

“Mainstream” Economics And Bangladesh’s Development - Some Issues

Ahmad Ahsan

Policy Research Institute of Bangladesh

Annual BIDS Conference On Development
December 1, 2022

November 25, 2022

Ahmad Ahsan, Mainstream Economics and Bangladesh's
Development

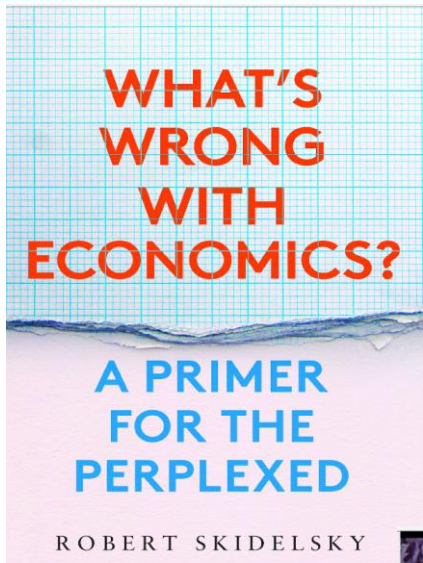


Mainstream Economics - Some Perspectives

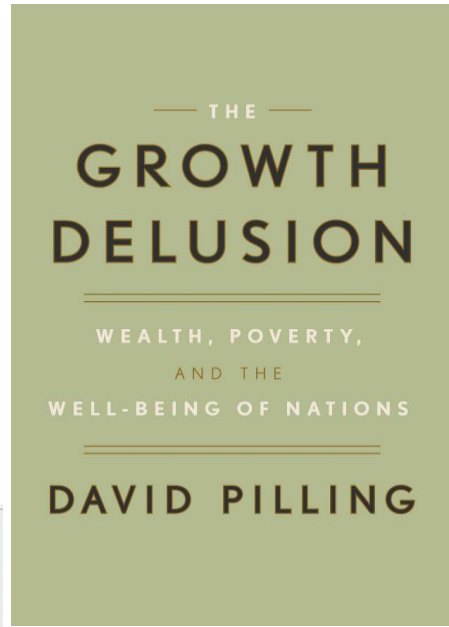
2022



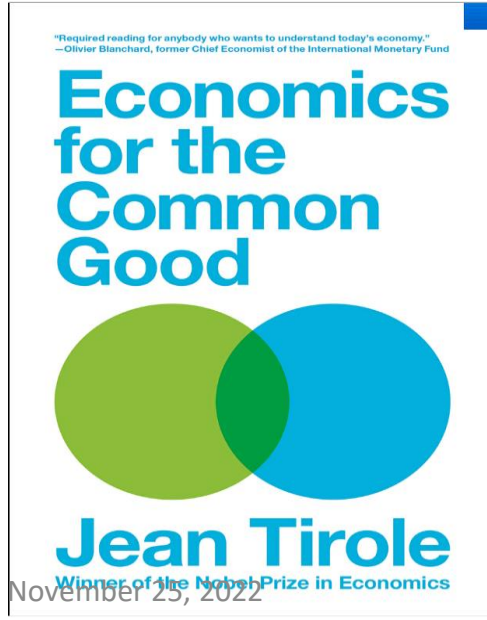
2020



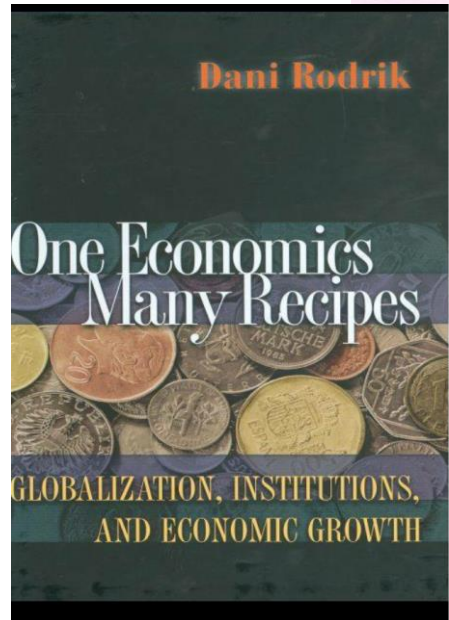
2018



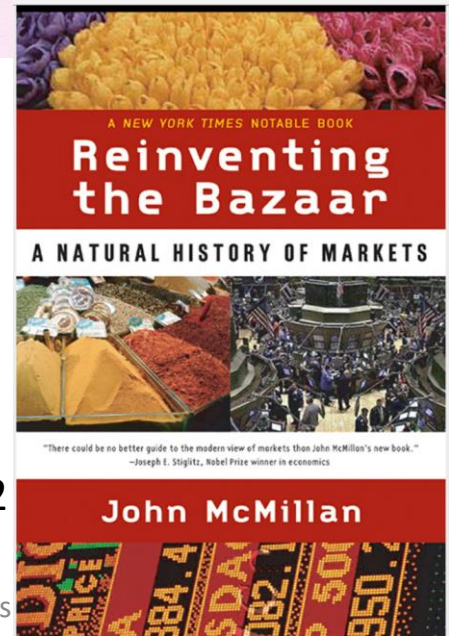
2017



2007



2002



conomics and Bangladesh
ent

Objective – Discuss

While mainstream economics has critics from Wall Street (Sharma) to sophisticates (Skidelsky, Piling) to Left (MMT, “socialism”), Right (Laffer Curve still kicking), *there is a rich literature, around a theoretical core, that provides:*

- A. Fundamental insights about economies, markets, governments
- B. Adaptation and advance, Contributions and Results
- C. Growth “mechanics” identifying fundamental issues for Bangladesh – I will discuss “Seven”

The closing point is the need for “bold”, critical, empirical research (Minister M. A. Mannan, Arvind Subramanian).

A. Mainstream Economics – Fundamentals

“Mainstream” Economics – Tries to Explain and Predict, using...

Choice theoretic, optimizing, marginal analysis, relative prices, in mostly imperfect markets, supply and demand (choices about resource allocation consumption, savings, work, education, family, production, hiring, investment, location, trade)

Micro

GDP, Household Incomes, Productivity, Employment, Wages, Inflation, Poverty, Welfare

New Keynesian synthesis, Keynes-Hicks plus expectations, price- wage stickiness, imperfect competition, Open Economy Mundell-Fleming (Prices, exchange rates, interest rates, aggregate Investment, saving trade)

Macro

- Generally, self-interested agents interact in Markets (and Organizations) to determine prices, allocate resources and income
- **Market Failures are Embedded in Economics → Market Design**
- **There are Fundamentals and Mechanics** (Bob Lucas, “mechanics”; Kaushik Basu, “Engineering” “Plane”)
- We know **a fair bit of “What” is needed, but much less “How”** (Policies and Instruments)- Need context specific research

Market Failures Are Embedded in Mainstream Economics

- Externalities - positive and negative. (i) Health, Education vs. pollution; (ii) Agglomeration & Network Externalities – QWERTY – institutional hysteresis (we can't adopt Korea); (iii) **Endogenous Growth – non-rival knowledge, research and education are Long Term Growth drivers.** (*Desh Garments*)
- Imperfect Competition – Not only in Supply, but also in demand, e.g. **labor markets –case for minimum wage & collective bargaining** (WB report on India; Trade Union's reaction vs job guarantees)

Market Failures

- Information asymmetries, “phishing”; moral hazard, adverse selection, principal-agent problems – need **Market Design** - (regulations against insider trading, cost sharing, etc)
- Behavioral Economics – **Animal Spirits; Herd Behavior, Narratives; Addiction;** Social Media’s psychological costs – Interventions needed.



Market Failures → Key Role of Government, Society

- **Inequity – Gains from trade, but also some losers too!**
The rise of the populist backlash, most of all in the US and England. Note: **High protection creates inequality, helps oligopolies.** Similarly, unequal access to education, health.
- **Leads to the critical role of Governments to** (i) provide “Public” Goods and Services; (ii) regulate markets (market design) and (iii) address Coordination Problems – “tragedy of the commons”: e.g., Climate Change; developing cities and lagging regions. **Advanced economies have large public sectors – 35 to 50 percent of GDP.**

Does not mean there was no ideological bias



- “Sterile” macro debates of the 1970s-80s: *Neither monetary nor fiscal policy work!* (Question to Olivier Blanchard)
- Greenspan – self regulation; Did not invite critics to Jackson Hole while Wall Street was making CDO “bombs”.
- Larry Summers, IMF – open capital markets are jet engines
- Tariff reduction vs Macro stability –sequencing of exchange rates, factor mobility reforms

But Careful about Government Failures

- **Governments work with incentives too and that can have similar deep failures.** (The Buchanan literature has insights).
- **Role of society** critical as a check – NGOs, academics, press, parents, consumers (and private sector) - the narrow corridor (Acemoglu and Robinson)

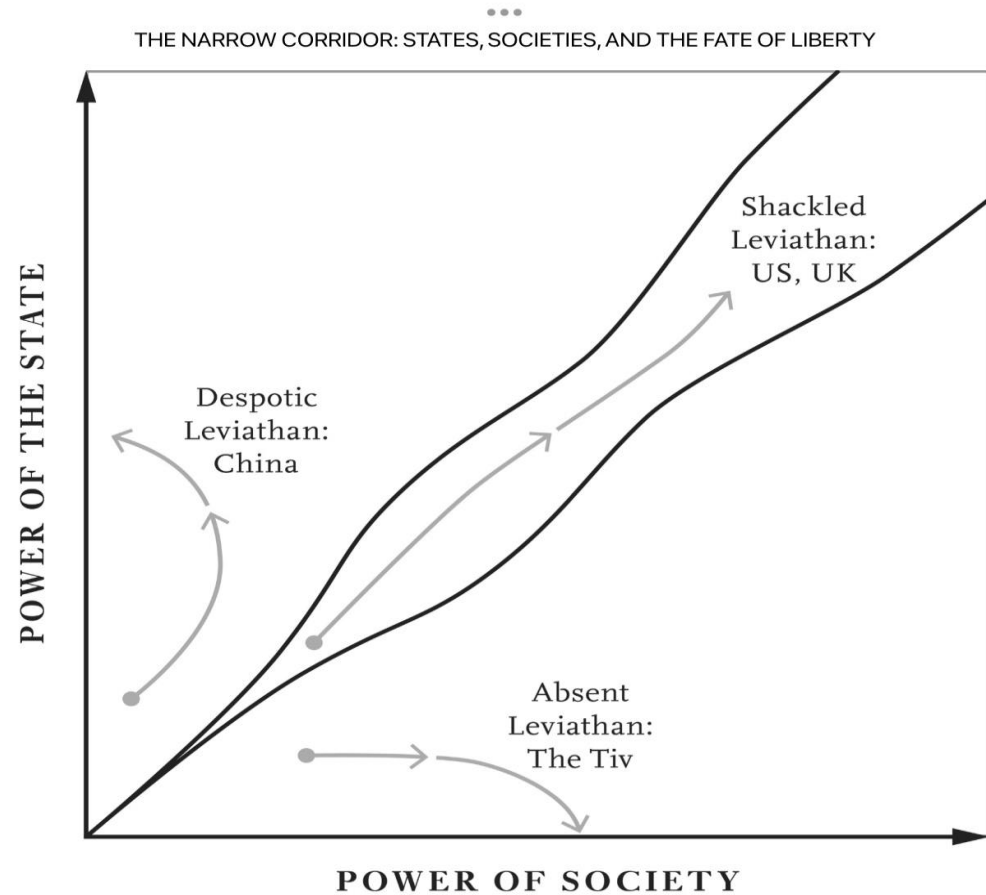


Figure 1. The Evolution of Despotic, Shackled, and Absent Leviathans

B. Adaptations and the Rise of Empirical Work - Becoming a science

- Macroeconomic management
- Market Design – Regulations pricing, competition, auction
- International Economics and Integration
- Finance (good and bad)
- Education, Health, Labour
- Welfare, poverty, safety nets
- Behavioural Economics
- Political Economy

