

# Bangladesh Economy into the 21st Century

(This is a slightly abridged version of the author's keynote paper presented yesterday at the inaugural session of the three-day Bangladesh Economic Association conference.)

Economic and social progress is a continuous process, and nobody expects that there will be any sudden break in these trends as we enter the new century and the millennium (incidentally, both in my view start on 1st January 2001). Nevertheless, there is something psychologically compelling, while crossing this historical milestone, to take stock of our situation and examine the challenges that lie ahead. That is how we have chosen the theme for this conference.

You know that in the BEA public lecture series, we have been lucky to have had very distinguished speakers to deliver the last three lectures, namely Amartya Sen, Joseph Stiglitz and Jeffrey Sachs. Even if one may not agree with all of their views (and their own views do not necessarily coincide), each of them discussed issues of great importance and relevance to the theme of this conference. I have therefore thought it fit to arrange this paper around some of the issues raised by them.

## The Political Economy of State versus Market

The BEA lecture by Stiglitz on 'state versus market' came as a sequel to his other recent writings, which reflect his search for a broad multi-faceted development approach that goes well beyond the orthodox neo-liberal agenda of market-oriented reforms. Between the ideological extremes, he looks for a 'third way' of finding an appropriate role of the state vis-à-vis that of the market. The recent emphasis on governance and institutional development, for example, has significantly widened the scope of the reform agenda; it also brings back many of the old structuralist ideas of development, such as regarding the institutional constraints to the private sector's market responses and the developmental roles of the state. It remains to be seen whether these new directions in development thinking will lead to a broader consensus beyond the one originally reached within the precincts of the 18th and 19th Streets of Washington, DC (Professor Stiglitz hopes it will) or will lead to new kinds of controversies (such as regarding 'good governance').

While it may be agreed that the choice of an appropriate state-market mix should be based not on ideology but on evidence regarding 'market failure' vis-à-vis 'government failure', there will be much less agreement on what that evidence is. I remember that during the floor discussions following Professor Stiglitz's lecture, someone asked about what the choice might be in an economy where the government and the market both had failed equally. The intervention was taken by everyone in a lighter vein (and it was meant to be so) as we moved on to more serious discussions. But, upon further reflection, I cannot dispose of this question so lightly. In the context of developed capitalist economies, many authors have stressed the close cultural and institutional linkages between market capitalism and democracy. In our quest for democracy and market-driven development, we need to understand more deeply these kinds of institutional linkages in the context of our own political-cultural structures. Otherwise, by posing the problem entirely as a choice between the government and the market, our attention may be diverted away from addressing the more fundamental constraints to our progress.

The kind of 'government failure' initially emphasised under market-oriented reforms is the alleged fact that the government is not good at doing business; this was the argument for privatisation and for excluding public investment from directly productive activities. But to the extent that the government is unable to create an environment for the proper functioning of the private sector, 'government failure' and market failure are the two sides of the same coin. In the absence of such an environment, privatisation and import liberalisation have often resulted in poor industrial performance and employment losses. The single-minded pursuit of deficit control and price stabilisation sometimes resulted in the overkill, particularly when there was poor response from private investment. Market cannot operate with any degree of efficiency unless the government is capable enough to enforce an economic and commercial regulatory framework. Unfortunately, the proponents of the Washington consensus' discovered these facts (and subsequently added 'good governance' in their reform agenda) only after some damage had already been done. In Bangladesh, the upheaval in the stock market in 1996 and the plundering of depositors' money by some sponsor-directors of private banks are two glaring examples of what can happen when financial sector's liberalisation is not accompanied by provision of adequate regulation and supervision.

Beyond the provision of market regulation and enforcement of contracts, the issue of governance in Bangladesh's present context has come down to the more basics (or call it the 'fundamentals'), such as maintaining law and order, ensuring property rights and keeping the highways and ports operational in the face of indiscriminate political programmes. Such a situation raises concerns regarding basic human rights and security, let alone the proper functioning of a market economy. Then, there is the menace of financial extortion, including collection of illegal tolls and protection money, which now pervades through most sectors of the economy and extends from cities to remote village bazaars. Whether this phenomenal growth of 'toll collection' and its decentralisation into the countryside particularly in the 1990s have anything to do with the transition to our kind of parliamentary democracy is a topic worthy of research.

