Is there any Bangladesh Growth ‘Paradox’?

Selim Raihan and Mirza Hassan

Over the past 40 years since independence, notwithstanding many external and internal shocks, Bangladesh has increased its per capita income four-fold, cut poverty by more than half, and is well set to achieve most of the Millennium Development Goals. Bangladesh’s economic growth rates in recent years have been higher than most of the South Asian countries and many of the sub-Saharan African countries. These positive development experiences provide the basis for optimism that despite many remaining policy and institutional constraints and despite the global uncertainties, Bangladesh is expected to make inroads in improving the living standards of its citizens. Such high growth performance and social development have been perceived as a ‘paradox’ or ‘development surprise’ by the economists at the World Bank as well as by other close observers of Bangladesh’s development (World Bank, 2007; World Bank, 2010; Mahmoud et al 2008). “The Bangladesh Paradox of good growth despite weak governance is... frequently posed as a serious puzzle” (World Bank, 2007, p 25). “Relatively strong progress on development has occurred within a challenging governance environment, characterized by paralyzing political rivalry, weak checks and balances among branches of government, weak accountability, inadequate systems for public resource management, and a widespread culture of corruption.” (World Bank, 2010, p ii). There are however two problems with such ‘paradox’ or ‘development surprise’ arguments. The first problem relates to the question on “how weak the governance structure in Bangladesh is”; and the second problem relates to the question on the “nature of the institutional reform measures required for higher growth”. On the first question we have looked into the 12 political risks variables from the International Country Risk Guide (ICRG) database (for details see: www.prsgroup.com) and their changes over time for Bangladesh during 1984 and 2010 (since ICRG data are available from 1984). These variables are: Bureaucracy Quality, Government Stability, Democratic Accountability, Control of Corruption, Law and Order, Military in Politics, Investment Profile, Internal Conflict, External Conflict, Religious Tension, Socioeconomic Conditions and Ethnic Tensions. We have considered only the 88 non-OECD countries because of the comparable status of development of these countries. It seems that out of these 12 indicators, Bangladesh made progress in index values of 10 indicators, indicating the improvement in the institutional environment in the absolute sense. However, during this time period other countries also made progress, and therefore, we looked into progress in the relative rankings of Bangladesh. In six indicators (Bureaucracy Quality, Government Stability, Democratic Accountability, Control of Corruption, Law and Order and Military in Politics), Bangladesh’s relative rankings improved, indicating to the fact that Bangladesh made progress in these areas of governance more than many other countries during this time period. For example, in 2010, Bureaucracy quality of Bangladesh was as good as of those in Brazil, China, Indonesia, South Africa, Sri Lanka and Thailand; Government stability was better than those in Brazil, India, Indonesia, South Africa, Malaysia, Philippines and Thailand; Democratic accountability was better than those in Singapore, China and Vietnam; Control of corruption was as good as that in Brazil, and was better than those in South Africa, Vietnam, India, Malaysia, China and Philippines; Law and order was better than that in Brazil and was very close to those in Philippines, South Africa and Thailand; and Military in politics was better than that in Indonesia and was very close to those in Philippines and Vietnam. However, in other areas, Bangladesh is lagging behind many other countries. The conclusion we can draw from here is that Bangladesh’s so called growth and development ‘paradox’ was not a ‘paradox’ at all. Bangladesh made mixed progress in institutional quality during 1990s and 2000s, and economic growth and social development, to some extents, can be explained by the relative progress in its institutional environment in a number of areas. However, for a fuller explanation we need to understand the critical role of “growth enhancing” institutions, which are largely informal. The problem with the ‘paradox’ argument is that it assumes only conventional market enhancing institutional reforms (leading to the establishment of formal property rights and rule of law etc) to explain improvement in the effectiveness of the institutions. However, countries in East and South East Asia in the past decades and a few countries in Africa in the recent years have experienced moderate to high growth where improvement in the effectiveness of institutions came along due to unconventional and creative reforms, together with the conventional reforms, leading to the creation of de facto enabling conditions for such higher and sustainable growth rate in these countries. Institutional reforms in these countries also focused on growth enhancing governance reforms which allowed states in these countries to promote growth by developing its capabilities to ‘navigate through the property rights instability of early development, manage technological catching up, and maintain political stability in a context of endemic and structural reliance of patron-client politics’ (Khan 2008, p 93). This approach emphasizes institutional functions over institutional form.

