Bangladesh's Development Dilemma: Assessing the Risk of Bangladesh's Descent into the Middle-Income Trap

Many least-developed countries share the common goal of transitioning to middle-income status, and Bangladesh is among the few countries that have made significant progress toward this objective. Bangladesh achieved the status of a lower middle-income country in 2015 and aspires to go beyond a developing country, with plans to become an upper-middle-income country by 2031 and a developed country by 2041.

In 2021, Bangladesh was ranked as the 32nd largest economy in the world based on GDP, with notable exports including knit t-shirts, non-knit men's suits, and knit sweaters. The country's main export destinations were the United States, Germany, Spain, the United Kingdom, and Poland. Bangladesh was also the world's largest exporter of non-knit men's shirts, jute yarn, jute and other textile fibers, and textile scraps in 2021.

The World Bank classifies countries into four income groups based on GNI per capita, with the classifications updated annually on July 1. As of 2021, the income groups are categorized as low (<1085 USD), lower-middle (1086-4255 USD), upper-middle (4256-13,205 USD), and high income (>13,205 USD).GNI measures are expressed in USD and are determined using conversion factors based on the Atlas method.

Countries often start their economic growth journey with an agrarian base and then transition to an industrial economy, followed by a predominantly services-oriented economy. This growth process contributes to rising per capita income, enabling a country to move from low-income to higher-income categories. Growth slowdowns are often attributed to productivity slowdowns. Bangladesh's growth has been largely driven by its success in garment exports, which account for 84 percent of its total exports, and remittances from overseas that amount to over 6 percent of its GDP. The investment is a principal driver of growth, with its share in GDP rising from 24 percent in 2000 to 32 percent in 2019. However, the contribution of total factor productivity to growth has been minimal, remaining below 1 percent per annum since 2000, which is a key determinant of long-term income growth for countries.

Despite its success in the garment industry, Bangladesh has remained focused on a narrow range of relatively low-value garments for over forty years, with a falling share of exports in GDP, declining from a peak of 20 percent in 2012 to 15 percent in 2019.

An overreliance on investment-driven growth without adequate consideration of efficiency gains, innovation, structural reforms, resource allocation, and environmental sustainability may have implications for TFP growth in the long run. Once the investment slows down or diminishes, the growth momentum may wane, leading to economic slowdowns or even recessions. (Ahmed, M., & Chowdhury, T. T.). Investment-driven growth can sometimes result in overinvestment or asset bubbles, where excessive investment is concentrated in certain sectors or assets, leading to inflated prices and potential risks of economic imbalances.

From Figure 1, we can see that the majority of the contribution to GDP comes from investment. Which has risen from 24 percent of GDP in 2000 to 32 percent in 2019. But at the same time, we can see that the share of contribution of export to GDP has decreased from 2014 to 2021, this has to do with the over-reliance on a narrow range of low-value garment exports for over four decades, with the share of exports in GDP declining from 20% in 2012 to 12% in 2021. Moreover, diversification has been hampered by weak private investment in new industries, compounded by limited access to credit, particularly for small and medium enterprises. The country's economy remains relatively closed, with high tariff barriers that exceed the South Asian average and are nearly double the average for lower-middle-income countries. This has resulted in an inward-looking approach, with firms engaging in rent-seeking activities.

