GDP growth: the numbers game

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The GDP growth numbers used in the FY2014-15 national budget

have come under considerable criticism from the national researchers. There is unhappiness regarding both the estimated GDP growth for FY2013-14 as well as the projected growth for FY2014-15. In this article I focus on this aspect of the budget numbers, looking at the underlying concerns and suggesting a way forward so that the debate could move away from the numbers game to the substantive policy issues and challenges relating to GDP growth and its measurement.

The GDP estimates are provided by the Bangladesh Bureau of Statistics (BBS). As the primary national institution vested with the responsibility of providing best possible data for use by all, including policymakers, business and research, it produces a public good and as such has accountability to the entire nation. Citizens therefore expect BBS to provide unbiased, best possible data using existing resources and methodology. As an institution of a developing country it is logical to expect BBS to be evolving with capacities improving over time. Indeed we have seen a gradual improvement in BBS capabilities and we expect it to grow further.

Against the backdrop of the above, BBS has made progressive improvements in the estimation of GDP, although there are substantial gaps on the expenditure side of the national accounts. So, why is there unhappiness with the estimated GDP growth provided by BBS for FY2013-14? Do the critics have a better method and better information for estimating GDP growth? While I cannot answer on behalf of all the critics, I can explain my own concern. I certainly do not have better information or a better method for estimating GDP and its annual growth. I always rely on BBS data to analyse GDP trends and its composition in my research. However, in looking at these numbers I do try to understand and explain them in the context of related national and international events.

In the end, the estimated GDP of a year is a summary reflection of what has happened to economic activities in that year. These economic activities are affected by a range of factors including the level of domestic production, weather, domestic turbulence, domestic demand and external demand. If there is severe adverse weather, it is likely that the GDP growth will be adversely affected; if external demand collapses due to recession our exports will fall and lower the GDP growth; if there is domestic political turbulence the GDP growth will likely fall. In each case, the magnitude of the adverse effect will depend on the extent of the shock.

Bangladesh faced a major domestic shock in FY2013-14 in the form of political turbulence that caused some serious disruption to economic activities for a prolonged period. There are several estimates of underlying losses. Manufacturing production, trade and transport all got disrupted during those periods of political turmoil. It is therefore intuitive that GDP growth in FY2013-14 will be lower than in FY2012-13, which was a normal year. So, when BBS came up with a GDP growth rate of 6.12 percent for FY2013-14 as compared with growth rate of 6.01 percent in FY2012-13, like other researchers I would certainly like to question the credibility of this higher GDP growth in an abnormal year marked by serious disruption of economic activities. I cannot say with certainty whether the growth was 5.5 percent or 5.7 percent and so on, as some other critics have argued, but I do believe that the GDP growth for FY2013-14 should be significantly lower than that in FY2012-13.

I do not want to argue about a specific lower number because I do not have a better estimation method or better data, but I certainly would like to request BBS to analyse and explain the rational for the higher GDP growth for FY2013-14. What were the offsetting factors that more than neutralised the adverse effects of the political disruption? Since BBS knows the GDP numbers best, they must also be able to explain the determinants of growth and the contributing factors. Depending on the convincing power of that analysis, I am willing to change my mind. But until then I remain sceptical of the FY2013-14 GDP growth estimate.

The government has not taken the criticism of the growth of estimate of FY2013-14 GDP well. This is unfortunate for two reasons. First, if I were a policymaker I would gladly accept that the political turmoil must have cost the economy some loss of output and services. I would then dwell on the positive aspects of this development. I would point out that even with a serious political turmoil, the per capita GDP growth has been a solid 4.2 percent-4.5 percent (using the 5.4 percent-5.7 percent estimated GDP growth rate suggested by international organisations like the World Bank). Although below potential, this remains a substantial growth rate by international comparison. It shows the resilience of the Bangladesh economy to external and domestic shocks. It also demonstrates the potential of the economy to attain substantially higher growth rate in an environment of political stability, better governance and better policies.

Second, the government’s response sends a wrong signal to BBS about the quality and reliability of the data. If the government is happy with the BBS estimates, the BBS will have no incentive to rethink and try to improve its work.

