# ISAS Brief

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## Bangladesh's Growth Enablers[1]

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*The Bangladesh economy has experienced sustained growth over the last three decades, but it has only been since the economic policy reforms of the 1990s that economic growth truly accelerated. The reforms bore fruition – the second half of this decade witnessed the growth in gross domestic product (GDP) exceeding six per cent annually – and the growth performance has kept pace with that of other countries in South Asia*.

The economies of South Asia are currently among the fastest-growing regions in the world. The four major economies – India, Pakistan, Bangladesh and Sri Lanka – achieved growth rates exceeding five per cent in the 2000s, with Bangladesh outperforming both Pakistan and Sri Lanka.[3] Various factors have contributed to Bangladesh's improved growth performance over the years, most of which can be attributed to increased exports of manufacturing goods, particularly ready-made garments, increased remittances from abroad, relative macroeconomic stability, financial integration and deepening. This paper highlights some of the other factors that have propelled Bangladesh's recent growth. Aspects such as labour productivity and national savings will merit attention in this regard.

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1 A phrase coined by the World Bank in its recent report on Bangladesh.

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3 Bangladesh: Towards Accelerated, Inclusive and Sustainable Growth – Opportunities and Challenges, The World Bank (2012).

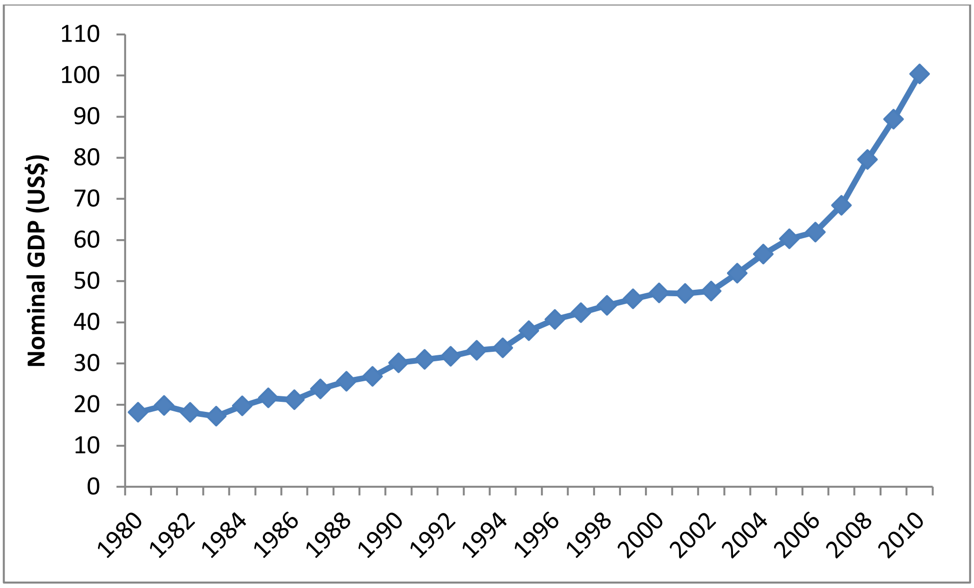
## Overview

About one-fifth of the erstwhile East Pakistan economy was destroyed during the Liberation War of 1971. Severe disruptions brought about by the war and the various dysfunctions already present in the economy left Bangladesh on a lower growth trajectory – the country only regained the output levels of the pre-liberation period in the late-1970s. The economy accelerated sharply from 1990s onwards – between 1990 and 2010, Bangladesh's nominal GDP (in US dollars) tripled to around $100 billion (Figure 1). This expansion in output can be attributed to the post-1990s policy reforms of opening up the economy and to the increasing contribution of the services and industrial sectors to the economy. The first half of the 1980s was beset by low and, in some years, even declining output. The latter half of the decade exhibited a gradual increase in output but it was not until the political transition to a democratically elected government in 1991 that the economy took off. A simple trend equation reveals that between the period 1980 to 2010, Bangladesh underwent two distinct growth phases. The trend growth rate for the period 1980 to 2010 was around 4.7 per cent per annum. Even though reforms started prior to the 1990s, the economy achieved greater momentum post-1990 – the annual growth rate between 1990 and 2011 was about 5.3 per cent compared to 3.6 per cent between 1980 and 1989. Evidently the economy was on a quicker arc after 1990 – the economic policies after 1990 could have resulted in adding 1.7 percentage points to growth annually.

An improved macroeconomic performance following the "crisis-driven reforms" [4] of 1990-1993 and the commitment to further economic liberalisation by successive governments enabled output to accelerate. Exports and imports have increased substantially as well and that has positively impacted growth. Bangladesh's trade has increased substantially and is linked with the ready-made garments (RMGs) industry in recent years. The establishment of the industry arose from comparative advantage and has since been the focus of export-led industrialisation in Bangladesh, which has led to further economic growth in Bangladesh.

[4] Economic Growth in Bangladesh: Experience and Policy Priorities, Jyoti Rahman and Asif Yusuf (undated).

