Economic Growth in Bangladesh: Is There Any Hope?

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" No country can devalue its way to prosperity" Larry Summers

Abstract

The neoclassical and the new growth theories developed against the backdrop of the prewar and postwar growth experiences respectively of the now industrialized countries have enriched the analytical basis of economic growth which in turn has driven home factually the importance of social and institutional factors to growth. Bangladesh, although has improved its growth performance since the 1980s and particularly in the 1990s, still remains a laggard with respect to the desired growth rate. The ability to make a marked improvement of growth performance critically hinges on the ability to improve various elements of institutions.

1. INTRODUCTION

IN **1820**, the starting point of modern economic growth, the area that now forms Bangladesh constituted the sixteenth largest economy in the world by the size of the GNP. Excepting U.K., France, Germany, Italy and the U.S. all the Western capitalist countries were smaller than Bangladesh measured by the size of the GNP. At that time China was the largest and India the second largest economies. Japan and the U.S. were in the sixth and ninth positions respectively. The size of the Asian economies, however, did not imply commensurate affluence of the people as per capita income of these countries including Bangladesh were much below the per capita income of most of the Western capitalist and some Latin American countries.

In 2000, the GNP of the U.S. economy was about \$7300 billion and that of Japan was \$3400 billion at 1990 constant prices[1]

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[1] All subsequent figures in dollars are at 1990 constant prices.

These are roughly about 600 and 120 times higher from their corresponding figures in 1820.The American and Japanese economies are now number one and number two in rank. China and India came down to ranks seven and eleven respectively with about $800 and $350 billions of GNP. And Bangladesh slipped to the rank 53 with a GNP of about $48 billion. The rise of GNP of these countries from their 1820 levels are respectively about 33, 14 and 12 times only. The performance of the U.S. and Japan. in respect of attaining higher level of per capita income is also superb. Per capita income of these two countries registers $25900 and $26800 in 2000 representing about 20 and 30 fold increase from their 1820 levels. The Western European countries also experienced similar, though not as much, progress. Whereas China, India and Bangladesh come out respectively with $640, $3400 and $370.0 in this respect. Increase of per capita income of these countries in nearly two centuries is very dismal. While China has managed to increase per capita GDP by about 10 times, India and Bangladesh have been able to increase per capita GDP by only about 2.4 and 1.7 times respectively form their 1820 levels. It goes without saying that economic growth has made it possible for the Western capitalist countries specially the U.S. and Japan to rise to such a height of affluence while the lack of it has meant backwardness for the other Asian countries specially Bangladesh. The hope of a better standard of living of the poorer countries is very much bound up with the success of their efforts to achieve economic growth. For Bangladesh, economic growth is all the more important if the rising expectations following independence are not to be frustrated.

Bangladesh is passing through a critical stage of its way to the long cherished social peace and economic prosperity. The social condition is seriously vitiated by wide scale corruption, extortion of money by armed gangs, abduction, intimidation, robbery and various forms of violence etc. These social menace have spread to such a scale that many quarters have started doubting the capability of the society to achieve peace and prosperity. In this paper, we make an attempt to look into this issue by examining the link between social behavior-cum institutions and economic growth. This is done by drawing on historical growth process of the developed countries and results of some empirical studies from cross-country data.

2. HISTORICAL GROWTH, THEORY AND EVIDENCE

For understanding the process of economic growth of the countries having undergone the experience, it is instructive to divide the period of growth into two broad parts: the first from 1820 to 1950 and the second from 1950 to the recent years. The first one is a period marked by the growth of the Western capitalist countries. The second one is a period of accelerated growth for these countries and ‘super-growth’ of some East Asian countries.

2.1 Pre-war Growth

In the eighteenth or early nineteenth century, there was a series of improvements in technology and a rise in per capita output in England. Economic growth initiated in England spread to the Western Europe and then to North America, Australia and New Zealand. Japan had the beginning of the economic growth in the latter part of the twentieth century. There was no serious economic crisis and the capitalist economies were growing more or less smoothly in a stable economic and social environment in most of the time of the long 130 years of the first period excepting 1913-49 which was disturbed by rivalry, war and depression. Yet during this entire period, the per capita income of the Western European countries – U.K., France, Germany and the Netherlands together grew at a little more than 1.0 percent per annum. The performance of the U.S. in this respect was better.

