

## CHAPTER 2 : DEVELOPMENT PERFORMANCE AND CHALLENGES

5. Bangladesh has made strong progress towards reducing income poverty, placing it roughly on track to meet the target of halving the share of the population living on under US \$1 a day by 2015. Rising and stable economic growth underpinned by good economic and social policies has been a key factor in making this possible. Pioneering social entrepreneurship, partnered under innovative institutional arrangements, have contributed immensely to the successes attained. These have also enabled the country to cope with some critical weaknesses in governance. Given this growth record, the current challenge is to steer the economy to middle income status. To that end, the much improved economic fundamentals and successful implementation of an array of first generation reforms augur well. But the challenges ahead are formidable. Bangladesh will have to actively pursue a range of second generation policy reforms, necessary to sustain and improve her good growth and human development achievements.

### I. The Development Record

#### *Background: Recent poverty trends in Bangladesh*

6. **Poverty Trends:** Data from Household Income and Expenditure Surveys show sizeable poverty reduction in Bangladesh over the last 15 years (between 1991-92 and 2005) and more recently, between 2000 and 2005. Poverty headcount rates based on both upper and lower poverty lines using the Cost of Basic Needs (CBN) method show that the proportion of poor in the population declined considerably between 2000 and 2005 (Table 2.1). In the year 2000, 49 percent of Bangladesh's population was poor (per capita consumption below the *upper poverty line*) as compared to 40 percent in 2005. 34 percent of the population was extremely poor (per capita consumption below the *lower poverty line*) in 2000 as compared to 25 percent in 2005.<sup>6</sup> The percentage decline in poverty was higher in urban areas (24 percent) than in rural areas (19 percent).<sup>7</sup>

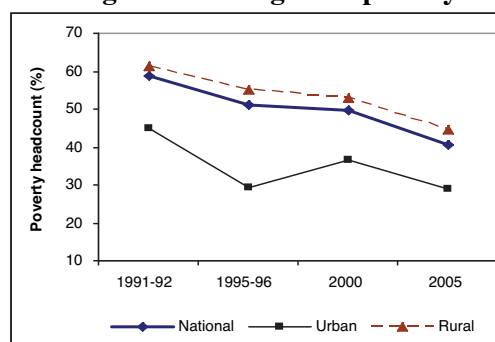
7. The long-term poverty trends show a significant decline in poverty over the period 1991-92 to 2005, with similar gains seen for urban and rural areas (Figure 2.1). Other measures of poverty, such as poverty gap and squared poverty gap show short and long-term

**Table 2.1: Poverty Headcount Rates (%)**

	Upper Poverty Lines		Lower Poverty Lines	
	2000	2005	2000	2005
National	48.9	40.0	34.3	25.1
Urban	35.2	28.4	19.9	14.6
Rural	52.3	43.8	37.9	28.6

*Source:* HIES 2000 and 2005; using poverty lines estimated with HIES (2005) and deflated to adjust for inflation during 2000-05  
*Note:* These figures are using BBS's adopted method of using the 2005 sampling frame to generate poverty lines and then deflating these lines to obtain poverty figures for earlier years.

**Figure 2.1: Long-term poverty trends**



*Source:* World Bank (2002); HIES (2005)

*Note:* The numbers are calculated using the Upper Poverty Line of 1991-92, adjusted for price changes between years

<sup>6</sup> Similar 8-9 percentage point declines in national poverty rate are also found employing different methods to calculate poverty lines and price indices, indicating that the measured reduction in poverty is similar across a wide range of methodologies. The robustness with respect to the choice of poverty lines is consistent with changes in the distribution of per capita expenditure between 2000 and 2005.

<sup>7</sup> The reduction in poverty headcount from 2000 to 2005 was statistically significant at 95 percent level of confidence for national and rural estimates, and at 90 percent level for urban.

## Accountability and Institutional Innovation in Bangladesh

trends similar to those for headcount rates.