**Figure 1 – Nominal GDP (1980 – 2010)**




Source: IMF, World Economic Outlook

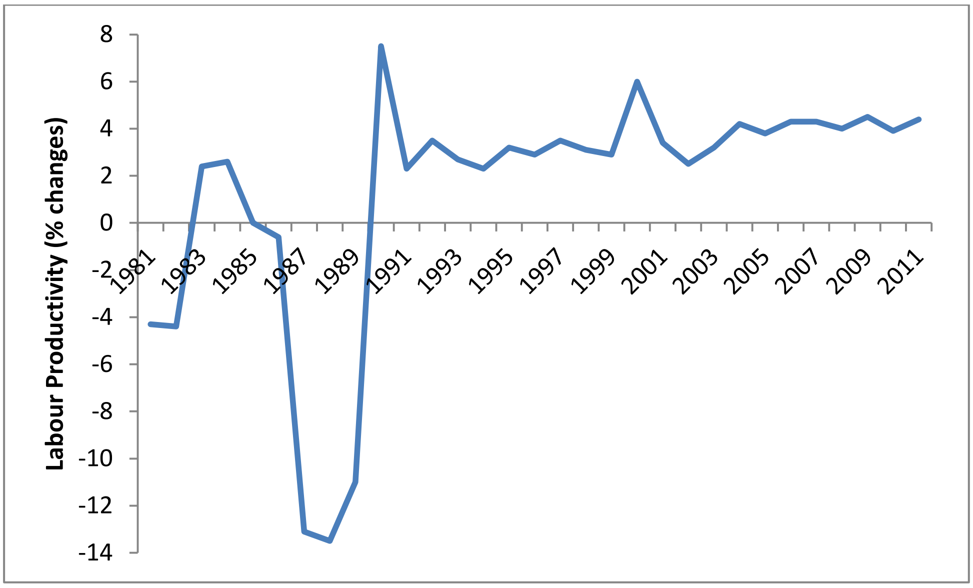
## Key Drivers of Growth

While the increased RMG exports, financial integration, rapid industrialisation and the proliferation of private sector activies have been credited with accelerating growth in Bangladesh, analysis has revealed the equal importance of TFP growth to labour productivity and hence economic growth.[5] Labour productivity, defined as total output in the economy per worker, is an indicator that measures how much output is produced in a given amount of time. In addition, it gives a measure of the relative efficiency with which inputs – in this case, labour – are used to produce output. An increase in labour productivity is also indicative of the workforce and firms in a country becoming more competitive. Bangladesh has exhibited some notable changes in labour productivity over the years (Figure 2). Productivity displayed negative growth in the 1980s and declined drastically during that decade. The period from 1990s onwards witnessed a steady rise in productivity, which corresponds to increasing national output. This increase in productivity can be attributed to capital deepening – the increase in capital stock per worker. Workers have been endowed with more machines and equipment, which changes the nature of production by making the production process relatively more capital-intensive, thus boosting labour productivity and increasing output. The inception and subsequent success of the light manufacturing industry, particularly the RMG sector, is a case in point. Large number of workers have been equipped with equipment which have contributed to increasing volumes of garments being produced. Other sectors such as pharmaceuticals, jute, ceramics, electronics and footwear are the upcoming sectors and these sectors are expected to entail more capital in the production process, further increasing labour productivity. In addition, workforce productivity has increased due to the

[5] The World Bank (2012).

*efficient* use of capital and labour inputs in the production process – this is the multifactor productivity growth which arises from the joint effects of factors such as technology, economies of scale and changes in the production structure. Other aspects that may not feature in the productivity calculation are the impacts of improved health, nutrition and education. The impact of improved welfare on workforce productivity in Bangladesh cannot be easily overlooked. The country has undergone steady improvements in social indicators; enhanced access to these services have been revealed to have direct effects on labour productivity and hence earning capacities of individuals.