The neoclassical growth theory was developed in the 1950s against the backdrop of this growth experience. Economic growth, having been a protracted and gradual one, was viewed as an evolutionary process rather than the result of conscious economic policy. The growth account, empirical counterpart of the neoclassical model, pioneered by Denison 1962, 1967) and Kendrick (1973, 1977) and continued most notably by Maddison (1987; 1995) and other techniques have brought to book a considerable number of sources of growth of which the three most important are:

accumulation of physical capital
technological progress, and
improvement of human skill.

There are three other elements which are also regarded as important. These are economies of scale, structural change, and the relative availability of natural resources.

Landes’ (1969) statement that “ the machine is at the heart of the new economic civilization” echoes the accounts that have assigned a central role of machine investment to economic growth. Until recently, modern quantitative studies like the growth accounting tradition attributed the lion’s share to technological progress. The assertion that technology embodied in machine is “the lever of riches” is reflective of this line of thinking. As regards the importance of human capital, first stressed by Schultz (1961), it is the key input to the research sector, which generates new products or ideas that underlie technological progress. And a country with greater stocks of human capital experience more rapid rate of introduction of new goods and tends to grow faster.

The factors mentioned above are called proximate elements of growth. The effectiveness of these factors depends on the availability of appropriate social behavior, policy and institutions – the deeper layer of causality, which support all proximate sources and the growth they promote. Economic historians in particular emphasized the role of these factors. Among others, Rostow (1960), Lewis (1955) and Hagen (1960) attach important role to socio-cultural values and institutions to economic performance. In the U.S. and Western Europe economic growth took off after the establishment of necessary political and social institutions. The spread of growth from England to Europe and America was facilitated by the presence of compatible socio-cultural values and institutional arrangement. However, a coherent analysis to link socio-cultural and institutional factors to economic performance was lacking. The neoclassical theory thus remains institution-free – there is no particular place in the structure for labor unions, banking systems, schools, legal systems, regulatory and enforcement mechanisms.

2.2 Post-war Growth

Post-war growth process is generally examined for period 1950-73 and then from 1973 onwards. The period 1950-73 is known as the 'golden age'of economic growth. This is because this period witnessed growth rates which were unknown in the entire recorded history of economic growth. Per capita income of Western Europe- U.K., France, Germany, and the Netherlands together grew at an accelerated rate of about 4.0 percent per annum. The performance of the U.S. economy in this respect was somewhat lower. The most dramatic change took place in East Asia. East Asian countries like Japan, Korea, Taiwan, Hong Kong and Singapore which did not experience a protracted and gradual process of economic growth as the Western countries did, had their growth process condensed into a short period. These countries experienced astonishing growth rates of their GDP of about 7.0 to 10.0 percents per annum during 1950-73. Eichengreen's study (1995) demonstrates that the elements of Europe's growth miracle – wage moderation, high investment and rapid export growth – were delivered by a tailor-made set of domestic and international institutions. These institutions solved commitment and coordination problems and without these neither wage moderation nor the expansion of international trade would have taken place. Also in East Asian countries, establishment of necessary institutions preceded the rapid growth: Japan was able to catch-up with the West after it had undergone a deep institutional transformation around 1867.

The new growth theory emerged in the 1980s with the pre and post growth experience at the background. This theory is characterized by several aspects. Of them the one most relevant for our present purpose is the crystallization of earlier ideas pertaining to the significance of the role of societal behavior and the influence of institution to economic performance. It was left to Douglas North (1990) to theorize the connection of these ideas with economic growth and thereby assert that ""they are the underlying determinants of the long- run performance of economies". The sparked interest of the World Bank in the institutional reforms of the developing and the emerging economies owes to this development.

North has broadened the concept of institutions by defining them as humanly devised constraints that structure human interaction. They are made up of three essential elements – formal rules (constitutions, laws, regulations), informal constraints (conventions, norms of behavior and code of conduct) and enforcement characteristics. Effective institutions reduce uncertainty in human exchange and provide a framework for low cost transacting. Empirical verification of the theory is by now a growth area in itself.