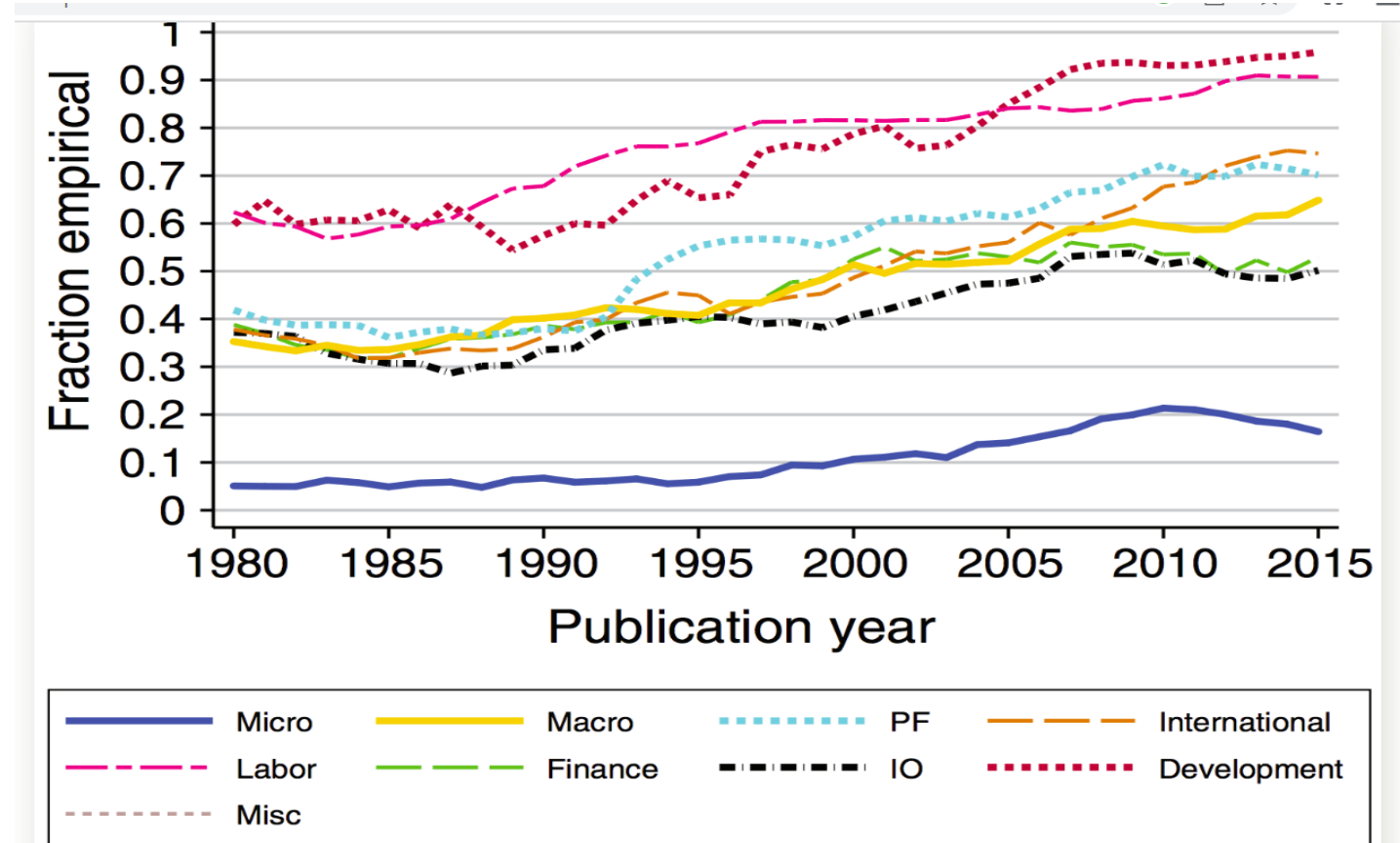


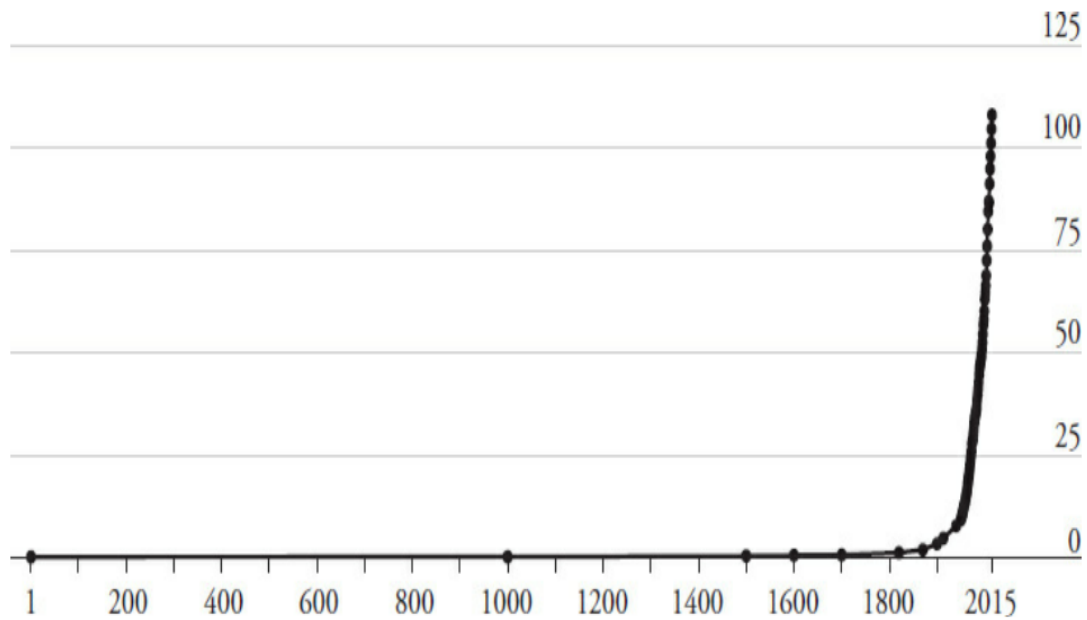
Figure 4 from Angrist et al. (2017)

