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KEC POLICY **BRIEF**

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Key drivers of the Bangladesh success story[1]

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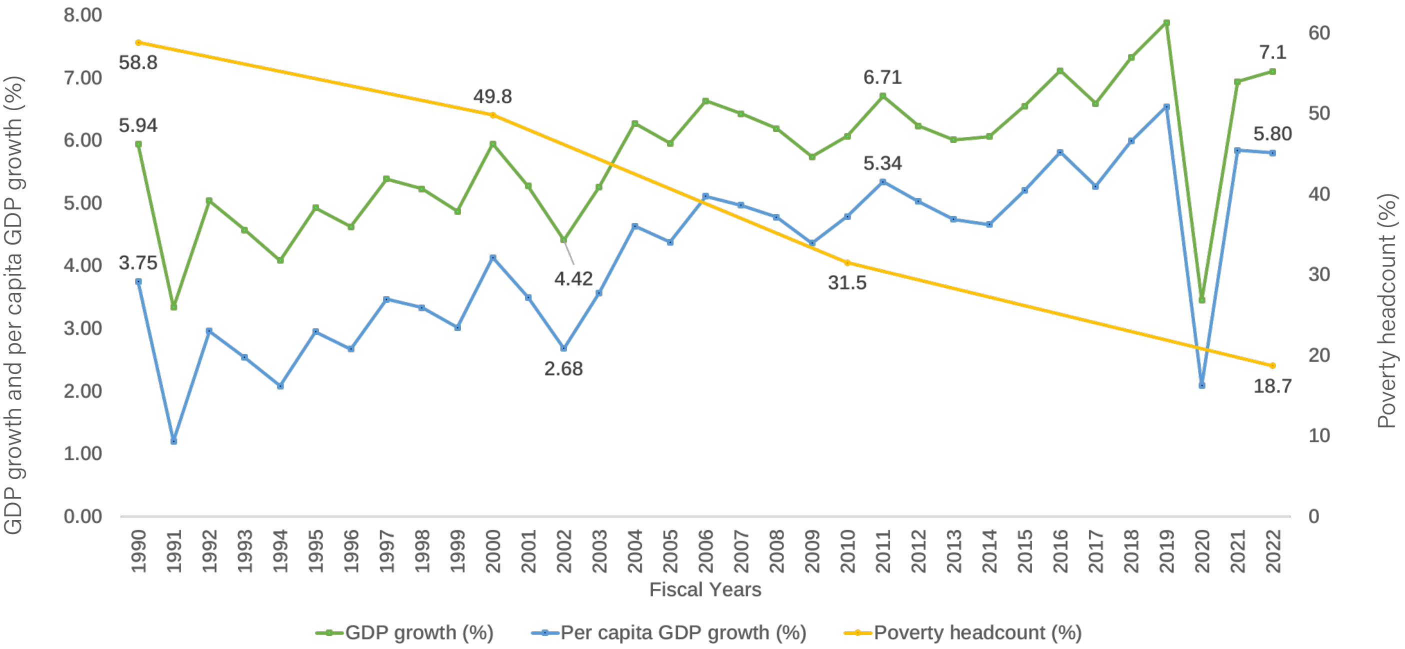
After winning independence in 1971, Bangladesh emerged as the world's 9th poorest nation, with a poverty rate exceeding 75%. Today, it is the 35th largest global economy (GDP USD 450 billion). Steady, rising growth propelled this remarkable journey from being a 'test case of development' to becoming a recognised 'success story of development' (Dercon, 2022).

Driven by the right policies, visionary entrepreneurs, and a tenacious workforce, Bangladesh has become the world's second-largest exporter of readymade garments (RMG). The economy has been going through structural transformation, which fits in with the 'stylised facts' of development: industry share in GDP rose

Figure 1. GDP growth, per capita GDP growth, and poverty trends (FY 1990 to FY 2022)



Source: Bangladesh Bureau of Statistics

Bangladesh's economic and societal transformation – despite missed opportunities – can be traced through a long term lens. Reforms after the 1990s led GDP to grow 5.7% per annum on average for three decades and 6.4% from 2011 to 2020. Poverty has fallen from 59% in 1990 to 18.7% in 2022 (Figure 1). Extreme poverty has nearly been eradicated.

from 17% in 1980 to 37.5% in 2023; agriculture share fell steeply from 33% to 11%; but services, largely informal, has stayed at 51%-54% (Figure 2). Most notable is the rise of the manufacturing sector, from 11% to 24%, driven largely by superior export performance, and showing no tendency towards deindustrialisation. Export-oriented production contributes almost 50% of manufacturing value added currently.

