

**Poverty Reduction Strategy**

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## Progress and prospects for poverty reduction in the Sixth Plan

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Bangladesh has made commendable progress with reducing poverty

since independence, whereby the percent of population living below the poverty line fell from more than 80 per cent in early 1970s to 31.5 per cent in 2010 (Table 1). However, Bangladesh still faces the tremendous challenge that 47 million people live in poverty. Additionally, many of those who have escaped poverty recently remain highly vulnerable and could slide back into poverty when faced with an economic shock.

✘ The poverty reduction outcome in Bangladesh can be attributed to a number of factors that

tell a story of significant economic and social transformation.

(a) The decline in poverty in Bangladesh stems in large part from strong economic growth. The 5.4 per cent annual average rate of GDP expansion between 1991 and 2010 provided the basis for strong growth in per capita income and household consumption. Manufacturing and services sector expanded much more rapidly than agriculture. In particular, rapid growth in the readymade garment exports provided strong impetus to manufacturing GDP and employment, growing by 7.2 per cent and 3.7 per cent per year respectively.

(b) The associated economic transformation emerging from rising GDP and employment shares of manufacturing and services is manifested in growing urbanization, increasing returns to human and physical assets, rising labor productivity and wages, the shift from low-return agricultural labor to non-farm employment and growth in export industries.

(c) Increasing flow of remittances, increasing from only \$868 million in 1991 to \$11.0 billion in 2010 supported the growth of household consumption. In per capita terms, remittances grew by nearly ten-fold, from only \$7 to \$67.

(d) The growth of micro-finance played a positive role in supporting incomes of the poor. For example, micro-finance as percentage of the total private sector credit grew from 4.9 per cent in 2000 to 5.3 per cent in 2010.

(e) Equally important were some of the social changes that happened over this period. For example, there was a noticeable fall in the number of dependents in a household, linked to reductions in fertility.

(f) Increases in labor force participation and educational attainment, particularly among women, have contributed as well.

The poverty reduction challenge in the Sixth Five Year Plan (SFYP)

Despite the progress with alleviation of poverty, Bangladesh still has a larger proportion of people living below the poverty line. In 2010, in addition to the fact that some 31.5 per cent of the population was below the poverty line, an estimated 17.6 per cent of the total population (26 million people) lived in extreme poverty. Locating these extreme poor and targeting policies and programmes to lift them from the poverty trap is a real challenge and requires concerted efforts.

The other dimension of poverty is the spatial distribution of poor beyond the urban-rural

divide. This concerns the distribution of poverty by districts and divisions. Despite recent progress, there is still an East-West divide in the distribution of poverty, with a significantly higher poverty incidence in the Western Divisions of Rajshahi, Khulna and Barisal as compared with the Eastern Divisions of Dhaka, Sylhet and Chittagong.

In addition to the structural causes of poverty, recurring community-wide shocks have a significant accumulated negative impact. Some of these are seasonal, while others are more unpredictable, like the major floods and tropical cyclone. There is evidence to suggest that severe and repeated community-wide shocks contribute to poverty traps in certain areas of the country. By (at least partly) mitigating the impact of the shocks, a well-functioning safety net system would ensure that the considerable gains Bangladesh has achieved in the area of poverty reduction through rapid economic and social transformation are not eroded.

There is considerable concern in Bangladesh about the growing income inequality. Results show that the distribution of income is much more unequal than the distribution of consumption. Income inequality as measured by the gini coefficient for the distribution of income rose substantially during the 1980s and the 1990s. More recent data shows a further increase in the income gini coefficient from 0.451 in 2000 to 0.458 in 2010 due to an increase in rural income inequality (Table 2). Thus, the rural income gini coefficient increased from 0.393 in 2000 to 0.431 in 2010. The urban income gini coefficient remained unchanged at 0.497 during 2000 and 2005 but declined to 0.452 in 2010.