Administering the rule of law, which is the most basic element of governance, is not only a matter of enforcement, but also has much to do with a system of common values and norms in a society. As pointed out by Kenneth Arrow, one of the earliest Nobel laureates in economics, ethical elements enter in some measure into every contract, without which no market could function. There is an element of trust in every transaction. Why do you not, for example, walk away after a rickshaw ride on a lonely street? If you argue that you do not do so because the rickshaw-puller happens to be physically strong enough to forcibly extract the fare from you, then why does not he attempt to extract the fare a second time after you have paid his correct fare? These are matters of norms or customary behaviour that underlie the working of the market economy. And it is not adequate to argue that there are enforcement mechanisms such as police and courts, since these are themselves institutions that cannot perform without some minimum ethical standards.

The actual governance outcomes are the result of both formal rules and informal norms. It is often argued that social habits and norms can be changed only very slowly. I cannot accept this when it comes to the kinds of perverse behaviour, including the routine violation of rule of law, which I have discussed here. Rather we should look at the political roots of such behaviour. If there is enough political commitment, institutional and legal reforms providing for both new rules and better enforcement can achieve results even within a short period of time.

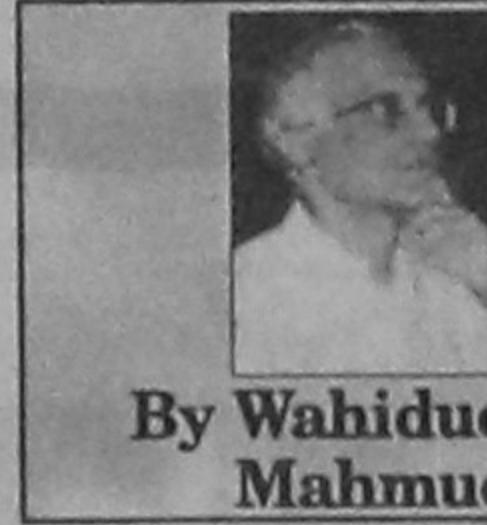
It is noteworthy that, in Bangladesh, there was no serious resistance to the market-oriented policy reforms that affected large proportions of the population, such as the abolition of food rationing or the withdrawal or reduction of agricultural input subsidies. In contrast, the politically-blocked reforms are of the institutional nature. These are reforms essentially to deal with economic crimes generating huge illegal incomes, whether from tax evasion, wilful default of bank loans, leakage in public development spending, electricity pilferage, or corruption in high places that undermines the credibility of the government's regulatory functions. It is most likely that effective policy measures to combat such rent-seeking activities will meet with strong popular support, except among the few beneficiaries of the system; yet resistance to such reforms has apparently proved quite insurmountable.

Maynard Keynes gave a definition of 'governance' long before the World Bank reinvented the term. According to Keynes, the quality of governance would depend on how the conflicting demands of various interest groups in the society are reconciled. The situation I described above could thus be explained as a problem of vested interest groups bent on protecting their sources of incomes, legal or illegal, and the government's inability to resist their appeals. Political leaders may forge alliances with these groups to create and distribute rents as a necessary tool of political management. This would of course lead one to the broader issue of the prevailing patterns of political power and the nature of engagement of the civil society and the electorate at large.

There is a vicious circle operating here. The emerging norms and rules (or their non-compliance) and the kind of incentives they provide are crucially important for the way political and economic institutions develop. If, for example, maintaining an armed cadre of musclemen and extortionists is the way to attain political clout, or if wilful default of bank loans becomes the surest means of business success, or if trade unionism is motivated towards securing illegal benefits for its unscrupulous leadership, then only those who specialise in these kinds of expertise will rise to prominence. They will eventually come to dominate the institutions of democracy and market economy - like political parties, trade bodies or labour unions. Since they are the beneficiaries of the existing rules of the game (if you choose to call these any rules at all) they will have no incentives to change the system from within. Among the general public, on the other hand, such a situation leads to political cynicism and erosion of faith in state institutions.

