BANGLADESH
CONSOLIDATING EXPORT-LED GROWTH
HIGHLIGHTS
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ADB Country Diagnostic Studies
Bangladesh: Consolidating Export-led Growth

ECONOMY
$194.8 billion current GDP
6.5% real GDP growth
GDP per capita of $1,234
2010–2015 Annual Average
Shares in GDP (%)

SOCIAL INDICATORS
31.5% of population considered poor
4.3% unemployment rate
61% adult literacy
97.7% enrollment rate in primary education
71 years of life expectancy
Infant mortality: 31.1 per 1,000 live births
Maternal mortality: 176 per 100,000 live births
87% of population has access to clean water
61% of population has access to improved sanitation facility

RESOURCES
14.8 TCF natural gas reserve
12,071 MW of installed electricity generation capacity
271 kWh electricity consumption per capita
60% electrification rate
159 million population

FOREIGN TRADE
Exports: $29.2 billion
(15.1% of GDP)
Imports: $40.6 billion
(20.8% of GDP)
Key exports:
ready-made garments,
leather products,
jute products,
seafood, and textiles
81% of exports are ready-made garments

GDP = gross domestic product
kWh = kilowatt hour
MW = megawatt
TCF = trillion cubic feet
Notes: $ denotes US dollar
Exchange rate used was average of 2015.
Bangladesh has transformed its economic structure over the last 2 decades, reaping the benefits of investment in the ready-made garments (RMG) sector and overcoming challenges such as the global financial crisis and the removal of preferential markets with the expiry of the Multi-Fiber Agreement in 2005. In 2015, the economy “graduated” to middle-income status under the World Bank classification, and average growth of 5%–6% over the previous decade helped to reduce sharply the number of people living below the poverty line and to substantially increase education of the population.

Challenges remain, nonetheless, and continued development requires more effort, coordination, and strengthening of the institutional framework. This study argues that some of the policies that allowed the country to grow and prosper in the last few years will become less effective, and the economy will need to “switch gears” to consolidate the growth momentum over the medium term. In some areas, the country has shown ingenuity—for example, in the proliferation of microcredit. This will continue to serve it well as it quickly adopts technology and “catches up” with its neighbors. In other areas, important changes in policies and institutional mechanisms are needed to ensure that the public sector can finance infrastructure services to support long-term growth.

The study performs an overall diagnostic of economic development in Bangladesh, specifically, by assessing the causes of and constraints to current and future inclusive and sustainable growth. Three critical constraints are identified. Two of these—an insufficient supply of reliable energy and a lack of economic diversification—are analyzed in greater depth in Chapters 4 and 5 of the study, respectively. The third critical constraint relates to uncertain property rights, but this issue is discussed in the broader context of governance in Chapter 2. Here are some of the key themes discussed in the study.
Bangladesh: Consolidating Export-led Growth

Economic growth rate has been high, but quality investments are needed going forward.

Bangladesh has been able to reach its economic growth potential over the 10 years leading up to 2015. Underlying this success has been the reduction in the population growth rate and the dependency ratio and a decline in the volatility of output. The movement of surplus labor from the primary sector into more productive manufacturing activities characterized the structural transformation of the economy. External inflows have soared, spurred by exports of garments and remittance inflows. Much of the successful outcomes were the result of a deliberate strategy by successive governments to promote industry in the context of the government’s ambitious 5-year plans. Improved fiscal and external macroeconomic stability have helped to sustain growth. Nonetheless, foreign direct investment, at around 1% of GDP, is low compared with other countries at similar levels of development. Also, the country’s high vulnerability to climate change-related damages continues to affect economic activity through setbacks and damages to the capital stock.

Lack of energy infrastructure, uncertainties in property ownership and lack of self-discovery in non-RMG sectors are significant barriers for private investment.

The study applies the growth diagnostics methodology based on Hausmann, Rodrik, and Velasco (2005) to identify the main barriers to growth using similar countries as comparators. Insufficient or inadequate growth-promoting ingredients—such as access and cost of finance, geography, transport and energy infrastructure, education and skills of the workforce, macroeconomic stability, governance and coordination externalities—can deter private investment.