✘ Measures of expenditure inequality, which is a more reliable measure of inequality in view of the weakness of income data in HIES, shows a similar picture of rising inequality in the 1990s. Expenditure inequality rose considerably during 1990s, particularly in urban areas. The HIES data suggest that inequality in the distribution of private per capita expenditures, as measured by the gini coefficient, increased from 0.259 in 1991-92 to 0.306 in 2000. Unlike in the 1990s, the expenditure inequality for the country showed no change between 2000 and 2005 (stayed at 0.31), and only a marginal increase (0.32) in 2010. The urban expenditure gini fell somewhat while the rural expenditure gini increased slightly, offsetting the impact on the national expenditure gini. Overall, since 1995-96, the changes in national and urban/rural expenditure ginis for are too small to be statistically significant, which indicates that changes in the distribution of expenditure (relative to the mean of the distribution) has remained stable for the last decade in Bangladesh.

Nevertheless, the growing income inequality is of major concern. The SFYP suggests a range of measures to address the income inequality problem including creating better access to high productivity, high income jobs; improving farm productivity and incomes; sharpening the focus on equity aspects of public spending on education, health, family planning; nutrition and water supply; reducing the regional disparity of growth; and improving the access of the poor to means of production (fertilizer, seeds, water, electricity and rural roads); and by improving the access of the poor to institutional finance.

These aspects of the poverty profile suggest that growth strategy alone will not be able to fully solve the poverty problem in Bangladesh. While growth acceleration and job creation will be the primary foundation for the poverty strategy, this will need to be complemented by well-designed specific and targeted interventions that go to the bottom of the various factors contributing to the rural-urban poverty divide, the regional variations in poverty, and the large concentration of ultra-poor and seek to remove those constraints.

#### The Sixth Plan strategy for reducing poverty

The SFYP emphasized productive employment as the most potent means of reducing poverty, which requires strategies and actions on the demand side of the labor market (driven primarily by economic growth) as well as strategies and policies on the supply side (labor force growth and quality). The specific elements of the SFYP poverty reduction strategy emphasized in the SFYP are:

- \* Acceleration of economic growth and employment.
- \* Taking advantage of higher labor force growth (the demographic dividend) and ensuring labor quality.
- \* Ensuring food security.
- \* Managing the spatial dimensions of growth.
- \* Reducing income inequality.
- \* Ensuring social protection for the under-privileged population.
- \* Ensuring gender parity.
- \* Sustaining growth and protecting the poor from the adverse effects of environmental degradation and climate change.

In order to ensure participation of the poor people in the growth process, the SFYP recognizes the importance of their ensuring access to financial services. It will also take necessary steps for protecting the poor from the adverse effects of environmental degradation and climate change. With a view to supporting overseas employment and fostering growth, efforts will be made to promote migration, especially from lagging districts of the northern and north-western regions of the country. Two major interventions will be undertaken – skills development through training programs and the financing of migration. Rural non-firm activities will continue to be supported as an important means for poverty reduction. In this context, future strategies will focus on two broad areas: (i) improving the rural investment climate; and (ii) supporting institutional framework including strengthening local governments.

Finally, the SFYP recognizes that the diverse underlying causes of poverty in Bangladesh include vulnerability, social exclusion, and lack of assets and productive employment. The extreme vulnerable poor can potentially lift themselves out of poverty with appropriate short to medium-term support. The Sixth Plan puts emphasis on Social Protection Programs that address basic needs of the poor and vulnerable people, namely food, shelter, education and health.

#### Assessment of poverty reduction progress in FY11 and FY12

A major constraint to assessing progress quantitatively on a yearly basis is the lack of relevant data. The HIES that serves as the basis for evaluating progress in poverty and income distribution is only available on a 5-year cycle and with an additional one year lag for data processing and analysis. Interim shorter-term surveys as done in India are not done in Bangladesh. This is a major data problem that needs to be addressed by the Bangladesh Bureau of Statistics. In the absence of quantitative evidence, some qualitative assessment can be made using past trends, growth outcomes and other determinants of poverty and inequality.

Although there are multiple determinants of an effective poverty reduction strategy, it is widely accepted that sustained high GDP growth is the most important factor. Poverty data from 2000 to 2010 shows a growth elasticity of poverty of 0.76. However, the more recent data from 2005-2010 suggests a growth elasticity of poverty of 0.89. It is important to note

that this higher poverty elasticity of growth is associated with a slight improvement in income distribution and a stable pattern of consumption distribution. Any worsening of consumption distribution in the future will lower the elasticity.

