Bangladesh's Economic Prospects and Challenges[1]
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Economic growth continues in Bangladesh, although at a slower pace, during the world economic slowdown. Once regarded as a basket case, Bangladesh has achieved steady economic growth at 5% a year or more over the past decade. Its growth exceeded 6% in FY2008 (July 2007 through June 2008) and reached 5.9% in FY2009, thanks to favorable agricultural outcomes and growth in both commodity exports and remittance income. The emergence of the export garment industry, which now employs more than two million mainly female workers and generates nearly 75% of the country's export earnings, has been crucial to this growth. Activity in this industry, which survived the expiration of the Multi-Fiber Agreement in 2006, has slowed this year, but demand for the low-cost garments in which Bangladesh specializes has fallen less than for some other categories.

The most important factors fostering economic growth in Bangladesh have been its macroeconomic stability and outward orientation. Major impediments to economic development have been weak government, political instability, a weak banking system, and an unreliable power supply. Low wages boost the country's competitiveness in overseas markets. Notwithstanding recent progress, however, Bangladesh still ranks near the bottom of Transparency International's corruption perception index. Interest rate spreads exceed regional averages, and power outages significantly reduce total factor productivity in manufacturing.

Economic growth in 2008, a year of multiple natural disasters and elevated world food and fuel prices, was remarkably resilient. Nevertheless, life became harder for large segments of the population. The natural disasters and rapid food price increases that occurred in early 2008 put severe pressure on household incomes. According to World Bank estimates, poverty levels in Bangladesh, although still very high, declined from 2000 to 2005. The percentage of the population living in poverty (less than $2 a day in purchasing power) fell from 85% to 81% while the percentage living in severe poverty (less than $1.25 a day in purchasing power) declined from 58% to 51%. The trials of 2008 reversed some of these gains. Inflation remained uncomfortably high during the year despite delays in passing through food price increases.

Growth is slowing in 2009. Recession in countries where Bangladesh sends both goods and people is hurting exports and remittance flows. Garment exports and remittance income both continued to increase in the first half of 2009, but more slowly than previously. Orders for garments have been declining since December 2008. Some buyers have asked for shipment delays and others have renegotiated prices downward. Weak economies in the Middle East are reducing the demand for Bangladeshi workers and will probably cut into remittance flows in the future. Despite an expectation that agricultural growth will be strong this year, the Economist Intelligence Unit (EIU) forecasts a slower 5.2% growth rate in FY 2010 with manufacturing value added increasing at only 3.2%. The service sector is expected to grow at 6.1%, slightly

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slower than in FY2009. Although weaker inflows of worker remittances are expected to depress consumption spending, private consumption will continue to be the main driver of economic expansion. Investment is expected to be higher in FY2010, but the global recession will cut into demand for Bangladeshi exports. Import growth will also slow as textile manufacturers reduce their imports of yarn.

The political environment for economic growth is currently stable following the December 2008 election but threats remain. The election returned the Awami League to power after two years of rule by a transitional government. Provided that it retains the support of the military, the current government is expected to remain in power and dominate policy making for the next several years. However the opposition Bangladesh Nationalist Party, which lost parliamentary seats in the election, may mobilize street protests (*hartals)* in the future. A rebellion in February by the Bangladesh Rifles, a paramilitary border guard force, did not escalate because it failed to gain broad support within the military.

Although the present regime is regarded as business-friendly, the business environment in Bangladesh is mediocre at best and is not improving. Bangladesh ranked 110th in the world (out of 181 countries) on the Ease of Doing Business Index in the World Bank's *Doing Business 2009.* This was a decline from 104th in the previous year, showing that other countries are reforming their business environments faster than Bangladesh. Areas of particular weakness in the business environment of Bangladesh were enforcing contracts (where Bangladesh ranked a dismal 178th), registering property (175th), employing workers (132nd), and dealing with construction permits (114th). According to *Doing Business,* enforcing a commercial contract in Bangladesh involves 41 procedures, takes nearly four years, and costs 63% of the claim. Registering property involves eight procedures, takes 245 days, and costs 10% of the value of the property. On the other hand, Bangladesh is outstanding in the area of protecting investors, where it ranks 18th in the world, and relatively good in getting credit (59th). For protecting investors, Bangladesh ranks close to mean OECD levels on indexes of disclosure, director liability, and shareholder suits.