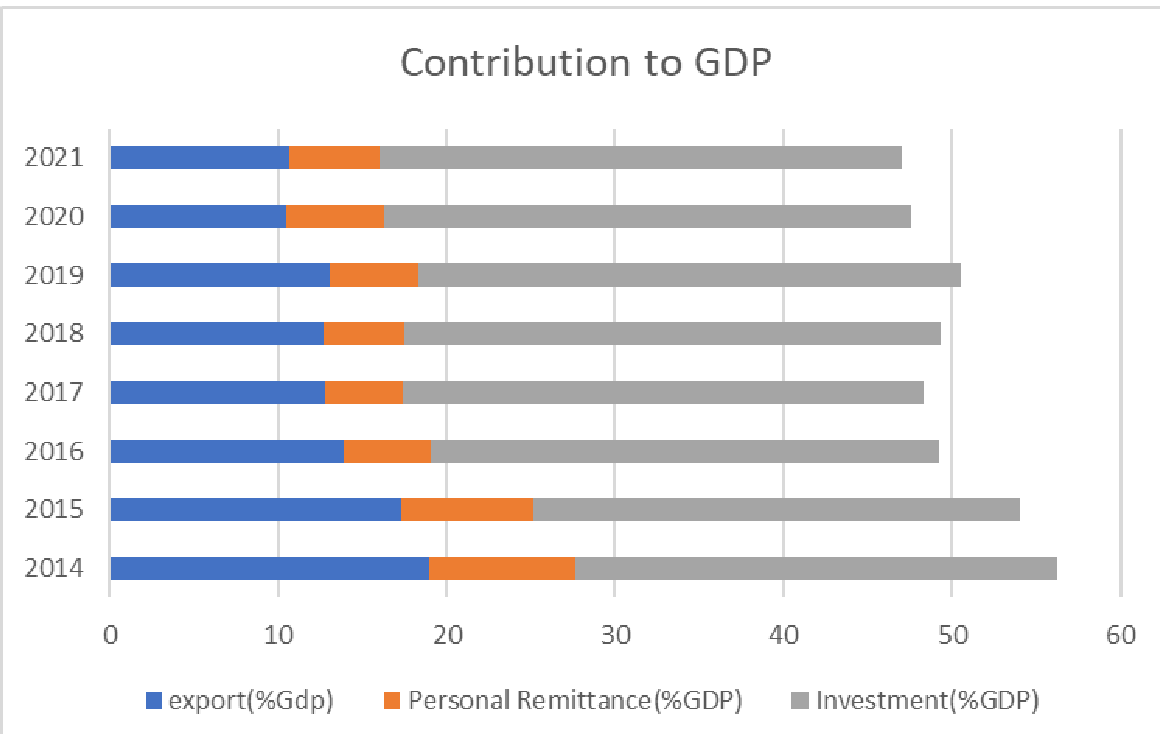

Figure 1: Data Source World Bank

Therefore avoiding the middle-income trap becomes a question of how to grow fast enough so as to cross the lower middle-income segment in at most 28 years, and the upper-middle-income segment in at most 14 years. (Jesus Felipe)

The transition from low-income to middle-income country status is often driven by cheap labor and export-oriented economic models, which may result in prolonged low growth rates. Some countries, such as Japan, South Korea, and Singapore, have successfully transitioned to developed country status, while others, like Argentina and Greece, have not been as successful.

The rapid transition from low-income to middle-income status can lead to reduced competitiveness in labor-intensive goods production as wages rise. These "newly minted" middle-income countries may struggle to compete with both low-income countries that still have lower wages and high-income countries that have advanced technology and innovation. This can result in sustained growth slowdowns and the emergence of informal economies in these countries. The intuition behind this is that the rising wages in middle-income countries can erode their cost advantage in labor-intensive sectors, leading to decreased competitiveness and economic challenges.

Furthermore, transitioning from middle-income to higher-income status can be challenging for countries due to institutional arrangements that may create vested interests benefiting from the status quo. If these vested interests are not addressed, countries may face stagnation and struggle to move to the next level of development. This underscores the importance of addressing entrenched interests and promoting reforms that support sustained economic growth and development.

Success stories of Japan, South Korea, and Singapore

Countries like Japan, South Korea and Singapore remain prime examples to learn from and prepare for the race to emerge as a high-income country.

Japan implemented an ambitious income-doubling plan after World War II, which initially seemed impossible. However, a series of well-planned measures in agriculture, industry, and commerce, including raising farm product prices, cutting taxes, and promoting trade liberalization, produced dividends in the 1960s, known as the "Golden Sixties" of Japan. The economy experienced rapid growth, with gross national product doubling in six years and average per capita income doubling in seven years. The government also made significant investments in infrastructure, communications, and technology innovation, while working towards balancing urban and rural development.

South Korea initiated the New Village Movement in 1970 to reduce the gap in living standards between urban and rural areas. The early stage focused on improving basic living conditions, while later projects focused on rural infrastructure and increasing community income. Education was also heavily invested in to develop human capital. The success of the movement in rural areas led to its expansion nationwide, becoming a modernization movement. As a result, the income of farmers in South Korea increased significantly, surpassing that of city dwellers. By the 1990s, the urbanization rate had reached above 70%, and the rural population had decreased to less than 10% of the total population. In addition to the New Village Movement, the South Korean government also implemented social safety nets to reduce absolute poverty, including measures for low-income individuals and underprivileged groups.

Singapore, after separating from Malaysia in 1965, implemented a talent hunt program with a strong emphasis on education as the key to success. From the 1980s onwards, the Singaporean government invested significantly in education, allocating a substantial portion of the annual state budget to education funds. Primary, secondary, and tertiary education is largely supported by the state, with equal emphasis on basic, advanced, and vocational education, as well as promoting creative and critical thinking. Higher education and vocational training have led to increased skills, job opportunities, and income for Singaporeans, resulting in the growth of the middle class in the country. The Singaporean government also offers preferential policies to attract foreign professionals to work and live in the country, contributing to the economy. Zero tolerance against corruption has been a significant hallmark in the successful advancement of Singapore towards a high-income society, supported by a stable and mainstream middle class.