The SFYP targeted an average GDP growth rate of 7.3 per cent for the plan period. If this growth path is sustained, the poverty profile under the assumption of no worsening of income/consumption distribution is shown in Table 3. It is obvious that the growth path in the Sixth Plan and the assumption of no worsening in the distribution of income/consumption are key factors for achieving the Sixth Plan target for poverty reduction.

✘ The experience so far suggests that the GDP growth rate in FY11 was on target; however, the rate of growth in FY12 is below target (Table 4). The composition of growth in terms of agriculture performance (5.0 per cent in FY 11 and 2.5 per cent estimated for FY12) and manufacturing (average growth of 9.5 per cent during FY11 and 9.4 per cent in FY12) suggests that earnings prospects in agriculture and overall employment prospects have improved, although the lower than-targeted growth in agriculture in FY12 is a matter of concern. Higher growth in agriculture in the context of a flexible agricultural labor market has favourable implications for real wages. Research suggests that labor market in agriculture works flexibly and employment and real wages have grown in response to higher labor productivity. So it is reasonable to conclude that agricultural wages and incomes have continued to grow in real terms and is contributing to poverty reduction.

Although the manufacturing sector was able to achieve its growth targets in both FY11 and FY12, the sharp decline in total exports from 41 per cent in FY11 to only 6 per cent in FY12 owing mainly to the slump in RMG exports linked to the Euro Debt crisis is of concern. The Sixth Plan's structural change and employment targets are intimately linked to the performance of the manufacturing sector. The manufacturing sector's growth outcome in turn depends to a large extent upon its exports performance. The Sixth Plan set a robust exports growth target (average of 14 per cent per year in nominal US dollars). The FY12 exports downturn is therefore worrisome.

✘ However, from the longer-term perspective, the biggest concern for the sustainability of the Sixth Plan's growth target is the substantial shortfall on the investment front. Recognizing the need to boost investment to reduce the infrastructure gap and to build

production capacities, especially in manufacturing, the Sixth Plan set an ambitious target for the expansion of the investment rate, up from 24 per cent of GDP in FY10 to 32 per cent in FY15. Both public and private investment rates were projected to increase.

The investment performance in the first two years of the Sixth Plan has been rather dismal (Table 5). As compared with target investment rates of 25.2 per cent of GDP in FY11 and 26.8 per cent of GDP in FY12, the realized investment rates were 24.7 per cent and 24.9 per cent respectively. It is well recognized that the inadequacy of infrastructure, particularly power, has emerged as a binding constraint to the expansion of economic activities, especially manufacturing. Unless the challenges of infrastructure and the expansion of the investment rate needed to finance the higher GDP growth are tackled upfront, there is a substantial risk that the Sixth Plan's GDP growth targets will not be achievable.

A primary reason for the shortfall in the investment rate is the shortage of resources. This is a new challenge that was unanticipated by the Sixth Plan. In recent years Bangladesh has been fortunate in rapidly expanding national saving. This made it possible to finance a growing domestic investment even in an environment of low foreign direct investment (FDI) and dwindling official assistance. The financing environment for investment has been changing rapidly over the past 2 years (Table 5). Compared to an estimated saving rate of 28.1 per cent in FY10, the saving rate declined dramatically in the first two years of the Plan, falling to 25.7 per cent in FY11 and further sliding to 25.2 per cent in FY12. This is a major negative development that requires urgent attention.

✘ The financing constraint appeared primarily in the public sector. In the private sector buoyant demand, accommodating monetary policy, low real interest rates and acceleration of housing prices that built up windfall untaxed wealth pushed the growth of private consumption. Nevertheless total private saving rate still substantially exceeded private investment. In the public sector the projected increases in public saving during the first two years of the Plan did not materialize as growing energy and food subsidies increased public consumption. As well, the financing of public investments from foreign sources, both official and through public-private-partnership (PPP) channels, did not materialize to the extent projected in the FY11 and FY12 budgets.