» [1] This paper is based on a lecture delivered by the author at the Kautilya Economic Enclave, 2023 (KEC). Any opinions and conclusions expressed herein are those of the authors only and do not necessarily represent the views of the institutions organising the KEC.

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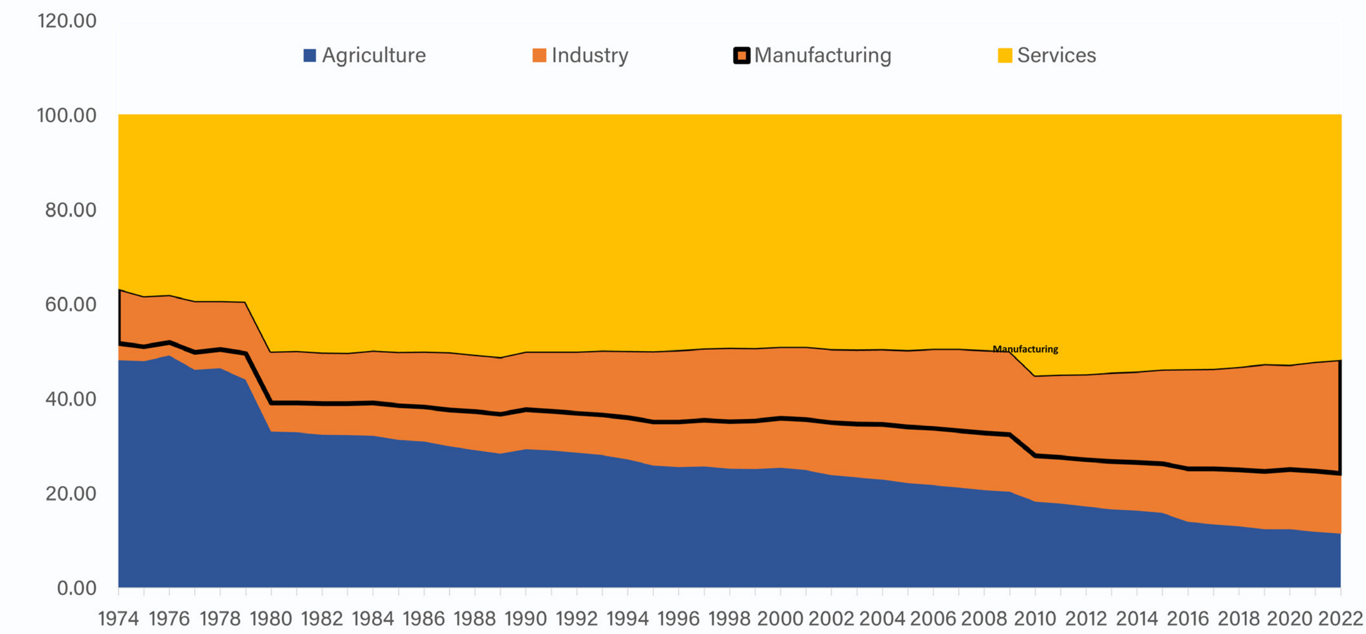
Figure 2. Structural transformation in Bangladesh (FY 1974 to FY 2022)



Source: Bangladesh Bureau of Statistics

So, what might be the secret of Bangladesh's success story?

Trade has been a key driver of Bangladesh development. The strategic shift from an inward looking trade strategy to an outward-looking export-oriented approach in the 1990s earned the nation the moniker of a 'globaliser' among developing economies (Dollar and Kraay, 2001). Driven by comparative advantage following (CAF) strategies, this transition aligns with the proven benefits of globalisation outlined by the World Bank and Nobel Laureate Michael Spence's Growth Commission.

Despite limited success in RMG until 1990, Bangladesh embraced export led growth strategy and showcased a major transformation from exporting primary products like jute, tea, shrimp, etc., in the 1970s. Apparel-making was a labour intensive activity. And Bangladesh's abundant, cheap, low skilled labour was just the resource needed to produce and exchange competitively in the world market.

BOX: DEVELOPMENT PARADIGMS BUILT ON TRADE OPENNESS

The four Asian development models

- Export – led growth – East Asia
- Export – led growth with FDI – China
- Export – led growth with FDI, FTA, GVC – Vietnam
- Export – led growth with trade policy dualism – Bangladesh

Liberalising reforms in the 1990s a la the augmented East Asia model (Box) generated momentum – driving export - oriented manufacturing growth, job creation, and poverty reduction – over the past three decades.