Results: The Great Escape

The Rise of World Income

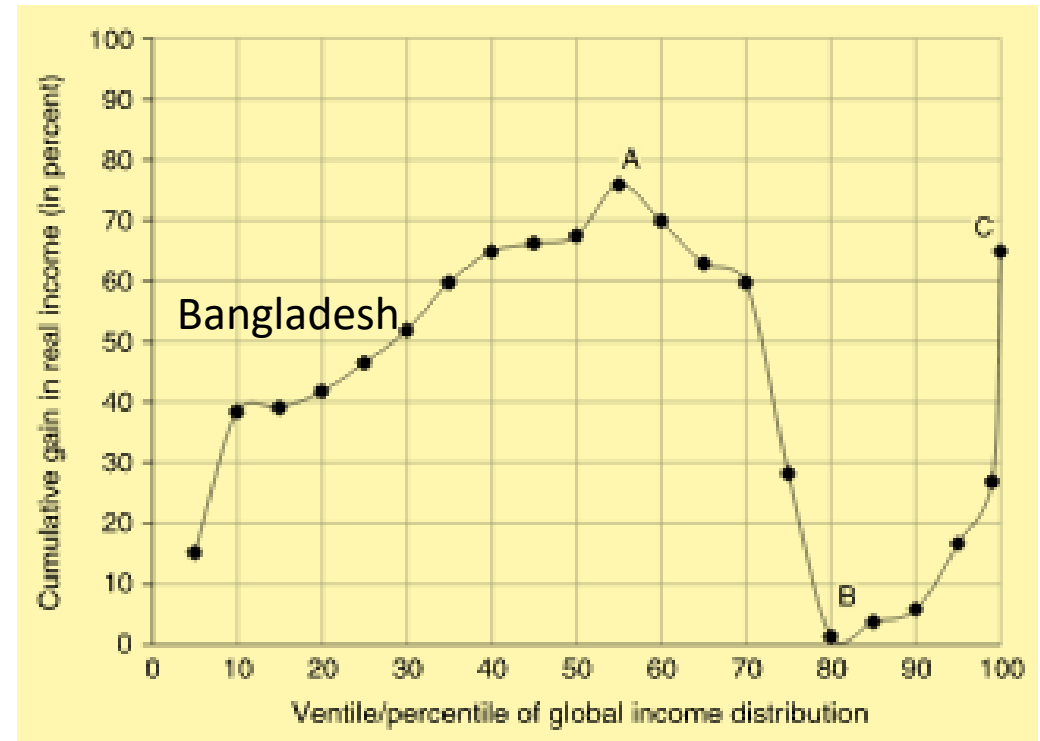
The Great Enrichment

World GDP, 2011 prices, international \$trn



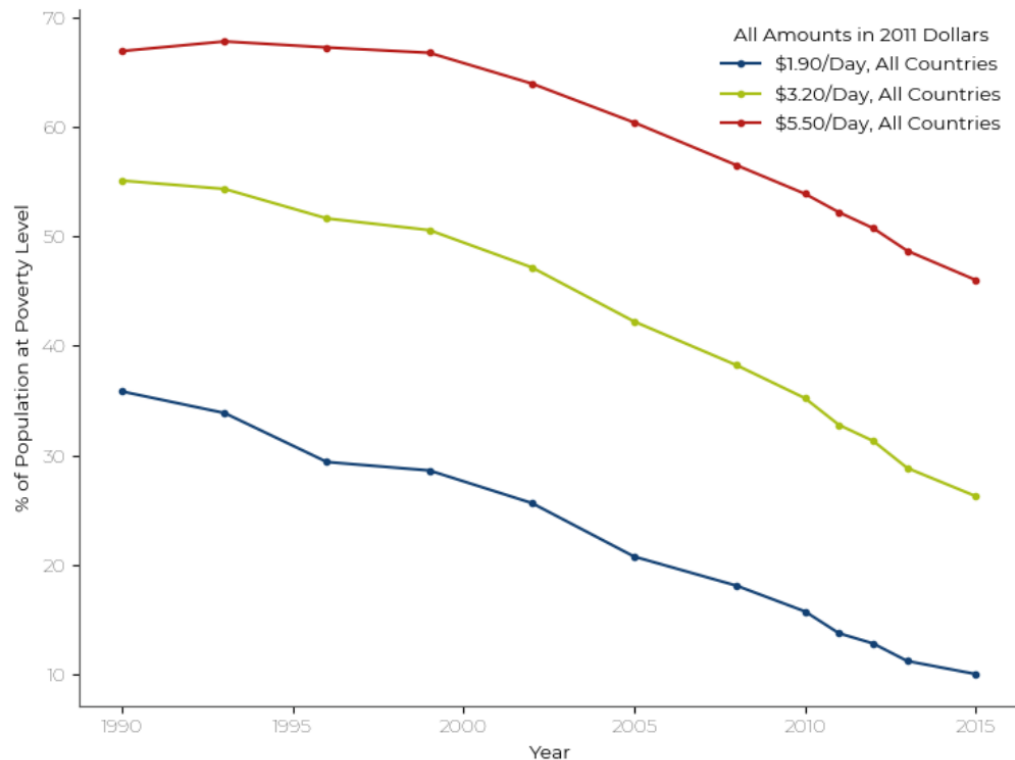
Source: Maddison Project Database

Convergence of the Poorer Countries – 1980-2005 (Milanovic, 2016)



Dramatic Reduction in Poverty – Digression: Was technology, not economics, the Driver?

Dramatic Reduction in Poverty



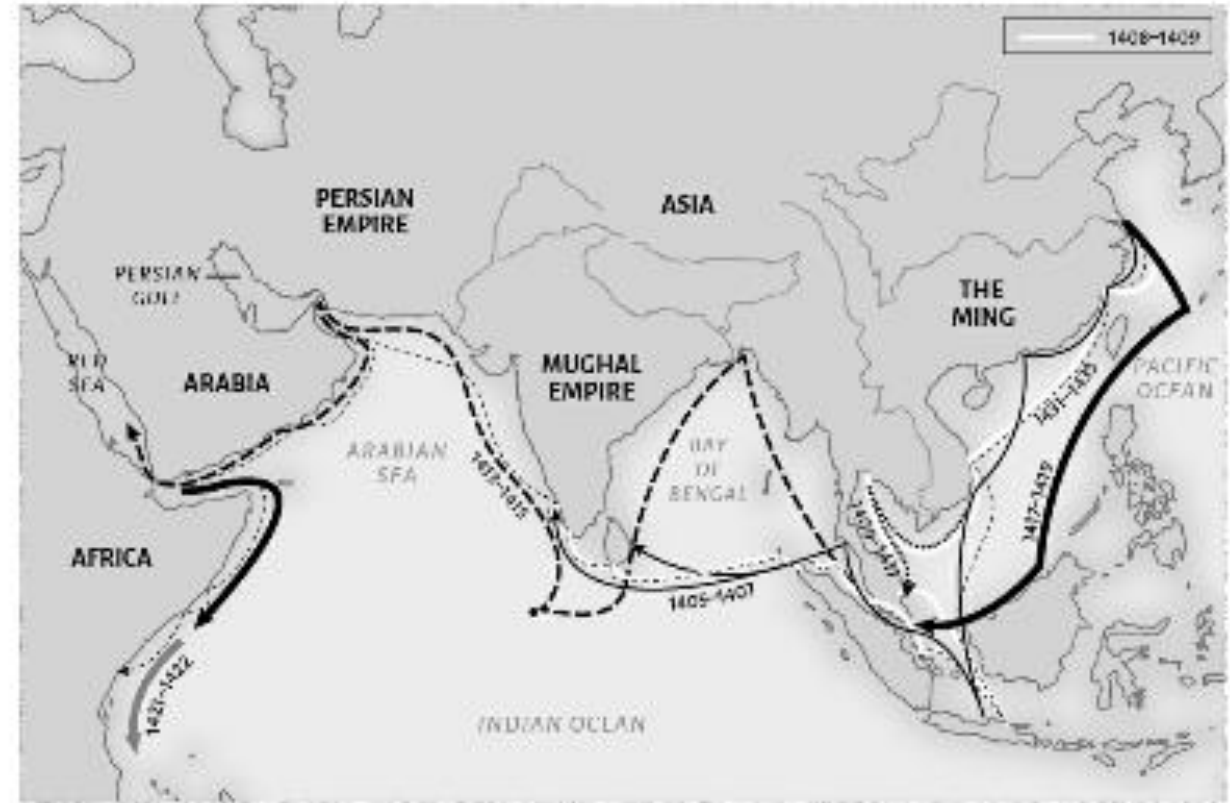
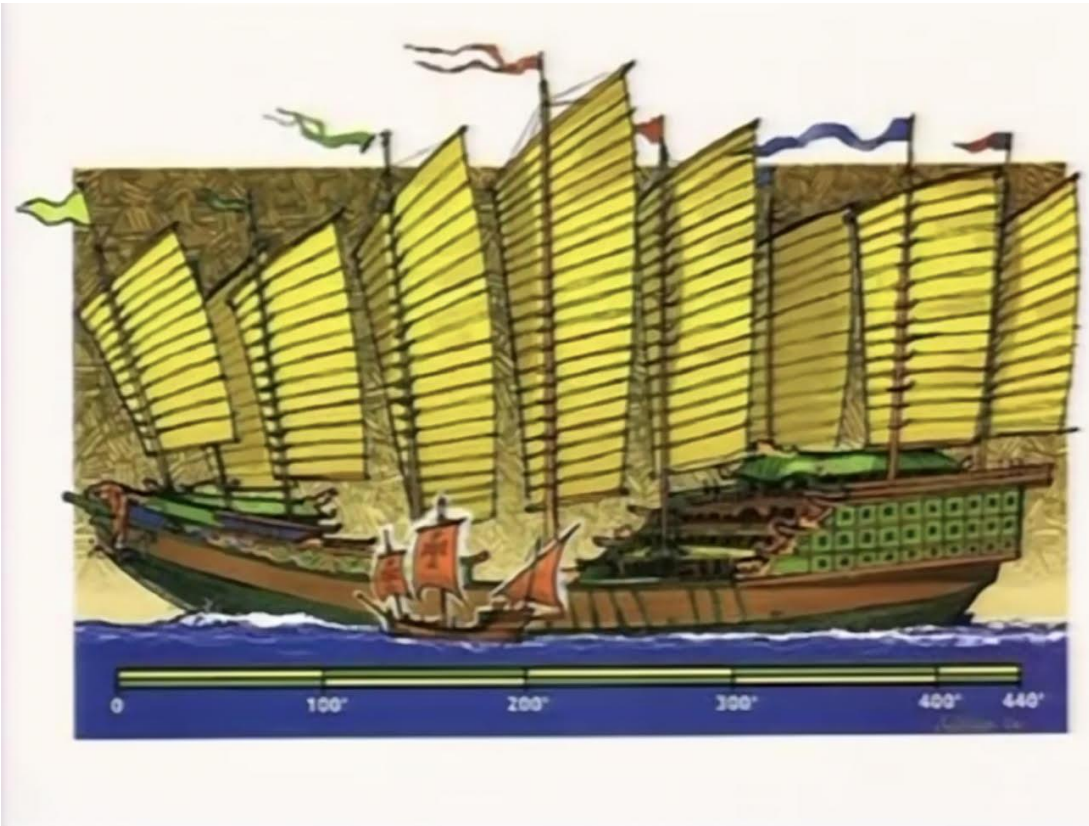
Source: The World Bank Poverty and Equity Database

DATA FOR PROGRESS

Probably Not – Technology is available and was historically available to countries such as China

- Advanced technology is available via trade and investment. But Economics has to provide the incentives to use that technology.
- In history it took centuries for available technology: steam, gearing 1st Century BCE, Water mills, 1st century CE, used in the 11th century
- China led in technology until about 500 years ago, : paper, waterwheels, locks, south-facing compass, wood-block printing, grand canal, sophisticated water clocks, gunpowder, seismograph, Earthquake protection for Forbidden palace, Navigational star charts and Maritime Power!