That is why, once a society's institutions start deteriorating, the problem is that these will deteriorate further unless checked by forces outside the system. This hypothesis of irreversibility of institutional change, whether in the direction of improvement or of deterioration, was put forward by Douglass North, who was awarded Nobel Prize for his contribution to what is now known as institutional economics. I have only interpreted his hypothesis in Bangladesh's prevailing context. But there is a much simpler way to put this idea across by citing a Chinese proverb: 'If we do not change our direction, we are likely to end up where we are going.'

How do we bring about that change in direction? It is not easy, since the stakes are high for those who are the beneficiaries of the system.



By Wahiduddin Mahmud

The fact that we do not have yet well-developed institutions of the market economy can actually be used to our advantage if we allow enough flexibility for innovations. If one were to go by the rules written by the book, then micro-credit would never exist. So there are many other types of institutional innovations that we need to allow to flower.

Politics today is, in effect, the fastest growing business in Bangladesh, only that most of that business belongs to the darker side of the economy. But the stakes are high for the society as well. I remain hopeful that citizens' groups, the printed media and the socially-responsible parts of our political and business leadership will forge an alliance to bring about the kind of change that will allow both the government and markets to work to the benefit of the society. Without such a change, the choice between the government and the market will not be much of a choice.

## Social Development and Poverty Alleviation

Although Amartya Sen's BEA lecture was titled 'social choice', he primarily dwelt on the kinds of public actions that could promote human development in countries like Bangladesh. Sen has popularised the notion that human poverty is a multi-faceted phenomenon, which can be defined in terms of a person's capability such as being well-nourished or literate. The UNDP has put this idea into practice by ranking countries in terms of a human development index, although Sen himself is aware of the problem of choice of appropriate capability-indicators and their aggregation into a single index. Such conceptual problems notwithstanding, Sen's message is clear: the single-minded pursuit of economic growth is not the best, or even an effective means for achieving human development. Hence the need for public action and social change towards achieving such goals as raising life expectancy or increasing the rate of literacy.

In the *Human Development Report 2000*, Bangladesh is ranked 146th, among 174 countries, in terms of both HDI and GDP per capita (adjusted for purchasing power parity of domestic currency with dollar). In other words, Bangladesh's level of human development is low, but is not different from what would be normally expected at the given level of GDP per capita. Sen makes the point that, given our low per capita income, we can hardly afford to wait for health and life expectancy to improve only through the mediation of GDP growth, since it will take an unacceptably long time. Instead, we should emulate the examples of those countries, which are high-achievers in human development in relation to their GDP per capita (like Sri Lanka or China).

Recent research has shown that GDP growth is important for improving health indicators (such as infant mortality rate), but it works mainly through higher incomes for the poor and larger budget allocations for primary healthcare. On the basis of available information, it is not easy to determine the trends in poverty incidence in Bangladesh. Poverty has been perhaps declining, but only very slowly (recent evidence suggests a reduction of 1 percentage point in every 3 years). Clearly, to make substantial inroads into poverty alleviation, we have to have higher and more equitable economic growth. In Bangla-

Historians of the Industrial Revolution have noted that much of the productivity improvements resulted, not from the patented inventions associated with famous names, but from the cumulative effect of minor adjustments made by numerous nameless skilled mechanics. The RMG sector, in spite of all its success, is a dead-end so far technology dissemination is concerned. One adverse effect of import liberalisation in Bangladesh has been to stifle the growth of our domestic small engineering industries. In this context, I should mention another new kind of business enterprises, namely, those run by the NGOs. These are businesses run purely on commercial terms, but the profits are meant to fund social development activities. As such, these can be called non-dividend profit-making business. In principle, these can be examples of how business enterprises can be run successfully without the incentives of private profit motive. There should be, however, safeguards that the NGO's access to subsidised funds does not distort market competition. The problem is that there is no appropriate regulatory framework for such businesses, since the legal reforms have not quite kept up with the rapid growth of the NGO sector in Bangladesh.