Bangladesh has crossed its 50th anniversary of independence. Provided its policymakers can rise to the immediate challenges, domestic and global, the momentum for sustainable growth at more than 7% is palpable. Despite disruptions from the COVID 19 pandemic and the Russo Ukraine conflict, signs indicate that Bangladesh is coping with external challenges and seeking a rejuvenated growth strategy to return to its pre-pandemic growth path.

However, to capitalise on opportunities in the 21st century global marketplace, aggressive trade policies and economic reforms – echoing the success stories of East Asian economies – are imperative. But can Bangladesh rely on the RMG sector to sustain its growth? That is the million-dollar question in academic and policymaking circles. And this question highlights the need for diversification and strategic initiatives to ensure sustained economic dynamism and resilience.

Bangladesh's remarkable success in the **RMG sector** has led to apparel constituting 84% of its exports. This success is closely tied to a unique trade policy duality. The RMG sector operates as a free trade enclave and benefits from special provisions like special bonded warehouses for duty free (world-priced) imported inputs. This contrasts sharply with the high-tariff, restrictive import regime faced by non-RMG exporters, hindering their growth and competitiveness.

The anti-export bias of the tariff regime poses a challenge to non-RMG exports and discourages diversification. Despite Bangladesh's potential comparative advantage in a variety of sectors, and due to the prevailing protectionist environment that makes domestic sales far more profitable than exports, non-RMG exports struggle. The exports of RMG have soared worldwide, accounting for 82%-84% of the export basket. This concentration makes the economy vulnerable and underscores the urgency for export diversification. Despite Bangladesh's labour cost advantage, and due to high domestic tariff protection, the effort to diversify into labour-intensive products beyond RMG face hurdles.

The tariff structure has become a binding constraint on export diversification. To break the stated trade policy dualism, several strategies are relevant.

First, domestic tariff–induced protection should be reduced to make exports more attractive. The National Tariff Policy 2023 plays a crucial role in addressing this. Second, a vigorous plan for geographical diversification into East Asia and the Pacific is essential.

Third, export competitiveness measures, like trade infrastructure and the ease of doing business, should be improved. Fourth, strategies should be formulated for diversifying into higher-value RMG items and expanding man-made fibre exports.

Fifth, intermediate goods production for exports and export-seeking foreign direct investment (FDI) should be sought for integration into global value chains (GVC). Finally, ensuring a flexible and non overvalued exchange rate is crucial for robust export performance and diversification.

Remittances from migrants constitute 5%-6% of the GDP of Bangladesh. Steady flows of remittances have had important stabilising effects on the balance of payments.

Remittances, a vital factor services export, contribute to consumption, investment, and the sustainability of external balance (facilitating the accumulation of foreign exchange reserves); drive robust growth; and positively affect poverty reduction and development.

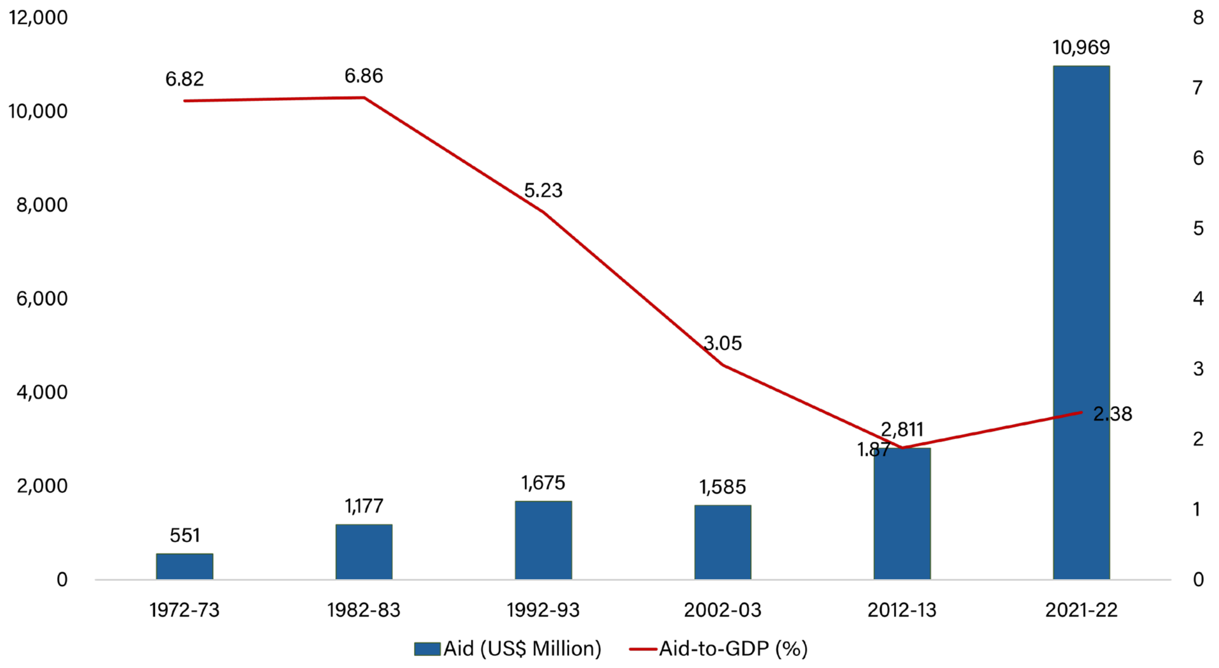
The chronic trade deficits – resulting from the import-dependent development programmes, and that arguably involve the rising imports of machinery, capital goods, and industrial raw materials – have been regularly offset by consistently rising remittance inflows.

