Confounding the pundits?

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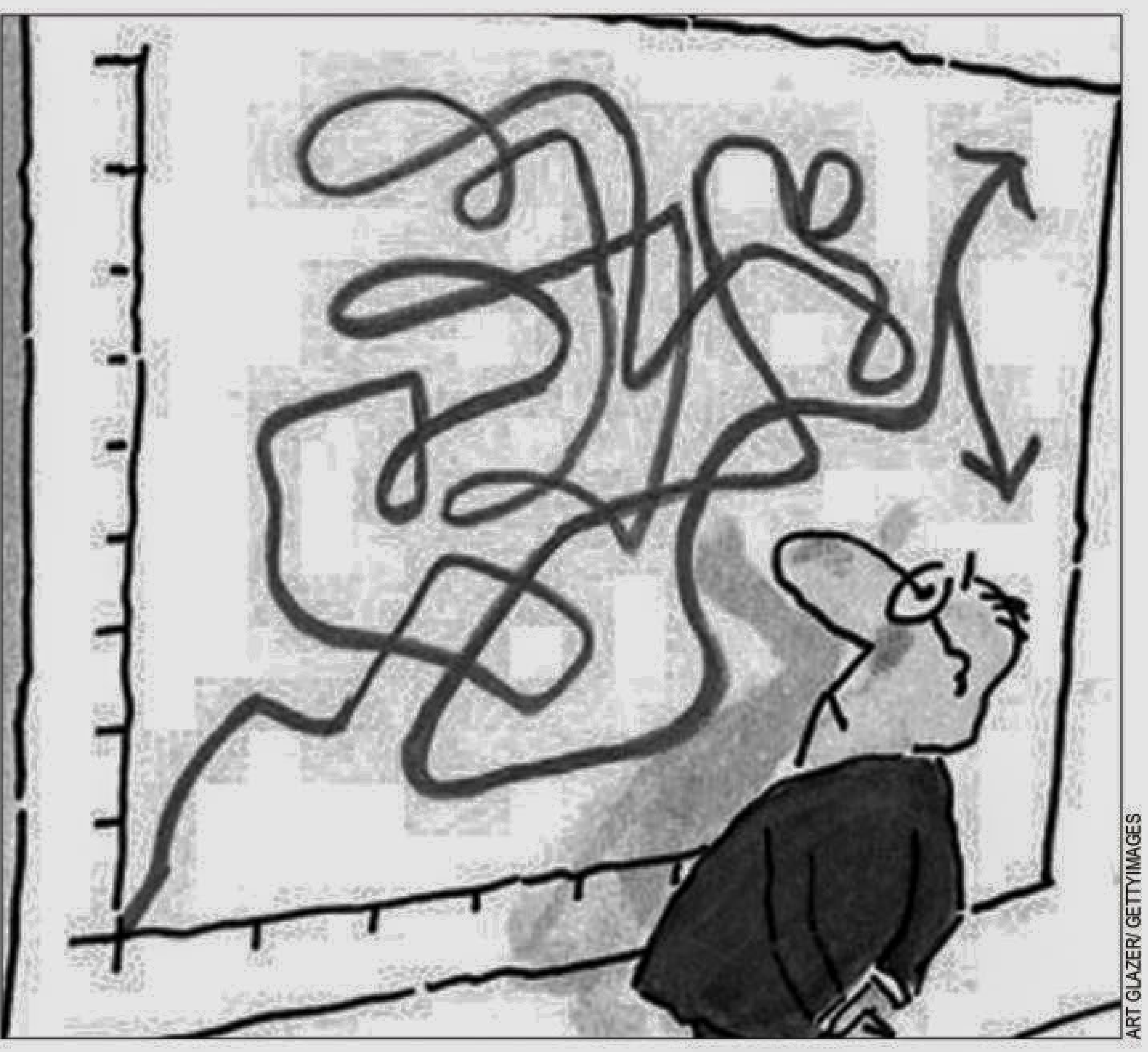
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SADIQ AHMED

STUDENTS of economics will recall the two-gap theory of development from their courses on growth and development. The genesis of the theory, where economic growth is driven by investment and constrained by saving, lies in the work of economists Sir Roy Harrod of the UK and Evsy Domar of the USA.

Other development economists, including Hollis Chenery and Alan Strout, extended the Harrod-Domar growth model to a two-gap development model where growth and development are initially constrained by a saving deficit over required investment (the saving gap), and subsequently by a foreign exchange gap whereby required imports are constrained by inadequate export earnings.