In principle, it is highly desirable that profit motive of private business is combined with a sense of social responsibility, provided that this does not create distortions in the functioning of the market economy. Amartya Sen has lamented the singular focus of economics on the 'profit motive'. Fortunately, he says, the real world is richer in human qualities than described in economics textbooks. When we assume that we can keep the profit-motivated private business from doing harm to the society and environment only by enforcing a regulatory framework ('governance' again), that may sound pretty dismal. So let me quote from Adam Smith, who first provided the theoretical framework for capitalism and the free market economy based on the 'invisible hand' of the market and the self-interested behaviour of individuals. He said: 'Man... ought to regard himself not as something separated and detached, but as a citizen of the world, a member of the vast commonwealth of nature... and to the interest of this great community, he ought at all times to be willing that his own little interest should be sacrificed.'

Notice that he talked not only of self-sacrifice, but also about the preservation of nature and the welfare of the global community. It is time to go back to this neglected part of Adam Smith's ideas.

## Towards a Development Strategy

The BEA public lecture by Professor Jeffrey Sachs was titled 'strategies for economic growth in the new global economy'. While introducing him, I described him as a proponent of the idea that global capitalism is potentially the most promising institutional arrangement for achieving economic convergence between rich and poor regions of the world. I then reminded him that there were critics who believed that global capitalism is inherently unjust, inequitable and unsustainable and that, in countries like Bangladesh, there is a great deal of apprehension surrounding the ideas of economic globalisation. This I mentioned rather intentionally, since I knew that as a speaker Professor Sachs is at his best when provoked.

In the actual event, Professor Sachs spoke mostly about the various pitfalls of globalisation, ranging from the wrong policies of the rich countries (e.g. the rich countries are reluctant to reduce duties on the exports of poor countries and they are very good at talking debt relief, but not giving debt relief) to the need for global initiatives for helping the poor countries (e.g. there should be a global consortium for funding research on tropical agriculture and health) and the nature of risks and challenges faced by countries like Bangladesh. But the particular theme that I would like to pick from his discussion and elaborate in Bangladesh's context is the need for the government to formulate a proactive strategy for economic growth. In his own words: 'Economic growth does not take care of itself and market does not solve all the problems'. This coincides with my own view, discussed in the first volume of the *Independent Review of Bangladesh's Development*, that market-oriented reforms can be no substitute for having an appropriate development strategy.

Formulating a development strategy, which I have in mind, is quite

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different from merely producing the kind of 500-page five-year plan documents with which we are all too familiar. The earlier plans were mainly about allocations of public investments, with detailed production planning based on input-output-type planning models. Since directly-productive investments in agriculture and manufacturing now lie mostly in the domain of the private sector, it is not very meaningful to highlight quantitative investment and output targets for these sectors. But a planning framework (or call it a development strategy) will still be needed to provide a strategic vision of the country's development potential and for guiding public actions in that direction. The quantitative supply-demand projections will still be useful, if not for determining the required level of public investment, but for identifying the supply or demand-side constraints and for formulating public policies accordingly. A strategic vision of development is also necessary to guide public investments in infrastructure and human resource development, which are complementary to policies for fostering private investment.

Although the development potential of the Bangladeshi economy remains largely unrealised, our achievements in some respects are not inconsequential. Among about 100 low to low-middle income countries, Bangladesh ranks in the top 10 per cent in terms of export and GDP growth over the last 10-15 years. The population growth rate has also slowed down considerably. Yet, the poverty incidence remains one of the highest in the world and the envisaged diversification of the industrial and export base has yet to take place. There are, of course, many countries, mostly in Sub-Saharan Africa, which have performed far worse. These countries are characterised as being 'distant', geographically and economically, from the global economic centres; they have a high debt burden, their populations are increasing at high rates with rising incidence of disease and malnutrition, their exports are undiversified and subject to deteriorating terms of trade, and they are torn by political instability, social strife and conflicts. In our rear-view mirror, we can still see this scenario not far behind us, and this is a scenario that we must not fall back into.

