be it underground or sky rails, need to be heavily subsidised even in cities with much wealthier city-dwellers.

But there is a brighter side. We can convert the disadvantage of city

congestion into a density dividend - like the population dividend - for the country as a whole, if we have a farsighted strategy for dispersed urbanisation and industrialisation. The density dividend may come from the entire country transformed into urban-like habitat where economic activities can reap the benefit of a lack of remoteness, closely-knit supply chains and from economising on the spatial spread of required infrastructure.

Well planned development of physical infrastructure is essential for such spatially dispersed development, but it has to be complemented by policies to improve business environment. Studies now show that the envisaged benefits from the Jamuna Bangabandhu Bridge could not be reaped in terms of more industrialisation in the Northeast part of Bangladesh. Part of this may be because of the land-locked feature of the region. The Padma bridge has a greater potential since the areas to be connected have access to sea, but we need to plan ahead. Note that the construction of rural networks of roads, once pioneered by LGED, has done at least as much for economic development through connectivity as some of the planned mega-infrastructure projects are envisaged to do.

These mega-infrastructure projects will be potentially beneficial to economic growth, but only if these can foster more private investment, especially export-oriented FDI, so that the repayment of the suppliers' credit for these projects would not create balance of payments problems in future. That again in turn is related to the whole issue of economic governance and the improvement of the business environment.

Dr Akhtar Mahmood has in a recent newspaper column aptly made a distinction between a market-friendly environment that encourages market competition and growth of efficient businesses vis-à-vis apparently business-friendly policies that provide high protection to selected favoured business houses along with providing other largesse, say, in the form of public contracts. This latter type of business-friendly policies may easily degenerate into what is called crony capitalism.

Governance is a complex issue and has been much discussed in the Bangladesh context, so I do not want to go much into that. Let me point out just one aspect of governance in contemporary Bangladesh. Economists are now aware that the functioning of markets and the capacity of the market system to foster economic growth depend on the political, social, cultural and ethical norms of behaviour, which together provide the infrastructure in which the market economy is embedded; this infrastructure is also called the social capital. The so-called governance indicators that we usually discuss are mostly to do with procedural and enforcement problems in the formal governance structure, such as policy reforms aimed at reducing corruption, maintaining the basic law and order, ensuring property rights, or to address the bureaucratic hurdles, all of which could presumably reduce the currently high cost of doing business.

But what is overlooked is that these administrative reforms towards enforcing accountability and reducing corruption among government functionaries are less likely to succeed without an understanding of

how incentives for deviant behaviour arise and how behavioural norms are formed. This is also true regarding attempts towards preventing unholly collusion among market regulators and unscrupulous businessmen when such collusive behaviour has already become the norm.

Social behavioural norms are all the more important in the non-urban setting, with relatively lax regulatory enforcement. And remember that a major driving force of the Bangladesh economy has been the diversification of the rural economy with scaling up of small non-farm enterprises and giving rural areas a semi-urban look. The growth of this mostly informal economy has been based on the traditional behavioural norms of trust, cooperation, reciprocity and moral codes that have evolved over time. The present danger is that this socio-cultural infrastructure of the market economy is in the risk of being undermined by political polarization, ethnic and religious strife and replacement of trusted village elders by politically powerful party cadres.

The last country-specific aspect of Bangladesh I would like to mention is the remarkable progress in many social development indicators, in which Bangladesh has transformed itself from being a laggard to a clear leader among comparator countries, as Binayak showed graphically in the opening presentation of this conference. How to consolidate these achievements and make further progress is an important policy issue, that I have discussed in many of my writings. Certainly, it will require more public social spending as well as better service delivery, since achievements thus far has been pos-

sible mostly by relying on low-cost solutions and through social awareness campaigns that bypassed the mainstream public service delivery establishment.

While these achievements in social development indicators are valued on their own rights in contributing to human well-being, we need to pay more attention to creating the synergies between these achievements and economic performance of the country. There is research evidence on the interlinks between female school enrolment and employment in the country's burgeoning garment industry. But there is also evidence of a large number of secondary school graduates remaining unemployed because of either their lack of employable skills or lack of enough employment opportunities to match their skills. The challenge is to create the needed skills and capabilities of the increasing labour force with enough employment opportunities to match those skills. Bangladesh has had an early demographic transition resulting in the so-called demographic dividend in the form of a youth bulge in the population age-structure, which is a factor fuelling the current economic growth. But we have to make better use of this window of opportunity that may last for another two decades, after which the growth of the labour force will slow down due to the aging population. What applies to individuals also applies to a nation: you have to get rich as a nation before you get old. Incidentally, the official target year for Bangladesh to become a rich country is also the year around which the era of demographic dividend will end.

EXTRACTS FROM KEYNOTE SPEECH