The connection between the two-gaps is that while investment drives growth, much of the required capital goods cannot be locally produced due to low level of development and, as such, they need to be imported. Without adequate exports, which are themselves constrained by low domestic capacities, the required volume of imports underlying the investment path is not financeable. By implication, the two gaps can be reconciled by foreign capital flows (foreign aid and direct foreign investment) in amounts that meet the larger constraint.

Over the 1960-80 period, lots of research focused on empirical verification, refinements, modifications and extensions of the two-gap model. While development theory has advanced since then, the basic presumption that low domestic saving or weak import capacity (poor export performance) could constrain development has prevailed over the years.

When Bangladesh started its development journey in 1972, it also suffered from these constraints. But over the years things have changed fairly dramatically. Today, Bangladesh has a surplus of saving over investment (8 percent of GDP according to national accounts data) and by implication a surplus in the current account of the balance of payments (3 percent of GDP according to Bangladesh Bank data).

By definition, the two gaps must match -- the lack of which is a statistical error. The current account balance is a relatively more accurate indicator of the saving-investment surplus. The larger surplus in the national account is most likely a reflection of underestimation of consumption or investment, or both.

Despite this statistical problem, a surplus in the current account is a remarkable result for a country that is still very poor (40 percent poverty rate) and has low income (around $700 per capita). What explains this dichotomy? Does the Bangladesh experience confound the pundits that resources are not a constraint to growth?

Bangladesh's growth rate has increased steadily over the past 4 decades, rising from 3 percent per annum in the 1970s to around 6 percent in the 2000s. Much of this growth was financed by rising saving and investment rates. Thus, the national saving rate expanded from 4 percent of GDP in the mid-1970s to 32 percent in 2009. The investment rate grew from 6 percent of GDP to 24 percent over the same period.

Commensurate with this, the export (including goods and services and transfers) to GDP ratio surged from 10 percent to 31 percent. The surge in export earnings more than offset the rising imports (goods and services), which expanded from 18 percent of GDP to 28 percent. These outcomes are welcome, and give some reason for Bangladesh to celebrate. But they also reflect a major development challenge that is not yet well recognised by the Bangladeshi policy makers.

With a poverty rate of 40 percent, per capita GDP of only $700 and 80 percent labour force engaged in low-productivity informal activities, there is no room for complacency. The opportunity provided by a hospitable macroeconomic environment in terms of a surplus in the nation's current account is not being used well to push for a higher growth rate.

There is no question that productivity levels are low and a higher growth rate can be achieved with more efficient use of resources. Indeed, formal analysis of total factor productivity suggests that past growth in Bangladesh has mostly been driven by factor accumulation with very little by way of growth in total factor productivity.

Yet, as the experiences of the East Asian economies and India show, the 24 percent investment rate in Bangladesh compares poorly with the 35-40 percent investment rates in these more dynamic economies. As a result, growth rates in Bangladesh are much lower than in these economies. So, the inability to convert the higher saving rates into a higher rate of investment is a source of concern rather than a reason to celebrate.

One does not need to be a development expert to realise that the investment needs of Bangladesh are large. Much of the infrastructure is rundown and inadequate. Lack of electric power and primary energy is threatening to choke off growth and citizens' welfare.

Huge investments are needed to upgrade the transport network at all levels. Massive investments are also needed to upgrade the labour force through education, health and training programs. Large investments are needed in the manufacturing sector to create good jobs.

One might rightly ask that when investment needs are massive, how does one explain the substantial unused savings? More research is needed to fully answer this question. At this time I have a few hypotheses based on my understanding of what is happening in Bangladesh presently.

The main variable explaining the surplus in the saving and the current account is remittance. The rapid surge in remittances has caused a sharp increase in the foreign currency reserves of the country. The domestic currency has mostly gone into the real estate and stock markets, heating up both these activities and sending the respective prices through the roof.

So, to find out why the surplus saving is not going into productive investments and is instead creating an asset market bubble, one needs to look at the incentive structure, the policy framework for investment, the financial sector, and at the public finances where resources are most needed for investment.

The government's tax policies favour ownership of land, land-based property and stocks over investments in manufacturing and infrastructure. The perceived rate of return on these assets in terms of capital gains through rapid asset price acceleration is far in excess of any imagined competing rate of return from investment in manufacturing or infrastructure.

Capital gains on assets are rarely taxed. Also, wealth taxes on property and income taxes on property income escape with a very light tax burden. Compared to this the relative tax burden on manufacturing and infrastructure is considerably higher.

Second, the overall investment climate for domestic and foreign investment remains constrained in a variety of ways, including regulatory restrictions, high transaction costs, shortage of critical inputs such as power, etc.

