Discussion-Meeting on

Avoiding the Middle-Income Trap
Opportunities and Challenges for Bangladesh

Presentation by

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Section I: Introduction

- In July 2015, Bangladesh joined the group of lower-middle income economies (LMIEs) according to the World Bank definition
- According to World Bank Atlas method, Bangladesh's GNI per capita was $1,080 in 2015. The reference threshold for LMIEs in the year was $1,045
- For FY2017, the thresholds of GNI per capita for low-income economies (LIEs) was $1,025 or less; for LMIEs this was $1,026-$4,035; for upper middle-income economies (UMIEs) this was $4,036-$12,475 and for high-income economies (HIEs) the income level was $12,476 or more
  - Thresholds are revised every year (in the month of July)
- In recent years, the discourse on the Middle-Income Trap (MIT) has been receiving heightened attention since a number of developing countries have failed to sustain their past growth momentum after having graduated to the status of middle-income country. Several countries have fallen into Lower MIT; others into Upper MIT
- For Bangladesh, a newly graduated LMIE, the critical challenge relates to not so much the MIT itself, but ensuring that the transition from LMIE to UMIE, and subsequently to HIE status, is made in a smooth manner, by avoiding the possible MIT
- Bangladesh's policymakers are now saying that Bangladesh will be a HIE by 2041, i.e. in about 25 years. It is reckoned that there are important lessons to be learned in view of this from the experience of countries which have found themselves in an MIT

Section I: Introduction

- Bangladesh's case is interesting in the sense that a large part of its middle-income transition will coincide with its LDC graduation timetable: Bangladesh's final graduation is envisaged to be in the year 2024. But Bangladesh's case is not unique - indeed, a number of LMIEs face this dual challenge of making LDCs transition and middle-income journey simultaneously

Table A: Cross-matching between World Bank and UN country classifications

Country Categories	LIEs	LMIEs	UMIEs	HIEs	Total
LDCs	29	16	3	0	48
Non-LDCs	2	36	53	79	170
Total	31	52	56	79	218

Source: Authors' calculation based on WDI 2016 database

- The interest of categorising economies on the basis of income criteria is well understood since eligibility for many of the official development assistance (ODA) funds is generally assessed on the basis of the World Bank income criteria only
- Many developing countries have failed to make the needed structural adjustments in sustaining growth momentum. A number of countries have continued to suffer from economic vulnerabilities and underdevelopment of social capital. This has resulted in falling in the MIT
- For example, Turkey, Malaysia, Brazil, Argentina have fallen into the MIT once having graduated to UMIE
- For instance, in FY2017, Equilateral Guinea dropped to UMIEs status from HIEs; the country is also struggling to graduate from the group of LDCs in last two consecutive triennial reviews
- With the global experience in the backdrop, it is reckoned that there is a need for a renewed urgency to look at economic development of Bangladesh, from the lens of the 'Political Economy of Change'. The CPD-FES study comes up with a number of questions in view of this

Section II: Evidence Relating to MIT

- However, it should be noted that when talking about 'falling into' and 'getting out' of the MIT, analysts are not constrained by the discourse on the World Bank classification alone
- Felipe *et al.* (2012) came up with four distinct income groups, which are defined in terms of GDP per capita (in 1990 PPP dollars): LIEs – below $2,000; LMIEs – between $2,000 and $7,250; UMIEs – between $7,250 and $11,750; and HIEs – above $11,750
- Felipe *et al.* (2012) showed that, in 2010, 35 out of the 52 middle-income countries were in the middle-income trap; of these 30 were in the LMIE trap, i.e. which have been in this income group for over 28 years; and 5 were in the UMIE trap, i.e. which have been in this income group for over 14 years. 8 out of the remaining 17 middle-income countries (i.e. not in the trap in 2010) were at the risk of falling into the trap (3 into the LMIE and 5 into the UMIE)
- The reference to GDP, as against GNI, highlights the importance of domestic factors and structural changes

Section II: Evidence Relating to MIT

Table 3 Economies that became lower-middle-income after 1950 and graduated to upper-middle-income

