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# Economic growth and challenges ahead

## A case study of Vietnam and Bangladesh

Student Research Internship Report

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**ECONOMIC GROWTH AND CHALLENGES AHEAD:**

**A CASE STUDY OF VIETNAM AND BANGLADESH[1]**

**Introduction-**

The economic powers of the continents changed by the passage of the last three centuries. While the 19th century emerged to be victorious for Europe and 20th century for the Americas, 21st century is predicted to be ruled by Asian economies. The initial stages of boom in Asian economies in 20th century was ignited by Asian tigers followed by India and China. Many internal and external factors can affect the political and economic performance of an economy. These Asian economies were not flexible enough to re-emerge themselves with full capability. Though experienced high rates of poverty and unemployment in initial stages of their independence in the late 20th century, Vietnam and Bangladesh have made remarkable contributions towards boosting their economy. Vietnam and Bangladesh, due to their cheap labour force, government policies and export-oriented industries have been experiencing growth rates at an annual average GDP (Gross Domestic Product) rate of 6.15% and 6.47%, respectively, since the very beginning of the present century. This has resulted in them to be among the fastest growing economies of Asia. Cheap labour is the common factor of production, which helped them to sustain consistent positive economic growth rate.

Though Bangladesh experienced several military coups, political imbalances, and global recession, it progressed consistently as its GDP per capita increased from $418 in 2000 to $1855 in 2019. Similarly, Vietnam despite facing several trade wars and economic recession, made a considerable progress in increasing GDP per capita from $390 in the year 2000 to $2715 in 2019. The economies of both countries are flexible enough to prevent the ripple effect caused by the 2008 Global Financial Crisis and recession that followed. They have successfully lifted millions of people out of poverty line within a short

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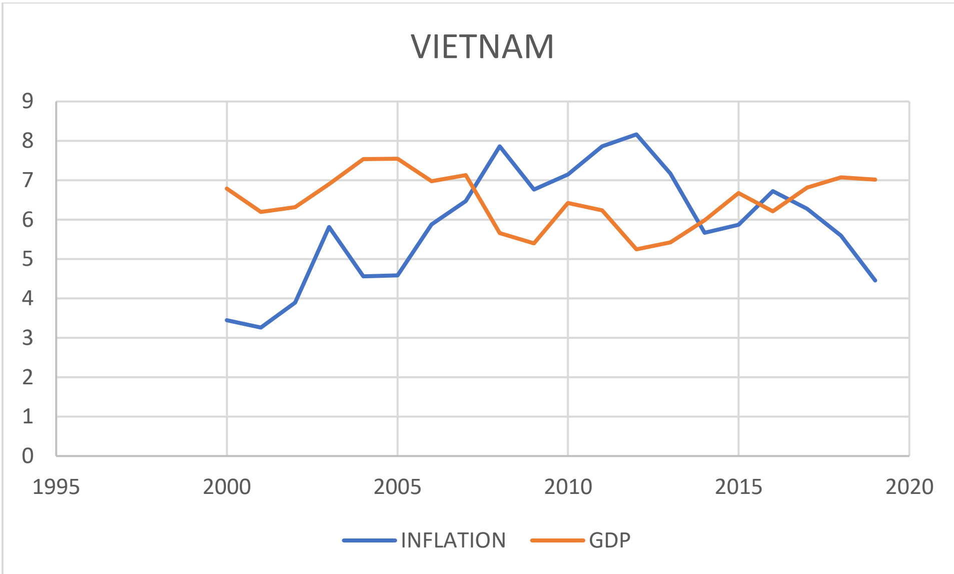
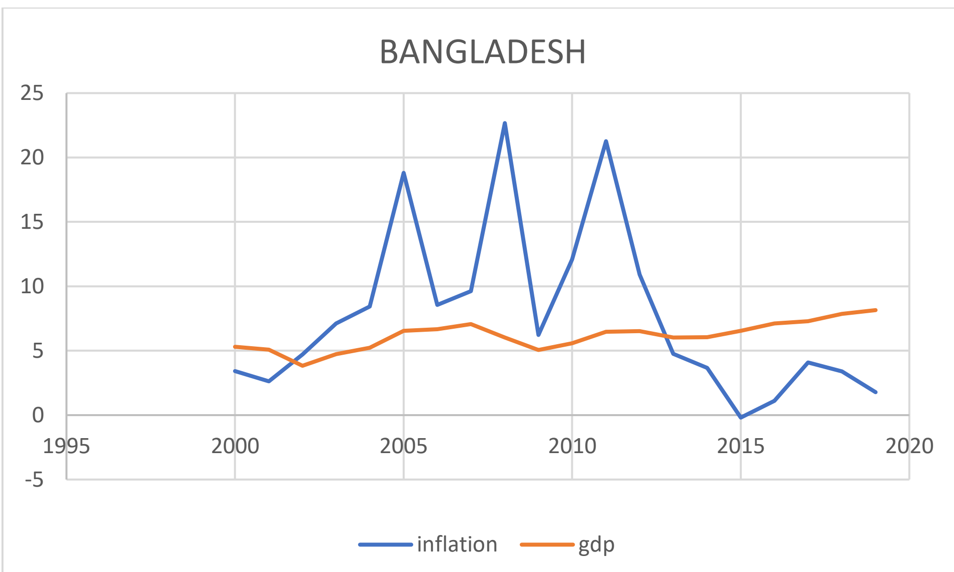
span of time due to regular investment in the social welfare sector and relaxed investment policies. Finance sector, agriculture sector, garment industry and remittances have played a crucial role in making Bangladesh an emerging market. On the other hand, agriculture sector, manufacturing sector, FDI and foreign trade has transformed Vietnam into one of the major exporting hubs of Asia. Both are on the verge of achieving a 'middle income status country'. Hence, they might become sprawling production market as well as consumer market for the international business and foreign investment. While Bangladesh's exports rely on agricultural commodities and garment industry, Vietnam's exports are driven by agricultural commodities and electronic equipment production.