8. **Growth in consumption:** The decline in poverty is driven by a sizeable growth in per capita consumption expenditure (Table 2.2). Per capita consumption expenditure increased by 12 percent in real terms between 2000 and 2005 – an average annual growth rate of 2.3 percent. While the increase in percentage terms was higher for rural areas (12 percent) than urban areas (5 percent), real per capita expenditure was still 39 percent higher for urban areas than for rural areas in 2005.

9. These figures are also broadly consistent with Bangladesh's macroeconomic indicators over the same period. Annual average growth in real GDP per capita as well as per capita private consumption was 3.8 percent during 2000-04—rates that are even higher than the growth in household consumption observed from survey data.

10. **How was growth distributed?** Growth in consumption occurred across the board for the poor and non-poor alike. Per capita consumption of the poorest and richest population deciles grew by 14 percent in real terms between 2000 and 2005, and that of the second-poorest and second-richest deciles by 12 and 11 percent respectively. Consistent with this trend, *relative* inequality as measured by the Gini index of per capita real consumption showed no change between 2000 and 2005. In fact, since 1995-96, the changes in national and urban/rural Ginis are too small to be statistically significant. On the other hand, *absolute* inequality has clearly increased nationally and for rural Bangladesh between 2000 and 2005, but remained almost unchanged for urban areas. Consistent with the Ginis, while relative differences (or ratios) between different percentiles of consumption have remained almost unchanged, the absolute *sizes* of the differences have increased from 2000 to 2005.

11. *Growth Incidence Curves* (GICs – measuring the annual average growth rate of per capita consumption for percentiles of the population) show that the highest growth in consumption during 2000-2005 occurred for the bottom 20 percent and top 10 percent of the population. Furthermore, growth rate for the bottom 30 percent is higher than the mean of growth rates (of all percentiles). A more disaggregated picture reveals that the rural GIC is similar in shape to the national one; whereas urban GIC is largely downward sloping, which indicates growth was more pro-poor than in the rural sector.

12. Decompositions of changes in poverty measures between growth and redistribution components yield results consistent with the above patterns. The effects of growth and redistribution act in opposite directions – with the growth effect contributing towards poverty reduction – nationally and for the rural sector. But in urban areas, growth and redistribution effects reinforce each others' impact in reducing poverty, and contribute almost equally to overall poverty reduction.

**Table 2.2: Mean Real (2005 rural Dhaka prices) Per Capita Monthly Consumption**

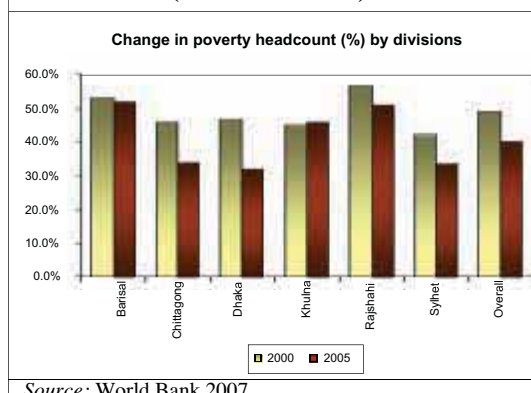
	2000	2005	% change
National	1082	1210	11.9
Rural	985	1103	12.0
Urban	1465	1535	4.8

*Source:* HIES 2000 and 2005

*Note:* To obtain real consumption, nominal consumption expenditures are deflated by price indices to adjust for inflation over time and by upper poverty lines to adjust for regional price differences.

13. **The regional picture:** While poverty reduction has occurred for both rural and urban areas, a disaggregation by geographic regions reveals a mixed picture (Figure 2.2). The largest decline in poverty incidence occurred for the Dhaka division, followed by Chittagong and Sylhet. By contrast, poverty headcount stagnated in Barisal and Khulna. A decomposition exercise shows that two divisions – Dhaka and Chittagong – contributed to as much as 79 percent of the aggregate reduction in poverty headcount between 2000 and 2005.<sup>8</sup> Regional differences were thus quite sharp in 2005 – the poverty headcount ranged from a low of 32 percent in Dhaka and 34 percent in Chittagong and Sylhet to over 50 percent in Barisal and Rajshahi.