Admiral Zhang He not only made seven voyages with 300 large ships, visited “Satgaon” among other places, and also found the time to write *Treatise on the Barbarian Kingdoms of the Western Oceans* (1434)



C. Growth Mechanics and Fundamentals

GDP (income transformative for lower income countries)

$$(1) Y = AK^\alpha(hL)^{1-\alpha}$$

Labor productivity

$$(2) y = Y/hL = A(K/hL)^\alpha$$

Allocation and Structural Change

$$(3) y = \sum_i L_i/L \times Y/hL_i$$

Per Capita Income

$$(4) \text{GDP/Population} = Y/L \times (L/WAP) \times (WAP/\text{Population})$$

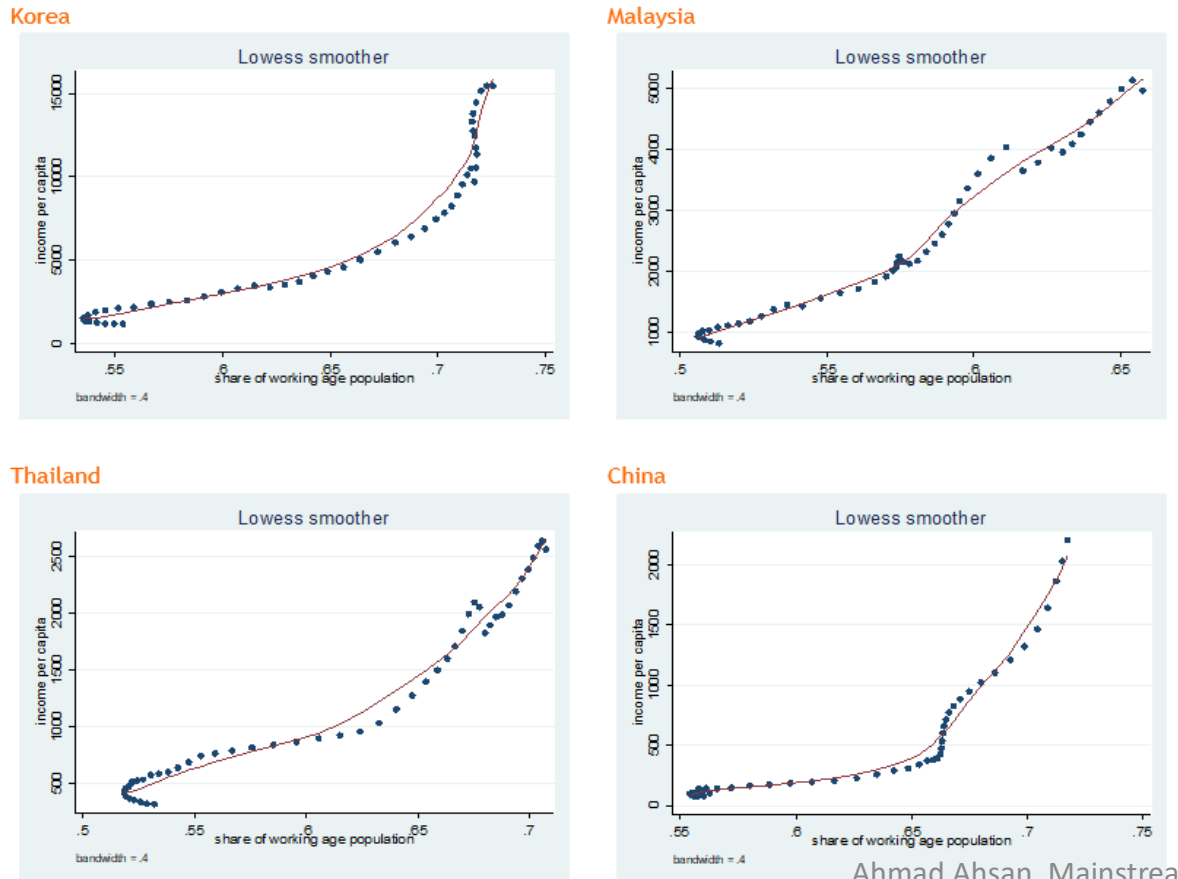
A = Total Factor Productivity K = Capital Stock, h = education unit, L = labor units, WAP = Working Age Population

- → Use Demographic Dividend (4), surprisingly large
- → Investment in K and h, Allocation, Structural Change (3), Factor Mobility (3) – *Finance and Creative Destruction*
- → Schooling, Learning – returns 11 percent to 18 percent
- → Total Factor Productivity (all) – critical in middle income – knowledge, technology, institutions

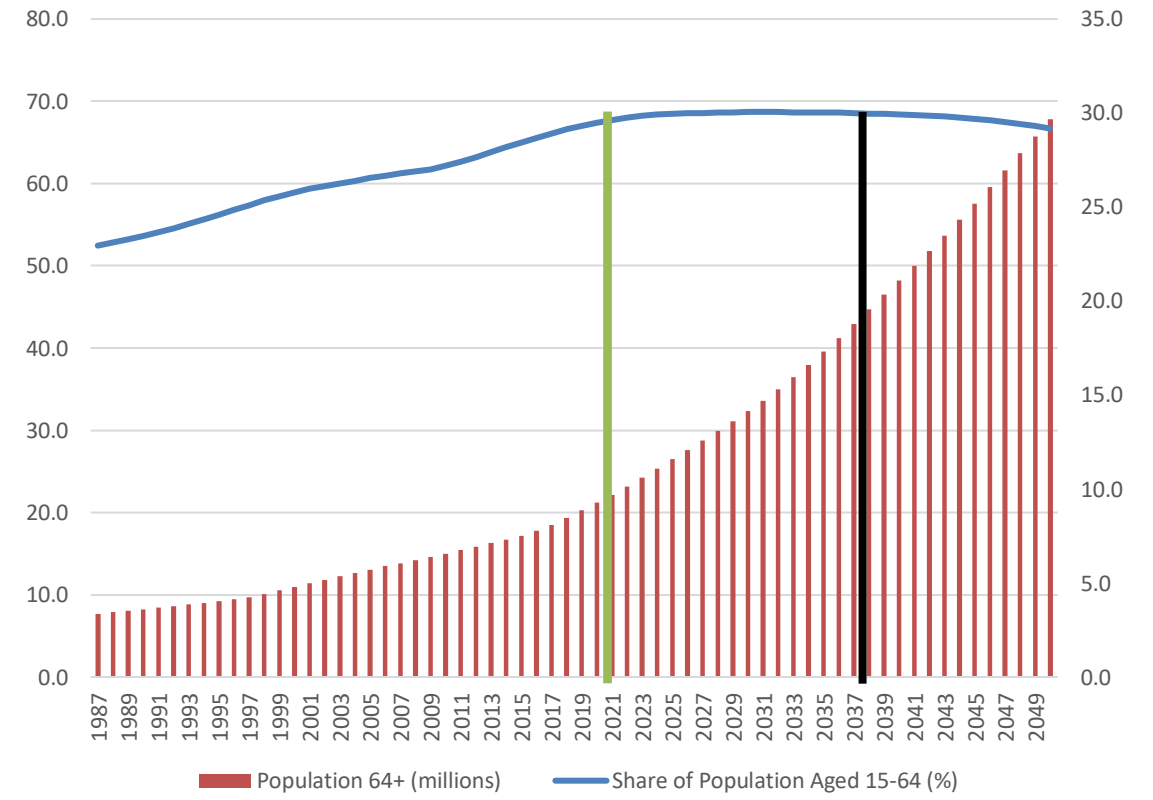
Issue 1 – Using the Demographic Dividend

Share of Working Age Population and Per Capita Incomes In East Asia

Figure 5: Share of Working Age Population and Per Capita Incomes Were closely Correlated between 1950 and 2009.



Bangladesh – Demographic Transition



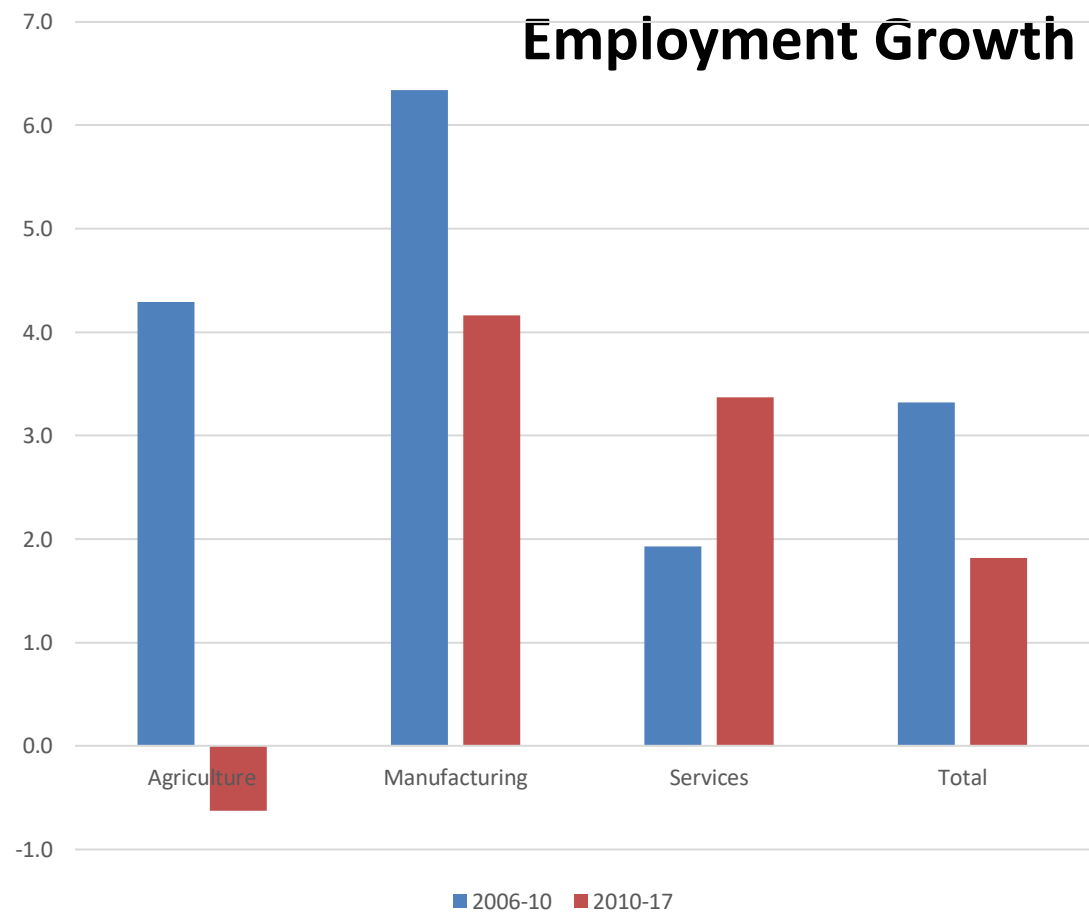
November 25, 2022

Ahmad Ahsan, Mainstream Economics and Bangladesh's Development

Whither Demographic Dividend ? – Employment growth falling – real wages sluggish.

