

BANGLADESH: ECONOMIC PERFORMANCE AND PROSPECTS

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Bangladesh is in one of the poorest and the most densely settled nations on earth. The country is subject to frequent natural disasters, floods and cyclones which destroy productive capacity and slow down growth. There is both large-scale underemployment and low labour productivity. In the last few years the government has been trying to promote economic growth through the denationalisation of public enterprises and an easing of controls. Over a longer period, the government has initiated a number of anti-poverty programmes to tackle the problem of underemployment. This Briefing Paper provides a background to these policies and reviews the economic progress of Bangladesh since independence. It also assesses the prospects for the economy and considers some policy changes currently advocated for a more effective realisation of the economic potential of the country.

Bangladesh's First Two Decades

The economic viability of Bangladesh as a nation has long been in question because of its over-population, poor natural resource base, vulnerability to natural disasters, and undiversified economy dependent on the production of two crops, rice and jute. At independence in 1971, the population density was over 500 persons per km² growing at 3% annually; the cultivable land frontier was exhausted; only 6% of the GDP originated from modern manufacturing (mostly jute and cotton textiles), and 85% of the export earnings came from raw jute and jute goods which had weak international markets. Businessmen, mostly of Pakistani origin, left the country, productive capacity and infrastructure had been damaged by the war of liberation, and domestic savings had fallen to almost zero.

Despite these adverse initial conditions, Bangladesh has managed to increase its per capita income at a moderate rate (1.5% annually). This growth did not significantly alleviate poverty, however, because of a concentration of assets and economic opportunities in a few hands. Studies show that the poverty situation deteriorated in the 1970s but improved somewhat in the early 1980s, although by 1986 half of the population had inadequate energy intakes, and 58% of rural and 44% of urban children suffered from chronic malnutrition. The infant mortality rate remains at 110 per thousand, one of the highest in the world. Adult literacy is less than one-third, and although three-quarters of children in the relevant age group enrol in primary schools, two-thirds of them drop-out before secondary school.

Economic Performance

A formidable development problem for Bangladesh is its large population and relatively rapid growth. The estimate for 1990 is 113m, a density of 785 persons per km². Official statistics show moderate progress in population control, with growth declining from 3.0 to 2.2% during the 1970-90 period. At the current growth rate 2.5m people are added every year and the population may reach 140m by the year 2000. The population in the reproductive age group and in the labour force is currently increasing at a faster rate because of past high fertility. The structure of the economy and the recent performance can be seen in Box 1.

Agriculture remains undiversified: crop production accounts for 75% of agricultural incomes and 80% of the land is allocated to rice. Foodgrain production has increased by 3% annually, but overall sectoral growth has been slower

Box 1: Economic Indicators

Population (January, 1990)	113 million
Population density	785 per km ²
Gross national product, (1989)	US \$20.8bn (\$185 per capita)

Growth and Composition of GDP

	Growth (1977-89) (% per year)	% of GDP 1989-90
Agriculture	2.1	39.4
Manufacturing	3.5	7.5
Energy & Construction	8.3	6.3
Services	5.0	46.8
GDP	3.8	100

External Sector

	\$ bn (1988/89)	% of GDP
Exports	1.29	6.2
Imports	3.38	16.3
Remittances	0.77	3.7
Foreign Aid	1.67	8.0
Debt Service Liability	0.50	2.4

Source: Planning Commission, Government of Bangladesh, *The Fourth 5 year plan: 1990-95*, Dhaka, June 1990; World Bank, *Bangladesh: Managing the Adjustment Process*, Washington DC, March, 1990.

than population growth due to the sluggish performance of other agricultural activities.

Jute and cotton textile industries have stagnated and their labour productivity declined. These large-scale industries continue to depend heavily on government subsidies. Raw jute and jute products face weak international markets due to competition from synthetic substitutes. Demand for cotton textiles has slackened as a result of competition from Indian manufacturers, in spite of the heavy protection provided by fiscal policies. A major factor contributing to inefficiency has been surplus workers hired when the mills were nationalised immediately after independence. Enterprises producing ready-made garments (with imported quality cloth), chemical fertilisers, electrical equipment, non-metallic minerals and non-alcoholic beverages have, however, made good progress.

Power, construction and services have been expanding sectors. The 1980s saw a 15% annual increase in the use of natural gas and a 13% increase in electricity consumption. Growth in construction has been fuelled by public investment for development of infrastructure, financed by foreign aid.

