GDP
Gross
Domestic
Product
goods
services
approach
output
Consumption
borders
Exports
final
deflator
Investment
country
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Calculating
Approaches
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Government
Real
expenditure
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inventory
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The six per cent Trap and seven per cent Solution

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In the chequered history of economic development, it is a rare event. Few countries have recorded gross domestic product (GDP) growth rates of seven per cent plus on a sustained basis, i.e., for two decades or more. Such an economic performance is transformational. It would turn a poor country into an upper middle income country in two decades; and a middle income country would become a developed country at the end of the period. No wonder development practitioners and policymakers of all shades and opinions agree that such an economic performance would be the mother of all economic goals, not just because of its transformational outcome but also because history has shown that it is also the end of poverty for those economies that have achieved that outcome.

The big question is how realistic is that goal – the seven per cent annual GDP growth — for the hundreds of developing economies of the world, including Bangladesh, that are striving for that rare achievement. Just as important to know, what will it take for some of these developing countries to reach that coveted goal. Clearly, there are the Chads and Burundis of the world who are not even aspiring for such a feat. Note that Chad, Rwanda and Burundi were the three countries that had per capita incomes below US$100, and about the same as that of Bangladesh at the time when we gained independence in 1971. Today, Burundi still remains the poorest country in the world while Bangladesh has moved on leaving some 30 countries behind in terms of per capita income. The source of rising per capita income over time of course is the rate of GDP growth. Given a certain growth rate of population, the faster that GDP – the value of goods and services produced in an economy – grows, faster will be the rise in income per capita.

Developed countries of the world, those who are members of the Organization for Economic Cooperation and Development (OECD), which used to be called the rich man's club, are not expected to grow at such high rates simply because they have reached such a high threshold of income that their potential growth is constrained by the modest growth of their labour force (nil for many rich countries), and capital formation that expands only modestly from a large base. Barring intake of immigrants, for the developed countries, it is the productivity of their labour and physical and human capital that drives growth which, for most developed countries, is typically around 5.0 per cent in the best of times.

So growth rates of 5.0-10 per cent or more are actually in the domain of the developing and less developed countries who still have to claw their way out of poverty and bridge the income gap between rich and poor countries. From a low output and capital base, high growth rates are possible when significant quantum of capital is added to a growing labour force – as the old protagonists of growth theory like Paul Rosenstein-Rodan and Ragnar Nurkse had stipulated. Today, we know that the development process is far more complex than simple capital infusion. Unless the capital investment from private sources or multilateral agencies is managed properly, supplemented by human capital formation and sound governance, there is no guarantee of a smooth development process with high rates of income growth and poverty reduction. Nevertheless, after many years of debate about the trade-off between growth and distribution, there is a reasonable consensus on the idea that distribution without growth is a non-starter, particularly in a market-oriented capitalist economic system. What is important is to make growth 'inclusive' so that the widest section of the population can share in the benefits of income expansion. In that context, history and cross-country evidence shows that high growth, defined as "7.0 per cent plus" GDP growth, has been instrumental (and clearly far more effective than low growth rates) in lifting vast swathes of the population out of poverty. The case of China and South Korea in the past 25 years is the best example that can be cited.

More recently, the world economy was battered by the worst recession since the Great Depression of the 1930s. It left the global leaders and policymakers wondering how, with all the advancement in technology and economic science, the world's richest economies could be faced with such a catastrophe; millions of workers were rendered jobless and whole economies (e.g. Greece), burdened with massive debt that would be almost impossible to pay without a cooperative effort of all the advanced nations. Furthermore, in the aftermath of the calamity, it had become clear that the richest economies of the world were beset with the prospect of a painful and slow recovery with slow output growth for at least another decade.

To find answers to many intriguing questions that were bothering global leaders and development practitioners alike, the UN Secretary General set up a high-profile Growth Commission, headed by Nobel Laureate economist Michael Spence – surprisingly, not a development economist by specialty. In studying growth experiences historically and around the world, the Commission came to an interesting revelation: since the end of the Second World War, there were only thirteen countries in the world that experienced high growth rates of "7.0per cent plus" for a sustained period of 20-25 years. These countries, mostly in East Asia except one, included China, S. Korea, Malaysia, Thailand, Singapore, and Botswana. The Commission also concluded that high growth for such a long period had transformed many of these economies from poor to upper middle income countries, and from middle to high income countries.