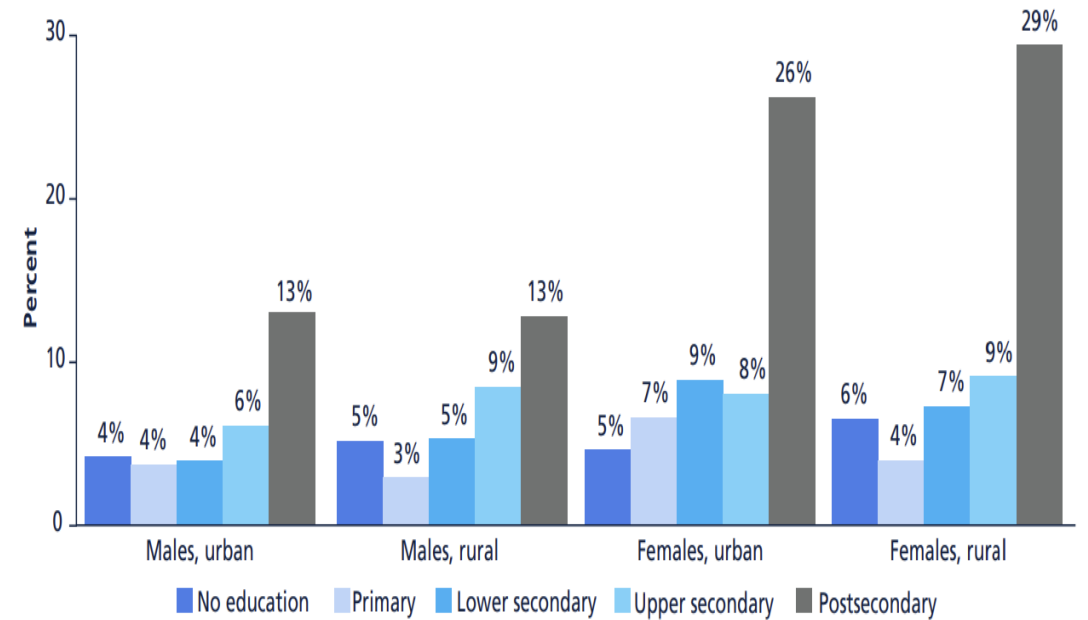
The female LFPR Challenge 36 % in Bangladesh vs. 60-70% in East Asia

Employment Growth



Informal Sector Real Wages stagnant - WRI. ILO estimate of Bangladesh Wage Growth 0.8% in 2018 LFS – 2.1% p a China 6% Vietnam 4%

Figure 55 Youth unemployment rate by sex, location, and educational attainment



Issue 2. Improving Education Quality

Schooling per se has weak impact

What matters is learning - competency

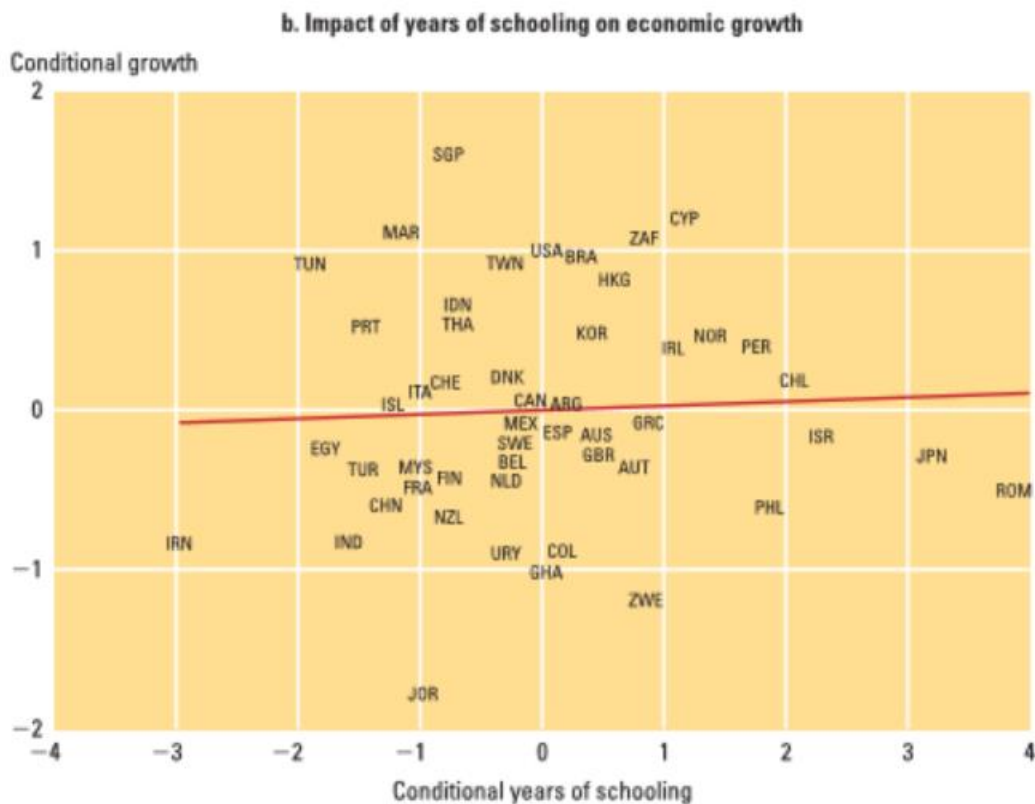
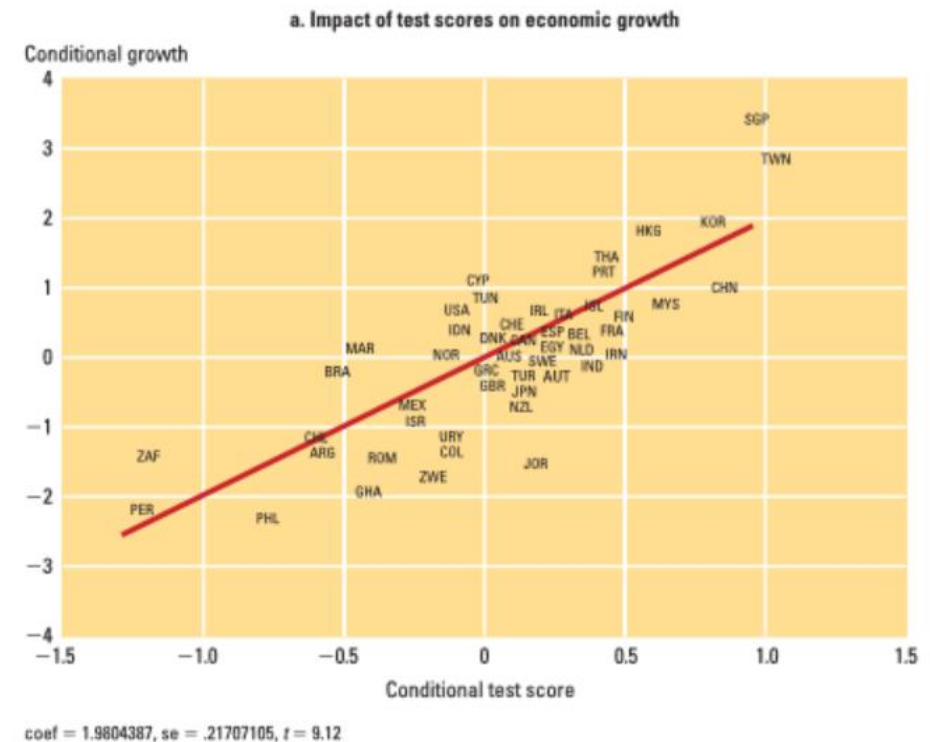


Figure 4 Test scores, as opposed to years of schooling, have a powerful impact on growth

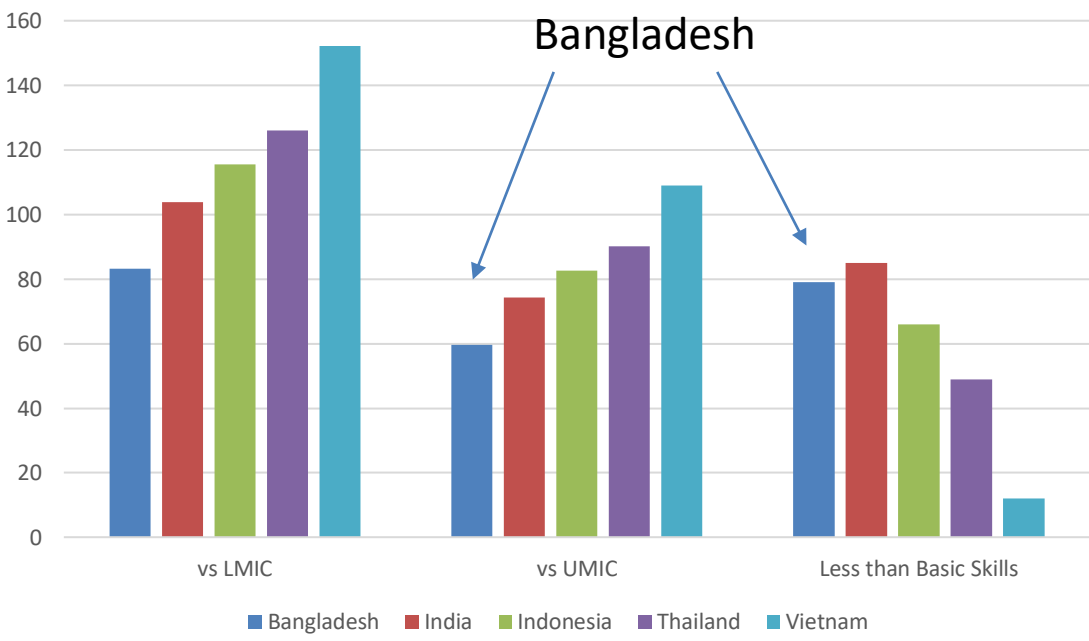


Quality of Education – We have work to do

International Student Assessment – Secondary, Age 15

(Gust, Hanushek, Woessman, NBER, 2022)

Mean Test Achievement vis. LMIC and UMIC, Percentage of Students with Less than Basic Skills



Bangladesh National Student Assessment, 2017

Table 4 : Percentage of Students in “Legacy Bands” for NSA 2013, 2015, and 2017

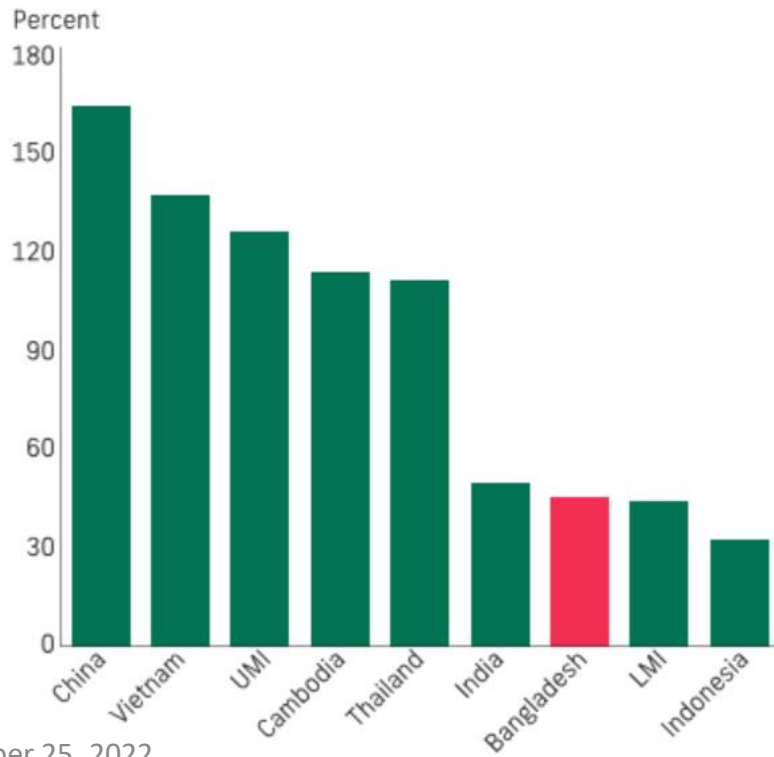
Administration year	2013		2015		2017	
Bands →	Below Grade 3	On/Above Grade 3	Below Grade 3	On/Above Grade 3	Below Grade 3	On/Above Grade 3
Bangla Grade 3	25%	75%	32%	68%	26%	74%
Mathematics Grade 3	43%	57%	59%	41%	59%	41%
Bands →	Below Grade 5	On Grade 5	Below Grade 5	On Grade 5	Below Grade 5	On Grade 5
Bangla Grade 5	75%	25%	77%	23%	88%	12%
Mathematics Grade 5	75%	25%	90%	10%	83%	17%

