The Legacy: 3 years of Thinking Aloud

This June, Thinking Aloud celebrates its 3rd anniversary: a milestone for the monthly economic digest published by SANEM. Envisioned as a chronicle of the contemporary economic contexts, SANEM’s Thinking Aloud set sail in June 2014. Since the beginning of its journey, 36 issues later, Thinking Aloud has successfully made a vibrant resonance in the development discourse in South Asia and beyond. Today, it is distributed among the researchers, policy makers and enthusiasts around the world. This digest offers a unique platform for young researchers to voice their thoughts on different socio-economic issues. Each issue presents articles on different themes backed by rigorous theoretical and empirical researches, reviews of publications, and interviews of eminent personalities from all over the world.

This issue of Thinking Aloud comes with the theme of ‘Growth Dynamics in South Asia’. The first article titled “Can Bangladesh continue to grow without ‘good governance’?” emphasizes that Bangladesh can continue to grow without so-called ‘good governance’ until the political capital, generated around growth without so-called ‘good governance’? If we look over the last three decades, obviously, Bangladesh had been growing without the so called ‘good governance’. Then what does this ‘good governance’ mean? Four contemporary analytical approaches can be linked to the discussion on ‘good governance’. The new institutional economics (contemporary lead presenters are Daron Acemoglu and James Robinson), representing a variant of the ‘elite agreement’ orthodoxy, argue for specific and well-defined rules and property right systems (‘good governance’) for economic growth. There are three alternative approaches to this new institutional economics. The approach by Douglass North, Joseph Wallis, and Barry Weingast argues for ‘limited access order’ in a large number of developing countries in contrast to ‘open access order’ in the advanced economies. ‘Limited access orders’, political elites divide up control of the economy, each getting some share of the rents; and since outbreaks of ‘violence’ (conflicts among the elites) reduce the rents, the elite groups have incentives to reduce conflicts among them. The approach by Mushtaq Khan stresses on ‘political settlement’, which highlights on the relative holding of power of different groups and organizations contesting the distribution of resources, and a ‘political settlement’ emerges when the distribution of benefits supported by its institutions is consistent with the distribution of power in society. Mushtaq Khan also emphasizes on ‘growth enhancing governance’ (un-orthodox institutional arrangements) in contrast to ‘market enhancing governance’ (orthodox institutional arrangements, as signified by new institutional economics). Finally, the approach by Lant Pritchett, Kuganathan and Eric Werker emphasizes on ‘deals space’, ‘rents space’ and ‘political settlements’ for growth acceleration and growth maintenance in developing countries.

Drivers of economic growth in South Asia

An Interview with Dr. Sabysachi Kar

SANEM events

Editor: Selim Raihan

Associate Editors: Iffat Anjum
Md. Nazmul Avi Hossain
Sunera Saba Khan

Coordinator: Sk. Ashibur Rahman

Can Bangladesh continue to grow without ‘good governance’?

Can Bangladesh continue to grow without ‘good governance’? Selim Raihan

If we look at the growth pattern of Bangladesh from 1990, we discover two specific characteristics: first, the growth rate has been on the rise, and second, it is less volatile compared to those of many other countries (for example, India, Vietnam, Cambodia, China, Malaysia, Thailand and Ghana) which are known as ‘high growth performing countries’. Bangladesh’s growth experience has often been termed as ‘Bangladesh paradox’ given that the country has been able to perform well despite ‘weak governance’. Now, the big question is: can Bangladesh continue to grow without ‘good governance’? If we look over the last three decades, obviously, Bangladesh had been growing without the so called ‘good governance’. Then what does this ‘good governance’ mean? Four contemporary analytical approaches can be linked to the discussion on ‘good governance’. The new institutional economics (contemporary lead presenters are Daron Acemoglu and James Robinson), representing a variant of the ‘elite agreement’ orthodoxy, argue for specific and well-defined rules and property right systems (‘good governance’) for economic growth. There are three alternative approaches to this new institutional economics. The approach by Douglass North, Joseph Wallis, and Barry Weingast argues for ‘limited access order’ in a large number of developing countries in contrast to ‘open access order’ in the advanced economies. ‘Limited access orders’, political elites divide up control of the economy, each getting some share of the rents; and since outbreaks of ‘violence’ (conflicts among the elites) reduce the rents, the elite groups have incentives to reduce conflicts among them. The approach by Mushtaq Khan stresses on ‘political settlement’, which highlights on the relative holding of power of different groups and organizations contesting the distribution of resources, and a ‘political settlement’ emerges when the distribution of benefits supported by its institutions is consistent with the distribution of power in society. Mushtaq Khan also emphasizes on ‘growth enhancing governance’ (un-orthodox institutional arrangements) in contrast to ‘market enhancing governance’ (orthodox institutional arrangements, as signified by new institutional economics). Finally, the approach by Lant Pritchett, Kuganathan and Eric Werker emphasizes on ‘deals space’, ‘rents space’ and ‘political settlements’ for growth acceleration and growth maintenance in developing countries.

