

GDP growth controversy: 'Potential Growth' enters the fray

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The national media is agog with reports on the gross domestic product (GDP) growth rate. Gleaning from the reports there seem to be more sceptics than believers of the official growth figure — provisional estimate for fiscal year (FY) 2018. That Bangladesh economy should be growing at 7.0%+ annual rate is anathema to many, despite reference to this economy by global investment firms like JP Morgan calling it the “frontier five” on the basis of its growth rate and economically active population. Lest we forget, after all the growth drivers are accounted for, it is the vast army of economically active population, young in age, that could fuel growth acceleration — a demographic dividend to move Bangladesh from being just an impressive underdog.

The record shows that since the 1980s, average decadal growth has been rising, from 3.7% in 1980s to 6.8% during 2011-17. During all these years structural reforms were never completely or wholeheartedly embraced. Yet the economy chugged along, with the glass always half full as it were, and produced higher average growth every decade by roughly one percentage point. The average growth target for FY2016-2020 under the Seventh Five-year Plan works out to 7.3%, and the economy appears to be on target thus far though questions remain whether the economy can attain the end-year growth of 8.0% in FY2020. If it does,

that will produce an average growth of 7%+ for the 2011-20 decade. Sounds improbable. Is it?

Yet, after frequently acknowledging the Bangladesh surprise of stable and robust growth for the past two decades, credibility questions have recently dogged the Bangladesh Bureau of Statistics (BBS) computation of growth rates, primarily originating from one of our development partners. Very early on in the current FY the World Bank came up with a projection of 6.4% GDP growth for FY2018, well below the now “provisional” estimate of GDP growth of 7.65%, while others like International Monetary Fund (IMF) and Asian Development Bank (ADB) have recently concurred with an estimate of 7.0%. Curiously, growth projections grab headlines, larger is the wedge between projected growth (of international agencies) and the government target. Of late, there is a new macroeconomic indicator that has entered the fray, the economy’s “potential growth”, proffered by a multilateral capital donor agency which, according to press reports, maintains — on what basis not being clarified — that the economy’s potential growth rate is 6.5%-6.6%. This notion of potential growth deserves some clarification.

The concept is not unknown in mainstream economic literature but mainly applied in the context of developed economies like the United States. Economists would like to know the difference between actual and potential growth of an economy in order to design policies that will stimulate growth to reach an economy’s potential output. Analogous to this concept is the idea of actual and potential GDP, the difference being described as the “output gap”. One approach is to describe potential GDP as the output of goods and services the economy can produce when its labour and capital resources are fully employed. In the US economy (where most economists make their living!), the simplest approach taken by economists is to regard an economy at ‘full employment’ to be producing potential GDP, full employment being ascribed to a rate of 4.0% unemployment (called frictional unemployment) or thereabouts. With current estimates of unemployment at 4.1% in US, the economy could be producing near potential output, though growth can then be fuelled by labour force growth, capital investment, and technological change (raising productivity of both capital and labour).

For a developing economy like Bangladesh, transposing the idea of potential growth that is relevant for developed economies raises a hornet’s nest of problems. The notion of potential output and its growth gets extremely nebulous. Far too many unknowns will dog the issue to

come to any resolution anytime soon. I am not aware of any development economist having reached any conclusion on the subject. For starters, the unemployment rate poses problems when we have to distinguish between open unemployment and under-employment. It is the latter that takes precedence in addressing the unemployment challenge in Bangladesh. Agriculture (rural economy) which now contributes only 15% to GDP has 42% of our labour force employed there — the vast majority of these would likely fall in the definition of under-employed.

Estimates of under-employment are around 20% of the country's labour force. Open unemployment in Bangladesh is estimated at 4.5% in the latest Labour Force Survey (LFS) of 2016. That would put potential GDP significantly above actual, when all labour is fully employed. Then again the full potential of labour cannot be realised without capital and technology being invested and put into service. What about productive capacities of our land? Have we reached full potential there? How about infrastructure? Generation capacity of electricity has crossed 13,000 MW but power shortages remain unavoidable due to lack of transmission and distribution capacities. Potential output could be much higher if generation capacity were fully utilised. Take human capacities that are under-utilised. If our education system were up to speed, productivity of our manpower could be much higher. The list goes on. The bottom line is, for a developing economy like Bangladesh, the notion of potential output that can be easily defined and recognised is far more complex than what it is for a developed economy.

Only when you have a fair notion of potential output (GDP) we can consider applying the principle to potential growth of the economy. Can it be disputed that our economy has all the potential to reach double digit growth rate if the right policies were put in place, the labour force was better educated and skilled, the investment climate was transformed, infrastructure was adequate and fully functional, and corruption was minimal? That idea of potential output could be more appealing to some of us than a mere stipulation of what growth could be under prevailing conditions. In the absence of a scientifically defined benchmark, floating the idea of Bangladesh's potential growth is at best an elusive juggernaut adding more obfuscation than clarity.