Why do countries find it difficult to overcome the Middle-income barrier?

Brazil, despite being predicted to achieve high-income status in the 1960s, has remained stuck in the middle-income trap for over half a century. Several factors have contributed to this situation. One key factor is poor levels of investment, which have limited the country's ability to grow its economy and create higher-paying jobs. Additionally, low take-up of tertiary education has hindered the development of a skilled workforce necessary for driving innovation and productivity. Political instability has also been a significant challenge, as it can disrupt policy continuity and deter foreign investment. High inflation rates have further undermined economic stability, leading to reduced investor confidence and hindering long-term growth prospects. Collectively, these factors have impeded Brazil's ability to break free from the middle-income trap and achieve high-income status.

Despite having significant economic potential, Malaysia has remained in the middle-income category, and Malaysian Prime Minister Anwar Ibrahim has identified poor governance and corruption as key factors hindering the country's progress toward becoming a successful economic power. Poor governance practices, including weak institutional frameworks, lack of transparency, and ineffective policy implementation, have limited Malaysia's ability to harness its economic potential fully. Corruption, both in the public and private sectors, has further eroded trust in the country's institutions, hindered foreign investment, and impeded economic growth. These issues have contributed to Malaysia's inability to break free from the middle-income trap and achieve higher income levels.

Where Does Bangladesh Stand

For Bangladesh to escape the middle-income trap within 42 years, it has to overcome the lower middle-income category by 2049 and the upper middle-income category by 2063. For this to happen, Bangladesh has to grow at a rate of 1.9% till 2049 to overcome the Lower-middle Income trap and at a growth rate of 8.5 % after that till 2063. In order to graduate from middle-income to Developed Income status.
However, if Bangladesh continues to grow as it is right now, it will surpass the middle-income segment by 2026 and the upper-middle-income segment by 2035.