Third, the financial sector is still not well-developed and diversified. There is hardly much scope for getting long-term finance from domestic sources for funding long gestation investments in infrastructure. The stock and bond markets are very thin. When rising stock prices are based on economic fundamentals, this is a positive development indicating growing investor confidence in stocks and providing alternative financing opportunities for productive investments.

But the recent stock market frenzy in Bangladesh is more a reflection of excess demand and speculative behaviour fueled by excessive liquidity, hopes of windfall gains, inadequate information about true value and risks, and a very thin market.

So although existing blue-chip enterprises may make a killing through their initial market offerings in this frenzied market, over the longer-term, as the market adjusts to more normal price levels, the resulting losses for many individual investors will likely dampen confidence and the healthy growth of the stock market. There are allegations of considerable manipulation of stock prices by a few influential players, making this a highly distorted and non-competitive market.

Fourth, due to the gap between the social and private rates of return in many of the human development and infrastructure investments, these activities need to be publicly funded. Over the years, public investment in Bangladesh has been sliding as a share of GDP, partly due to implementation capacity constraints but also due to financing constraints. Poor public resource mobilisation limits the ability to convert private savings into public investment funds.

Both these constraints could be relieved through a public-private partnership (PPP) initiative. This is constrained by inappropriate policy framework in terms of legal issues, incentives, risk-sharing, financing instruments and dispute resolution mechanism.

Resolution of the issues and challenges constraining investment is not impossible. These can be addressed if there is strong political will and commitment. Bangladesh needs to dispel any sense of complacency and move full speed with needed reforms in the taxation policy, public expenditure management, financial sector reforms, investment climate, and PPP framework to take full advantage of the prevailing favourable macroeconomic environment and convert the saving surplus to financing the investment needs of a more rapid rate of growth.

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Asean-India talks fire Thai enthusiasm

PETCHANET PRATRUANGKRAI, *The Nation (Thailand)*

WITH continuing growth of the Indian economy, Thailand is planning to forge a resilient partnership in trade and investment cooperation with the revival next year of the Asean-India Business Council (AIBC), after its deliberations have been suspended for nearly four years.

The move is part of closer cooperation between Asean and India following the signing of their free-trade agreement last August.

Trade Negotiations Department deputy director-general Noppadon Sarawasi said the private sector had played a significant role in driving trade and investment between Asean and India. Reviving the AIBC will lead to better opportunities for increasing trade and investment on both sides.

The seventh Asean-India Summit, held in October last year, agreed on the revival of the AIBC and fixed a date for its next meeting -- one day before the Asean-India Business Summit in New Delhi next year. Thereafter, meetings will be held twice a year.

"The private meeting of the AIBC is an efficiency mechanism to strengthen cooperation between the government and private sectors. Private participation will help to eliminate any barriers to trade and investment, while addressing any particular need from the private sectors," Noppadon said.

To motivate private-sector participation, the department has asked the country's most powerful private organisations -- the Federation of Thai Industries (FTI), the Board of Trade of Thailand and the Thai Bankers' Association -- to send two representatives each to next year's meeting.

The FTI's principal representative will be Boonpeng Santiwattanatam, a federation committee member concerned with Thai-India, Asean-India, and Bimstec (Bay of Bengal Initiative for Multisectoral Technical and Economic Cooperation) free-trade agreement affairs.

He said the private sector was already working on the detail of the negotiation issues, which would focus on investment.

At present, Asean and India are negotiating the liberalisation of investment, and talks are expected to be finalised this year.

Asean and India have already implemented liberalisation of trade in goods since the signing of their free-trade agreement last year. They are expected to reach a conclusion on investment this year and then on services later, turning the FTA into a more comprehensive pact, Boonpeng said.

However, due to possible effects on the competitiveness of Thai enterprises arising from investment liberalisation, this issue will be one of the major points raised at the AIBC talks, he said.

Potential areas of investment are agriculture, goods manufacturing, healthcare and construction, while sectors in Thailand concerned about investment liberalisation include steel, automobiles and pharmaceuticals.

Moreover, Thai businessmen want to see progress towards the Thailand-India Free-Trade Agreement, following implementation of the associated early-harvest program.

Boonpeng said bilateral talks between Thailand and India should also be addressed because such talks should benefit Thai traders and investors more than the regional pact.

The AIBC meeting aims to provide a private-sector perspective and feedback on the broadening and deepening economic ties between Asean and India.

It also aims to identify priority areas for enhancing economic cooperation between Asean and India by facilitating, coordinating and promoting private-sector participation.