The summary table below encapsulates the growth diagnostics results for Bangladesh. It finds that the most critical constraints to private investment and thus productive growth are (i) insufficient net supply of reliable and environmentally sustainable energy, (ii) insufficient security about property ownership, and (iii) policies that stunt new self-discovery on industry and economic activities. If policies are designed to tackle these constraints urgently, Bangladesh will be free to harness its full potential for inclusive and sustainable growth.

These identified constraints are the immediate ones; it may well be that critical constraints will change as structural transformation proceeds and the priority sectors shift. Two candidates for this position are (i) increasing the education
and quality skills of the workforce; and (ii) raising domestic savings and broadening the tax base (with fewer distortions) to provide funds for education, health, and infrastructure.

**Summary Table: Critical Constraints to Growth in Bangladesh (and Main References)**

<table>
<thead>
<tr>
<th>Source of Constraint</th>
<th>Evaluation</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Information externality/ self-discovery</td>
<td>Inadequate</td>
<td>Anti-export bias of non-ready-made-garment sectors constrains self-discovery (Chapter 5)</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>Inadequate</td>
<td>Major barriers in electricity and transport (Chapter 4)</td>
</tr>
<tr>
<td>Property security</td>
<td>Inadequate</td>
<td>Affects land development and property rights (Box 2.2)</td>
</tr>
<tr>
<td>Domestic savings</td>
<td>Adequate given development level</td>
<td>Reforms need to accelerate (Appendix 3.1)</td>
</tr>
<tr>
<td>Human capital</td>
<td>Adequate for now</td>
<td>Emerging constraint (Chapter 5 of Employment Diagnostics Study [ADB 2016b]).</td>
</tr>
<tr>
<td>Financial intermediation</td>
<td>Adequate</td>
<td>Policies are improving situation (Section 2.2)</td>
</tr>
<tr>
<td>International finance</td>
<td>Adequate</td>
<td>High access to concessional finance and grants so far (Section 2.2)</td>
</tr>
<tr>
<td>Geography</td>
<td>Adequate</td>
<td>But vulnerable to effects of global warming (Appendix 1.1 and Section 2.3)</td>
</tr>
<tr>
<td>Macroeconomic environment risks</td>
<td>Adequate</td>
<td>But downside risks from impact of political disruptions (see Section 2.5)</td>
</tr>
<tr>
<td>Coordination externalities</td>
<td>Adequate</td>
<td>Government is using information and communication technology and other policies to tackle coordination externalities (see Section 2.6).</td>
</tr>
</tbody>
</table>

Source: Authors.

It is important to note that growth in this context refers to fostering investment in activities that will create know-how and value added. It does not refer to boosting short-term growth—Bangladesh has been enormously successful in achieving high rates in the recent past. It refers to placing the country on a high-quality sustainable development path that can significantly improve everyone’s standard of living and minimize poverty. It will take time for effective policies that foster private investment to reap full benefits and may require reforms in emerging areas (such as reforms that deepen financial development and initiatives to improve urban transport). In this regard, Appendix 2.1 examines more specifically how traffic congestion in Dhaka constrains the quality of urban living and what measures could be taken to ameliorate this.
Economic growth has been inclusive: poverty has declined; the provision of health, education, and basic infrastructure has improved; and financial inclusion has thrived.

Greater equality of opportunity is the main pillar of a high-quality development path. Despite considerable challenges, the government has managed to successfully implement many programs in the areas of basic needs. The poverty rate (the population living under the national poverty line) has fallen from 48.9% in 2000 to 31.5% in 2010. However, the study finds that the decline of poverty was not evenly distributed across Bangladesh’s seven divisions. The study also analyzes whether growth has also come with equal and quality access to basic social services (health and education). Despite the progress in health outcomes overall, access to basic health and sanitation services are still limited for the poorest quintile families. And the labor force is still largely unskilled (employment is touched briefly in this study in the context of inclusiveness, given the more detailed discussion in ADB [2016b]). Chapter 3 also highlights how access to basic infrastructure and productive assets in Bangladesh is limited, in particular for the poorest quintile families.

