

## Why Bangladesh invests less

In addition to dismantling or replacing the NSS with market-based instruments, comprehensive efforts/reforms would be needed to lower the interest rate structure and spread if Bangladesh wants to achieve higher levels of investment and growth like China and India.

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ECONOMIC theory stipulates that if a country wants to achieve higher economic growth it has to invest more. As investment increased in recent decades, Bangladesh's growth performance also improved, from 3.2% in the 1980s to 5.8% in the 2000s.

Despite these gains, Bangladesh is still investing (at 24.2% of GDP) much less than what it should. As a matter of fact, the economy cannot even invest what it saves domestically (29.2% of GDP). This column reviews the relationship between investment and growth in China, India and Bangladesh, and tries to identify why Bangladesh is not investing as much as it should.

Since the 1990s, China's real economic growth rate has averaged more than 9% while that of India was around 6% (Figure 1). The rapid growth in both China and India has been driven by high levels of investment (Figure 2).

The figures reveal that over the last three decades Bangladesh invested much less than the other two countries, and the recorded growth in Bangladesh was correspondingly lower. For all three countries, the data also show that as the rate of investment increased (India) or remained high in relation to GDP (China), so was their performance in terms of real GDP growth. What is the

secret behind China's and India's success in sustaining high levels of investment, and what is the lesson for Bangladesh from their experience?

Investment theory states that level of investment in a firm or economy is inversely related to level of interest rate. The lower the interest rate in real terms (nominal interest rate adjusted for inflation) the higher would be the level of investment. A review of the real lending rates of the three countries reveals that the rate in Bangladesh has been the highest since 1990, and the lowest in China (Figure 3).

The difference is even more pronounced in the case of nominal interest rates. In nominal terms, Bangladeshi investors had to pay 15% during 1990-2006, compared with 7% and 13%, respectively, in China and India. In real terms, Bangladeshi investors had to pay 5.3 and 2.8% age points more than their Chinese and Indian counterparts.

Certainly, this higher interest burden in real terms had a punishing impact on Bangladeshi entrepreneurs and can help explain the country's low level of investment.

In a recent, article Indian Reserve Bank Deputy Governor Rakesh Mohan blamed the Indian National Savings Schemes (NSS) for the relatively high interest rate structure in India. He observes that by offering very high

interest rate at 8.3%, the NSS is distorting the domestic interest rate structures and creating impediments to monetary policy operations. If the Indian Reserve Bank is voicing concern about the situation in India, we should be screaming about the situation in Bangladesh. Interest rates on Bangladesh NSS instruments are about 3.5% age points higher than their Indian counterparts (currently offering 8.3% interest).

Why is it important for the NSS interest rate structure to be market-based? Right now, NSS instruments offer risk-free interest rates ranging between 11.5 to 12.0%, with effectively no tax withholding and for the most part tax-free. Since commercial banks have to offer equivalent rates to be attractive to the depositors on their time deposits, the NSS rates effectively serve as the floor for the deposit interest rate structure in Bangladesh.

Since these rates are set administratively on an ad-hoc basis at high levels, monetary policies of Bangladesh Bank essentially have no effect on the structure of time deposit rates. If we want to reduce lending rates in Bangladesh, the current administrative basis for setting NSS rates must be replaced by a market-based system.

It is interesting to observe that the Indian government's successful financial sector reform has contributed to a significant reduction in the spread between lending and deposit rates (Figure 4).