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From a political economy perspective, in my view, there must be some substances by which these growth drivers are fueled; and I want to name these substances as ‘political capital’. The usual meaning of ‘political capital’ is a feeling of trust that politicians build among the common people through which they exert their influence in the society. But, according to my opinion, ‘political capital’ is an outcome of agreements among the political elites and support from the non-elites on such agreements over certain growth drivers in the economy. In order to source such support, elites ensure some critical benefits for non-elites. Over the last three decades, Bangladesh has been able to generate crucial stock and flow of ‘political capital’ in favor of the aforementioned growth drivers. Bangladesh is not rich in natural resources, which did not help to generate substantial rents for the political elites. Elites, thus, focused on RMG sector as a source of generation of rents, and they were able to draw support from the non-elite through creation of large scale employment opportunities in the RMG sector. In case of remittances, international migration of a large number of people helped alleviation of poverty, and thus gathered support from the non-elites. For the agricultural sector, this ‘political capital’ is generated from the experience of the 1974 famine, as the political elites realized that the country like Bangladesh cannot afford anything like this in the future. Therefore, subsequent governments, focused on the development of the agricultural sector to ensure food security. Finally, as microfinance, another example of elite and non-elelite nexus, played important roles in generating growth and alleviating poverty in Bangladesh, there had been construction of significant stock of ‘political capital’ around microfinance over the last three decades.

Therefore, Bangladesh can continue to grow until the ‘political capital’ provides returns over the existing drivers of growth. Given the fact that there are growing challenges for these existing drivers, political elites in Bangladesh also need to find new drivers for growth acceleration. There are two new prospective drivers, for which critical ‘political capital’ is yet to be formed. The first one relates to the comprehensive economic and trade integration with neighboring countries, and the second one is government’s initiative of setting up 100 special economic zones (SEZs) by 2030 for rapid industrialization of the country through large scale domestic and foreign investments. It is a high time that political elites in Bangladesh come out from their comfort zone of old drivers towards the journey of building ‘political capital’ for new drivers.

Dr. Selim Raihan, Executive Director, SANEM. Email: selim.raihan@gmail.com
Drivers of economic growth in South Asia
Selim Raihan, Md. Jillur Rahman & Mahtab Uddin

In recent years, South Asia has become the fastest growing region in the world. According to the Asian Development Bank’s Outlook of 2017, the impressive growth performance of South Asia is, in fact, expected to drive economic growth for overall Asia in the coming years. What factors are driving economic growth in the South Asian countries? This article analyzes the pattern and trend of growth of five South Asian countries namely Bangladesh, India, Nepal, Pakistan and Sri Lanka and explores the major drivers of economic growth for these countries.