Thus the Commission concluded that high growth that is transformative in impact for economies would have to be 7.0 per cent or higher annually. This is also the minimum growth rate for the least developed countries (LDCs) proposed by the Open Working Group (OWG) of the post-2015 UN Development Agenda. Given past performance and future outlook for the Bangladesh economy, average annual growth rate of 7.0-8.0 per cent in the coming years appears realistic and feasible, provided the economy is supported by a stable political environment.

Furthermore, it is also a fact that in all of the high growth countries, income prosperity and substantial elimination of poverty went hand in hand. Thus it is no surprise then that 7.0 per cent growth rate has become a mantra for development practitioners and policymakers in all developing countries – perhaps rightly so, with so much poverty still around.

So it is in Bangladesh where many of the vital indicators that accelerate a country's growth rate already exist, in its extremely resilient and hard working people, its dynamic entrepreneurs, its growing working age population, its rising female labour force participation rate, and export dynamism of its readymade garment sector. However, as we have all come to realise, with all these factors in its favour, the economy having achieved 6.0 per cent annual growth for the past decade seems to have fallen into a 6.0 per cent growth trap as it has been unable to break out of it. To make a long story short, while the demographic dividend of a growing working age population continues to support growth acceleration, what is not fuelling growth is the stagnancy in the other of the two sources of Bangladesh's growth – the investment rate, which contributes to capital formation and a rise in productivity. Without any appreciable change in the investment rate for much of the past decade, GDP growth has also been stuck at around 6.0 per cent.

Yet, most analysts of the Bangladesh economic scene argue that Bangladesh's growth performance, though respectable by developing country standards, continues to remain below its potential of 7.0-8.0 per cent annual GDP growth. If that is true, how do we break out of this 6.0 per cent mold and move into the "7.0 per cent plus" growth trajectory?

To accelerate growth to the next higher level, i.e. "7.0 per cent plus", what is needed is the stimulation of Bangladesh's growth drivers. Two key drivers are well known: (a) investment, especially private investment and foreign direct investment (FDI), and (b) exports. Gross Domestic Investment (GDI) as a ratio to GDP, which has been stagnant for long, will have to rise to at least 31 per cent before we can see 7.0 per cent growth. Though public investment is critical for stimulating private investment, it is the latter that must break out of the stagnancy that has been witnessed in the recent past. A careful review of the relationship between aggregate investment and GDP growth suggests that the minimum investment rate (Gross Domestic Investment-GDP ratio) would have to be 31.5 per cent for a sustained growth of 7.0 per cent or more. And the rise in investment rate would have to be real, not statistical. Additionally, economies that grow at 7.0 per cent plus also attract substantial quantum of FDI, which must rise to at least 2.0 per cent of GDP in Bangladesh to get the required boost in growth.

With the Bangladesh economy fast integrating with the world economy, exports have become a strong growth driver and the economy needs to sustain the 15 per cent average annual growth – with diversification — to prop up 7.0 per cent plus growth. For that to happen, what is needed is a dynamic and globally competitive manufacturing sector, beyond readymade garments alone. Finally, what could be a driver of higher growth in Bangladesh is the rate of female labour force participation (FLFP). According to the World Bank, a rise in this rate from the current 40 per cent to one that is close to male labour force participation rate (80 per cent) in the country, when that materialises, could add as much as 1.7 per cent to the growth rate.

Bangladesh economy has been knocking at two doors simultaneously: a higher trajectory of 7.0 per cent plus growth rate, and crossing the threshold of a Lower Middle Income Country (LMIC), according to World Bank's income-based country classification. The current stable 6.0 per cent GDP growth rate will be sufficient to take the economy past the LMIC income threshold in the next year or two. But breaking into the higher growth trajectory of "7.0 per cent plus" on a sustained basis appears to be the tougher challenge to overcome.

Bottom line: our economy is on a respectable 6.0 per cent growth momentum; getting to the 7.0 per cent plus growth trajectory will require unblocking of several constraints to higher growth in the near term: (a) investment rate has to rise to 31 per cent of GDP – real, not statistical; (b) FDI inflow must exceed 2.0 per cent of GDP; (c) exports will have to grow by 15 per cent annually, and get diversified from a competitive and dynamic non-RMG manufacturing sector; and (d) female labour force participation rate must rise above 50 per cent. To conclude, the seven per cent solution beckons, and is within reach, but for a few hurdles on the way.