ASIA DEMOCRACY NETWORK

SYDNEY POLICY & ANALYSIS CENTRE

Briefing Paper #2 on

Democracy in Bangladesh:

Challenges for sustainable growth, development and democracy in Bangladesh

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Background

Bangladesh’s economy has been experiencing a tumultuous phase since 2020 due to a host of challenges. The country's foreign exchange reserve has fallen by around 60% in less than two years, forcing the government to restrict imports.

The import restrictions have impacted the lives of Bangladeshis in multiple ways.

Inflation has been hovering around 9% for more than a year due to the shortage of supplies in the market and the dysfunctional supply chain. The lack of required fuel caused power plants and industries to function in limited capacities, impacting overall economic growth. In recent months, export growth has seen a decline, and the foreign exchange reserve has become largely dependent on remittances sent by Bangladeshis working abroad.

Over the longer term, Bangladesh has not been able to diversify its export basket and is highly reliant on the ready-made garments (RMG) sector, which contributes 85% of the total exports. Nor has the country managed to attract sufficient foreign direct investments, which is reflected in the low FDI-to-GDP ratio.

On the other hand, Bangladesh's GINI coefficient is the highest in its history, and the last BBS survey concluded that the richest 10% of the country now earns 40.9% of the country's total income. The visibly widening inequality is raising concerns about the fairness of economic growth’s distribution.

Experts suggest fiscal mismanagement and poor governance are the proximate causes behind these economic woes. These causes themselves are manifestations of a far deeper problem of lack of accountability, a core component of democracy.

In this context, the second episode of the bimonthly webinar series on Bangladesh by Asia Democracy Network (ADN) and Sydney Policy and Analysis Centre (SPAC) was held on June 4, 2024. The participants discussed the economic challenges of Bangladesh, the possible policies and actions for the upgradation of the economy, how the economic growth can be more sustainable and equitable and the need for accountability and democracy to ensure that.

This brief provides a summary of the discussion.

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1. Outline and the Discussants

The webinar was divided into four segments based on the types of economic and governance challenges in Bangladesh: (i) the current economic challenges, (ii) medium-term structural challenges, (iii) broader social and human development challenges, and (iv) whether the fraying democracy has a role in the recent economic challenges.

Three experts with decades of experience joined the webinar:

- **Dr Fahmida Khatun**, the Executive Director of Bangladesh's eminent policy think tank Centre for Policy Dialogue (CPD)
- **Dr Syed Akhtar Mahmood**, an economist who has worked at the World Bank Group and
- **Professor Naomi Hossain** from the Department of Development Studies at the SOAS University of London.

Jyoti Rahman, Director – International Policy of SPAC, moderated the webinar. **Ichal Supriadi**, Secretary General of the Asia Democracy Network, delivered the opening remarks.

The 90-minute session started at GMT 1200.

2. Key discussion points

2.1) Current economic challenges

Bangladesh is under significant stress due to both external and internal factors. External factors include the COVID-19 pandemic and the Ukraine War, while internal factors include fiscal mismanagement, imprudent policy implementation, failure to implement the required reforms, and poor governance.

These factors have impacted the country's macroeconomic stability in several ways. Despite stable economic growth in the last several decades prior to the pandemic, Bangladesh's revenue mobilisation has been poor, with a low tax-to-GDP ratio of less than 10%. As a result, in the recent constrained fiscal environment, the government has been dependent on borrowing from commercial banks to fund the budget deficit, creating a tightened liquidity situation in the banks.

Meanwhile, foreign exchange reserves have depleted significantly, forcing the government to restrict imports to manage the balance of payment issues. This is also linked to the challenges of energy and power and high external debt. Inflation rose after imposing restrictions on imports curbed the supply of essentials, including fuel. For almost 2 years, the average inflation has been around 9-10%, according to the state-run statistics agency BBS, and the price of some essentials grew by 15% to 60% within a year.

The government often overlooks many other important economic indicators due to its myopic focus on GDP growth. Thanks to the IMF's recommendation to release GDP data every quarter, economists in Bangladesh now have a clearer understanding of real growth, which shows that GDP growth has been weakening in the last couple of years. According to the BBS's provisional estimates in the 2023-24 fiscal year, the GDP growth is expected to be 5.8%, while the government's target was to achieve 7.5% growth. The World Bank, IMF and ADB have projected an even slower rate, ranging from 5.6% to 6%.

Bangladesh's private sector investment growth has not been satisfactory, and the investment-to-GDP ratio has declined recently. Though investments and economic growth usually tend to produce more jobs, not enough employment has been created in Bangladesh, and the employment elasticity of GDP is low. Most of the jobs created have been in informal sectors, creating concerns about the growth in decent employment.