To keep uniformity, we have used time series data for the selected countries for the period of 1980-2015. The data are collected from World Development Indicators (WDI) and Penn World Table (PWT) version 9. We have analyzed the factors of growth using the neo-classical growth framework. In the econometric model, instead of looking at the growth of GDP, we have focused on the growth of GDP per effective labor which is basically real GDP divided by human capital adjusted labor (human capital multiplied by labor). The rationale behind using growth of GDP per effective labor instead of growth of GDP is that, while the former inherently captures the dynamics of growth in GDP, population and human capital altogether, the later only focuses on growth in real GDP. High growth of GDP per effective labor inherently indicates a high GDP growth, however, the converse may not be true. In our econometric analyses, real GDP per effective labor is considered as the dependent variable and capital stock per effective labor (capital stock divided by human capital adjusted labor), CPI, export, remittances, FDI, financial development and money supply are used as independent variables. Financial development is measured by the domestic credit to private sector. All the variables are transformed into log form. The long run and short run relationships between real GDP per effective labor and its determinants have been analyzed using Engle-Granger cointegration technique. The order of integration has been tested using the ADF test and the Phillips-Perron test. The results show that all the variables for each country are I(1) except capital stock per effective labor for India. However, analyzing the correlogram of this variable, we have considered it to be I(1).

The five graphs on trends and patterns of growth for South Asian countries suggest that while Bangladesh, India and Sri Lanka experienced upward trend of growth during the last three decades, Pakistan experienced a downward trend. Nepal, on the other hand, experienced a stagnant and low growth trend. It is also clear that among these five countries Bangladesh experienced the least volatility in growth rates around the trend. During 2011 and 2015, the average growth rates in Bangladesh, India, Nepal, Pakistan and Sri Lanka were 6.3%, 6.8%, 4.2%, 4% and 6.1% respectively. Drivers of growth have been estimated using time series regression for each country following the Engle-Granger cointegration technique. As theories suggest, capital accumulation stands out as an important factor of growth for each of these countries. The regression results suggest that the long run elasticity of real GDP per effective labor with respect to capital stock per effective labor is 0.52 for Bangladesh while the elasticities are 0.63, 0.29, 0.90 and 1.06 for India, Nepal, Pakistan and Sri Lanka respectively. Moreover, the long run cointegration equation for each country shows that export and remittance are the major drivers of growth in South Asia. Export has positive and significant impact on real GDP per effective labor for each country except Nepal. In the long run, one percent increase in export in Bangladesh leads to 0.07% increase in real GDP per effective labor whereas it increases by 0.04% in India, 0.16% in Pakistan and 0.12% in Sri Lanka. As already mentioned, remittances play a positive and significant role for the growth of real GDP per effective labor for Bangladesh, India, Nepal and Pakistan whereas its impact appears to be insignificant for Sri Lanka. One percent increase in remittance leads to increase in real GDP per effective labor by 0.05% in Bangladesh, 0.09% in India, 0.06% in Nepal and 0.04% in Pakistan. While FDI stands out as another key variable for attaining higher growth rate of real GDP per effective labor for India and Pakistan, its impact for other countries are not significant meaning that FDI inflow is yet to work as a growth driver for those countries. The elasticity of real GDP per effective labor to FDI is 0.008 for India and 0.014 for Pakistan. Financial development has positive and significant impact on real GDP per effective labor in India and Nepal, however, it appears to be insignificant for other countries. One percent rise in domestic credit to private sector increases real GDP per effective labor by 0.05% in India and 0.05% in Nepal. Inflation, measured by CPI, has negative and significant effect on real GDP per effective labor in Bangladesh and Nepal, whereas it appears to have insignificant effect in India, Pakistan and Sri Lanka. In the long run, one percent increase in CPI decreases real GDP per effective labor by 0.14% in Bangladesh and 0.15% in Nepal. Money supply does not appear to have any significant effect on the long run growth in five South Asian countries. Error correction models (ECM) of the long run cointegrating relationships have been estimated for each of the countries. The estimated coefficients of the error correction terms are negative, less than one in absolute value and statistically significant for each country. This indicates that real GDP per effective labor may deviate from the long run equilibrium, however the deviation is being adjusted each year. This deviation from the long run equilibrium is being corrected each year by 40% in Bangladesh, 44% in India, 84% in Nepal, 75% in Pakistan and 34% in Sri Lanka.

