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Growth in uncertain times

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Following the publication of Nobel laureate economist Robert Solow's seminal work A Contribution to the Theory of Economic Growth in 1956, it has been widely believed that economic growth is a continuous process that will persist forever. While boom and recession are mirror image of a business cycle, prolonged recession and weak recovery in the advanced economies and less than projected growth in most developing economies prompted many to rethink about the future of economic growth.

Bangladesh economy was projected to grow at 7.0 to 7.2 per cent in the fiscal year 2012 and even higher in subsequent years, according to the Sixth Five Year Plan. However, most estimates provided by the International Monetary Fund (IMF), World Bank (WB) and Asian Development Bank (ADB), among others, indicate that the economy could grow at around 6.0 per cent during the current fiscal year.

The ADB's Asian Development Outlook 2013 indicates that growth could slip to below 6.0 per cent (5.7 per cent) in the current fiscal year. Earlier the WB also revised down its GDP growth forecast to 5.8 per cent. Slowdown in private sector credit, export and import growth in recent months indicate that the economy may not achieve the target growth during the current fiscal year. Nevertheless, higher than expected remittances flows, decline in LC opening and better FDI flows could strengthen the balance of payment position. Slackening domestic demand could help subsiding inflationary pressure.

This growth shortfall seems not a one off event given the uncertainties in the global economy as well as policy and political uncertainties at home. This means Bangladesh might not achieve the target growth set by the Sixth Five Year Plan and could miss the opportunity to join the 'seven per cent club' of economies sustaining at least 7.0 per cent growth annually for an extended period. Economists at Standard Chartered Bank earlier expected that Bangladesh could join the club along with China, Cambodia, India, Mozambique and Uganda.

As far as external factors are concerned, the global economy, notably the developed economies, risks undergoing extended period of slow growth rates. The recovery in Europe and in the United States (to some extent) faces new setback. This could cost Bangladesh's growth to some extent.

Uncertainties in the global economy, notably in the advanced economies, are captured in a number of influential publications. World Economic Outlook 2012 of IMF outlined the factors such as fiscal consolidation and weak financial markets hurting the recovery in the west. Growing public debt and deleveraging are costing their growth outlook.

However, what worries us most is the elevated uncertainty in these economies. Both macroeconomic and policy measures of uncertainty generally rise during economic recessions. When uncertainty rules, very little or nothing is known about the future state of an economy. Faced with the higher uncertainty businesses reduce their investment demand and households lessen their consumption demand. The report observed that the recent pickup in uncertainty raises the spectre of another global recession.

Empirical analysis indicates that one standard deviation (how much variation or dispersion exists from the average/mean) increase in uncertainty is associated with a decline in output growth of between 0.4 and 1.25 percentage points depending on the measure of macroeconomic uncertainty. Policy-induced uncertainty has increased to record levels since the Great Recession. An uncertainty index developed by two American economists shows that the index hit its highest in 25 years during debt-ceiling battle in 2011 and remains high. They calculate that the rise in uncertainty between 2006 and 2011 reduced real GDP (gross domestic product) by 3.2 per cent and cost 2.3m jobs.

Economic growth outlook in the neighbourhood in general and Asia in particular is not bleak but the region's high growth economies, notably China and India, could experience relatively lower growth in 2013 and 2014. Experiencing near double-digit growth for many years China's economy could expand 8.0 per cent, according to ADB's 2013 outlook. Indian economy could experience 6.0 to 6.5 per cent growth. East Asia, in particular, is becoming an important market for Bangladesh as direction of trade with the region is on the rise. While growth in developing Asia could range between 6.0 to 7.0 per cent, one downside risk is the region has not decoupled from the advanced economies' growth.

Being a smaller economy and price taker in the international markets Bangladesh can do little in mitigating growing uncertainties in the global economy. What worries investors and consumers more than the global environment is the growing policy and political uncertainties at home.

Bangladesh has largely failed to take the advantage of the gradual shift in global production to low-cost countries. Policy uncertainties in terms of infrastructure and power sector development mean stagnation in its investment-to-GDP ratio (about 25 per cent of its GDP). Bangladesh has failed to secure billions of dollars of cheap money from donors and development partners to develop these two sectors, critical for manufacturing growth, due to, among others, the country's weak governance, corruption and lack of political commitments.

While the Padma bridge project is an oft-cited case in this regard, the list of failure in infrastructure sector is indeed quite long. The government has largely failed to make much headway in developing base load power plants, critical for cost-effective electricity production. Its increasing focus on rental power plants has not only generated huge economic inefficiencies and corruption, but also gave a wrong signal to the donors and investors. Similarly, due to its policy inertia and lack of a geo-strategic vision the economy is missing an opportunity to develop the coastal belt of Chittagong like the east coast of China. This could have been done by developing a deep-sea port and export processing zones.

The next point to ponder is the nexus between political instability and economic growth. Domestic political weaknesses arising from incomplete democratic transition and weak consolidation efforts result in political instability that affects the economy adversely. A recent study conducted by the Dhaka Chamber of Commerce and Industries shows that the total revenue loss of the country amounts Tk 2.50 billion in a daylong strike.

There are several channels through which political instability could affect economic growth. Academic research indicates that political instability is likely to shorten policymakers' horizons leading to sub-optimal short-term macroeconomic policies. Socio-political instability generates an uncertain politico-economic environment, raising risks and reducing investment. As political instability is linked to greater uncertainty about future economic policy, it is likely to affect investment adversely.

There is no denying that even after two decades of democratic rule Bangladesh has failed to develop key political institutions that could have facilitated a smooth transition process. This democratic deficit is costing the country's growth. However, good economic policies could have limited the impact of bad politics had the government formed a strong economic and geo-strategic team when they assumed power. We rather have witnessed the rise of 'big ticket' corruption, reflected by a series of financial and other scams. Poor regulation, policy uncertainties and the rise of 'illiberal state' gave wrong signal to investors.

To sum up, Bangladesh economy has showed much promise to grow at 7.0 to 7.5 per cent per annum when the current government took office in 2009. The path of higher growth has also been outlined in the Sixth Five Year Plan. However, at the end of its tenure economic prospects are overshadowed by a plethora of uncertainties owing to adverse developments both at home and abroad. The growing uncertainties could dampen investment and consumption demand significantly and with lag effects of six to 18 months, the economy is likely to experience their adverse consequences in the last quarter of the current fiscal year and subsequent years. This means Bangladesh economy has to be satiated with lower than its trend growth rates in the next couple of years.

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