However, there are upcoming challenges as well, which the emerging economies might have to face in future. The lack of product diversification, state of low export market diversification, low capital accumulation, obsolete technology and lack of skilled workforce may turn them into fragile economies in the long term. According to Keynesian economics, they are currently facing the real economic constraint due to inefficient utilisation of resources (skills, machines, technology, land and exhaustible resources), which is stagnating the qualitative aspect of its production. Moreover, institutions should be given some degree of freedom so that they can be resilient enough to frame policies according to the contemporary economic scenario. This article discusses driving the force behind economic success of Bangladesh and Vietnam and what policies they can pursue to make them more resilient to economic shocks. Data for the time period 2000-19 has been used for analysis.




*Source: World Bank*




*Source: World Bank*

**Impact of the Great Recession of 2008-**

Since the components of GDP in both the economies contribute differently to GDP, the extent of economic shock and policy responsiveness of both countries were quite different. Exports account for 76.4% of GDP in the Vietnam economy. Since the Vietnamese economy is more prone to international markets fluctuations due to large exports and FDI, it was crucially impacted by the 2008 Great Recession. Inflation rates increased to 23% in 2008, and exports declined by 8% y-o-y in 2009. Debt-to-GDP ratio increased from 31% to 36.3% in 2009. This increase in debt-GDP ratio was due to several stimulus packages announced by the Vietnam government to contain the high unemployment and poverty caused by the recession. It was argued that government expenditure could further increase the aggregate demand (and hence inflation) when supply was falling due to rising food and input prices. However, the impact was reverse as inflation cooled down to 6.7% in 2009 as government expenditure if spent on productive programmes leads to net asset accumulation with the private sector (which increases income and hence saving leading to increased lending by banks. This increased lending by banks could increase production activities, thereby cooling inflation). Fiscal policy was accompanied by contractionary and subsequently expansionary monetary policy. To cool down inflation (caused by high aggregate demand) and promote savings, The State Bank of Vietnam first adopted a contractionary monetary policy in 2008 by increasing lending interest rates to 15.9% (World Bank). To promote further investment to revive production activities, expansionary monetary policy was adopted and interest rate was brought down to 10.01%. in 2009.

Consumption, accounting for an average annual 73.6% of the GDP, is the largest component of GDP in the Bangladesh economy. Due to high domestic consumption and low international financial exposure, the economy of Bangladesh was moderately impacted by the recession. Exports slightly reduced from 17.7% to 16.9% (as % of GDP) as Bangladeshi exports consist mainly of low-priced products (garments) and agricultural commodities (jute yarn & fabrics and seafood). Fall in exports, FDI and remittances affected Bangladesh's GDP as it reduced from 6.02% in 2008 to 5.04% in 2009. To counter the destabilising effect on the Taka currency, the Bangladesh Bank adopted managed float approach wherein the bank could stabilise the rates to prevent the excess appreciation/depreciation of the currency.