Thailand has set an ambitious target of boosting two-way trade with India to US$7.5 billion (Bt242 billion) this year, from $6 billion last year. India is Thailand's 10th-largest export market. The value of exports to India last year reached $3.22 billion. In the first two months of this year, exports to India jumped by 114.02 percent year on year to $777.86 million.

Bilateral trade is expected to exceed $10 billion by 2012.

Instilling confidence

During the past 35 years or so, hundreds of mid-level and senior public servants had fallen victim to this Act. The repeal of the act will help instill confidence and neutrality in the senior public servants.

M. ABDUL LATIF MONDAL

WHILE addressing the inaugural session of the 17th biennial conference of Bangladesh Economic Association at Osmani Memorial auditorium in Dhaka city on April 8, Prime Minister Sheikh Hasina said that her government was still trying to bring back confidence among the public servants that had been lost during immediate past army-backed caretaker regime, and added that hectic day and night labour of her government could not bring any good for the people just for lack of confidence among the public servants.

She alleged that the caretaker government was engaged in absurd works in the name of eradicating corruption. The stalemate, fear and panic created by the last caretaker government still persisted, she said, adding that her government would remove those obstacles in the near future.

A public officer is a twenty-four hour servant of the republic. Till the mid-eighties, the defunct Bureau of Anti-corruption (BAC) had to have clearance from a high-powered committee headed by the cabinet secretary for formally instituting a case against a Class I officer.

In the nineties, the government issued a circular, which said that clearance from the Prime Minister's Office would be required for instituting cases against mid-level and senior officers by the BAC. With the establishment of the Anti-Corruption Commission (ACC) in late 2004, this requirement was done away with.

More importantly, there are disciplinary and appeal rules for drawing proceedings against public servants for offences like inefficiency, desertion, misconduct and corruption. If an accused is found guilty after proper inquiry, the authority may impose on him a penalty that ranges between censure and dismissal from service. Hundreds of officials have been punished under these rules. If deemed necessary, the authority may also refer a case to the anti-corruption watchdog for investigation and follow up action.

During the period of the last caretaker government, the ACC instituted cases against scores of public servants on various charges of corruption and irregularities. Many of them, including secretaries to the government, were put behind bars. This created panic among the public servants, particularly among the senior bureaucrats, which led to loss of initiative and dynamism in their official work.

A two-time chief executive of the government, Sheikh Hasina could realise the gravity of the situation after coming to power in January 2009. She has more than once asked the senior bureaucrats to work sincerely without any fear, and assured them protection. This is because of the fact that she is well aware of the important role of the public servants for the success of the government.

They execute policies embodied in existing legislation, formulate new policies to meet the requirement of time and place them for approval of the government, develop development programs and execute them after approval of the appropriate authority, manage international relations, carry on research on commercial and economic policies, manage law and order and perform all other functions relating to day-to-day administration of the government.

Instilling confidence among the public servants, particularly among the mid-level and senior bureaucrats, will require a number of measures. It is known that the committee constituted by the government for amending the ACC law has made a recommendation for reintroducing the system of prior approval of the government for taking up cases of corruption against government officials. The main logic apparently behind this proposal is a slow-down in the administration for fear of being harassed by getting implicated in corruption cases.