Several policy issues are contributing to the current challenges, including expansionary monetary policy at a time when most other countries in the world followed contractionary monetary policy to reduce inflationary pressure. The central bank's cap on the interest rate for lending at 9% and for savings at 6% made the money cheap when the country faced high inflation. The Bangladesh Bank later implemented a new method for determining the interest rate, but it was also not a policy driven by the market, so the challenge persisted. Following advice from the IMF recently, they removed the cap on interest rates, but the problems caused by the previous policies still exist.

Another key challenge is the conflicts and contradictions between different policies. For instance, although monetary policy is now contractionary, fiscal policy remains expansionary. The government has not shown any signs of reducing its expenses or operating costs, and administrative costs remain almost unchanged. As a consequence, one policy is disrupting another. A similar conflict in policies was observed in the measures taken to curb inflation. The delay in depreciating Bangladeshi currency taka also negatively impacted the market and foreign exchange reserves.

Non-performing loans have increased significantly over the last ten years. According to the Bangladesh Bank's Financial Stability Report 2022, the total gross non-performing loans, outstanding balances written off, and rescheduled loans amount to 3779.22 billion takas, around 25% of the total loans. The central bank's inconsistent policy implementation in managing risky loans also sent a wrong signal to the market, complicating the situation further.

Bangladesh's total external debt, including both public and private debt, has crossed the $100 billion mark. With a debt-GDP ratio of 21.6%, the country's debt level is relatively low compared to many other nations, but the crucial concern lies in the country's capacity to service this debt. Given the low tax-to-GDP ratio, stagnant growth in export and remittance flow, and depleting reserves, Bangladesh's ability to manage its debt remains a growing concern for the government.

The economic challenges have, however, created an opportunity for Bangladesh to learn from its mistakes, though the government's reaction has been slow regarding making decisions based on past experiences.

2.2) Structural Challenges and Policy Dynamics

The events of the last several years in Bangladesh offer a case study of how policies are formed and rolled out. Even before the current difficulties, economists recommended a more flexible exchange and interest rate policy. However, the government was complacent due to the high GDP growth rate, which led to a reluctance to make significant changes. The recent challenges ultimately shook this complacency, leading to a realisation that the Bangladeshi economy operates within market dynamics, and government intervention has its limitations. This has resulted in a shift towards comparatively bolder policy actions, though in some cases, the government appears to remain hesitant. This case presents an opportunity to understand Bangladesh's policy dynamics and the drivers of policy formulation.

While most economists focus on efficiently allocating visible resources, seeking out hidden, latent, or underutilised resources and devising inducement mechanisms to harness them for the greater good is also imperative. Post-independence, Bangladesh's success story lies not only in utilising visible resources like land and labour but also in unleashing its people's latent entrepreneurial abilities. This entrepreneurial spirit is not limited to specific communities or regions but has permeated all sectors, from small farmers adopting high-yielding rice varieties to large conglomerates and garment manufacturers who have put Bangladesh on the global map by creating an RMG hub in Bangladesh.

Bangladesh's development has been influenced by a combination of factors, including government policies, public investments, NGO and private sector contributions. The country's progress is the result of interactions between entrepreneurship, policy, and public discourse. Though the government tended to adopt only a few proposed policies, this cautious approach, despite frustrations, has led to a significant response from entrepreneurs. This long-term interaction has shown that consistent effort can lead to substantial outcomes.

Bangladesh aims to achieve middle-income status by 2031 and developed country status by 2041. To escape the middle-income trap, the country needs to shift focus from expanding production capacity to improving productivity and prepare to invest in innovation. While foreign direct investment (FDI) plays a crucial role in this transition, most FDI in Bangladesh has been either natural resource-seeking or market-seeking.

One good example is the comparison of electronics exports between Vietnam and Bangladesh. In the past 30 years, Vietnam's electronics exports have increased to almost 40% of its total exports, while Bangladesh's remains below 1%. During this time, Vietnam received about 6% of its GDP in FDI, while Bangladesh received less than 2%.

To diversify exports and create new products, Bangladesh needs to attract FDI that is looking for efficiency and focus on producing new products apart from RMG.

Three crucial points need to be addressed to attract more efficiency-seeking FDI. Education and training play an important role in attracting FDI, but the university curriculum often fails to keep pace with technological advancement. In addition, the universities do not cover soft skills like teamwork and meeting deadlines. Moreover, regulations should be clear and predictable, as they are important for both local and foreign investors. Streamlining and simplifying regulations are often discussed, but predictability is just as crucial. And finally, Bangladesh needs to update its regulations to incorporate new technologies, which is crucial for local and foreign entrepreneurs.

Bangladesh needs to address three key areas to make the government more performance-oriented for medium-term structural change. Bangladesh should track the outcomes of international events and assess the number of investors who have actually come to Bangladesh. The private sector should be provided with subsidies tied to performance targets to drive change and innovation. Government activities related to investment promotion should be more coordinated across agencies to attract foreign investment effectively.