The study also analyzes the development of and access to microfinance institutes. It finds that microfinance has been largely inclusive. Two institutions have taken on a leading role in propelling microcredit: Bangladesh Bank and the Microcredit Regulatory Authority. Microfinance will continue to be an important source of financing for low-income families, but some groups particularly in agriculture continue to be underserved. Last, the report notes the government’s commitment to improving the social protection landscape, as shown in the recent increase in social spending. The challenge is to increase coverage, as some 64% of poor households still do not have access to social protection.

In the context of social insurance, Appendix 3.1 advocates for the faster development of a national pension system. Because Bangladesh is still a relatively youthful country, setting up the institutions for a lasting pension system will come at a small cost. Moreover, as studies around the world have shown, the ability to save a portion of income is not confined to the rich. Incentive programs to encourage Bangladeshis to open a bank account, use cell phone and biometric technology to make payments and log into the formal network, and finally, save some of their income, will slowly but surely create a long-term pool of funds that can eventually be channeled to finance much-needed investment, including in infrastructure. Bangladesh is well poised for innovation in this area.
Measures to increase long-term energy supply and foster energy conservation are urgently needed.

The lack of reliable electricity supply and the impending shortage of natural gas are major binding constraints to economic growth. Firms and the government bypass some of these difficulties by using private generators and establishing export processing zones. But the study notes that unless the energy supply gap can be narrowed across the country, economic growth will not match its potential. A combination of highly subsidized fuel and electricity prices for consumers coupled with difficulties for the private sector to enter the electricity and oil and gas industries led to inadequate supplies. The impact on aggregate economic activity is already palpable. The study considers the supply-demand balance under current policies, as well as the policies available to increase supply and maintain sustainable demand growth through greater efficiency.

An analysis of the most recent 5-year plans of the Government of Bangladesh suggests that policy makers are well aware of the energy challenge, particularly the need to ramp up supply. This study emphasizes three key areas, which should be part of the solution. First, electricity and fuel subsidies should be reduced and combined with programs that promote energy conservation and energy efficiency. Second, private investment in electricity generation and oil and gas exploration should be promoted. Third, the government has to push harder for development of the South Asian regional electricity market.

The success of the RMG sector has inadvertently come at the expense of poor growth and limited prospects for diversifying into other sectors.

The RMG sector in Bangladesh was initiated in the late 1970s with nine export-oriented garment manufacturing firms earning less than a million dollars a year. By 2015, it was the second-largest garment exporter in the world behind the People’s Republic of China, with continued prospects for growth. At the same time, some sectors considered promising in earlier days, such as leather products and shipbuilding, have not taken off despite substantial potential. Having a relative comparative advantage in just a few exports would be acceptable if other diverse sectors and services that cater to domestic consumers developed in parallel. Unfortunately, quite the opposite development is occurring in Bangladesh, at least since 2000. The study looks more closely at the development of the RMG sector in the context of expanding productive activity through global value chains, as well as through potential links to other domestic sectors.
We argue that the RMG sector has limited potential to expand the economy in its current state, because it relies solely on the comparative cost advantage that comes from excess labor supply and government incentives such as tax waivers. If that cost advantage were to change, Bangladesh would not currently be diversified enough to compensate with other exports. Moreover, in recent years the demand trends of the “fast fashion” industry have made it more challenging for Bangladesh to move up the fashion industry value chain (see Box 5.2).

The study’s estimates confirm the large comparative cost advantage of Bangladesh’s RMG relative to other garment producers, given trends in global demand. It then uses the input-output tables and measures of revealed comparative advantage to analyze the relationship between economic diversification, sector-level linkages, and structural transformation. The results show that over the last 10 years, the domestic economy has become more concentrated in a few sectors. This is in contrast to other Asian countries, such as the People’s Republic of China and Viet Nam, which have leveraged their beginnings in basic manufacturing to link to other sectors, including business services that increase the productivity of manufacturing exports, even though goods in those sectors themselves are not exported.