Further financial sector development is needed to allow Bangladesh to achieve its growth potential. Financial development in Bangladesh lags behind that of comparator countries. Plans to divest or corporatize the four state-owned commercial banks appear to be a standstill following an unsuccessful effort to sell off one of them, Rupali Bank. Strengthening the financial position appears of these banks to be a prerequisite to their eventual divestment. Allowing interest rates in the primary market for government securities to be market-determined will give impetus to the development of a secondary market and thus to financial deepening. Meanwhile, Bangladesh Bank, the central bank, has advanced reforms aimed at deepening financial markets. The regulatory framework has been strengthened, on-site and off-site supervision has been enhanced, and steps have been taken to restructure, corporatize, and privatize the large nationalized commercial banks. However, the IMF warns that the observed improvements in published aggregate indicators of bank soundness conceal wide divergences in individual bank's performance and mask underlying weaknesses in the banking system. .

The budget for FY2010 that was presented to Parliament in June reduces subsidies, expands protection of the poor and vulnerable, seeks to redress regional imbalances, and

aims to provide economic stimulus. But its revenue goals will be hard to meet and its expenditure plans may be hampered by implementation weaknesses. Despite some recent improvement, Bangladesh still has one of the lowest ratios of tax receipts to GDP in the world at 11.8% of GDP in FY2008. The budget includes a challenging revenue target, anticipating that revenue will rise much faster than the rate of economic growth, something that has not happened in the past. One promising innovation is greater openness to public-private partnerships for infrastructure development. The budget aims to lower the budget deficit to 5% of GDP (vs. 6.1% the previous year), but if the rate of economic growth is slower than officially expected this decline may not occur.

The government is obtaining extra budget support from the World Bank and Asian Development Bank to help combat the domestic effects of the global recession in FY2010. With this support, the government hopes to increase spending on social safety nets, employment creation, and export promotion. The government is also preparing a five-year plan for development of the power and water resources sectors with support from international donors.

The budget partially reverses the trend toward trade liberalization by raising some import duties and lowering duties on imported raw materials, which increases effective protection. The average protection rate has been increased from 20.1% to 22.9%, mainly through wider imposition of para-tariffs and the introduction of a 5% regulatory duty. Although customs duty has been reduced on 865 items, the benefits are offset by wider application of a supplementary duty. These measures favor domestic producers over consumers. They have received a positive reaction from business interests, who welcome assistance with selling in the local market at a time when overseas demand is weakening. However, they hurt exporters and will have a negative impact on Bangladesh's competitiveness in the longer run.

Inflation has been moderate but may accelerate as a consequence of the expansionist budget. Inflation**,** particularly in food prices, was a major problem in Bangladesh until recently, especially during the surge in world rice and wheat prices in 2008, since these commodities are important components of the consumer price index. However, lower prices of imported grain as well as a strong domestic harvest have brought inflation down. The EIU expects consumer prices to increase by 5.1% in 2009, then accelerate to 6.4% in 2010 as a result of the resurgent demand side pressures that could be generated by the budget deficit and permissive monetary policy. While inflation is not a near-term threat, the IMF stresses that monetary vigilance must continue.

A recent World Bank study sheds light on the importance of worker migration for the Bangladesh economy. Bangladesh is among the top ten remittance-receiving countries. Workers from Bangladesh have taken advantage of the opportunities that globalization has afforded for poor and unskilled workers to improve their lives and those of their families. In 2008 about 5.8 million Bangladeshis were working overseas, primarily in Saudi Arabia, the UAE, Kuwait, and the UK. The average migrant is a young male with seven years of education who found overseas work either through friends and family or through an employment agent. A prospective migrant faces a substantial initial outlay, averaging $2,300 (almost five times per capita income). He raises this sum through savings, help from family and friends, and from sale of assets. However, the returns are high in local terms. Workers are able to remit an average of

102,000 taka per annum, or about 2.4 times per capita income. These remittances provide substantial benefits to their families in Bangladesh.

Bangladesh continues to face formidable natural challenges. With 90% of its landmass lying less than ten meters above mean sea level, Bangladesh has repeatedly suffered horrendous human and property losses from storms and flooding. In the longer run, global warming threatens to reduce its area by a sizable amount.

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