The article thus draws some important policy directions for the selected South Asian countries. For further growth acceleration and sustaining high growth rates, the South Asian countries need to invest quite significantly on the improvement in human capital. Also these countries need to foster their exports further through export diversification policies, and in this context, access to finance at lower costs along with better infrastructures and better quality institutions are important. Also, the role of remittances could be magnified if steps such as improving the quality of migrant labors through training and education, and reducing the cost of migration and remittance are taken. Finally, the role of FDI as a driver of growth needs to be critically explored and required promotional measures need to be taken in most of the South Asian countries in the coming days.

Dr. Selim Raihan. Executive Director, SANEM. Email: selim.raihan@gmail.com
Md. Jillur Rahman. Research Associate, SANEM. Email: jilluruhan@ecoundu.ac.bd
Mahtab Uddin. Lecturer. Dept. of Economics, DU. Email: mahtab.ud@du.ac.bd

Vol. 4 No. 1
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"...The high growth rates brought down poverty in India, however it led to rising inequality in the economy..."  
Dr. Saybasyeci Kar is Professor at the Institute of Economic Growth, India, and an Honorary Senior Research Fellow at the University of Manchester. He has written a number of books and academic articles on macroeconomics, growth and development economics, with particular focus on the Indian economy. In the past, he worked extensively for the Perspective Planning Division of the Indian Planning Commission, and provided them inputs for the successive five-year plans. He has also worked on projects sponsored by the World Bank, the Global Development Network (GDN), the European Commission and the DFID, UK. For June 2017 issue, SANEM speaks to Dr. Kar on prospects and challenges of growth acceleration in India.

SANEM: According to a recent ADB report, India is the leading growth performer in South Asia. What are the driving factors behind this recent growth in India?
SK: In the recent past, India has been growing at 7 to 7.5 percent per annum. This can be characterized as high growth, although it is nowhere near the 9 percent annual growth rates that India achieved before the global meltdown or the 8 percent average long run growth rate that most experts believe the economy is capable of reaching. Thus India can be said to be growing below its potential. This point is further bolstered when one attempts to identify the factors that are driving the current growth rate. The most important factor underlying this growth spurt is the benign condition of the macroeconomic balances, i.e., the fiscal and external balance, both of which are reaping the advantages of historically low international oil prices. This has also led to significantly low rates of inflation which is another factor helping investment and growth. On the demand side, the growth momentum is driven by the government’s consumption expenditure, driven mainly by the 7th pay commission that determines salaries of government employees and other salaries that are pegged to the government’s pay scales. This contributes to higher value addition in public administration. The government’s consumption expenditure has also been boosted by the expenditure on defence. Secondly, private consumption expenditure is also a significant source of demand for the Indian economy. Thirdly, some improvements in the global growth scenario has also improved net exports to a certain extent. Finally, normal monsoons have helped significantly by giving a big boost to agricultural growth. The main concern has been with the growth of private investment, which has shown deteriorating tendencies over this period. This is partially due to institutional uncertainties and partly the result of weaknesses in the banking system. If these problems can be dealt with then private investment’s growth will also take off and the Indian economy can expect to grow at 8 percent per annum.

SANEM: How would you link the institutional and political economic issues with growth performance in India?
SK: Perhaps, the most important institution that underpins the growth process is the nature of State-Business relationship. Like most developing countries, State-Business relationship in India is defined, not so much by rules and law, but more in terms of the deals that private businesses are able to get from the political elites and the bureaucrats. There are two aspects of these deals that are very significant in determining the growth of these businesses and the overall economy. The first is the predictability of these deals, i.e., whether the political elites and bureaucrats are capable of keeping their promises made to the businesses, currently and also in the future. The second is whether these elites bestow the privileges in the deals to a few businesses, mostly big business houses, or to a large number of businesses, fostering competition. A shift from unpredictable to predictable business deals leads to growth acceleration, even if the deals are struck with a few big businesses, to begin with. However, if the deals do not extend to a larger number of businesses over time, then the growth acceleration may not be sustained and result in growth slowdown. In the past, particularly after the reforms of 1991, Indian State-Business relationships have transitioned from largely unpredictable to more predictable deals for businesses and this has enabled India to undergo two back-to-back episodes of growth acceleration. There has been some unpredictability in the deals following 2010 and this has led to less than potential growth in the Indian economy in recent years.