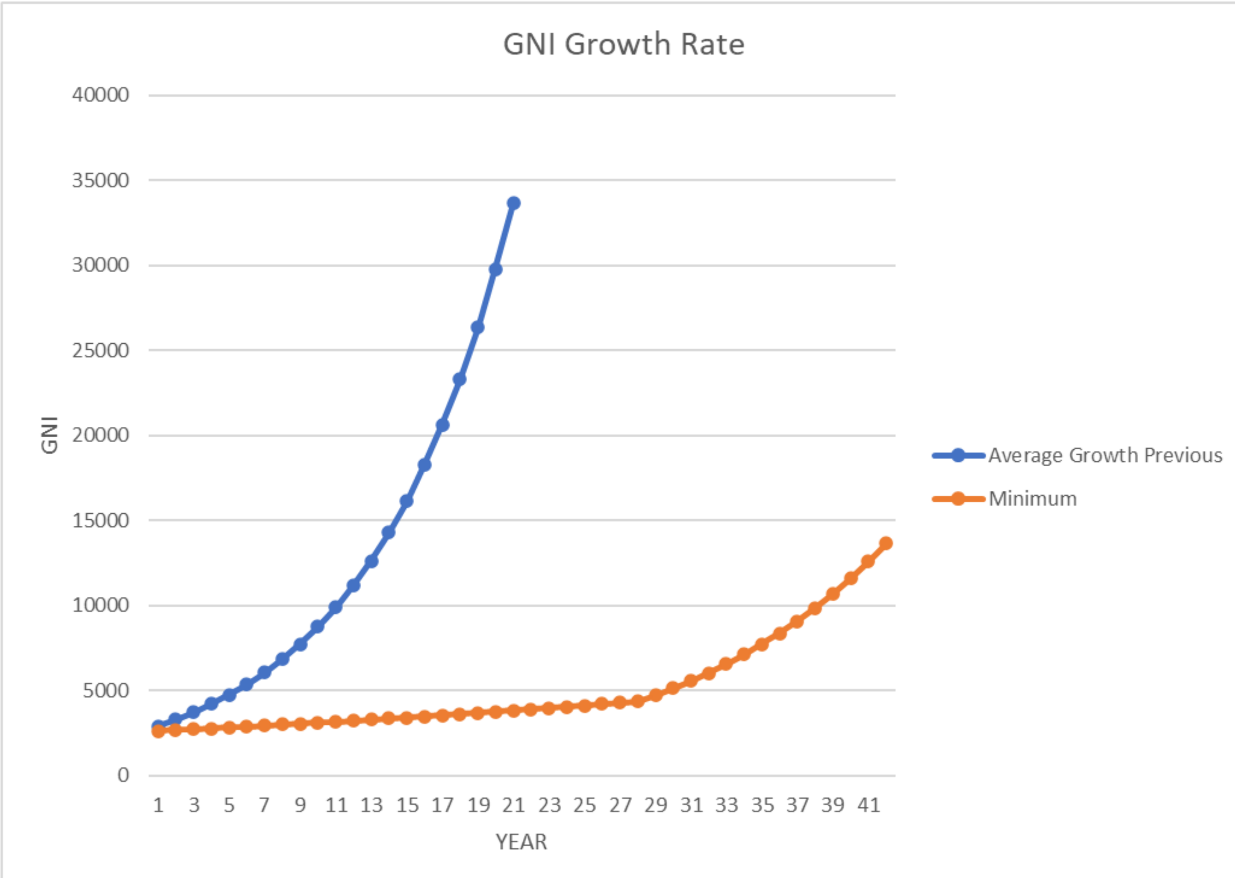

Figure 2: Data Source World Bank

Though, based on projections, it may seem easy, it is not the case. Many countries, such as India, have been low-middle-income countries for 13 years, Malaysia for 27 years, and Brazil for 33 years. The challenge for Bangladesh remains in its ability to maintain this high year-on-year growth rate.

Bangladesh continues to face challenges as a capital-scarce country. The twin shocks of the pandemic and the war exposed the vulnerability of the economy, leaving Bangladesh struggling to recover with surging default loans and pressure on the balance of payment, forcing the country to impose restrictions on imports to keep a healthy forex reserve for rainy days.

To address the impacts of emerging manufacturing technologies, Bangladesh needs to invest in skills development, efficient infrastructure, machinery, and technology to enhance the productivity of its abundant labor force. A well-functioning and efficient financial system is also crucial. Additionally, fostering innovation through trade and investment openness will be instrumental in achieving a competitive advantage.

Bangladesh has made incremental progress in addressing certain obstacles to investment, such as improving the reliability of the electricity supply. However, challenges persist in the form of inadequate infrastructure, limited financing options, bureaucratic delays, lax enforcement of labor laws, and corruption, which continue to hinder foreign investment. While the government has made efforts to enhance the business environment, implementation has yet to be fully realized. Furthermore, the slow adoption of alternative dispute resolution mechanisms and sluggish judicial processes impede the enforcement of contracts and the resolution of business disputes. Although there have been attempts to improve the situation, there is still a need for further actions to create a favorable environment for investment in Bangladesh.

Herein lies the need for a more outward-looking trade policy that goes beyond thinking about ways just to protect inefficient domestic producers. If Bangladesh's budget allocation for education and health remains as low as it is currently, the illusion of the trap will be justified, and the journey will be delayed and staggered at times. Its finances are increasingly being held hostage by loan defaulters, money launderers, and politically powerful bank looters. If these three institutions are not addressed properly, Bangladesh's road to becoming a developed nation will feel like a trapped expedition. Bangladesh will need to do everything to escape the middle-income trap that countries like Brazil and Argentina are languishing in for years

In conclusion, Bangladesh has made significant strides in its economic growth and development, transitioning from a low-income to a middle-income country. However, challenges remain, including the need to overcome the middle-income trap, address issues such as rising default rates and balance of payment pressures, and increase public funding for healthcare and education. It is crucial for Bangladesh to continue pursuing sustainable and inclusive economic policies, invest in human capital development, and address institutional constraints to achieve long-term and inclusive growth. With concerted efforts and effective strategies, Bangladesh can overcome these challenges and achieve its aspirations for sustained economic progress and improved living standards for its people.

Questions

1. How does the rapid transition from low-income to middle-income status impact the competitiveness of labor-intensive goods production in countries like Bangladesh, and what challenges may arise in transitioning from middle-income to higher-income status?
2. How did Japan, South Korea, and Singapore implement policies and measures to promote economic growth, reduce income inequality, and advance toward higher income status after World War II, and what were the key factors contributing to their success?
3. What are the key challenges that Bangladesh faces in achieving sustained high year-on-year growth rates in order to escape the middle-income trap, and how do these challenges compare to those experienced by other countries, such as India, Malaysia, and Brazil, that have been in similar income categories for extended periods of time?

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