Unless we devise far-sighted strategies, there is a risk of our getting increasingly marginalised in the global flows of commodities, technology, information and capital. We shall face stiff competition in ready-made garment export after 2004. One option is to set up backward linkage industries for the RMG sector to the extent that we have long-run comparative advantage in those industries. There may be other options as well, such as establishing warehouses of imported cloth to reduce the time lag in between the placement of orders and export delivery. In any case, we have to go for export diversification, since

there is ample evidence that relying on one or two export items can be extremely risky and can lead to sudden and severe deterioration in the terms of trade. To battle distance and remain competitive, we have to pay serious attention to ports, telecommunications, and other logistics. In particular, we need to have inexpensive access to the global Internet backbone.

A well-functioning seaport is the key to export development and better integration with the global market. All landlocked countries outside Europe happen to be very poor. (Botswana, which has diamond mines, is perhaps the only exception.) It is an irony that we have to sometimes suffer from the disadvantage of being landlocked because of work stoppages in the Chittagong port. The Chittagong port has earned the reputation of being one of the most inefficient ports in the world, not so much because of lack of physical facilities, but because of the unhealthy politics of trade unions. It has been said in a recent seminar that about 50 individuals control the functioning of the port through their influence on the unions. Political leadership must recognise that, even if politics for some has become a business, we must at the minimum keep certain strategic sectors of the economy from the grip of such politics. If nothing else works, society will benefit by bribing those 50 individuals out of public funds in order to dissuade them from their destructive activities (provided they will not be replaced by another 50). I recognise that this is a thoroughly repugnant and immoral proposal, but it is based on cool rationality.

We have to also upgrade and modernise our institutions if we are to do business in the global market. A survey of potential foreign investors found that their lack of confidence in the efficiency of our judicial system to quickly dispense with commercial disputes is the foremost factor inhibiting investment in joint venture projects in Bangladesh. We need a credible and modern banking system that can connect us with the global financial markets. How can this be achieved when as high as 70 per cent of the officials in the nationalised commercial banks have been promoted from clerical positions instead of being directly recruited from qualified university graduates? In case of the recruitment of officers in Bangladesh Bank in the last 10 years, this proportion has been as high as about 90 per cent. This is not the way to improve our institutional capability to deal with the global economy, even though I am ready to argue for higher pay and better facilities for low-paid employees. Again, for devising and implementing the kind of development strategy that I have in mind, we need an economic technology that is well regarded for its competence and integrity. In this respect, our situation is deteriorating, while even many poor African countries have now caught us up from behind.

The technological gap between the rich and poor countries is even more striking than the gap in income per capita. Although we have the advantage of choosing from a wide range of technologies available in the global market, we need skills to adapt them to our requirements. For this we need workshop mechanics and craftsmen as much as we need highly trained researchers. Historians of the Industrial Revolution have noted that much of the productivity improvements resulted, not from the patented inventions associated with famous names, but from the cumulative effect of minor adjustments made by numerous nameless skilled mechanics. The RMG sector, in spite of all its success, is a dead-end so far technology dissemination is concerned. One adverse effect of import liberalisation in Bangladesh has been to stifle the growth of our domestic small engineering industries. This adverse effect has been discounted because of the rather small size of this sector and because the removal of duties on machinery imports has been a means of providing incentives for other industries. What has been overlooked is that the potential contribution of a domestic engineering industry cannot be measured only by the size of the industry.