**Figure 2.2: Poverty Levels by Division (2000 and 2005)**



14. Growth and poverty reduction since 1990 has been accompanied by faster progress on some human development measures. In the human development area, secondary school enrollment remained stalled at 19 percent between 1975-90, but has since increased to 46 percent; access to sanitation facilities has been doubled from 23 percent in 1990; children malnutrition rates (by weight) stagnated during the 1980s but have been reduced considerably since, although Bangladesh still has a lot of distance to cover in this respect.

15. In many ways, progress on most human development indicators (see Table 2.3) has been as impressive (or more so) than income growth and poverty reduction, and stands out in comparison with most low-income countries (See World Bank 2003).

**Table 2.3: Progress in Social Indicators**

	Then	Now
School enrollment, secondary (% net)	19 (1990)	44 (2005)
School enrollment, primary (% net)	71 (1990)	84 (2004)
Fertility Rate	7.0 (1972)	3.0 (2004)
Immunization, DPT (% of children ages 12-23 months)	1 (1980)	93 (2004)
Immunization, measles (% of children ages 12-23 months)	1 (1982)	76 (2004)
Improved sanitation facilities (% of population with access)	23 (1990)	64 (2005)
Life expectancy at birth, total (years)	45 (1972)	62 (2003)
Malnutrition prevalence, weight for age (% of children under 5)	68 (1983)	47 (2005)
Mortality rate, under-5 (per 1,000)	239 (1970)	88 (2005)
Mortality rate, infant (per 1,000 live births)	145 (1970)	65 (2004)

Source: GoB and World Bank

<sup>8</sup> This refers to a sectoral decomposition of changes in poverty headcount between 2000 and 2005, with the sectors as the 6 divisions. Total intra-sectoral effect accounts for 99.8 percent of the change in poverty headcount (Dhaka and Chittagong contributing 52 and 27 percent respectively); the population shift effect has an (opposite) effect of -0.4 percent, and the interaction between the population-shift and intra-sectoral effects contributes 0.6 percent.

## II. Moving Development Forward

### *More rapid growth needed to achieve the Millennium Development Goals*

16. Despite the good development achievements, formidable social and economic challenges remain. In 2004, Bangladesh's PPP US \$ per capita gross domestic product (GDP) was only US \$1,875 (or US \$440 at market exchange rates), compared with US \$3,115 in India, US \$5,494 in China, and US \$9,760 in Malaysia. The population of about 140 million is compactly packed in a land area of 147,570 sq. km., resulting in one of the highest population densities in the world, and about 2 million people are added to this each year. Some 63 million people live in deprivation, two-thirds of them caught in extreme poverty. The level of human development remains low despite the tremendous progress since independence. Adult illiteracy is persistent at about 50 percent and falling slowly, particularly among women. Child malnutrition rates are among the highest in the world, and maternal mortality rates, albeit lower than in India, Pakistan, and Nepal, are among the highest in the world outside of Sub-Saharan Africa.

17. At US \$440 in 2004, Bangladesh's gross national income (GNI) per capita was a little over half the US\$825 cut-off for Middle Income Country (MIC) classification used by IDA. The challenge for Bangladesh is to build on the growth momentum since the early 1990s to close this gap as soon as possible. If the country's per capita income grows at 3.5 percent (the average rate in the last ten years), it would take until 2022 to attain MIC status (as per the 2004 IDA classification). The transition to MIC status would be put on hold for another 5 decades if per-capita growth slips back to the 1 percent rate seen in the 1980s. Alternatively, Bangladesh could become an MIC within a decade (by 2016) if per capita growth could accelerate to 6 percent, implying GDP growth at a challenging (but not impossible) 7.5 percent. There is international precedence for such performance: for instance, average GDP growth in China has been close to 9.5 percent since 1976, while Indonesia, Malaysia, and Thailand each attained average growth rates of 7-8 percent for over two decades before the East Asian crisis in 1997. A possible hypothetical scenario of Bangladesh's transition to MIC status by 2016 is outlined in Table 2.4 below.