Financial sector reforms in China, on the other hand, contributed to an increase in the spread but still remained below 4%. It is also widely believed that China's deliberate policy of keeping

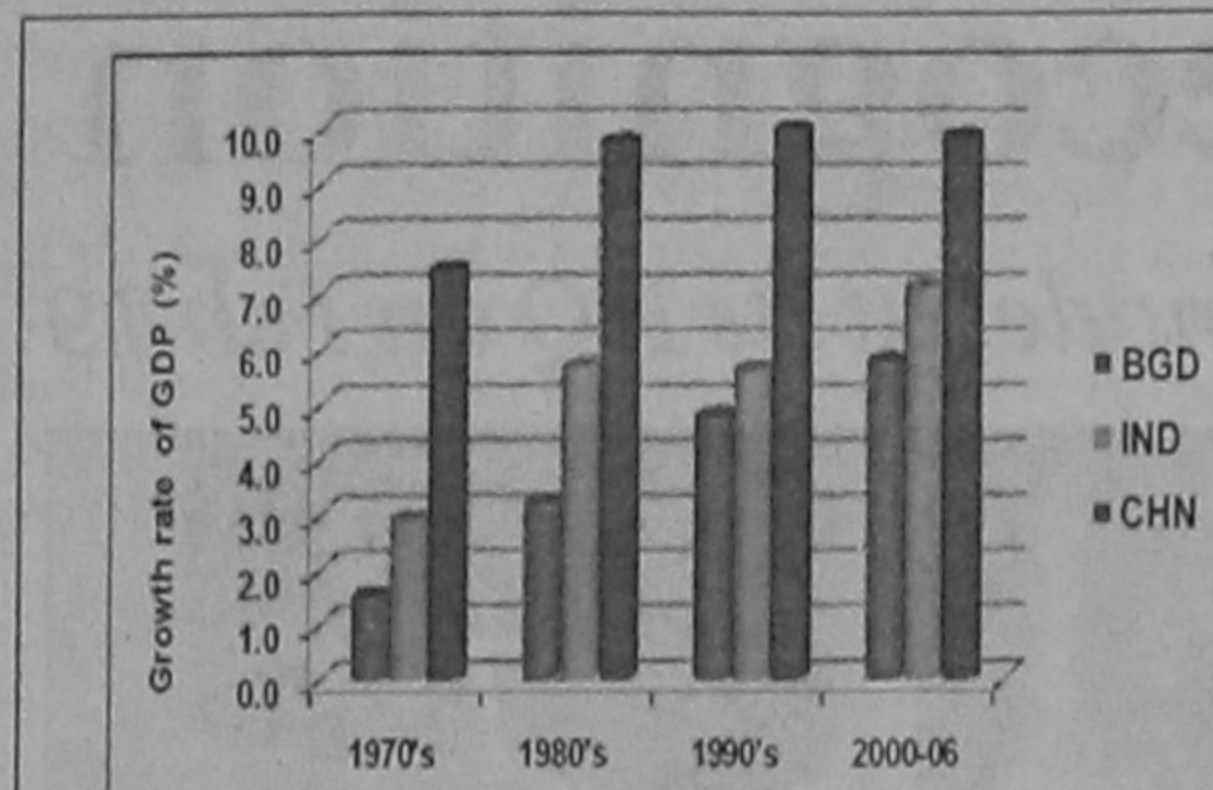


Figure 1: GDP Growth in Bangladesh, India and China

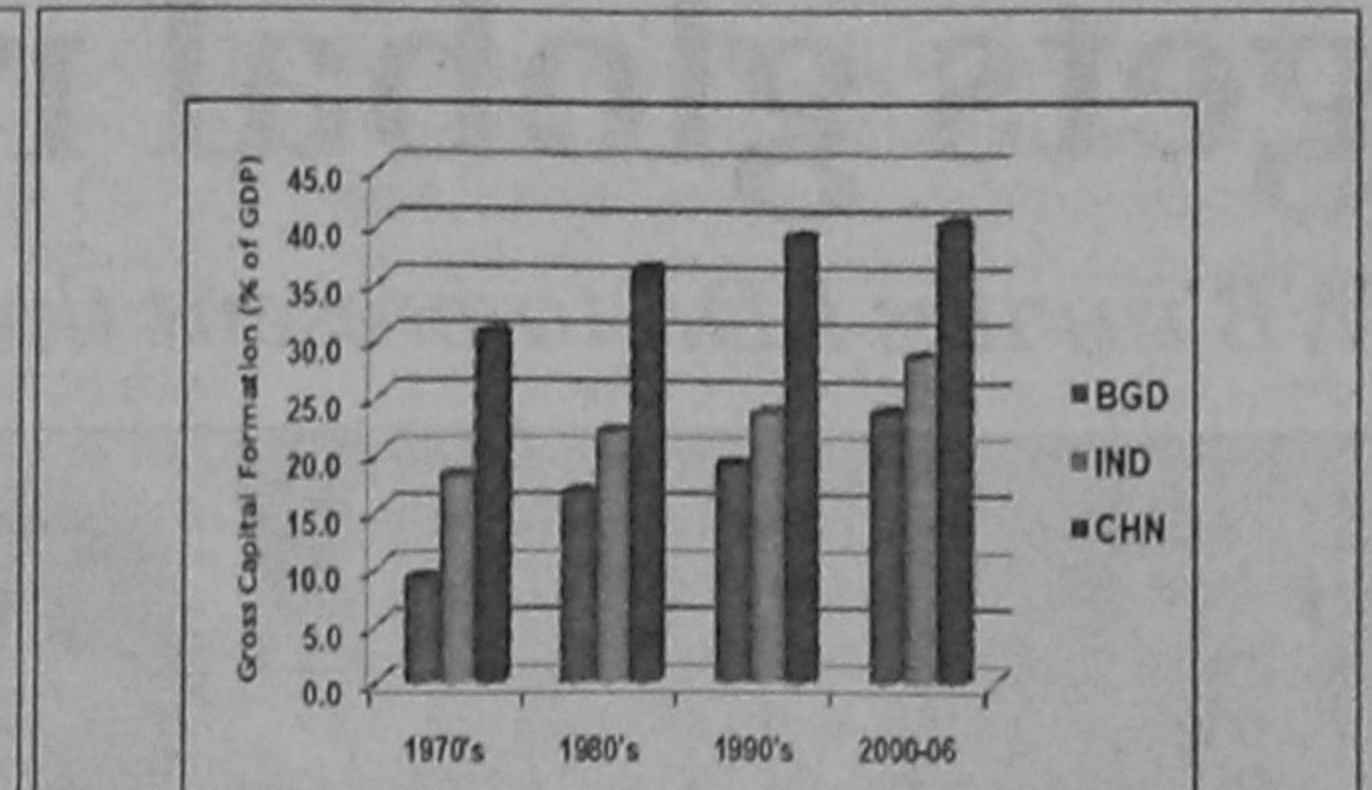


Figure 2: Investment Trend in Bangladesh, India and China

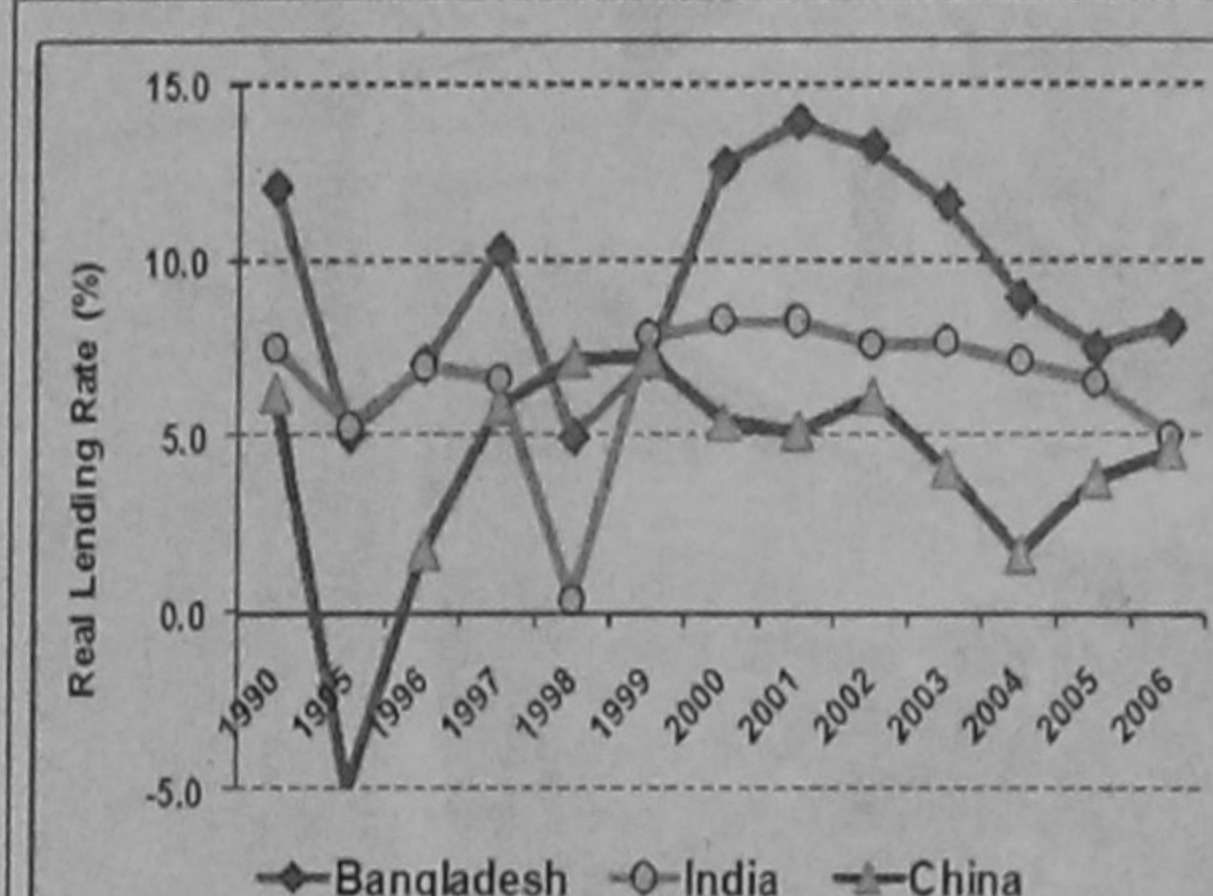


Figure 3: Real Lending Rates in Bangladesh, India & China

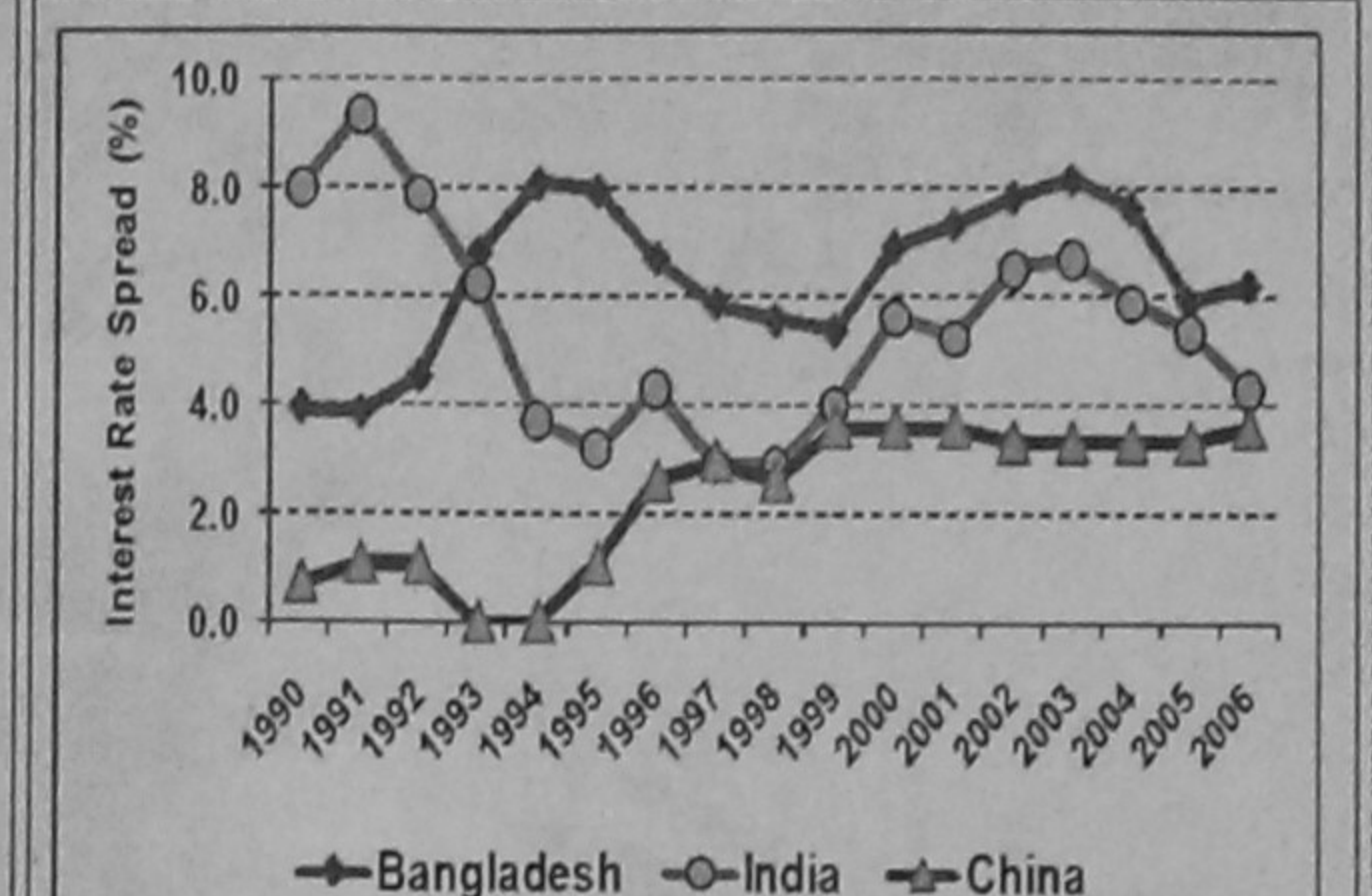


Figure 4: Interest Rate Spread in Bangladesh, India & China

price of capital low and maintaining the interest spread at a positive but moderate level has contributed to its unusually high investment rate.