The rise of **agriculture** brought food self-sufficiency within reach. Bangladesh has transformed from being a food-deficit nation in 1971 (relying on food aid) to becoming nearly self-sufficient in food production (rice, wheat, and maize) in 2023, with an annual production of 46 million metric tons. This success was facilitated by proactive government measures and the adoption of high-yielding varieties (HYV) of seeds. A pivotal role was played by the liberalisation of agricultural input markets in the 1980s, the government's reduction of control, and the fostering of private sector participation. This transformative policy shift enhanced agricultural productivity and contributed to the overall economic landscape. Private enterprise engagement, climate-resilient crop varieties, rising mechanisation, and effective disaster management bolstered the agricultural sector, turning subsistence farming into a quasi-commercial enterprise and securing a stable domestic food supply.

Nongovernmental organisations (NGO) have been instrumental in Bangladesh's development, particularly in poverty reduction, and in delivering accessible and effective health services, fostering education, and providing targeted credit initiatives. What sets Bangladesh apart, as observed by Stefan Dercon (2022), is that 'this expansion has been primarily driven by local NGOs, and in no other developing countries have indigenous development organisations, set up explicitly to support poor populations, had such an impact'.

Finally, **official development assistance (ODA)** has catalysed the country's rapid progress. Bangladesh, though not perfect, is a notable example of effective aid utilisation – 25 million people have been lifted out of poverty in 25 years, and the World Bank calls Bangladesh 'an inspiring story of reducing poverty'. Bangladesh is not only a story of development success but also a model of development cooperation. Since

Figure 3. Trend in aid (US$ million) and aid-to-GDP ratio (%)



Source: Flow of external resources into Bangladesh, Ministry of Finance

independence in 1971, ODA has been rising, from $8 per capita in 1972 to $65 in 2022. Throughout this period of development progress, the reliance on aid has been falling, from 6.8% of GDP down to 2.4% (Figure 3) – a crucial sign of aid effectiveness.

In FY 2023, concessional debt formed 94% of the outstanding public external debt of $70 billion. The interest rate averages 1.3% and the repayment period is 23 years. The World Bank IMF Debt Sustainability Analysis finds that annual debt servicing is under 5% of its foreign exchange earnings and that the country's debt carrying capacity is strong.

Evolving geopolitics is transforming trade. China+1, a strategy of diversifying supply chains, introduces both opportunities and challenges for Bangladesh. The shifting geopolitical landscape signals a significant transition in RMG sourcing. China, once the predominant choice, has lost a quarter of its RMG exports since 2020, prompting buyers to seek alternatives. Offering advantages in price and capacity, satisfactory quality, and acceptable speed and risk levels Bangladesh emerges as a prominent contender.

In light of the shifting geopolitical order and the rising wage costs in China, at least $100 billion of the $625 billion apparel market in 2030 will move away from China, reports McKinsey Global. In 2022 China exported $165 billion of apparel (31% of world exports); meanwhile Bangladesh's share edged up from 6.3% in 2020 to 7.9% in 2022.

Bangladesh's entrepreneurs must adapt to accommodate evolving sourcing strategies away from China. In the long term, Bangladesh needs proactive measures to spot opportunities, enhance competitiveness, and leverage the global marketplace for future growth. To secure a prosperous future, Bangladesh needs to prioritise new drivers of growth. It needs to shift from a price-led competitiveness model to one grounded on quality and innovation. That warrants substantial increases in health and education expenditures to catch up with comparators and focus sharply on upskilling the workforce of the future.

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