Note: Open shading denotes students who are grade level performers and orange shading denotes

Issue 3. Financial Sector Depth and Stability

Investment and Its Allocation

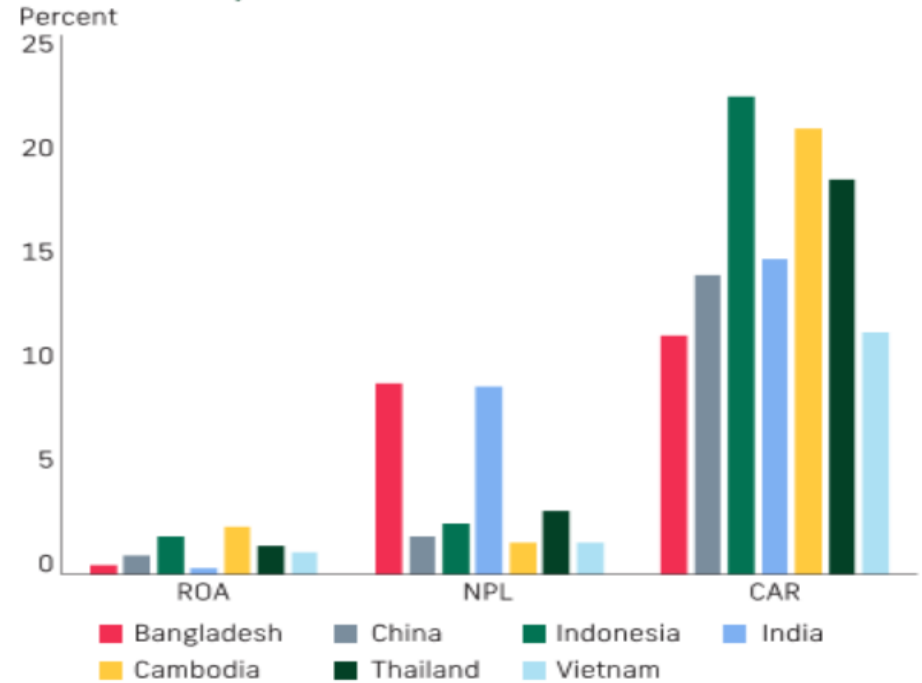
Figure 4.7: Private Credit to GDP



November 25, 2022

Financial Sector

Figure 4.3: Financial Stability Indicators, Bangladesh versus Peers, 2019



n, Mainstream Economics and Bangladesh's Development

From: Change of Fabric, WB

Underdevelopment of the SME Sector

Has Significant Implications

Table 4: Growth Opportunities of SMEs in Bangladesh

Country	SMEs as % of all enterprises	Contribution of SMEs to GDP (%)	Contribution of SMEs to Employment (%)
Bangladesh	50.91	20.25	35.47
India	97.60	80.00	-
Pakistan	60.00	15.00	80.00
China	99.00	60.00	92.00
Japan	99.70	69.50	72.00
Hong Kong	-	-	61.50

Source: Economic Survey 2017, Bangladesh Bureau of Statistics; International Cooperation Organization for Small and Medium Enterprises in Asia (ICOSA), Japan: The Daily Star, September 30, 2013; Asian Development Bank 2014.

Finance the critical constraint for SME

Bangladesh

South Asia

MSME Finance Gap as % of GDP: **19.98%**

MSME Finance Gap: **\$38,972,713,376**

Micro Finance Gap: **\$2,849,819,097**

SME Finance Gap: **\$36,122,894,280**

Women's MSME Finance Gap: **\$2,504,551,901**

(6.43% of country's Total MSME Finance Gap)

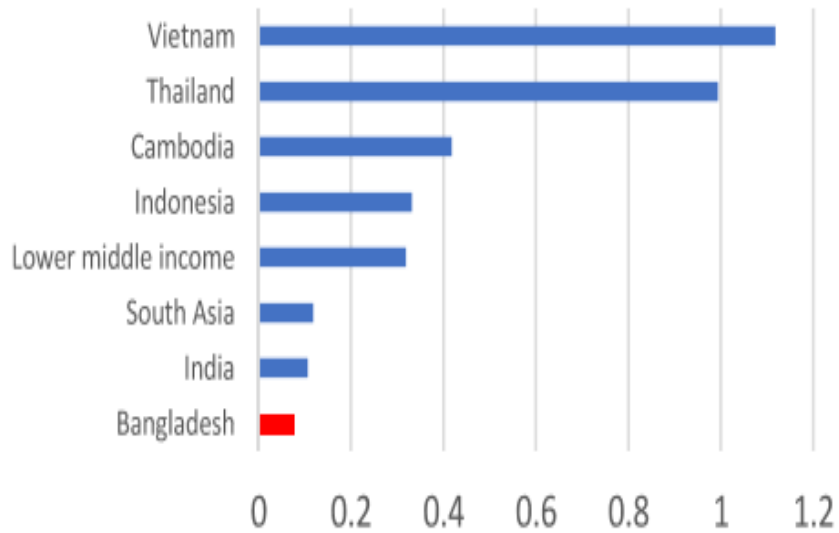
Men's MSME Finance Gap: **\$36,468,161,475**

(93.57% of country's Total MSME Finance Gap)

Issue 4. Low Competition and High Protection

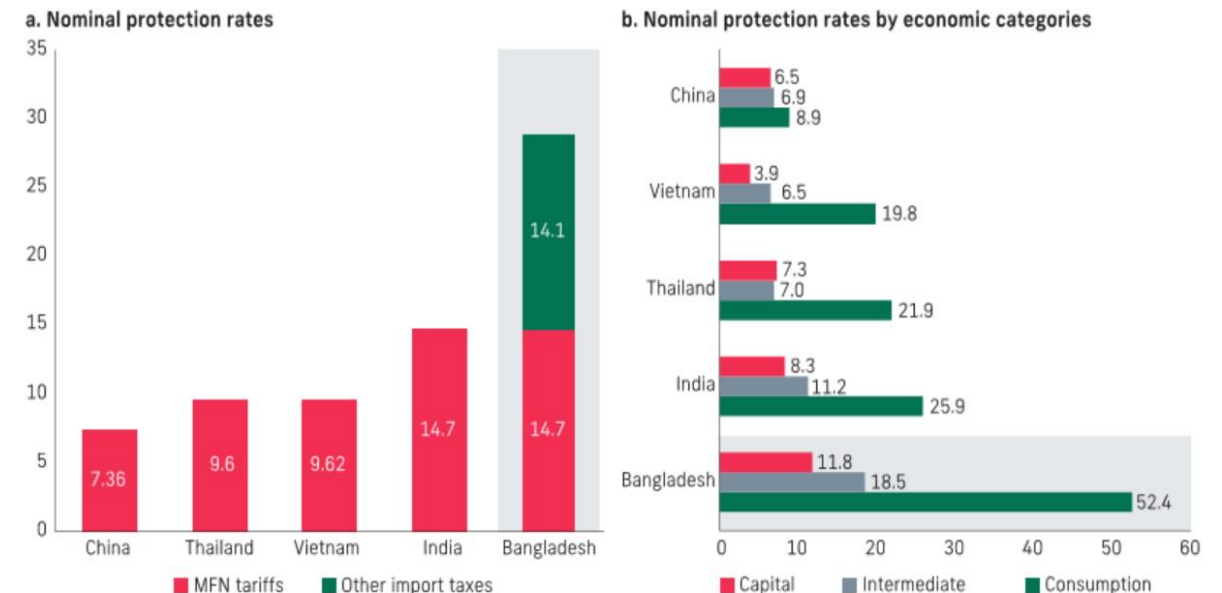
Tariffs and Protection – Stolper Samuelson – Skewed towards Capital

New Business Density (per 1000 persons)



Source: World Development Indicators.
 Note: New business density is new registrations per 1,000 working-age people.

Figure 3.11: Bangladesh's Tariffs in Comparative Perspective, 2021



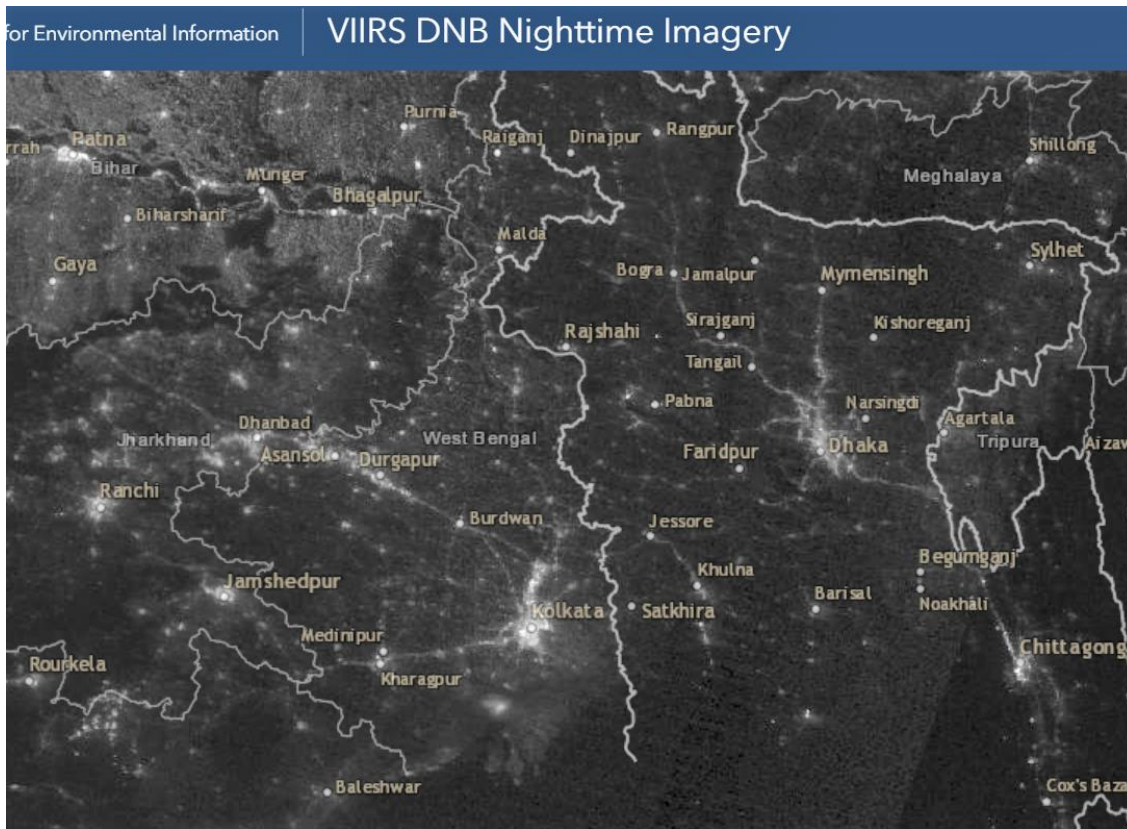
Sources: Calculations using data from Bangladesh Customs and WTO 2022.
 Note: MFN = most favored nation; Other import taxes include regulatory and supplementary duties.