Exports, although still accounting for a small share of the economy, have grown at 8% annually and have become more diversified in recent years. The share of jute and jute manufactures had come down to 30% in 1989, although nominal earnings in dollar values have remained unchanged. The dynamism in the export sector is mostly the result of two non-traditional items, shrimps and ready-made garments. From nowhere in 1980, garments emerged as the single largest export item in 1987 and in 1989-90 accounted for 40% of export earnings.

Despite a fairly rapid growth in exports, Bangladesh has a large deficit in merchandise trade running at 10% of GDP throughout the 1980s. Remittances made by Bangladeshi

workers abroad, which had a rapid upward trend throughout the 1980s, financed about a third of the trade gap. The remainder was filled by net foreign assistance.

Bangladesh currently receives foreign aid amounting to \$1.7bn annually, \$15 per person. In the 1980s aid financed nearly three-fifths of total investment. Because of soft terms, the debt service liability still remains at a manageable level. In 1989/90 debt servicing on medium and long-term loans was equivalent to 12% of foreign exchange earnings, 20% if liability on short-term commercial loans is included.

Economic Policies

Agriculture

Successive five year plans have given emphasis to rural development and put self-sufficiency in food grain production as the foremost objective. In the 1960s, when expansion of cultivated area and cropping intensity dried up as sources of agricultural growth, a 'grow more food' campaign was initiated focusing on increases in land productivity. Public sector corporations were set up for investment in flood control and irrigation, and for the procurement and distribution of modern agricultural inputs at highly subsidised prices. Co-operatives were promoted for better distribution of public sector services.

With increases in the use of modern inputs, agricultural subsidies began to put a heavy burden on the government budget, which led to a shift in agricultural policies beginning in the late 1970s. Emphasis on water development shifted from flood control to irrigation by the private sector using small scale equipment (pumps and tubewells). Fertiliser subsidies were phased out and completely eliminated by 1985. Fertiliser prices were decontrolled, and distribution was handed over to the private sector, with incentives provided for wholesale trading. Recognizing that this policy change would increase input prices and production costs, the government also adopted a policy of price support through public procurement of foodgrains at a pre-determined price and expansion in credit supply through public sector financial institutions.

These policies have contributed to the diffusion of new 'seed-fertiliser-water' technology, which has increased both land and labour productivity and has been the main engine of agricultural growth. Although new seeds and fertilisers have been adopted at the same rate by small and large farmers, the process of agricultural growth has led to a greater concentration of rural incomes. Richer farmers have acquired subsidised irrigation equipment with loans from public sector institutions but have generally failed to repay the loans and have sold water to small farmers at high prices. The average size of farm is about 0.92 hectares. Growing land scarcity has raised the share of land rents in agricultural incomes. Labour demand has increased at a slower rate than output, which together with a large labour surplus has kept real wage rates unchanged. Although labourers have gained somewhat through increases in employment, labour's share in incremental incomes has gone down.

Agricultural growth has had a narrow base because of the emphasis given to water-resource development and to the generation and diffusion of new foodgrain technology. Growth has originated mostly from wheat (1970s) and winter rice (1980s). Other crops, livestock and most fisheries have been relatively neglected.

Industry

Immediately after independence the government nationalised major large-scale industries and imposed limitations on the size of new private industrial enterprises. Direct foreign investment was allowed only in collaboration with the public sector. In 1972 the government owned over 90% of the fixed assets of the modern manufacturing sector. After the violent overthrow of the Awami League government in 1975, a policy of denationalisation of industries and easing of controls over private enterprises was initiated, with advice from donors led by the World Bank and USAID.

This policy has been pursued vigorously since 1982 with promulgation of the New Industrial Policy which paved the way for large-scale denationalisation of jute and cotton textile

mills and simplification of licensing procedures for the import of capital goods and raw materials. The Revised Industrial Policy of 1986 brought in further liberalisation and incentives for the private sector. Approval for industrial investment is no longer required for investors importing machinery and equipment with their own resources, or with foreign exchange procured from the secondary market. Public sector corporations have been given operational authority in pricing and procurement of inputs.

Macro-economic policy making has also changed in recent years with advice from the IMF. The exchange rate is now only a little overvalued, discrimination against exports has declined, quantitative restrictions on imports have largely been eliminated and tariff rates have been reduced, particularly for industrial raw materials. The rate of interest on term deposits was raised from 6.0% in 1974 to 13%-14% during 1980-90, and the real interest rate has become significantly positive. The premium on the secondary foreign exchange market has come down from 25% in 1980 to less than 10% since 1985, while inflation has recently averaged 8.5% compared to 12% during 1975-85.