*Table 1: Bangladesh Data*

| Year | Consumption | Debt to GDP ratio |
|---|---|---|
| 2000 | 77.5 | 46.4 |
| 2001 | 77.5 | 46.2 |
| 2002 | 76.8 | 50 |
| 2003 | 76.0 | 49 |
| 2004 | 74.9 | 48.2 |
| 2005 | 74.4 | 46.9 |
| 2006 | 73.1 | 40.2 |
| 2007 | 73.9 | 38.6 |
| 2008 | 75.6 | 37.1 |
| 2009 | 74.6 | 35.9 |
| 2010 | 74.1 | 32.3 |
| 2011 | 74.3 | 32.4 |
| 2012 | 73.7 | 31.8 |
| 2013 | 72.8 | 30.4 |
| 2014 | 72.6 | 29.6 |
| 2015 | 72.4 | 27.7 |
| 2016 | 69.1 | 27.7 |
| 2017 | 68.7 | 27 |
| 2018 | 70.8 | 28.1 |
| 2019 | 68.7 | 29.6 |
| AVERAGE | 73.6 | 36.755 |

Source: Asian Development Bank and tradingeconomics.com

*Table 2: Vietnam data*

| Year | Consumption | Debt to GDP ratio |
|---|---|---|
| 2000 | 66.5 | 24.8 |
| 2001 | 64.9 | 25.4 |
| 2002 | 65.1 | 27.7 |
| 2003 | 66.3 | 29.8 |
| 2004 | 65.1 | 29.4 |
| 2005 | 65.5 | 28.7 |
| 2006 | 65.1 | 30.2 |
| 2007 | 68.1 | 32.2 |
| 2008 | 70.9 | 31.0 |
| 2009 | 68.5 | 36.3 |
| 2010 | 66.6 | 36.8 |
| 2011 | 66.3 | 35.8 |
| 2012 | 64.5 | 38.3 |
| 2013 | 65.5 | 41.4 |
| 2014 | 65.8 | 43.6 |
| 2015 | 68.0 | 46.1 |
| 2016 | 68.5 | 47.6 |
| 2017 | 68.0 | 46.3 |
| 2018 | 67.6 | 43.5 |
| 2019 | 68.2 | 46.7 |
| AVERAGE | 66.7 | 36.1 |

Source: Asian Development Bank and tradingeconomics.com

**The way forward-**

As Bangladesh and Vietnam are among the N11 (next 11) economies that will dominate the world trade in the 21$^{st}$ century, their policies and economic stability are necessary to sustain long-term growth. Due to stringent measures and timely identification of the virus, both countries were able to bring the outbreak under control and hence they were moderately affected by COVID-19. Bangladesh, a consumption-driven economy that is now heading towards increasing exports, needs to increase the productivity of its factors of production (through skill development, technology upgradation, transparent laws) so that it can export more given its limited physical resources. Apart from the garment industry, it should diversify its international production market to handicrafts, service sectors like microfinance, insurance and telecom to achieve resilient exports. It should also diversify its markets which are currently centred in Western nations to different parts of the world. Since the country has an average annual inflation rate of 6.34%, fiscal policy should not be focused on direct transfers and unnecessary subsidies but on productive expenditures like infrastructure, education, health, skill enhancement, logistics which can increase GDP by shifting AS curve rightward keeping inflation under control. Spending on productive areas in the long-run will increase production, increased production will lead to increased investment (due to high profits) and high investment will increase production and aggregate income which will promote saving and hence further investment. This business cycle is necessary for the country to grow progressively. The government should not be hesitant to release fiscal stimulus packages at the time of crisis since it has a stable average annual debt-to-GDP ratio of 36.8% which is well below the ideal debt-GDP ratio of 60% as stated by UNESCAP (United Nations Economic and Social Commission for Asia and the Pacific). Similarly, expansionary monetary policy (decrease in interest rate and increase in money supply) should be adopted to promote investment and business activities in the country. However, it should be stable enough to control high levels of inflation in the economy.

Vietnam has an export-driven economy that contributes 76.4% to its GDP. However, it lacks product and market diversification which can affect its market (like the 2008 recession) if its trading partners undergo any economic crisis. COVID-19 pandemic has changed the scenario of globalisation where many companies are shifting their production units from severely affected countries to less-affected countries. Through mutual cooperation of fiscal and monetary policies, Vietnam should welcome MNCs (Multinational Corporations) who want to shift their units to Vietnam due to its skilled workforce and trade openness. Since it has average annual debt-to-GDP ratio of 36.1%, fiscal policy should be aimed to bring transparency through digitisation of the economy, free trade agreements and relaxed investment policies. Since exports and FDI may flood the economy with domestic currency, the monetary authority of Vietnam should consider selling the dollar in the market to stabilise inflation and the currency's value.

**Data Sources:**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