Systematic Country Diagnostic (2021) and Change of Fabric (2022) respectively

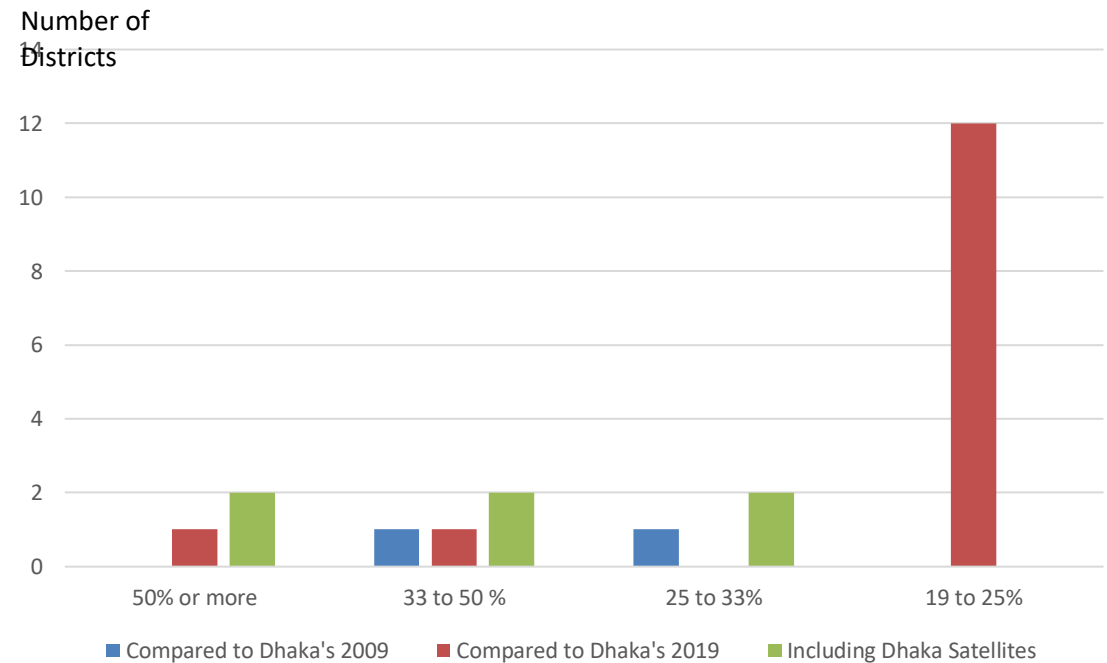
Economic Activity Proxied by Night Lights

Bangladesh, West Bengal, Bihar – November 8, 2021

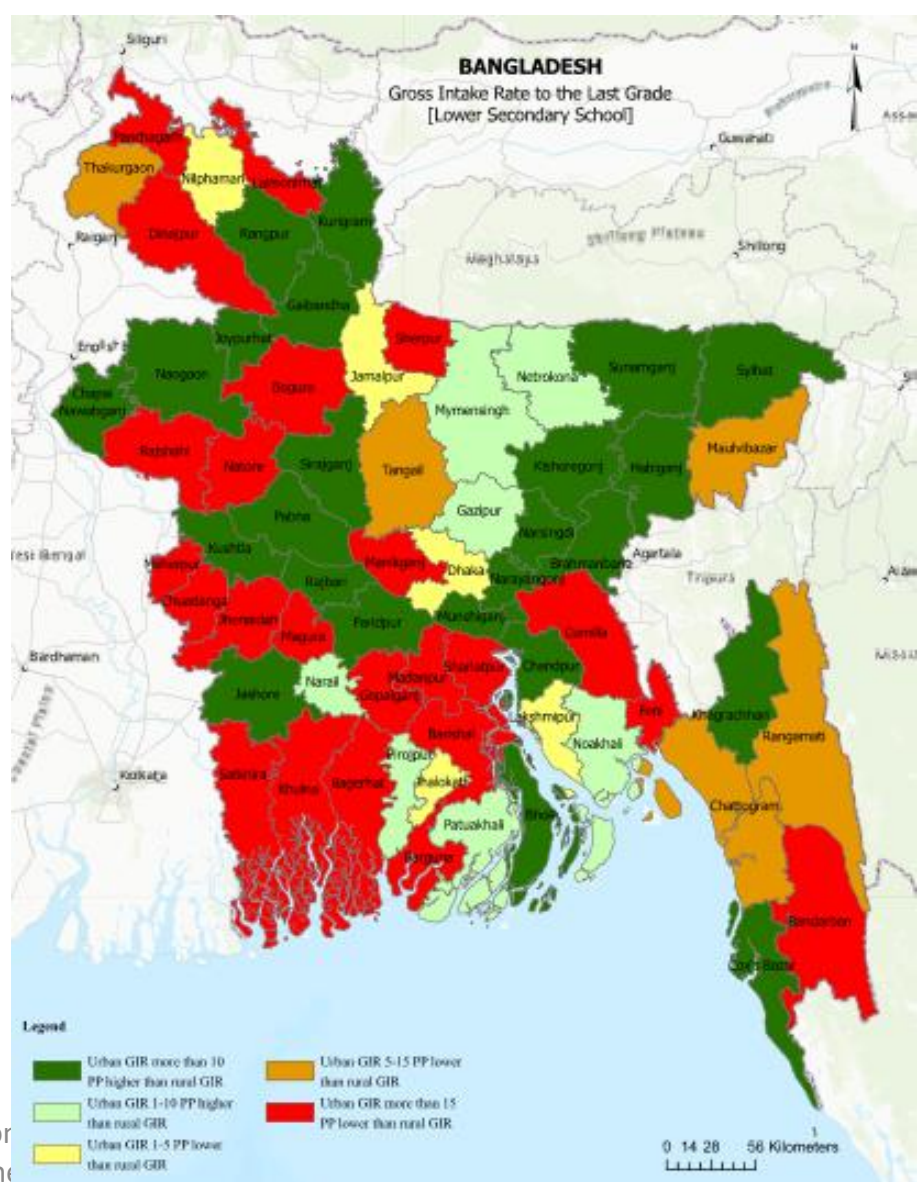
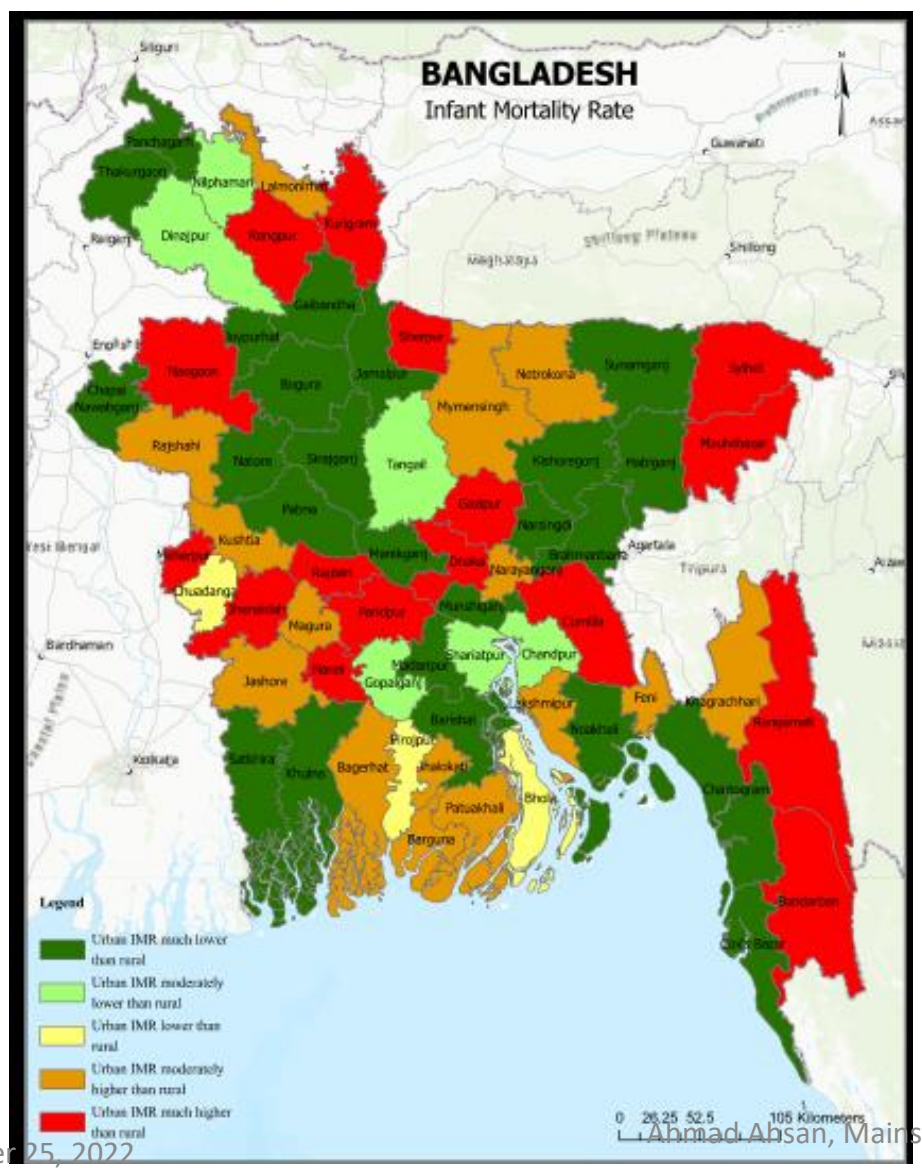
There has been growth in North Bengal, Cumilla/B.Baria, Tangail. Share of greater Dhaka, Chattogram halved - but still too dim and needs clustering. Calls for urban planning.