Such changes in the policy regime have not, however, led to rapid growth in manufacturing and private sector investment. The growth rate for industry (including energy and construction) was 9% during the first plan period (1973-78), which helped a recovery to the pre-independence investment level. But the rate of growth declined to 4.8% p.a. during the Second Plan (1980-85) and fell further to 4.3% during the Third Plan period (1985-90). Industrial investment was about one-third higher during the Third Plan period compared to the Second Plan but the private sector share of that investment fell from 48% to 34%. The sluggish response of the private sector is blamed on lack of confidence in the stability of policies, political patronage and widespread corruption, and higher returns and low risks in trade and smuggling relative to manufacturing production.

Anti-poverty programmes

The major factor behind pervasive poverty is large-scale underemployment of the labour force, estimated at one-quarter to one-third of their available time, and low wages. The 'trickle-down' effects of slow agricultural and industrial growth have been insufficient to address this problem and the result has been overcrowding in the services sector. During 1973-84 three-quarters of the additional labour force remained in rural areas and four-fifths of them sought self-employment in low-productive non-farm rural activities — e.g. rudimentary trade, cottage industries, and transport services by rickshaw. The lack of rural employment has also fuelled a large-scale migration of the landless to Dhaka city, contributing to a rapid growth of slums.

To create employment during slack agricultural seasons the government has been carrying out public works programmes with food aid, intended to build and maintain rural infrastructures at low cost. The allocation of foodgrains to the 'food-for-work' programme (involving mostly workers from poor households) has increased from 200,000 tonnes in late 1970s to over 800,000 tonnes in recent years. Additionally, a vulnerable group development programme targets 250,000 tonnes of wheat annually on distressed women and female-headed households. Evaluations of these programmes have noted a positive impact on employment and nutrition. Critics however claim significant leakages during implementation, low quality infrastructure with little development impact, adverse environmental effects with roads and embankments blocking natural drainage and occasional use of the programmes for political gains. The government also continues to support farmers' co-operatives on the Comilla (intensive rural development) model as a means of addressing rural poverty. Since 1982 this has been done through a parastatal, the Bangladesh Rural Development Board.

A number of NGOs have come forward to support the poor for the generation of productive self-employment through the supply of capital and provision of training for skill development. Productive self-employment is the objective. A particular beneficiary group has been poor women whose incomes from self-employment have eased poverty in the household and earned them the security and status so strikingly lacking elsewhere in Bangladesh society.

The Grameen (rural) Bank, the largest of these programmes, now covers over 700,000 landless households with women constituting 90% of the borrowers. BRAC, Swanirvar and PROSHIKA are other NGOs with large-scale credit programmes targeted on the poor. Although the cost of administration is high, these programmes have been effective in mobilising the poor in groups and associations, delivering loans without collateral security, and recovering most of the credit when due. This is in sharp contrast to the massive defaults seen on agricultural and industrial loans. Such agencies have also contributed to social development by providing services for education, health and sanitation and population control. Encouraged by their success, the government has also initiated similar programmes through the Rural Development Board and other departments.

Economic Prospects

Agriculture and the Environment

The Bangladesh government continues to give high priority to agriculture as a source of economic growth. Yet agricultural growth is seriously constrained by shortages of land; cultivation and cropping intensities have tended to stagnate and yields of modern varieties (MVs) have declined in some areas. Some scope may remain for increasing yield through use of better quality seeds, and more intensive and efficient use of chemical fertilisers; but this depends in part on the effectiveness of flood-protection investment (Box 2).

There remains some potential for increasing foodgrain production through the shifting of land from low-yielding traditional to high-yielding MVs. The MVs have now spread to about 40% of the cereal area. In spite of a faster increase in input over output prices, MVs are still more profitable, have lower costs and are internationally more competitive than traditional varieties. The constraints to further expansion are inadequate drainage, flood control and the need for the development of irrigation facilities, which are becoming more costly, as easy options have already been exploited. A recently completed long-term water sector development plan estimates that with exploitation of available water resources, irrigation could be extended to about 62% of the cultivated area, which would increase foodgrain production to 30.7m tons from the present levels of 18.5m tons. This can feed about 185m people given the present level of foodgrain intake. Assuming a moderate decline in population growth that number will be reached within the next 25 years. Exploitation of this potential will however be slow. There are heavy investment requirements but, in addition, there are growing concerns over the possibly adverse environmental impact of flood control and irrigation projects and of the use of agro-chemicals.

There is also scope for increasing production of vegetables and horticultural crops through more intensive use of homestead land. The cost of production is lower compared to less perishable crops, but farmers do not get incentive prices because of the lack of storage and marketing facilities, reflected in large seasonal fluctuations in prices. Exports of vegetables to foreign markets, though still small, have been growing in recent years.