In contrast, the incomplete financial reform in Bangladesh in the 1990s widened the spread from 4% in 1990 to the 6-8% range thereafter, which is well above the international norm.

The simple analysis presented in this piece very plainly helps identify the twin problems faced by Bangladesh in ves-

tors: (1) persistent high interest rates; and (2) the wide spread between lending and deposit rates.

The wide spread is attributable to market inefficiencies like high operating costs, lack of competition and the consequent high profits of the commercial banks, and relatively high loan loss and associated provisioning resulting from asymmetric information between borrowers and lending institutions (in part

reflecting inadequate credit information and collaterals).

In addition to dismantling or replacing the NSS with market-based instruments, comprehensive efforts/reforms would be needed to lower the interest rate structure and spread if Bangladesh wants to achieve higher levels of investment and growth like China and India.

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## Grappling over economic rescue

In the face of global complaints about the dangers of trade imbalances and the need for more domestic consumption, the Chinese government has unveiled a massive stimulus package. Thanks to heated debate in Caijing, a biweekly economic journal the idea of issuing consumption coupons has already been introduced in some of China's major cities.

XU SITAO

THE six month-old global financial crisis felled the first government this week -- of Iceland -- for its failure to cope with the crisis. In China, the government's efforts to respond to the domestic crisis of millions of job losses, and foreign pressure to stimulate its domestic demand, have triggered a new popular activism. Heated debate in both media and internet blogs over the best policies to help reform the economy marks a new phase.

Regardless of which method succeeds in stimulating Chinese economy and meeting the world's objection to China's rising trade surplus, the people taking ownership of policy would be good for everyone.

In the face of global complaints about the dangers of trade imbalances and the need for more domestic consumption, the Chinese government has unveiled a massive stimulus package. Thanks to heated debate in Caijing, a biweekly economic journal, and many others, the idea of issuing consumption coupons has already been introduced in some of China's major cities.