Country	Region	Year country turned LM (Y_{LM})	Year country turned UM (Y_{UM})	No. of years as LM	Ave. GDP per capita growth rate (%) (Y_{LM} to Y_{UM})
China	Asia	1992	2009	17	7.5
Malaysia	Asia	1969	1996	27	5.1
Rep. of Korea	Asia	1969	1988	19	7.2
Taipei, China	Asia	1967	1986	19	7.0
Thailand	Asia	1976	2004	28	4.7
Bulgaria	Europe	1953	2006	53	2.5
Turkey	Europe	1955*	2005	50	2.6
Costa Rica	Latin America	1952*	2006	54	2.4
Oman	Middle East	1968	2001**	33	2.7

*This refers to the second time Turkey and Costa Rica attained lower-middle-income status. Turkey became lower-middle-income in 1953, but slipped back to low-income in 1954; Costa Rica became lower-middle-income in 1947, but slipped back to low-income in 1950.
**This refers to the second time Oman attained upper-middle-income status. It became upper-middle-income in 1997, but fell back to lower-middle-income in 1998.

Source: Felipe *et al.* 2012

Section II: Evidence Relating to MIT

Table 4 Economies that became upper-middle-income after 1950 and graduated to high-income

Country	Region	Year country turned UM (Y_{UM})	Year country turned H (Y_H)	No. of years as UM	Ave. GDP Per capita growth rate (%) (Y_{UM} to Y_H)
Hong Kong, China	Asia	1976	1983	7	5.9
Japan	Asia	1968	1977	9	4.7
Rep. of Korea	Asia	1988	1995	7	6.5
Singapore	Asia	1978	1988	10	5.1
Taipei, China	Asia	1986	1993	7	6.9
Austria	Europe	1964	1976	12	4.1
Belgium	Europe	1961	1973	12	4.4
Denmark	Europe	1953	1968	15	3.3
Finland	Europe	1964	1979	15	3.6
France	Europe	1960	1971	11	4.4
Germany	Europe	1960	1973	13	3.4
Greece	Europe	1972	2000	28	1.8
Ireland	Europe	1975	1990	15	3.2
Italy	Europe	1963	1978	15	3.4
Netherlands	Europe	1955	1970	15	3.3
Norway	Europe	1961	1975	14	3.5
Portugal	Europe	1978	1996	18	2.8
Spain	Europe	1973	1990	17	2.7
Sweden	Europe	1954	1968	14	3.6
Argentina	Latin America	1970	2010	40	1.2
Chile	Latin America	1992	2005	13	3.7
Israel	Middle East	1969	1986	17	2.6
Mauritius	Sub-Saharan Africa	1991	2003	12	4.0

Source: Felipe *et al.* 2012

Section II: Evidence Relating to MIT

- There is a growing literature (Aiyar *et al*., 2013; Beddies, 2008; Foxley and Sossdorf, 2011) that argues that the scope of the discourse on the MIT should be broadened beyond economic issues

- An IMF working paper (Aiyar *et al*., 2013) has made an attempt to analyse the MIT by testing the various factors that induce growth slowdown and tend to hinder a smooth transition to HIE status under seven broad categories: (a) institutions, (b) demography, (c) infrastructure, (d) macroeconomic environment and policies, (e) economic structure, (f) trade structure, and (g) others

  - The IMF paper: emphasises that economies can address the causes of growth slowdown by – reducing government intervention in the market; deregulating labour, product, and credit markets; and improving the legal system, contract enforcement, and property rights

  - argues in favour of stimulating FDI; raising investment share in GDP; incentivising trade openness, intra-regional trade and regional integration; and diversifying exports as means of avoiding economic slowdown

  - highlights that good infrastructure alone is not sufficient to prevent slowdown in the economy, which may be driven by other factors, such as demographic composition, institutional efficacy, political stability, trade structure, etc

Section III: Learning from Others, Lessons for Bangladesh

Table B: Inter-country comparison of economic performance for countries with GNI per capita similar to Bangladesh as reference points (in USD at constant 2010 values)

Country	Year	GNI per capita in USD	Growth Rate (%, 10 years average)					
			1st	2nd	3rd	4th	5th	6th
South Korea	1960	1117	6.0	7.2	8.5	5.7	3.9	2.5*
Malaysia	1960	1341	3.4	5.3	3.2	4.6	2.8	3.7*
Philippines	1963	1098	2.1	2.0	(-) 1.5	1.6	3.7	4.4*
Thailand	1976	1139	4.2	8.0	2.1	2.6*	-	-
Indonesia	1981	1112	4.4	2.4	4.1	4.0*	-	-
China	1994	1117	8.3	9.5	6.4*	-	-	-