2.3 Empirical Evidence of Institutional Influence

In recent years, empirical verification of institutional influence on economic performance has experienced a renaissance. Various aspects of institutional characteristics have been put into test to capture their effects on growth. We take up only a few of them that are of particular interest from our point of view. These are the following:

(a) Corruption

In its simple definition, corruption consists in abusing official power for private benefit. The most common form of corruption is taking bribe. Mauro's study (1997) reveals evidence to the effect that higher costs caused by corruption acts as disincentive to investment, and thereby reduces economic growth. There are important fiscal effects of corruption too. Corruption leads to increase in public investment because concerned government officials, to obtain bribe, manipulate public investment projects. On the other hand, corruption reduces government revenue for its effect on tax administration, thus reducing the ability of the government to carry out the needed public expenditure. Corruption distorts allocation of resources and encourages improper allocation of human capital. The talented young people are encouraged to become rent-seekers rather than entrepreneurs and they are prone to allocate their energies in counterproductive rent seeking.

(b) Extortion of Money

Extortion of money by armed gangs in the form of toll, subscription etc. is more coercive and creates more excess burden than does corruption. The act of extortion entails uncertainty and insecurity because of its random and violent nature and has more debilitating effect on growth than simple corruption (Tanzi 1998)

(c) Nepotism and Politicization of Government Institutions

An efficient, disciplined and incorruptible administration is essential to effectively carry out the basic functions and the role of the state. Nepotism and politicization of government institutions lead to loss of efficiency and discipline in the administration. Instead of being loyal to work ethic and integrity, the favored persons tend to become more loyal to their promoters and allocate their energies to appease them and their lackeys. If politicization is large-scale, the quality of the institutions is seriously affected. Knack and Keefer (1995) and Aron (2000) found significant relationship between institutional quality and economic growth.

(d) Violation of the Rule of Law

When social menace like hatred, animosity and distrust between various groups, social organizations and political parties reach a high level and organized crimes, violence, abduction, killings are rampant, the situation is an anarchic one - absence of the rule of law. Such a situation discourages investment – local and foreign. A state which performs its core functions like maintaining law and order well provides a congenial framework for its citizens to save and entrepreneurs to take risk and invest with confidence. The countries which are now developed ones, had long ago reached a high level of law and order besides other institutional attainments (Geiger 1989).

3. ECONOMIC GROWTH: BANGLADESH SCENARIO

3.1 Conceptual Issues

To comment on the state of economic growth of Bangladesh, it is instructive to spell out some relevant concept and issues. **First**, economic growth in common parlance is referred to as percentage change of GNP over a period with little or no consideration for the length of time period. In fact, it is a long-term concept. For our present purpose, it is instructive to use Hagen's (1960) notion who conceptualize it as a period which has witnessed the occurrence of steady technological progress in any given society and the behavior pattern of the society promises the continuation of the technological progress. If this happens the society in question has solved the fundamental economic problem and can be regarded to be "on the way" so that marked change occurs during each decade. Hagen makes four classifications of countries according to their status of economic growth.

Group 1: Certainly growing – countries in which growth has continued for four decades or more

Group 2: Very probably growing- countries in which growth is noticeable for three decades or more

Group 3: May be growing- countries in which growth is noticeable for less than two decades, so that it is not clear whether growth is a continuing characteristic of the society.

Group 4: Not growing- countries, which do not fulfill the minimum requirements of group 3.

Hagen did not lay out any specific figure to represent the typical growth rate. Arthur Lewis (1955) and Simon Kuznets (1965) put the figure at about 2.0 percent per capita based on pre-war growth experience which is an outdated estimate. The desired growth rate put forwarded by the World Bank Country Study (1995) seems to be in line with Hagen's conceptualization. The essence of the study is that Bangladesh is required to undergo a sustained growth of over 4.0 percent per capita for a decade in order to enable an average poor Bangladeshi to cross the poverty line. **Secondly**, the issue of time horizon in growth process is important. Studying growth as the trend of GNP over a substantial time span involves eliminating short-term fluctuations. However, if the purpose is to see the growth process as well as to investigate whether growth accelerate or decelerates over time, the differences in growth rates across sub-periods need not be averaged out. In fact, it may be desirable to relate long- term to short term behavior, since the long term is only a succession of short terms.

3.2 Growth facts

Information presented in the following table summarize growth pattern in Bangladesh Economy.