SANEM: How can the current growth performance in India be compared with those in past decades?
SK: India’s GDP per capita grew very slowly right up to the eighties with an average of 1.85 percent for the period 1950 to 1992. While this entire period was characterised by slow economic growth, there were clear differences in decadal growth rates within this period. The 1960s and 1970s were periods of very weak economic growth, with GDP per capita growing annually 1.49 and 0.84 percent per annum respectively. In the 1980s, there was a recovery in the growth rate to 3.19 percent per annum. The increase in economic growth that was witnessed in the late eighties was consolidated further in the nineties and as a result, for the period 1993-2001, the growth of GDP per capita accelerated to 4.15 per cent per annum. The high growth momentum continued and the Indian economy witnessed its highest growth rate during 2002 to 2010, when the average rate of growth of per capita income went up to 6.42 per cent. Following 2010, however, the economy experienced an initial slowdown followed by a partial recovery. Thus the current growth rates are high by historical standards, but much lesser than the highest rates reached in the past. The difference is mainly due to lower rates of growth in mineral and infrastructure sectors, which slowed down after 2010 due to the corruption-related political backlash in these sectors. The current growth rates are sustainable in the long run if private investment growth can be revived.

SANEM: What is the quality of economic growth in India in terms of inclusiveness and addressing economic inequality?
SK: The high growth rates in India during the last twenty-five years have been largely successful in bringing down poverty rates, which is an important measure of inclusiveness. This has been made possible both due to the higher growth rates as well as higher elasticity of poverty reduction, implying more pro-poor growth during this period. The factor underlying this is mainly an increase in real wage rate. This has been due to changes in the labor market, both in terms of supply factors, i.e., labor shortages in the private sector due to the government’s food-for-work program (MNREGA) and demand factors like the large boom in construction, infrastructure and real estate. The high growth rates have, however, led to rising inequality in the Indian economy. This is true both in terms of personal and regional inequality. Thus, while the growth process in India has been inclusive in an absolute sense, it has failed on this count in a relative sense.

SANEM: What are the emerging global challenges which can affect growth in India?
SK: The global economy has been in recession since 2008 and this trend has been much more prolonged than expected. In the near future, the biggest challenge for growth in India and other developing countries is this slow rate of growth of the world economy. If there is indeed a ‘secular stagnation’ in the developed world, the chances of export led growth are further diminished for developing economies. A second, and related challenge, is that the slow growth in the developed world is also strengthening voices in favor of protectionism in these countries. Any increase in protectionism and subsequent fall in world trade will add to the lack of external demand driven growth in India and other developing countries. A partial remedy for this loss of demand from developed countries is to encourage larger trade within developing and particularly emerging countries. A different set of challenges for growth in India, particularly in the longer run, comes from climate change and its impact. Climate change has a possibility of adversely affecting agricultural productivity, and this will hinder growth, not only due to lower growth in the agricultural sector, but also due to its inflationary effect on the rest of the economy. There is no easy solution to problems related to climate change but India needs to increase her agricultural productivity by other means, including adoption of appropriate technologies.

SANEM: Thank you for your time.
SK: My pleasure.
South Asian Network on Economic Modeling (SANEM) is proud to announce that SANEM-North America Discussion Forum 2017 will be jointly organized by SANEM and the World Bank Group. The Forum will be held on June 12, 2017 at the World Bank premises in Washington, D.C., USA.