I have a similar concern about the projected GDP growth of 7.3 percent for FY2014-15 used in the budget. While the governments in many countries often make optimistic growth projections, in this particular instance I have a concern that the projected growth rate of 7.3 percent is based on wrong information about the national investment rate. The BBS estimates national investment rate at 28.7 percent for FY2013-14. If the investment rate was indeed 28.7 percent of GDP in FY2013-14 and it reaches 29-30 percent of GDP in FY2014-15, then with an incremental capital output ratio around 4 it looks reasonable that GDP growth rate would be in the 7 percent plus range in FY 2014-15. So, where is the catch?

The catch is in the reliability of the 28.7 percent investment rate estimated by the BBS. There are several problems with this estimate. First, BBS has not provided any analysis of how the 28.7 percent investment rate was obtained. Second, when comparing the investment number for FY2012-13 between the 1995-96 base and the 2005-06 base, total investment increases from Tk 2,786 billion to Tk 3,404 billion, a massive 22 percent increase. This is even larger than the percent increase in rebased GDP.

How did BBS rediscover the missing Tk 618 billion of investment spending? This has several implications that are counter-intuitive. If this were correct than it suggests a significant increase in the capital intensity of production. The rebased GDP primarily accounts for underestimation in value added from informal activities that are likely to have very low capital intensity. So, this cannot explain all the increase in investment. For 1995-96 base, the data on components of investment for FY2012-13 published by BBS shows that 22 percent of investment is in terms of machinery and transport. The remaining 78 percent is construction. Since machinery and transport is largely imported, the additional Tk 618 billion in the 2005-06 base must mainly reflect additional construction. This massive increase in estimated construction investment implies a large increase in the value added from construction. Surprisingly, the value added from construction for FY2012-13 in the 1995-96 base was Tk 899.8 billion whereas in the 2005-06 base its contribution was revised downwards to Tk 824.3 billion.

It is clear that the reliability of the rebased investment value for FY2012-13 is very low. Using that data for projecting investment for FY 2013-14 is therefore misleading. The story does not end here. The BBS data for public investment for FY2012-13 and FY2013-14 is highly suspicious. In Bangladesh much of public investment is financed through the budget. Public enterprises and autonomous bodies have very little surplus and their investment is mostly funded by the budget. Similarly, own financing of local governments is very small and investment of local governments is mainly financed by the budget. Against this reality, while the budget shows public investment of Tk 532 billion for FY2012-13 and Tk 651 billion for FY2013-14, the BBS estimates public investment at Tk 796 billion for FY2012-13 and Tk 986 billion for FY2013-14. This is incredible. Which public entity is funding additional investment to the tune of Tk 300 billion plus outside the budget? Where is this additional funding coming from? Clearly BBS expenditure accounting under the rebased GDP estimation is seriously flawed. The national budget cannot rely on these numbers to make any realistic growth and expenditure projections. By implication, the estimated revised savings rate is also suspect.

I draw three policy implications moving forward. They are all very important and deserve serious attention of the policymakers.

First, the government's GDP growth assumption for FY2014-15 is optimistic. The shortfall in private and public investment observed in the first three years of the Sixth Five Year Plan has constrained the increase in the economy's capacity to go beyond the 6 percent growth rate during the four years of FY2010-FY2014. The political turmoil in FY2014 is likely to have prevented an improvement in the national rate of investment from the 24-25 percent of GDP observed in the first three years of the Plan. As such, even if the investment rate goes up by 1-2 percent of GDP in FY2014-15, which is optimistic, the GDP growth is not likely to reach the 7 percent plus range in view of the lag between investment and increase in production. Yet, policy effort must continue to achieve a 6 percent plus growth rate, which is certainly feasible. A 6 percent plus GDP growth rate would be a superior performance if achieved.

Second, renewed focus on higher investment from both public and private sectors is essential to lay the foundations for 7 percent plus GDP growth in the Seventh Five Year Plan. The government should learn from the experience of the Sixth Plan. The mid-term review of the Sixth Plan provides a useful analysis of the reasons for the shortfall in the investment effort and policies that would help increase the investment rate.

Third, the BBS is an essential national institution that provides public good. It must be treated as such rather than as an arm of the government. It must be equipped with resources that make it possible to generate the best possible data and verify the quality of data it produces. The data must be based on best available information and internationally acceptable methods. The resulting information must be accepted gracefully by the government even if they are not consistent with its expectations. The government must welcome independent reviews of data quality from other clients of BBS and use these reviews to improve its own understanding and inform policy making accordingly. Institutions like UNDP, World Bank and the IMF have considerable data management capabilities and BBS can benefit from technical assistance from these institutions to upgrade its capabilities.