Source: Authors' calculation by using WDI, 2016. Note: * less than 10 years average

Table C: Inter-country comparison of investment (as % of GDP) for countries with GNI per capita similar to Bangladesh as reference points (in USD at constant 2010 values)

Country	Year	GNI per capita in USD	Investment (as % of GDP, 10 years average)					
			1st	2nd	3rd	4th	5th	6th
South Korea	1960	1117	18.9	25.9	28.0	32.6	30.9	29.5*
Malaysia	1960	1341	18.7	25.6	30.1	35.5	22.4	25.2*
Philippines	1963	1098	19.1	25.9	19.9	22.2	19.8	21.0*
Thailand	1976	1139	26.9	37.6	24.6	25.2*	-	-
Indonesia	1981	1112	26.6	25.3	25.5	32.6*	-	-
China	1994	1117	34.8	43.0	44.0*	-	-	-

Source: Authors' calculation by using WDI, 2016. Note: * less than 10 years average

Section III: Learning from Others, Lessons for Bangladesh

Table D: Inter-country comparison of trade openness (as % of GDP) for countries with GNI per capita similar to Bangladesh as reference points (in USD at constant 2010 values)

Country	Year	GNI per capita in USD	Trade openness (as % of GDP, 10 years average)					
			1st	2nd	3rd	4th	5th	6th
South Korea	1960	1117	27.9	55.4	61.3	57.6	76.8	100.6*
Malaysia	1960	1341	90.0	91.5	116.7	185.5	190.3	143.6*
Philippines	1963	1098	39.1	48.3	56.8	95.4	78.8	62.1*
Thailand	1976	1139	49.1	76.2	116.9	131.8*	-	-
Indonesia	1981	1112	49.2	62.2	54.9	47.1*	-	-
China	1994	1117	40.4	53.2	40.7*	-	-	-

Source: Authors' calculation by using WDI, 2016. Note: * less than 10 years average

Table E: Inter-country comparison of young-age dependency ratio (% of working-age population) for countries with GNI per capita similar to Bangladesh as referenced points (in USD at constant 2010 values)

Country	Year	GNI per capita in USD	Young-age dependency ratio (%, 10 years average)					
			1st	2nd	3rd	4th	5th	6th
South Korea	1960	1117	77.6	64.3	44.7	32.2	25.6	20.3*
Malaysia	1960	1341	90.3	76.7	65.1	58.2	47.0	37.7*
Philippines	1963	1098	92.1	81.8	74.1	67.2	57.1	50.6*
Thailand	1976	1139	65.4	44.9	33.8	26.2*	-	-
Indonesia	1981	1112	66.0	52.2	44.9	42.0*	-	-
China	1994	1117	36.6	24.5	23.5*	-	-	-

Source: Authors' calculation by using WDI, 2016. Note: * less than 10 years average

Section III: Learning from Others, Lessons for Bangladesh

Table F: Inter-country comparison of population in the largest city (% of urban population) for countries with GNI per capita similar to Bangladesh as reference points (in USD at constant 2010 values)

Country	Year	GNI per capita in USD	Population in the largest city (%, 10 years average)					
			1st	2nd	3rd	4th	5th	6th
South Korea	1960	1117	37.5	39.6	35.1	29.1	25.0	23.7*
Malaysia	1960	1341	13.7	14.6	20.1	26.2	28.8	29.7*
Philippines	1963	1098	30.0	33.2	27.8	27.2	27.9	29.0*
Thailand	1976	1139	36.8	34.8	31.2	27.7*	-	-
Indonesia	1981	1112	15.8	11.1	8.5	7.6*	-	-
China	1994	1117	3.0	3.0	3.1*	-	-	-

Source: Authors' calculation by using WDI, 2016. Note: * less than 10 years average

- Of the economies, data for which were presented in the tables, only South Korea has managed to grow consistently over the first three decades
- In contrast, most of the others have lacked consistency in their growth trajectory which is also reflected in subdued investment growth
- The trends in trade openness also indicate towards strategic trade liberalisation policy adopted by the South Korea, and in more recent times by Malaysia and Philippines

Section III: Learning from Others, Lessons for Bangladesh

- One of the key constraints in the backdrop of the MIT that also emerges from the literature review (theory of change) is that, after making significant progress in the initial years, many countries have failed to nurture a political economy and develop a coalition of forces that are required for sustaining the growth momentum
- The dichotomy of 'democracy' versus 'development' can be posited in the context of above experience, and discourse
- The issue for discussion is: could the prevailing political economy emerge as a binding constraint that could undermine Bangladesh's ability to avoid the MIT?