On the whole, the GDP growth and employment aspects of poverty reduction strategy of the

Sixth Plan require careful monitoring and policy responses. The outlook for agriculture remains favourable but policy actions are needed to diversify agricultural production and explore opportunities for exports. Slow growth of domestic demand for foodgrain cannot alone support a 4-5 per cent annual average long-term growth rate of agriculture that is heavily dominated by food-crops. Exploring export markets for foodgrain and diversifying agriculture production to more income elastic and higher value-added production will need to be a key element of the agriculture development strategy for the future. Manufacturing exports need to be boosted through a diversification strategy to support sustained rapid growth in manufacturing. The inability to achieve the investment targets is a serious setback for the GDP growth path of the Sixth Plan and associated expansion of the manufacturing sector. Unless corrective actions are taken immediately, there is a serious risk that the average GDP growth of 7.3% and the associated yearly path that takes GDP growth rate to 8% in the terminal year of the Plan will not be realized. This in turn is going to hurt employment prospects and will make it difficult to achieve the poverty reduction target of an HCR of 22.5% by FY15.

The assumption of no worsening of income/consumption distribution is predicated on proper implementation of all the Sixth Plan programs related to the poor and vulnerable population including higher funding for social security programs. The target to increase social security spending to 2 per cent of GDP in FY11 was not achieved and the prospect for increasing this spending to 3 per cent of GDP by FY15 is challenging. Additionally, available reviews of a number of social protection spending suggest a mixed record of achievement. Corrective policy actions to improve program design, reduce the multiplicity of programs, and improve targeting are needed. Similarly, while the FY11 and FY12 budgets have emphasized spending on education, health, and rural infrastructure, the levels of spending are below the levels needed for sustained improvement in these services. So, stronger efforts are needed to further improve expenditure priorities by cutting energy subsidies and increasing greater allocation to social protection, human development and rural infrastructure.

The other key development that could seriously hurt income/consumption distribution is inflation. There is considerable empirical evidence that inflation hurts the poor relatively more than the rich. So, higher inflation since 2009 is of serious concern. While the Government has taken steps to keep staple food prices under control and the general inflation rate has come down recently, double digit inflation is not good for poverty reduction

and must be reduced on a sustained basis with concerted policy efforts.

### Prospects for Poverty Reduction in the Sixth Plan

It is obvious that the poverty reduction targets for the Sixth Plan face serious downside risks that require careful monitoring and policy actions. The prospects for attaining the poverty reduction targets of the Sixth Plan will depend upon the following factors.

- 1) The growth momentum needs to be restored to achieve the Sixth Plan GDP growth rates. The highest priority is to increase the investment rate. The domestic financing constraint should be eased through additional tax mobilization, focused especially on income and property taxes, and through expenditure reallocations that lowers fuel subsidy and increases allocation for investment in infrastructure and human development. Special efforts to mobilize official assistance for financing infrastructure and for direct foreign investment in infrastructure and manufacturing can be instrumental in raising total investment rate in Bangladesh. Public investment programmes should be protected from budgetary cutbacks and implementation capacity strengthened by recruiting professional staff from outside the civil service. Stronger partnership with development partners in project development and implementation will also help.
- 2) The slippage in the growth of the agricultural sector needs to be reversed by focusing on farm productivity and by strengthening agricultural diversification. The rice sector will continue to be the backbone of farm production in Bangladesh. To strengthen farmer incentives, policy efforts should focus on increasing rice productivity and exploring options for rice exports. If Pakistan, Thailand and Myanmar could export foodgrain without jeopardizing domestic food security, there is no reason why Bangladesh should not take advantage of the profitable export markets for foodgrain.
- 3) Exports could be boosted by reducing trade protection, reducing trade logistic costs by improving transport and port services. In addition to exploring options for food exports, diversification of manufacturing exports and options for entering the services exports market beyond labor service may also be explored. Non-factor services exports growth in India provides a good example of how this might be promoted in Bangladesh.
- 4) Macroeconomic management has to be improved with a view to sharply reducing the rate of inflation and keeping inflation rate at the 5-6 per cent level. Along with prudent fiscal management that keeps Treasury borrowings from the Bangladesh Bank within prudent

limits, monetary policy growth must be made consistent with the targeted rate of inflation.

5) Increasing the level of spending and improving the quality of social safety net spending are of particular significance for securing the poverty reduction goals of the Sixth Plan. The FY14 Budget should increase social safety spending to the level targeted in the Sixth Plan (3 per cent of GDP), while efforts to improve targeting and strengthening the monitoring and evaluation of the safety net programs should be given priority.