**Welcome and inauguration**
Dr. Selim Raihan, Executive Director, SANEM and Dr. Martin Rama, World Bank, Washington, DC

**Session 1**
(09:30am-11:00am)
**Challenges of growth acceleration and growth maintenance in South Asia**
Moderator: Dr. Selim Raihan, Executive Director, SANEM
Trigger presentation: Dr. Robert Carl Michael Beyer, World Bank, Washington, DC
Panelists: Dr. Ajitava Raychaudhuri, Professor, Department of Economics, Jadavpur University, India
Dr. Baziul Haque Khondker, Chairman, SANEM and Professor of Economics, Dhaka University
Dr. Kaz Maruf Islam, Professor, Development Studies, Dhaka University

**Session 2**
(11:30am-12:00pm)
Emerging challenges of regional integration in South Asia
Moderator: Mr. Richard M. Rossow, Wadhwani Chair in U.S. India Policy Studies, The Center for Strategic and International Studies, Washington, DC
Trigger presentation: Dr. Martin Rama, World Bank, Washington, DC
Panelists: Amadssador Faraq Sobhan, President, Bangladesh Enterprise Institute, Dhaka
Dr. Ajitava Raychaudhuri, Professor, Department of Economics, Jadavpur University, India
Dr. Ravindra A. Yatawara, World Bank, Washington, DC

**Session 3**
(02:00pm-03:30pm)
Are South Asian countries ready to meet the targets of SDGs by 2030?
Moderator: Dr. Abdullah Shibli, International Sustainable Development Institute (ISDI), Boston, MA
Trigger presentation: Dr. Selim Raihan, Executive Director, SANEM
Panelists: Ms. Maria Qureshi, Consultant, World bank
Dr. Ipsita Pal, Columbia University
Dr. Abu Eusuf, Professor, Development Studies, Dhaka University
Mr. Fadil Rabbani, World Bank, Washington, DC

**Session 4**
(04:00pm-05:30pm)
Making the best use of demographic dividend in South Asia (a SANEM session)
Moderator: Dr. Martin Rama, World Bank, Washington, DC
Trigger presentation: Dr. Ipsita Pal, Columbia University
Panelists: Mr. Moogtho Mm M ahzab, PhD student, University of Virginia
Mr. Sohail Shahid, IMF, Washington, DC
Ms. Bibi Roquaiya Sayeq, Pricing Specialist at Core Centric Solutions

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**First Thematic Sectoral Growth Diagnostic Report presented in Dhaka**

Dr. Selim Raihan, Executive Director, SANEM and Professor, Department of Economics, University of Dhaka presented the “First Thematic Sectoral Growth Diagnostic Report: Economic Dialogue on Inclusive Growth (EDIG)” on May 9, 2017 at Hotel Lakeshore, Dhaka. The program was organized by the Asia Foundation in partnership with the Overseas Development Institute (ODI). In the presentation, Dr. Selim Raihan indicated that in spite of remarkable growth record, further ‘inclusive’ growth is required as over 40 million Bangladeshis are still living below the poverty line. The agro-processing sector, leather and leather goods, and the ICT sectors have great potential to stimulate inclusive growth in Bangladesh. To conclude, Dr. Raihan advocated for a new policy agenda to address both common and sector-specific constraints and barriers to boost the performance of these sectors. Professor Shamsul Alam from General Economic Division (GED) and Sara L. Taylor, Deputy Country Director from The Asia Foundation were present among the distinguished guests.

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**Call for Applications for the 10th South Asian Training Program on CGE Modeling, Cox’s Bazar, Bangladesh, August 12-16, 2017**

SANEM invites applications for the 10th South Asian Training Program on CGE Modeling to be held on August 12-16, 2017 in Cox’s Bazar, Bangladesh. The program will be organized by South Asian Network on Economic Modeling (SANEM), Dhaka, South Asia Watch on Trade, Economics and Environment (SAWTEE), Kathmandu, and the Centre for WTO Studies (CWS), New Delhi.

**ELIGIBILITY**
Applicants should have at least a Masters degree in Economics or in a related discipline and a good knowledge of applied micro- and macro-economics. Interested candidates are requested to visit this link [http://sanemnet.org/call-for-applications-for-10th-south-asian-training-program-on-cge-modeling/](http://sanemnet.org/call-for-applications-for-10th-south-asian-training-program-on-cge-modeling/) and apply by June 10, 2017.

**INSTRUCTOR**
Dr. Selim Raihan will conduct the training program. Dr. Selim Raihan is Professor at the Department of Economics, University of Dhaka and the Executive Director of the South Asian Network on Economic Modeling (SANEM).