The debate underscores a nascent yet powerful trend of Chinese consumers taking a proprietary approach towards public finance. The issue is not whether the government issues a few hundred renminbi in coupons or not, but rather

that Chinese consumers are more critical of policy responses.

Analysts expect that China to be better prepared for the synchronised worldwide recession, thanks to its huge savings and relatively closed financial system -- meaning the country could maintain relatively stable economic growth while at the same time unlock private demand. Yet, the Chinese have decided to continue saving funds for the troubles that may lay ahead.

The government has also cut large interest rate and massive fiscal stimulus -- \$588 billion for 2009 to 2010. Yet the fiscal stimulus now underway has drawbacks. Capital-intensive projects are unlikely to create many jobs, and government-sponsored investments may force state banks to take on non-performing loans.

Similar coupon schemes were implemented in Japan, Korea and Taiwan. Caijing and others endorsed the idea of time-limited coupons for China. The economists surmised that ordinary mainland Chinese have greater needs for basic necessities and would spend more on consumption. The theory suggested that consumption coupons could get a bigger bang for the buck in China.

The analysts also considered coupons better than a tax cut, encouraging spending rather than saving.

Even as Caijing launched the debate, the municipal government of Chengdu in



Chinese returning to their villages after losing jobs. How to make them spend?

Sichuan issued gave RMB100, or \$15, to 380,000 low-income earners, a small step, but reflecting public consensus that greater subsidies should go to the needy. Since then, some of the major city governments issued coupons with expiration dates. Hangzhou quickly replicated Chengdu's move. Other cities offered innovative twists. For the Lunar New Year, Nanjin of Jiangsu gave RMB100m of tourism coupons to those who intend to travel for selected tourist sites during the first six months of the year.

Variations of consumption coupons could spread rapidly throughout the country, as local governments compete on GDP growth and foreign direct investment.

The objective of the coupons is to restore consumer confidence. To paraphrase Prime Minister Wen Jiabao: "Confidence is more valuable than gold." Yet the various subsidies in China linked to pur-

chases of cars and apartments introduced in recent months have yet to prove effective and have attracted unusual scorn, resistance compounded by fear of more job losses.

A columnist for Shanghai Daily News called it "grotesque for a government official to urge the public, most plebeians, to buy a particular product in the name of patriotism."

Even those who argue for consumption coupons air some reservations. Ideally, coupons should go to low-income earners, more vulnerable to economic hardship with little to save. But, creating socially fair criterion for the dispersion of a few hundred renminbi worth of consumption coupons is a tedious exercise, and the potential of administrative costs, abuse or corruption cannot be overlooked.

Coming months may prove that coupons are not the silver bullet for stimulating domestic demand in China. First of

all, the severe global economic crisis has hit hard the Pearl River Delta, China's powerhouse of exports.

According to Caijing's investigative report, more than 10 million migrant workers had to return to their villages early this year. The consumption coupons do not cover rural China. Beijing is correct to list job creation as a priority because Chinese peasants derive about 40% of their incomes from proceeds in factories.

Chinese consumers refuse to loosen their wallets, so it's unrealistic for the government to rely on consumption coupons to mitigate entrenched concerns about education and restraining, health care or income security for the aged.

There's also a subtle reason for most consumers to be skeptical about the consumption coupons. The reason behind such consumption coupons is implicitly based on the hypothesis that consumers could also anticipate tax cuts or other relief.

Yet the government has shown little signs of cutting taxes either for firms or individuals since the global credit crisis has emerged. Most consumers can't help but view any consumption coupons as short-term benefits to be paid by their future tax burdens, and a natural response among the insecure is increased savings.

Accompanying the lukewarm response to consumption coupons is passionate debate over the purpose, eligibility and monitoring of the scheme. Chinese consumers are taking more ownership in shaping economic policies where they can.