**Table 2.4 Hypothetical Scenario of Bangladesh's Transition to MIC Status**

	1996-2000	2001-05	2006-08	2009-12	2013-16
GDP Growth	5.2	5.4	6.8	7.5	7.5
Capital Stock Growth	6.7	7.5	8.0	8.4	9.0
Labor (quality adjusted) Growth	3.4	5.2	5.0	4.7	4.5
TFP Growth	0.5	-0.8	0.6	1.2	1.2
Investment Rate ( % of GDP)	23.0	24.4	25.6	27.8	30.5

*Source: BBS, Barro-Lee (2000), and staff calculations*

18. The key requirement to approximate this hypothetical scenario is to boost productivity growth and capital accumulation. Not only would the recent declines in TFP growth have to be reversed, TFP growth rates would also have to increase significantly above previously attained levels. Progress on this will be predicated upon tackling the structural constraints (see below). In addition, capital accumulation will need to accelerate, with the underlying investment rate increasing by as much as 5 percentage points. Demographic trends would be conducive, with a rising share of working age population (in total) tending to raise household savings rates, as has happened in India and other countries. Increases in domestic savings would also depend upon improvements in the domestic financial intermediation. The government budget is unlikely to be a significant source of additional savings even as revenue generation catches up from its current low levels. It would be important, however, to tackle the mounting losses of the energy SOEs—estimated at 1.1 percent of GDP in FY06—to make space for private investment and the priority development spending. FDI would need to pick up pace, although that would require better economic governance and business environment. Remittances and donor support would continue to play an important role.

19. Continued strong growth in quality-adjusted labor would also be important. A special emphasis on women's advancement would bring considerable growth dividends. Only about one-quarter of the working age women participate in the labor force, compared with at least double that in advanced economies. Educational attainment of the labor force should increase as a result of the higher school enrollment rates over the past decade. However, more emphasis on improving the quality of education and making it more market oriented would be needed.

***Managing the key transitions***

20. Based on the major structural transformations already at play in Bangladesh and also connecting those to the experiences of other successful developing countries, it appears that the following four transitions will have to be better understood and managed:<sup>9</sup>

- A middle income Bangladesh will have reached a more advanced stage of ***transition out of agriculture and into the industrial and services sectors***. In particular, the country would have a much deeper manufacturing base driven by globally competitive private firms.
- A middle income Bangladesh would be significantly ***more open to investment and trade***, where Bangladeshi firms will be plugged into global supply chains and the country will figure prominently on global investment maps.
- A middle income Bangladesh would be able to provide ***more ample and productive job opportunities to citizens***.
- A middle income Bangladesh will be ***far more urbanized*** than today.

***Transforming the Labor Market to Provide Fuller and More Productive Employment***

21. The labor force has been growing at an increasingly rapid rate, with growth rates reaching 4.3 percent—more than two-and-a-half times the population growth rate—between 2000-2003. Increasing by almost 2 million each year, the labor force has reached an estimated size of around 50 million. Two important factors have caused the rapid increases: the phase of the demographic transition Bangladesh is in and increasing female participation. Both forces are expected to persist in the foreseeable future (although with some slowing down).

22. The economy has been able to only partially accommodate the increase in the labor force. While most of the new entrants were able to find a job, this was accompanied by a sharp increase in the underemployment rate in almost all major economic sectors and for all job statuses. This meant that rather than creating new jobs, many of the new entrants were accommodated by “dividing up” jobs that already existed. Consistent with the increase in underemployment, the average hours worked per week declined for all economic sectors, with the sharpest reductions occurring in manufacturing, construction, transport and communication services. However, the extent of the decline in average hours worked was much smaller than the increase in the underemployment rate. Job creation was also not necessarily in the most productive sectors.