Section IV: Current Status of Political Economy

A review of literature would suggest that, the political economy scenario of Bangladesh may be characterised by:

- Recontested identity
- Emergence of confrontational politics
- Winner-take-all political culture
- Role of monetary power in politics
- Exclusionary role of electoral politics
- Political confrontation and political legitimacy
- Lack of devolution of power and weak local government institutions
- Weak institutions and weak governance
- Shrinking space of civil society

Section V: Strategies to Avoid MIT

Bangladesh's most precious resource is its people. Their quest for a higher standard of living and higher income, secured livelihood, and upward mobility will need to be met if the opportunities originating from the demographic dividend are to be realised

Sobhan (2016) identifies the following imperatives for Bangladesh for taking advantage of the demographic dividend and people's aspirations:

- People as development resources
- Investing in people
- People as market
- Incentivising the people through inclusive policy agendas
- Promoting inclusive politics
- Giving people a stake in democracy
- People as a source of global competitiveness

Section V: Strategies to Avoid MIT

- Through a critical examination of the existing political framework and economic landscape in Bangladesh, and by learning lessons from cross-country experiences, Bangladesh will need to design a roadmap that will accelerate the growth momentum in order to become a UMIE within the shortest possible time period, and thus avoid the MIT
- The key elements of such a strategy could be:
  - Productivity enhancement and efficiency gains
  - Inclusive development and distributive justice
  - Infrastructure
  - Structural transformation and decentralisation
  - Efficiency in public expenditure allocation and better public sector management
  - Good governance, strong institutions, rule of law, and transparency and accountability
  - Policy predictability and contingent coalition (*a coalition of policy entrepreneurs, social entrepreneurs and political entrepreneurs that coalesced around a focused policy goal, e.g. secondary education, urban development, youth, agriculture, etc.*)
  - Participatory politics

Section V: Strategies to Avoid MIT

- To address the emerging challenges, there is a need for new coalitions of drivers, which have high stakes in bringing transformative changes in Bangladesh, to emerge.
- Such a coalition could include drivers that support:

i. Inclusive politics and the democratisation of political parties

ii. Effective devolution of power

iii. Promotion of reforms geared towards good governance and accountable, transparent administration

iv. Greater mobilisation of domestic resources

v. Productive private sector

vi. Effective public-private partnerships

vii. Empowered working class and enforceable trade union rights

viii. Women's empowerment

ix. Development of productive forces to cater to the needs of building supply-side capacities, moving up the value chain, building production networks through higher investment in technological upgrading and imparting of skills

x. Greater space for civil society and citizen's voice

xi. Strengthened regional and global integration of the Bangladesh economy

Section VI: Key Questions

- Will an income-centric development objective (reaching UMIE and HIE status) undermine the importance of having a broad-based development vision for Bangladesh?
- Will lack of broad-based developed vision constrain Bangladesh's aspiration to become HIE?
- Is a broad-based, consensus-driven politics must for going forward at an accelerated pace towards HIE?
- Is there an alternative to participatory politics? Can a 'contingent coalition' (Hossain Zillur Rahman) be forged without participatory politics?
- Is there a tradeoff between 'democracy' and 'development' as Bangladesh goes forward by avoiding to fall into the MIT?

Section VI: Key Questions

- What are policy interventions that will be required to ensure that attainment of higher per capita income will also help attain other development objectives (e.g. making growth more inclusive, distributive justice) for Bangladesh?
- As manufacturing/industry sector needs to be the driver for Bangladesh into higher growth trajectory, a sound industrial policy will be critical for Bangladesh. How important will it be for such industrial policy to ensure balance between 'export-led' and 'domestic market oriented' policies?
- Bangladesh needs to emphasise developing a strong social security system along the journey to HIE status. Is there a tradeoff between accelerating economic growth and establishing a strong social security system?
- Creating more employment and enhancing productivity are the two critical components of the desired growth trajectory for Bangladesh. Is there a tradeoff between rapid productivity enhancement and faster job creation?
- Inability to utilise the 'demographic window of opportunity' is one of the important factors contributing to falling into MIT for many countries. How will it define the future of Bangladesh economy?

Thank You