Per Capita Per Annum GNP Growth Rate of Bangladesh

Period	1913 1950	1950 1960	1960 1970	1970 1980	1980 1995	1991 1998	1996 2000	1980 2000
Grow Rate	-0.30	-	1.0	4.0* 6.0*	2.2	3.2	3.5	2.5

Source: Maddison (1995) for 1913-1950; UNDP (various issues) for other years

Growth rates of 4.0 and 6.0 are for periods 1972-80 and 1972-75 respectively.

We leave out the 1970-decade because increase in GNP of most of this period cannot be considered to represent genuine growth; the growth represents recovery to the prewar conditions, a case of Okun's Law. Following this, the period 1980-2000 of two decades witnessed an annual average per capita growth rate of 2.5 percent. Although this growth rate is higher than all previous recorded records, it falls short of the desired growth rate by about 1.5 percent and therefore does not qualify to represent economic growth we are talking about. This sluggish growth is in consonant with lacklustre technological improvement or efficiency gain of the period. This is reflected by the fact that total factor productivity (TFP) contributed only 8.7 percent to annual growth of GNP during 1982-88 against corresponding figures of 32.0, 36.0 and 12.0 respectively for India, Pakistan and Sri Lanka (Fry 1991). However its significance to growth during 1980- 97 was found to be of no consequence (Chowdhury 1999). This implies that the apparent economic growths have been input-driven.

It is of interest to see growth performance in the sub-periods of the decades under investigation. One can see gradual improvement of growth performance in the successive sub-periods with a 3.5 percent per capita annual growth in the last sub-period 1996-2000 and about 4.0 percent in the fiscal 2000-2001. Many analysts are of the opinion that if sociopolitical environment of the country were more congenial, the growth rates would be significantly higher.

3.3 Sociopolitical Impediments

Social instability caused by corruption, cheating, extortion of money, robbery, abduction, eviction, violence at meetings, processions, hartals etc. and other organized crimes form an important component of daily news of the local dailies in recent years. These untoward events have spread to such a scale that Bangladesh hit newspaper headlines recently by being one of the most corrupt and crime hit countries in the world. The most worrying aspect of these phenomena is that these menaces have been on the rise without any sign of being abated. This has cast a shadow of gloom in the society.

The economic effects of various sociopolitical variables are evidenced in the various studies mentioned above. These findings are universal in respect of their effects on economic growth and policy implications. In the case of Bangladesh, the negative effects of these variables on economic performance has been mentioned by experts and donor agencies on many occasions. About 2.0 to 3.0 percent GDP growth rate per annum is reportedly sacrificed at the altar of corruption alone. This would imply that a conservative estimate of the adverse effect of the social malpractice would be quite large indeed.

There are different views, opinions and also theories regarding the causes of corruption and other malpractice. One can muse over these. But in the background, there is the state in totality of its actions. The actions are carried out by many agencies that constitute the government and the administration. The government and the administration, to a great extent, create the environment and the incentives for various malpractices. The problem is compounded because often rule is overruled and directives take precedence over rule and law.

4. SUMMARY AND CONCLUSION

4.1 Summary

In 1820, the area constituting Bangladesh now was the sixteenth largest economy in the world with a GNP of little over $3.0 billion and per capita income of about $160.0 in 1990 prices. Excepting U.K., France, Germany, the Netherlands, Italy and the U.S., all the Western capitalist countries were well below Bangladesh in respect of the size of GNP. However, per capita income of Bangladesh was lower than per capita income of most of these and some Latin American countries.

In 2000, the GNP of Bangladesh stands at $48 billions and per capita income at $370.0

The GNP and per capita income of the U.S. in the same year are $7300 billions and $25900 respectively. The Western European countries also experienced similar rise, although not as much, in their national income and per capita income. The rise of the Western capitalist countries to such heights of affluence owes mostly to their economic growth while lack of economic growth has meant backwardness for Bangladesh.

Economic growth first took off in England in the eighteenth century and subsequently spread to other European countries, North America, Australia, New Zealand and Japan. Western European countries grew at about 1.0 percent per year in per capita terms during 1820-1950. The performance of the U.S. economy was better during this time. These countries experienced protracted, gradual growth process for about 130 years preceeding1950 and this process of growth was viewed as evolutionary The post-war period 1950-73, marked as the Golden Age of economic growth, is remarkable for accelerated growth of the Western European countries at about 4.0 percent per annum per capita and super-growth of the East Asian countries at about 7.0 to 10.0 percent per annum.