An unintended consequence of consumption coupons was a shift in focus of the stimulus from headline GDP growth and fiscal revenues to consumer demand. The debate has touched upon the transparency of distribution and

highlights consumer desires for greater understanding of government-mandated projects and more emphasis on social services rather than infrastructure. Indeed, investment in transport and power grid accounts for 45 percent of the well-touted stimulus package of \$585 billion to be spent between 2009 and 2010; health care and housing account for just 8 percent of the package.

The reality is that China has adequate fiscal resources to mitigate the misery of the urban poor and millions of migrant workers who lost their jobs. Beijing's challenge remains in ensuring quality growth that can only be achieved by more efficient allocation of savings.

China is open for grassroots reform -- remember, rural reform in 1978 was triggered by the decision of 18 farming families in Anhui province, one of the poorest provinces then, to secretly "privatise" land. Eventual official endorsement of the "unlawful" behaviour dismantled communes and triggered economic reform.

The consumption coupon debate has created a grassroots proprietary attitude towards public finance, particularly at the local level. The challenge for the government is how to come up with consumption-targeted boosting measures while keeping administrative costs and public concern about the purpose of economic growth in check.

Bottom-up changes are often more lasting. In planning measures to boost demand, Beijing could learn more from the savvy of ordinary Chinese and their response to economic policies than the expert advice from well-intentioned foreigners.

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## World's least original hero storms airport



ONE million new books are set to be printed globally this year. But most will come from Western countries, with almost 400,000 from just two: the UK and the US.

"What hope is there for creative people in Asia?" sighed a young author with whom I shared these figures.

I told her that the lack of books from Asia was good news for people like her. Asian tales are rare and unusual. In contrast, Western stories are often extremely predictable. To prove my point, I went out and bought the latest big-selling thriller at the airport. The Whole Truth by David

Baldacci (who has written some excellent books in the past) is probably stacked high in every major international airport on the planet.

Here's the story, so you can make up your own mind how original it is.

Once there was a law enforcement guy called Shaw. He was good-hearted but a bit of a maverick. He was handsome and tall. "Rugged is how most people would describe his features, ruggedly handsome," the author tells us.

Shaw goes to Holland and speaks the local language to a surprised immigration officer. The officer, who is 6 feet 2 inches (1.85m) tall and towers over most people, says: "You speak Dutch?" Shaw, who is 6 feet 5 inches (1.95m) tall and towers over him, replies: "Doesn't everyone?" Shaw then speaks to an Iranian in the Farsi language before switching to "a Chinese dialect from a tiny province in the south of the communist country". So now we know that

Shaw is handsome, tall AND clever.

Shaw meets a woman who is "young and beautiful with raven hair". She says: "You're very good-looking. And large!" (Now that line rang true. Strange women are ALWAYS saying that to me.)

But Shaw repels her, saying, "I'm married." So now we know that Shaw is handsome, tall, clever AND principled.

As the action heats up, we find Shaw has an amazing ability to get into battles with groups of villains and single-handedly defeat all of them.

At this point, I was thinking that Shaw was the least believable fictional character I had ever encountered, Spongebob Squarepants and the Hindu "cow which gave birth to the world" NOT excepted.

But I was wrong. For the author then introduced me to Shaw's woman, Anna. "The love of his life was fun-loving in many ways, emotional and romantic, but she also possessed an IQ far to the



"And they lived happily ever after. Or so it would seem -- after they were forced to sign a nondisclosure agreement."

north of genius level: brains and beauty." Anna had "long, elegantly formed legs" and "could speak fifteen languages at last count and all of them like a native."

Shaw decides that he is going to give up being an action hero and settle down to a quiet domestic life with Anna. At this point, the reader knows that if this is the most predictable story ever written, Anna will be blown to bits.

Anna is then blown to bits. I said to the young Asian author: "So there's your challenge. Can you think of a more original story than that?"

She replied: "It wouldn't be humanly possible to think of a less original one." Too true. One character in the book was shot at but later "found the flattened bullet in her hair". I can only imagine that her head must have been as thick as Mr Baldacci thinks his readers' heads are.

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