Fishing

Prospects for increasing fish production are mixed. Nearly a third of the country is under flood plains and rivers, but the yield is very low compared to other tropical countries. This natural resource base is being gradually depleted as additional flood plains are reclaimed for irrigation and drainage, and embankments affect the movement of fish. This has given rise to major environmental concern at the effects of the emphasis given to the irrigation-dependent growth of foodgrain production.

Flood plains apart, Bangladesh has a long coastal belt with nearly 225,000 hectares suitable for brackish water fishery. Cultivation has been extended to less than one-third of this area, mainly with traditional practices having a yield of only 100-150 kg per hectare. With semi-intensive culture, yields could be raised to 500kg. This development, however, would require heavy investment in structures and the use of new

Box 2: Flood Prevention

Bangladesh is one of the countries most seriously affected by natural disasters being chronically prone to floods and cyclones. Indeed, during 1960-81 Bangladesh experienced 17 major floods and 37 cyclones, leading to a recorded loss of life of nearly 800,000 people.

There were especially devastating floods again in 1988. Besides causing enormous human distress, floods destroy standing crops and damage infrastructure. The fluctuation in production and prices makes crop cultivation a risky venture and discourages risk-averse subsistence farmers from adopting modern technology and from applying inputs at optimal levels. The 1988 floods reduced rice production by an estimated 1.6m tons, and did \$1.3bn worth of damage to roads, railway tracks, houses and industrial machinery.

Bangladesh has long been attempting to negotiate a regional solution to the flood problem without success. National technical studies undertaken with donor assistance after the 1988 floods advocated a 15-20 year programme to provide embankments along the major rivers with structures for 'controlled flooding' and embankments around heavily populated towns. This would require an investment of \$5-10bn over a 20 year period, representing an average yearly investment more than double the public sector allocation for agricultural development during the 1980s. Implementation of the plan would necessitate acquisition of a significant proportion of scarce land for embankments and canals and resettlement of about 5m people between the main embankments and the riverbanks. Maintenance costs for the huge structure would put a severe strain on the government budget, and the environmental impact of such a massive intervention is uncertain. There has therefore been some opposition in Bangladesh as well as internationally to a major embankment programme. Alternative proposals for a moderate programme, basically non-structural in nature, have been presented.

A meeting of major donors in December 1989 gave broad endorsement to the large-scale approach and adopted a 5-year action plan (1990-95). This includes a limited pilot project of embankment construction on the left bank of the River Brahmaputra, technical studies to investigate possible embankment and drainage requirements for various regions and their environmental impacts, and socio-economic studies of the impact of already-completed flood control projects, on flood proofing and preparation, and on responses to land acquisition.

technology, beyond the means and knowledge of local smallholder landowners.

The production and export of shrimps continue to increase, processing capacities have been built up, links with foreign markets established, but there are signs of emerging social problems. Urban entrepreneurs, often with political connections, have invested in shrimp farming but at the expense of evicting tenants and small landowners and they also often breach the existing embankments constructed for protection against saline water intrusion, reducing rice yields and the incomes of local paddy farmers.

Animal Husbandry

Bangladesh does not have comparative advantage in livestock farming because of the scarcity of grazing land, but there is some prospect of increasing poultry production and raising milch cows in family based units. Three-quarters of rural households own some poultry and the number of birds has increased at 5% annually. Loans extended to the poor by NGOs are frequently used for livestock and poultry raising. Moderate growth in these activities could be encouraged through setting up demonstration livestock and poultry farms, importing poultry feeds, and improving training in veterinary services.

Employment

The prospects for growth and poverty alleviation in the long run will however depend on the productive utilisation of Bangladesh's most abundant resource, low-cost unskilled labour. An optimistic 3.5% growth in agriculture may absorb

at most a third of the new entrants to the labour force. The small size of the manufacturing sector and its patchy performance do not generate optimism regarding the growth-augmenting and labour-absorbing capacity of the sector. Favourable export markets for labour-intensive manufactures, concessions obtained as a Least Developed Country and a better climate for foreign private investment may however turn things for the better.

This is demonstrated by the recent success of the garment industry. Rapid expansion has occurred as a result of collaboration with entrepreneurs from East Asia facing export quotas imposed by developed countries. By 1985 there were 700 garment factories employing more than 300,000 workers, mostly women from poor urban households. The potential for further expansion is partly limited by quotas imposed in the USA and EC markets under the Multifibre Arrangement, but the 1990s could see rapid expansion of employment in the garments industry if quotas are eliminated or reduced after the completion of the Uruguay Round negotiations on trade.