A host of factors contributed to the historical growth. These factors are broadly of two types: the proximate sources and the ultimate sources of growth. The three topmost important proximate sources are (a) accumulation of capital (b) technological progress, and (d) improvement of human skill. The ultimate sources of growth are the sociopolitical conditions, which support and promote the proximate elements of growth. The most prominent of these ultimate elements are behavior pattern of the society and its institutions. Today's developed nations had established congenial social culture and necessary institutions before their economic growth took off in the eighteenth or early nineteenth century. The post-war growth period is characterized by conscious economic policy – international and domestic institutions were created with the Bretton Woods system to build up war-torn economies which brought high returns to these countries. Yet the neoclassical growth theory remains institution-free. It was left to the new growth theory to acknowledge the significance of institutions.

The role of institutions in promoting growth in the developing and emerging countries has sparked renewed interest in recent years. Empirical investigation into the effects of various institutional variables has been revealing. Studies relating to corruption finds that higher costs caused by corruption reduces investment and thus reduces growth. It also imposes fiscal burden on the government by reducing revenue from taxes and fees and increasing public investment cost through manipulation to get bribes. Extortion of money is more burdensome than corruption because of its randomness character and violent nature. Small and medium traders and entrepreneurs are the easy prey of these practices. Politicization in various government organizations seriously affect efficiency and discipline and become counterproductive. Failure to maintain a reasonable level of law and order- a core function of the state has debilitating effects on economic performance.

These findings are universal in terms of their adverse effects and policy implications. For Bangladesh, corruption alone is reported to have been a source of loss of GDP growth rate of the order of 2.0 to 3.0 percent per annum – a great drain on our national income. This is indicative of the order of national income we are sacrificing on account of the institutional weakness.

Economic growth, a long-term concept implying sustained growth of per capita

income at a rate of about **4.0** percent per annum for Bangladesh along with the growth of capacity, is yet to be visible. The annual average per capita income growth of **2.5** percent experienced in two decades during 1980-2000 falls short of the desired growth rate by about **1.5** percent per annum. The short-term successive per capita growth rates exhibited gradual improvements ending with **3.5** percent per annum in the 1996-2000 sub-period.

4.2 Conclusion

Historical growth process which involved treading a long way on the part of the now developed countries has left important lessons and made available important ingredients e.g. technology, capital, skill etc. other countries who can shorten their way to prosperity by making use of the knowledge and ingredients. However, making use of the knowledge and ingredients is conditional upon the capacity of the nation, known variously as “initial conditions”, “social capability” etc. A very important element of these conditions or capability is high quality institutions. The downgraded quality of the institutions has robbed the nation of a sizeable rate of economic growth, which appears to be of magnitude needed to fill up the necessary gap to put the economy “on the way”.

Lack of enforcement of rule / law etc. and downgrading of socio-cultural values and norms have, for the most part, contributed to the deterioration of the institutional quality.

Both of these – lack of enforcement of rule / law, and downgrading of socio-cultural values and motivation – have reinforced each other with snowball effect, the latter taking precedence over the former. Without significant improvement of these conditions, fruits of institutional reforms will be seriously circumscribed.

The government and the political party in power and other political parties, being the most influential in the society, should hold the key to reverse the downhill process of the institutional quality. Because the nation’s leadership is with these organizations and it is “leadership that will see a country through its crisis”. The important question that logically follows is that “ will the leadership do it?” or “is it capable of doing it?” Unfortunately, this is not the subject matter of this paper.

About thirty years have gone by for this nation. If we were in the Middle Age, marked by the lack of technological improvement and slowness of the speed of movement and activities, thirty years would be a short period. But the present time, marked by hi-tech and high speed, thirty years is a very very long time – about **1000 years** for a common labor of Bangladesh, judged by American productivity standard. Can we afford killing any more time?

Kenneth Boulding describes hope as a complex concept. In all its various meanings it implies optimism, opposed to pessimism, about the future. In its extreme form along pessimism, it is despair. Our position on the contour of hope depends on where our leadership will take us. If the leadership fails in its duty, history will “punish for not learning its lessons”.

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