23. Improving the labor market conditions is critical for growth and poverty reduction in Bangladesh. Labor, it is often said, is Bangladesh's most precious resource, one that has the potential to unleash a rapid transition toward prosperity under the right conditions, as the East Asian economies have shown. A relative abundance of labor provides Bangladesh with a comparative advantage in production

---

<sup>9</sup> The Government's PRSP draws out another major ongoing transformation with implications for long-term growth: the evolution of the meso-economy (rural market centers): formal and informal activities in service, trade, construction and small industries that are rapidly expanding in the rural market centers. The area, no doubt critical, is still little understood. Its analytical underpinnings need to be deepened for incorporating it into the mainstream growth story.

## Accountability and Institutional Innovation in Bangladesh

of labor-intensive goods. But this does not automatically translate into global competitiveness, which depends on a host of factors that affect productivity. Productivity is also being undermined by a number of labor market conditions themselves.

24. Unlike in neighboring India, labor laws and regulations do not appear to be serious hindrances to the functioning of the labor market. Union activity is also limited, though there are frequent, politically-motivated nation-wide strikes (*hartals*), which adversely affect labor productivity. Overall, firms retain considerable flexibility to hire and fire, which is also confirmed by results from the *Investment Climate Assessment* and *Doing Business* surveys. Of more serious concern are some structural barriers that impair the efficiency of the labor market and need to be tackled:

- ***There appears to be a mismatch between economic performance and labor allocation.*** Allocation of labor across major economic sectors has had little to do with growth performance of those sectors, as seen in the table below. Part of the reason is that most of the women entrants into the rural job market enter as unpaid family workers, more often than not in the agriculture sector. This group has very limited mobility; out of agriculture and certainly to urban areas where the more productive jobs are. While continued gender empowerment would be needed to increase their mobility, that will be worth little if the manufacturing sector does not do better in terms of job creation.

**Table 2.5: Economic Performance and Labor Allocation**

	Share of Increase in GDP (%), 1996-2003	Share of Increase in Employment (%), 1996-2003
Agriculture, Forestry, Fisheries	18	62
Manufacturing and Mining	18	10
Construction	12	6
Services	52	22

- ***The manufacturing sector has its own set of structural inefficiencies.*** Real wages in the sector have increased sharply while the sector was sluggish in creating new jobs. This could arise from any combination of: an improvement in labor productivity in the sector; a premium on certain skill sets that are not readily available and preclude leveling out of wages; informational problems that prevent matching of jobs with available workers with the right skills; and wage setting by collective bargaining. While collective bargaining doesn't seem to be prevalent in Bangladesh, the other three forces appear to be at play.
- ***Part of the reason for real wage inflation in manufacturing could be the pressures from the public sector.*** Public-private segmentation is apparent in the considerable wage premium (over 30 percent) for public jobs. Analyses have shown the disparity to be arising from the lower-end (classes III and IV) public sector jobs. Not only does this lead to rationing of the high premium public sector jobs, it also distorts wage signals across the economy.
- ***Another segmentation is between urban and rural areas:*** Urban areas provide more employment opportunities (more hours of employment) in addition to a significant wage premium. The barriers to rural-urban mobility of labor – that would also be productivity improving – likely have to do with the shanty living conditions in the cities, especially for fresh migrants and the poor, and the higher cost of living.
- ***Female workers continue to face considerable barriers in the labor market.*** Improvements notwithstanding, only a quarter of working age females participate in the labor force. This emanates mostly from the social barriers commonly seen in developing countries, but it is hard to

imagine a path of rapid development, if three-quarters of females are not there to participate in and shape it. The solutions of more education and female empowerment are happening but could be speeded up.

- ***The quality of labor is not only low but also does not seem to match the needs of the labor market.*** On average, the employed labor force has only 4 years of schooling; 4.2 years on average for male workers and 3.2 years for female workers. In addition, it is a major loss to productivity when even this scarce human capital is not properly utilized, as highlighted by the fact that almost a fourth of the unemployed hold a SSC, HSC or higher degree: 30 percent in the case of women. This is consistent with studies that have found substantial gap between the skills demanded by the market and those being supplied by the system. A focus on market oriented vocational skills and good quality secondary and tertiary education, therefore, appears essential in addition to consolidating earlier gains on primary education.