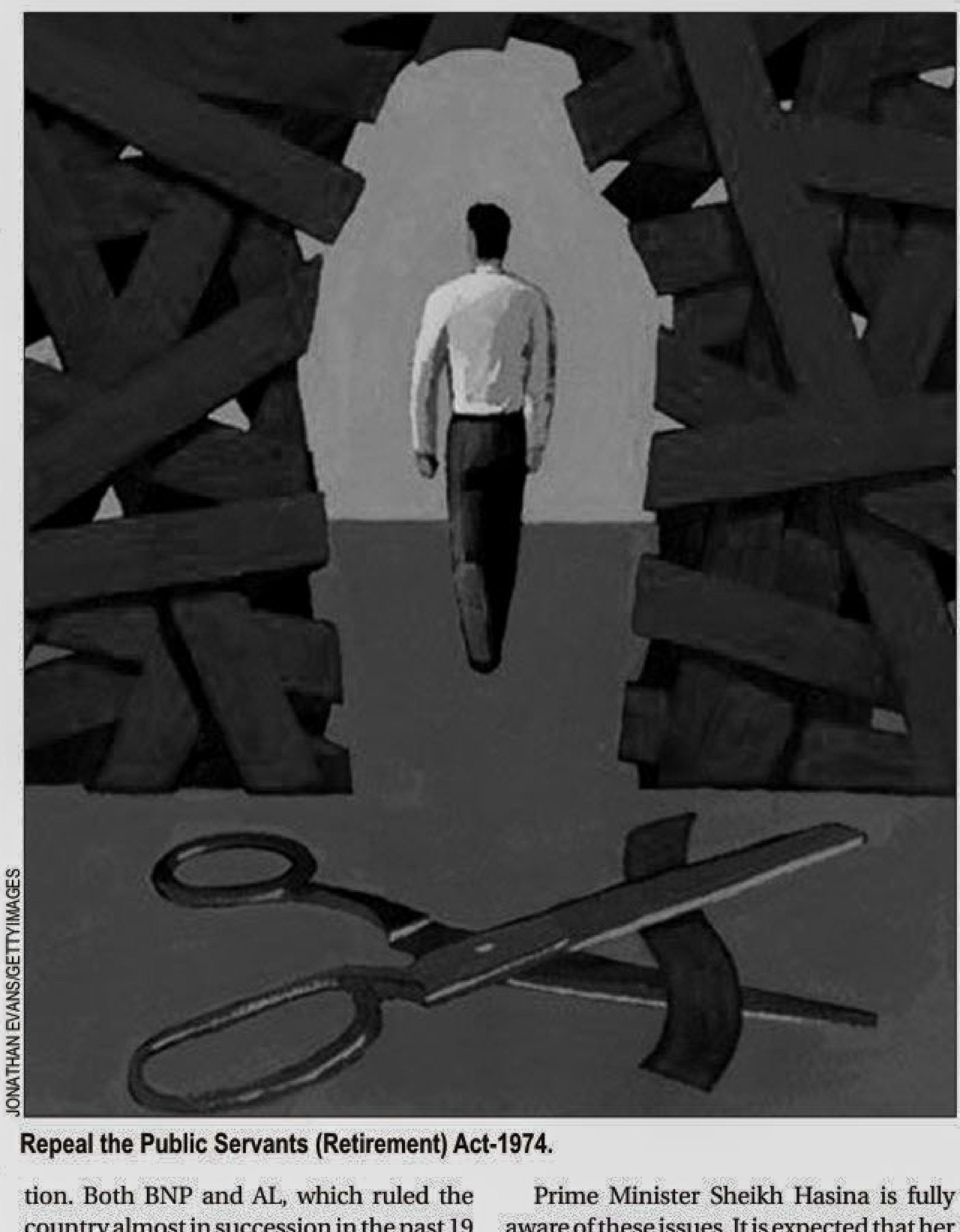
But, civil society members and the media have criticised this move. They argue that the reconstitution of the ACC by the post 1/11 caretaker government and amendments made to the Act-2004 provided the ACC some degree of dynamism and vibrancy, aiming at making corruption a punishable offence and challenging the culture of impunity. We must find a way to ensure that officials "working in good faith" do not suffer, and corrupt officials do not escape punishment.

Second, under the defunct Rules of Business (ROB)-1975, the minister-in-charge of a ministry was responsible for policy matters concerning his ministry, and implementation thereof. The secretary was the official head of the ministry/division. The ROB-1996 formulated by the then-AL government added that "all business allocated to a ministry/ division under Schedule I of these rules shall be disposed of by, or under the general or special directions of the minister-in-charge." The status of the secretary as the official head was abolished.

The above addition and amendment means that hardly any case can be disposed of at the level of the secretary of the ministry/division, not to speak of a level below him. The authority that the secretaries of ministries/divisions enjoyed prior to 1996 has to be restored to the maximum extent possible in the interest of bringing back their confidence and expediting disposal of work.

Third, the Public Servants (Retirement) Act-1974 empowers the government to retire a public servant without assigning any reason on his/her completion of 25 years of service. This act hangs like the Sword of Damocles over the heads of the mid-level and senior public servants. During the past 35 years or so, hundreds of mid-level and senior public servants had fallen victim to this Act. The repeal of the act will help instill confidence and neutrality in the senior public servants.

Last but not the least, politicisation of bureaucracy since the return to parliamentary democracy in 1991 has been a distinguishing feature of the administration. Both BNP and AL, which ruled the country almost in succession in the past 19 years, found politicisation of administration to their advantage. The division of the bureaucrats along party lines has adversely affected the neutrality in the administration. Good governance has become the victim.


JONATHAN EVANS/GETTYIMAGES

Repeal the Public Servants (Retirement) Act-1974.

Prime Minister Sheikh Hasina is fully aware of these issues. It is expected that her government will pay due attention to them in order to bring dynamism in the administration and establish good governance.

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