## The Environment and Habitat

There is a unique aspect of Bangladesh's development perspective that is seldom noticed. In spite of the very low per capita income, GDP per square kilometre of land area in Bangladesh is one of the highest in the world; in this respect, Bangladesh is behind only the developed capitalist economies of West Europe and USA, and South Korea and Singapore among the developing countries. This high physical density of economic activities is the result of an extremely high population density. It is remarkable that such a density of economic activities has taken place in spite of an extremely low level of technological development, as reflected in the existing low levels of labour productivity, and the still dominant rural-agricultural nature of the economy. (True that the land is fertile, but it is also an unstable delta land that regularly gets flooded and provides the world's largest drainage system!) This is a measure of the enormous demands already made on the country's physical and environmental resources. The resulting stress will continue to intensify as Bangladesh strives to attain higher levels of per capita income for an increasing population by extracting more value-added from the limited physical resource base.

It is therefore not surprising that the tension between economic growth and environment protection has taken severe proportions in Bangladesh even before the economy has had a chance of experiencing much economic growth. The air pollution in the Dhaka city is already higher than in, say, Bangkok, Hong Kong or Jakarta, which are some of the cities with the filthiest air, and where the present level of pollution has resulted from decades of very high economic growth (associated with rapid increase of car ownership, air-polluting industries and high-rise buildings). Unlike in other developing countries, it is land, and not capital, that is the scarce factor of production in Bangladesh. Land prices in the Dhaka city is already comparable to those in London. One can get a clue from this as to why illegal land-grabbing has become increasingly so irresistible and why it takes so much civic activism to save (often without success) the city parks and lakes, open public spaces and even the river beds.

In the absence of a historical precedence of economic development taking place under such conditions, it is not easy to make projections, however tentative, about how the economy and the landscape will look like, say, 20 or 30 years from now. Where will the increasing population and the labour force be accommodated in terms of economic activities and in terms of physical habitation? How much land will remain available for crop production? What increasing numbers of the population can be accommodated in the existing cities before the urban infrastructure crumbles down? And, what patterns of economic growth and technological developments will allow higher standards of living in an environmentally sustainable way?

These questions must be answered in the context of a development strategy I mentioned earlier. One way is to go for solving problems as and when they become unbearable. But this will be at great social costs, because of irreversibility of many damages done and the time lags in getting results from corrective measures. The Dhaka city is already a victim of unplanned urban growth. Urban development experts have time and again stressed the urgency of undertaking immediate remedial measures and enforcing strict codes of urban planning. Innovative proposals have been made for economically viable resettlement of the slum dwellers. Investments for mass transport and for drainage and water supply must be undertaken in a planned way in order to avoid problems of unmanageable proportion at a later time.

In the countryside, as agricultural land shifts to other uses (to some extent it is inevitable), it is essential that incentives are created for the best use of scarce land and other natural resources. The present pattern of growth of rural dwellings in scattered isolated units is not sustainable. It will be too costly, if not impossible, to provide such settlements with access to roads and utilities (i.e. gas and electricity). The road density in Bangladesh is already highest in the world. Although most of these roads are of extremely low quality, nevertheless, these take up agricultural land and require costly maintenance. In spite of ambitious targets, only a small proportion of rural dwellings have been provided electricity. The indiscriminate felling of trees in village forests to meet fuel requirements is leading to an ecological disaster. Much of these problems can be solved if rural settlements grow in conglomerations, possibly around the so-called rural towns. The idea of such settlements has been there for some time under various names like compact townships, habitation centres, or rural growth centres. With proper incentives and infrastructure planning, such settlements can grow in a self-sustaining way, having access to employment and the amenities of modern living. The idea becomes more feasible as more people are finding employment in rural non-farm activities and do not have to therefore live near their agricultural land. This is a process that is already at work. It is the semi-urban areas rather than the urban municipal areas that have experienced the highest growth of population and employment. We need only to enhance the process in a planned and efficient way by providing the right kind of incentives. I leave it to the creative imaginations of my fellow professionals to fill in the gaps in this strategy.

## Looking Ahead

The world economic scenario is fast changing and there are both risks and opportunities. Never before, the global economy was characterised by so much poverty amidst so much plenty. Never before, the global community was confronted, at the same time, with so much prospects of technological breakthroughs and such grave dangers of environmental catastrophes. Never before was there such a stark conflict between the ideas of national sovereignty and globalism.

As a nation, we cannot afford to despair about our future. Lack of confidence about