In addition to taking these steps, Bangladesh needs to be more efficient and effective in curbing corruption to attract FDI, as the recent Bangladesh Business Environment 2023 survey revealed corruption as the biggest hurdle for businesses to expand.

2.3) Social and human development challenges

Accelerating economic growth aims to achieve human development. Hence, the government needs to keep working to improve people's lives by empowering them. Education is a key aspect of empowering people. However, due to the rising cost of food and energy, families are compelled to adapt to the new realities by cutting the cost of education for the children and, in the worst cases, withdrawing them from schools. And at this conjuncture, Bangladesh cannot afford to go backwards.

Meanwhile, Bangladesh's allocation to education is low, and the curriculum and quality of teaching often lack global standards. Bangladesh also needs to realise that, as a lower-middle-income country with a high portion of people working in the informal sector, it cannot leave the education and health sector on the market.

Two turning points in Bangladesh's history were the 1970 Bhola cyclone and the 1974 famine, which contributed to strengthening a social contract that shaped Bangladesh's development policies. This social contract, which developed through the events of the 1970s, later proved to be effective in protecting vulnerable people from climatic and economic challenges in Bangladesh. It helped focus on the development of rural poor, women, children, livelihoods, and employment.

Hence, Bangladesh is known for its relatively fair distribution despite its history of corruption, elite domination, and anti-democratic tendencies, often referred to as the 'Bangladesh Paradox'. However, a burning question is whether the political elites still see inclusive development as important as they did in the 1970s.

Bangladesh's four main drivers of development policy choices have been nationalistic pro-poor impulses, performance legitimacy, clientelism, and the labour-intensive export sector dominated by RMG. As political settlements have changed in recent decades, the influence of nationalistic and pro-poor impulses is declining. Meanwhile, pressure on the ruling government to ensure economic growth and public services is being compromised in favour of the elites, especially in the absence of free and fair elections. Clientelism is shaping policies, and competition between the elites and aspiring elites is on the rise.

There is a lot of focus on building physical infrastructure but not enough on reducing poverty and improving social services to appease the elites and cronies who are winning the contracts, especially when facing high levels of debt. The returns on these investments are currently very low, so it might be more beneficial to spend this money in other areas, such as helping people living in poverty.

2.4) Democracy and economic growth

Some observers, mostly supporters of the incumbent regime in Bangladesh, have argued that democracy is not required for development, citing China and Vietnam as examples. A section of the business community and civil society have also opined that democracy impedes development initiatives. They even question the necessity of independent media, claiming that reports on corruption and human rights abuses harm the country's image.

There are two key problems in such arguments.

Firstly, Bangladesh's development has been facilitated by a free society where citizens can express their concerns through elections, public dialogues, civic organisations, and the media. The diminishing ability of politicians to genuinely hear the public's concerns can undermine equitable and sustainable development.

Secondly, though the incumbent Awami League might be running the country akin to a one-party state, it does not possess the institutional capability or authority, such as the Chinese Communist Party, to combat corruption or foster competition within the party.

In Bangladesh, the three worlds—enterprise and market, ideas and discourse, and policy—interact with each other, and the impact of crony capitalism on policy can shape development initiatives. Economists' language and approaches to interacting with politicians need to be re-evaluated, and the democratic deficit must be examined within the context of these interactions.

Understanding the difference between policy stability and regime stability is also paramount. While policy stability is crucial for economic progress and attracting investment, regime stability is a different thing. Strong institutions and good policies should make it immaterial which party is in power.

However, since Bangladesh lacks this institutional stability, even the correct policies often have fewer checks and balances, leading to a lack of accountability. This has allowed crony capitalism to thrive, with powerful individuals or groups controlling policy-making in various sectors.

Therefore, a competitive democratic environment is crucial for strong economic policy.

3. Recommendations

The webinar highlighted Bangladesh's economic, social, and developmental challenges, offered insights into the crisis, and provided recommendations.

a) To achieve sustainable economic growth, Bangladesh should diversify exports beyond ready-made garments and attract foreign direct investment by improving the regulatory environment and enhancing workforce skills.

b) To empower people and ensure long-term socio-economic development by increasing budget allocation, integrating technology into curricula and emphasising both hard and soft skills are essential.

c) To address growing inequality, Bangladesh should focus on policies promoting inclusive development, including targeted social protection programs, investments in rural and underdeveloped areas, and policies ensuring fair economic benefits distribution.

d) To address the current challenges and pave the way for a more prosperous and equitable future, a competitive democratic environment should be ensured to enhance accountability, reduce crony capitalism, and ensure that economic policies are inclusive and beneficial to all citizens.

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