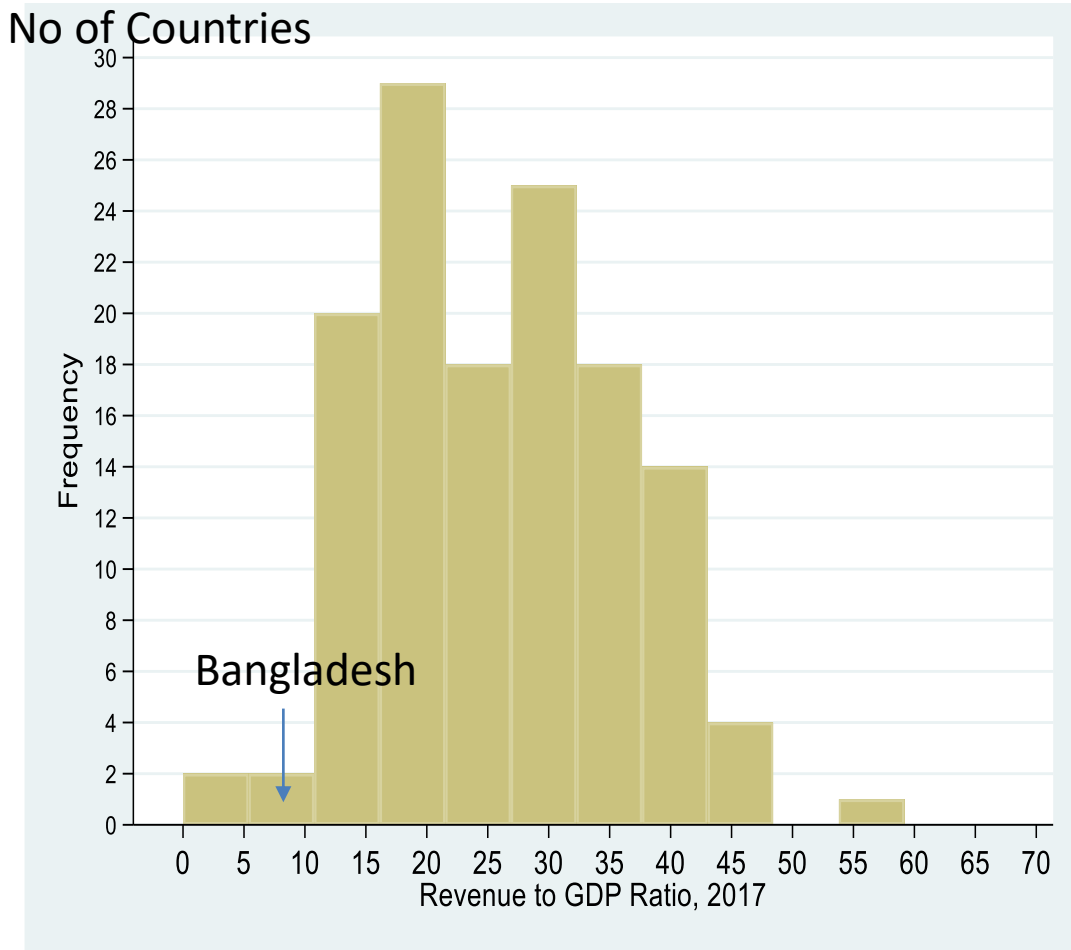
Nightlight of Districts Compared to Dhaka (% of Radiance)



Lagging Urban Services – Health and Education



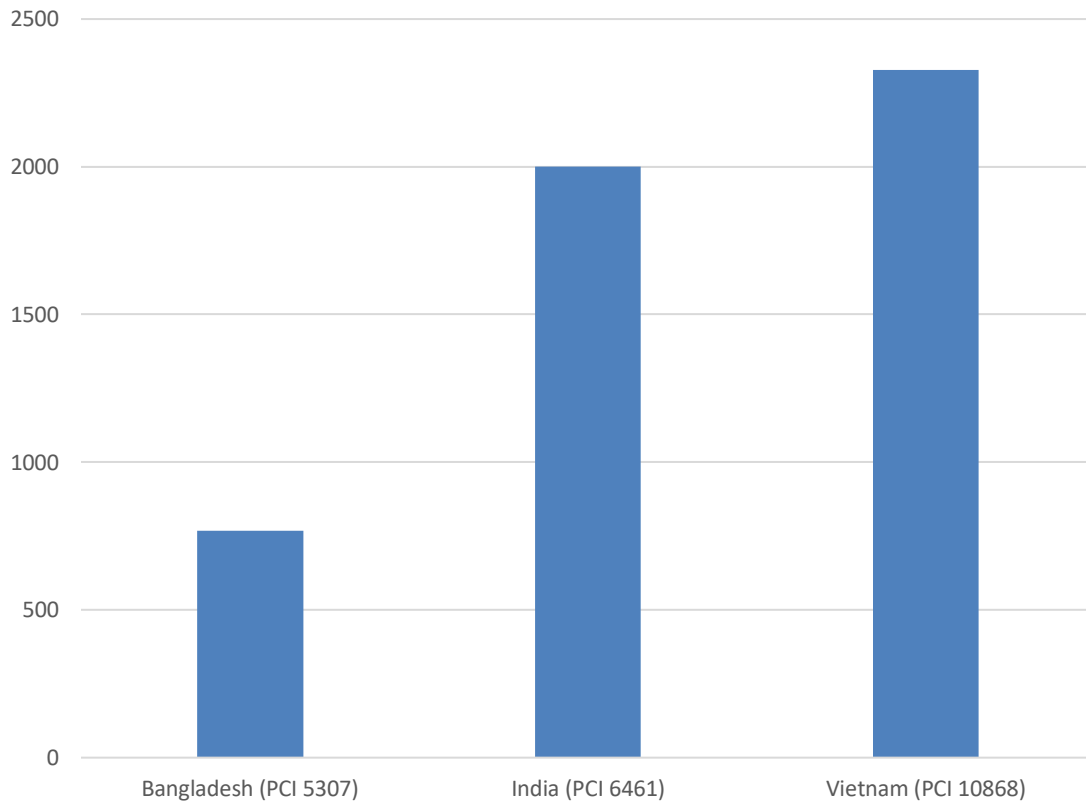
Issue 6. Need State Capacity – Extremely Low Revenues and Expenditures



- Bangladesh bottom of revenue collection – 1/2 of what per capita income would predict
- Cannot provide public goods and services, infrastructure needed for Long term growth. (England collected more revenue 200 years ago)
- Revenue Structure has to be changed. Shift from Tariff Revenue to Income taxes, VAT, and Property taxes. Between 20-40% of revenues involved.
- Radical institutional thinking need

Public Expenditures

Public Expenditures Per Capita in 2020 International Dollars



Public Expenditure Effectiveness

- ADP Process Needs Strengthening
- Highly Inadequate Monitoring
- * 0.27% of Budget is spent on Statistics and Informatics – about 1/3rd of practice
- * 0.1% of ADP spent on Monitoring and Evaluation.

Maintenance

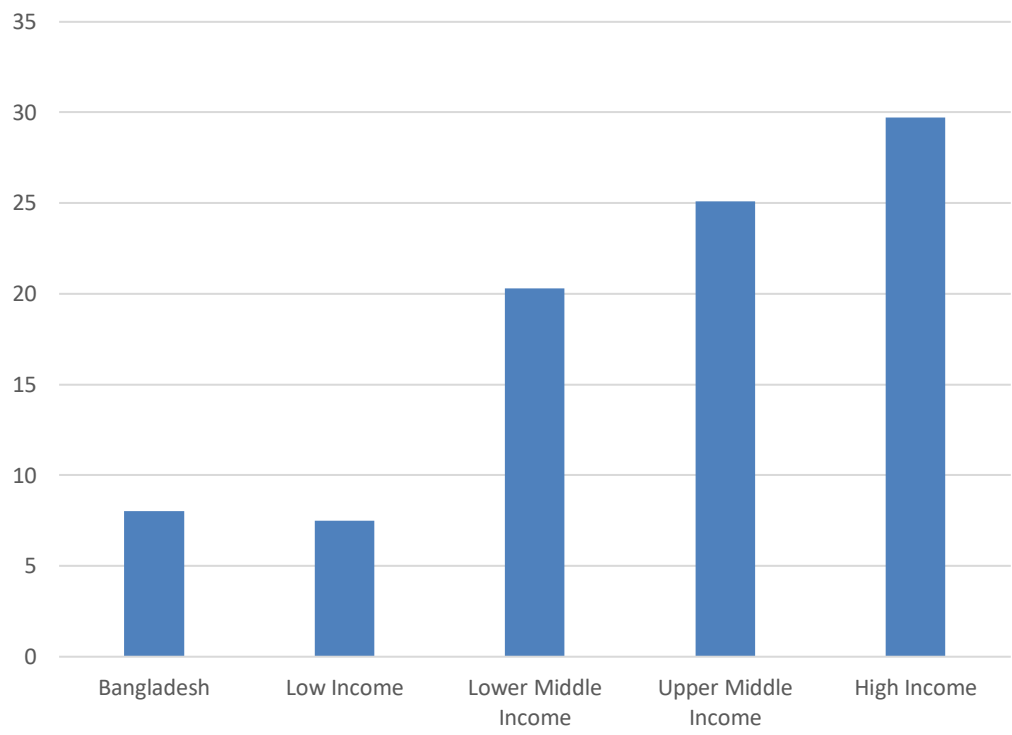
- Only about 15 % of Maintenance needs are met - Lowers growth

“Endogenous” Growth = Investment Rate*

Productivity – Depreciation Rate

Issue 7. Can Bangladesh Develop Without Decentralising?

Share of Local Governments in Public Expenditures



Without Decentralization will it be possible to:

- Achieve High Quality Urban Development?
- Improve Public Schools? (MPOs are controversial)
- Train and identify national leaders? (Myerson)
- Foster healthy regional competition? – In Vietnam, China, Indonesia, Germany, USA provinces compete vigorously.

Thank You