**Figure 2 – Labour Productivity changes (1981 to 2011)**

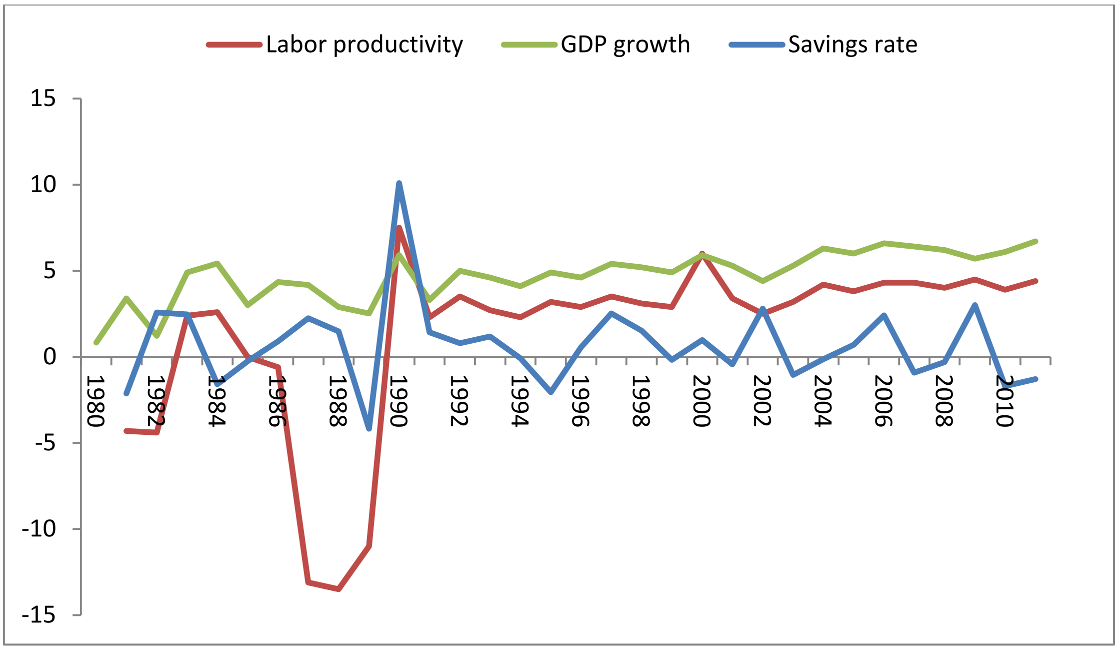



Source: Economist Intelligence Unit (EIU)

Gross national savings have increased steadily as well, thanks to a rapid rise in domestic savings rate over the last two decades and strong inflow of remittances (Figure 3). The national savings rate in Bangladesh is estimated to be the same as the South Asian average and that of the low-income countries.[6] It has been established in the literature that countries with high savings rate for long periods tend to experience sustained economic growth and Bangladesh has been no exception to this. Periods of economic growth have broadly been in line with increases in savings rate. In accordance with the neoclassical growth theory, an increase in national savings rate has driven growth forward in Bangladesh. However, national savings rate has stagnated somewhat over the last few years and hovered around 25 per cent of GDP. In addition, Bangladesh's less-than-ideal investment climate means that a sufficient portion of the national savings has not been absorbed/utilised and the country has been unable to attract foreign savings in the process. Very weak growth in private investment and declining public investments have resulted in domestic savings not being harnessed.[7]

[6] Ibid.
[7] Ibid.

**Figure 3 – National savings, productivity and GDP growth**




Source: Economist Intelligence Unit (EIU)

Even though national savings and labour productivity have exhibited the same movements as GDP growth in Bangladesh, does this mean that they have contributed to the positive growth developments over the years? Some simple regressions do reveal that savings rate and productivity increases have had an impact on growth. Over the past three decades, both changes in labour productivity and national savings rate have had a positive impact on the growth rate of national output and the estimates are statistically significant. Growth in worker productivity and national savings rate has contributed 0.09 and 0.08 percentage points to Bangladesh's GDP growth respectively, resulting in a net addition of 0.17 percentage points.

When the growth performance is broken up into two phases – 1980 to 1989 and 1990 to 2011 – the results differ. The pre-liberalisation period revealed no statistically significant impact of labour productivity growth and national savings on GDP growth, while the latter period shows a strong positive impact of the variables on growth. It was only after the 1990s that both worker productivity and national savings rate displayed rapid increases; with labour productivity, having undergone declines in the past decade, has only now approached a positive growth territory. Other associated reforms in the capital and financial markets had also put Bangladesh on the platform towards rising growth. Although the regressions did not include other key determinants, the point of this exercise was to provide a *prima facie* view of the effect of productivity and national savings on Bangladesh's economic growth. It is important to note that one factor alone cannot really determine this growth surge and both national savings and labour productivity are interrelated. This capital deepening has been made possible by the increasing national savings rate. The increase in capital stock for workers has led to increased output and hence productivity. Such capital deepening in both agriculture and industry has played an important role.[8]

## Policy Implications and the Way Forward

Increasing investment in physical and human capital, along with efforts to further increase labour force participation and worker skills through schooling, will enhance productivity growth. The average years of schooling is currently 5.8 years and is expected to increase to 6.3 years by 2021, while Bangladesh's labour force is estimated to grow at 3.2 per cent per year till 2015. In light of the recent collapse of the factory building which resulted in the death of over 1000 workers, the manufacturing sector may have to contend with some negative publicity. The notion is that Bangladesh will lose the competitive edge it has in offering cheap labour if some of the major multinational clothing retailers do pull out. However competitiveness in the RMG sector and the manufacturing sector overall, can be sustained and even enhanced if the country manages to increase its worker productivity – low-priced labour is not the only way through which Bangladesh can maintain its competitiveness. Furthermore, to generate savings, the savings institutions in Bangladesh with long-term liabilities can become a major source of financing. These factors along with significant developments in the manufacturing and service sectors point to a promising horizon for increased growth in Bangladesh. However the recent political instability and violence threaten to derail Bangladesh's prospects. Good economic policies and a conducive economic structure will not suffice; the institutions of property rights, justice and governance have appeared to exhibit a precipitious decline and will be inimical to growth in the long run. Bangladesh's growth performance has been robust in spite of weak governance and unstable political conditions – however, when confrontational politics pushes Bangladesh to the brink, further economic progress will be challenged.

[8] Ibid.