Possibilities of export-orientated labour-intensive manufacturing growth also exist for fruit and vegetable processing, leather products and electronic goods; but even under the most optimistic scenario it will take a long time for a dynamic export-orientated manufacturing sector to clear the backlog of huge underemployment and absorb new entrants. The present trend of seeking employment in informal sector activities will thus further intensify in the 1990s. The alleviation of poverty will depend not only on an acceleration of growth in agriculture and industry, but also on the capacity of the informal sector to absorb the surplus labour without reducing productivity and earnings.

Constraints on Development

A formidable constraint to realizing the development potential is the country's inadequate level of domestic savings. A 5.5% rate of GDP growth, the target set by previous development plans, would require an investment rate of at least 20%. Mobilizing resources of this magnitude is difficult. The domestic savings rate amounts to less than 5% of national income, and while private saving has been low, public saving has shown a downward trend and has been negative in recent years. Inadequate counterpart funding has been a major constraint to the disbursement of project aid. A part of the resource gap has been met by the flow of foreign aid (some of which is permitted to pay local costs) and a rapid increase of remittances. Yet the prospects for increasing resource flows from both these sources do not appear promising. It is felt locally that developments in Eastern Europe may make it hard to attract more aid from OECD countries. The Gulf Crisis has already put a severe strain on the economy and will certainly reduce earnings from remittances (see Box 3).

The poor quality of human resources is another constraint. Bangladesh has one of the lowest secondary school enrolment ratios in the world. Only 36% of boys and 16% of girls in the relevant age group attend secondary school. It is also felt that the quality of higher education has deteriorated and labour is generally held to have become less disciplined partly as a consequence of political opposition and the use of students and labour organisations for promoting narrow political interests.

Success in population control will depend largely on substantial advances in female literacy; and any increase in the inflow of private foreign investment will depend not only on favourable policies, good infrastructure and cheap labour, but also on the availability of an educated and disciplined labour force. The government currently spends only 1.8% of the GDP for education and training, compared to 3.0% for defence and administration, 3.3% for development of infrastructure and nearly 6% for directly productive investment in agriculture and industry. In the long run, investment on education and health could give a better return than public investment in agriculture and industry, which would have a crowding-out effect on private investment.

Box 3: Impact of the Gulf Crisis

The most immediate effects of the Gulf crisis on Bangladesh will be the economic impact of the increase in oil prices and the costs of repatriating Bangladeshi workers from Iraq and Kuwait. But in the long-term the rehabilitation of returned immigrants together with the loss of remittances from these workers will cause considerable economic dislocation.

Bangladesh does not produce oil but its import dependence is relatively low since natural gas is used as an alternative source of energy. In 1988/89 Bangladesh imported 2.02m tonnes of crude petroleum and petroleum products. This was only 10% higher than in 1980/81 and oil's share of the total import bill fell from 20% to 8% during this period due to a rapid growth of imports and the decline in the price of oil. If the Gulf crisis leads to a doubling of oil prices, Bangladesh would need to pay an extra \$400m per year, nearly 15% of foreign exchange earnings, to maintain import levels. In practice the consumption of imported oil would decline as prices rise.

The cost of worker repatriation and the loss of remittances will be severe. Between 1976 and 1989 an estimated 650,000 people migrated abroad for employment, one-fifth of them to Kuwait and Iraq. The government estimates the number stranded there at 100,000 and has asked for international assistance to bear the cost of repatriation. It is difficult to see how the economy will cope with returned migrants, as nearly three-quarters of them are unskilled.

The economy is heavily dependent on remittances from migrant workers. In 1988/89 Bangladesh received \$770m in remittances, amounting to about 30% of total foreign exchange earnings. \$1.44bn worth of imports were financed under the wage earners' scheme, 42% of the total import bill. A loss of one-fifth of this income would seriously widen the foreign exchange gap. The effect may be more severe if workers' experiences lead to a fall in the future flow of emigration to other Arab countries.

Recent statements by policy makers suggest that policy changes addressed to these constraints are in the offing. The government appears determined to achieve universal primary education and is in the process of formulating a national health policy. It is also trying to restrain other public expenditure (particularly subsidy programmes but also capital investment on infrastructure) and to provide incentives to savers to mobilise domestic resources. Further revisions in industrial policy are planned to redefine the government's role as a supporting institution rather than a controlling one. The implementation of these policies cannot be assured, however. As in the past, internal shocks — natural and man-made — and changes in the external economic environment are likely to continue to influence the course of economic development in Bangladesh.

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