The RMG production model based solely on low-cost labor may limit innovation and the country’s ability to link to the global fashion industry value chain. However, lateral links to other areas of manufacturing and services seem more promising if policies changed. Despite an increase in capital investment in RMG, net foreign direct investment remains relatively low, and is concentrated in banking, telecommunications, oil and gas, and RMG. Policies have to foster production processes that will allow production to thrive and move into other areas in which the country has shown important capabilities selling in the domestic market. Bangladesh could also expand into activities such as the maintenance and repair of machinery and light engineering. While it is impossible to predict where the country will eventually expand, it is clear that on-the-job training to expand skills, with a steady increase in the quality of basic secondary education, will be paramount if the country wants to develop faster.

In addition, the anti-export bias faced by non-RMG sectors limits competition and product diversification.

Two case studies are presented as illustrations of the challenges non-RMG sectors face in expanding their business: leather processing and pharmaceuticals. Policy makers have pitched both sectors as promising, but problems, including
some that could be addressed through policies, have prevented their full development.

Chapter 5 concludes that the incentives and tariff structure faced by non-RMG sectors explain in large part their inability to penetrate the export markets. Effective tariff protection rates on non-RMG final goods have stunted their exports by providing an environment where other sectors can become complacent producing for the domestic market due to the protection of final goods. Bangladesh has not been able to increase its links to global value chains as shown in a demand decomposition analysis. Instead, exports of intermediate goods began to decline since 2014. The implications of this chapter are that the policies that so heavily promote the RMG sector have reached their useful life. Instead, it is possible that they are creating rents for the very large RMG companies that enjoy a mostly tax-free environment under the special economic zones.

**Policies need to enhance opportunities for all.**

The concluding chapter of the study presents a broad policy framework which takes into account the interactions of all the ideas that have emerged. The recommendations suggest the need for a rethink of strategy for industrial policy.

One broad recommendation is to alter the tax regime to eliminate special exemptions and reduce tax distortions across sectors. Bangladesh is in dire need of more spending on basic health and education, but with one of the lowest tax-to-GDP ratios in the world, it will be unable to meet such basic expenditure. Successful sectors should be expected to contribute to some of the infrastructure they use, including through participation in public–private partnerships. More importantly, policies need to ensure that there are mechanisms for growth to continue to be inclusive. The emphasis should be on promoting good jobs (see ADB 2016b) and on reallocating expenditure toward infrastructure and education, as envisioned in the Five-Year Plan.
Finally, a policy framework to enable self-discovery of economic activity is recommended.

Rather than identifying thrust sectors and targeting a specific share of industry to GDP, policy makers have to find better horizontal interventions (those that cut across sectors without “picking winners”), as well as dealing with the issues that deter foreign direct investment. These are well identified in various surveys through the World Economic Forum’s “Global Competitiveness Indicators.” Paramount among these issues is the need to improve certainty about property ownership by tackling related governance issues (discussed in Box 2.2), strengthening registration systems of land ownership, and making drastic improvements in urban planning and development. Indeed, one of the greatest deterrents of foreign investment in Bangladesh is the expected poor quality of life in urban areas.

The amazing growth of RMG exports attests, not so much to the ability of Bangladeshis to produce garments well, but more to their ability to move ahead with resilience amid enormous challenges. This is where Bangladesh’s true comparative advantage lies.
BANGLADESH: Consolidating Export-led Growth

Highlights

Bangladesh has transformed its economy over the last 2 decades, graduating to middle-income status as average annual growth remained strong at 5%–6%. The country’s goal to become an upper-middle-income country by 2021 will require even stronger annual growth of 7.5%–8%. This study finds that the most critical constraints to growth are (i) insufficient reliable energy supply, (ii) policies that indirectly stunt development of economic activities unrelated to ready-made garment exports, and (iii) insufficient security about property and land rights due in part to inadequate registry systems. If policies are designed to urgently tackle these constraints, Bangladesh will be free to harness its potential for inclusive and sustainable growth.

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