Reference:


World Bank (2010), Bangladesh Country Assistance Strategy 2011-2014, Dhaka

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Do Institutions have Higher Returns in South Asia than in East Asia?

Selim Raihan

The link between growth and institution is a much debated issue in the recent growth literature. There is now a considerable size of empirical literature which has shown the important contribution of quality of institutions on economic growth. Most of these studies illustrate how institutions affect economic growth in the cross-country growth regression models. Literature on institution and growth has however argued that the most important channels through which institutions affect growth are capital accumulation and the rise in total factor productivity (TFP).

In order to see the impact of the quality of institutions on capital accumulation we have run fixed-effect cross-country panel regression models for capital stock as the dependent variable and institutions as the explanatory variables. Variables, such as initial GDP per capita, initial capital stock, initial human capital (years of schooling in 1990), government expenditure as % of GDP, official development assistance (ODA) as % of GDP, and trade as % of GDP are taken as control variables.

Apart from the institutional variables all other variables are considered in natural logarithm. Data of capital stock (at constant 2005 national prices in million US$) are derived from the Penn World Table (PWT 8.0) where capital stocks are estimated based on cumulating and depreciating past investments using the perpetual inventory method. Data on most of the control variables are taken from the World Development Indicators of the World Bank, and years of schooling data are taken from Barro-Lee database (www.barrolee.com). Six institutional variables are considered from the International Country Risk Guide (ICRG) database: Bureaucracy Quality, Corruption, Investment Profile, Law and Order, Democratic Accountability and Government Stability (for details see: www.prsgroup.com). The higher the score value of these variables the higher the quality of the institution. The ICRG data are available from 1984 and our panel regression models have the time dimension from 1984 to 2010 for 113 countries. With a view to seeing whether South Asia and East Asia behave differently in the regression models, two interaction dummy variables are introduced: the first one is the interaction between South Asia region dummy (Bangladesh, India, Pakistan and Sri Lanka) and the institution variable, and the second one is the interaction between East Asia region dummy (China, Hong Kong, Indonesia, Japan, Malaysia, Philippines, Singapore, South Korea, Taiwan and Thailand) and the institution variable. We have run six separate regressions considering six institutional variables.

The regression results suggest that, in most cases, initial capital stock, government expenditure as % of GDP and trade-GDP ratio have positive and statistically significant effect, initial human capital and ODA as % of GDP have negative and significant effect, and initial GDP per capita has no significant effect on the capital accumulation. The regression results also suggest that higher bureaucracy quality, control of corruption, higher investment profile and better law and order have positive significant effects, democracy (democratic accountability) has a negative significant effect, and government stability doesn’t have any significant effect on the capital accumulation. The results for the interaction dummies show that bureaucracy quality, control of corruption and investment profile have larger positive effects on capital accumulation in South Asia than in East Asia. In the case of democratic accountability, South Asia interaction dummy is positive and significant and the net effect for South Asia is positive, while the East Asia interaction dummy is not significant, which suggests that democracy plays a positive role in capital accumulation in South Asia, while it is not important in East Asia. Though government stability variable is statistically insignificant, the interaction dummies for South Asia and East Asia are positive and significant, suggesting that, for these two regions, government stability has a positive significant effect on the capital accumulation, and the effect is larger for East Asia than for South Asia. In the case of law and order, both the interaction dummies are positive and significant, and East Asia appears to have a larger positive effect than South Asia. These results show that institutions play an important role in the accumulation of capital, and the returns from institutional development in the case of bureaucracy quality, control of corruption, better investment profile and democracy are higher for South Asia than for East Asia. We have conducted similar exercises considering log of the capital-labor ratio as the dependent variable and the results are very similar.

The exercise involving log of total factor productivity (TFP) as the dependent variable has a similar set of control variables with an addition of log of the capital-labor ratio variable. The data of TFP (at constant 2005 national prices) are derived from the Penn World Table (PWT 8.0) where a measure of TFP is estimated based on the second-order approximation to the production function, and the real GDP measure that accounts for differences in democratic accountability, law and order, and government stability, South Asia has larger positive effects than East Asia. The East Asia interaction dummy for democracy is negative and significant, and the net effect for East Asia is negative, which shows TFP growth in East Asia has been associated with lack of democracy. In the case of control of corruption, South Asia interaction dummy is insignificant while East Asia interaction dummy is negative and significant indicating larger negative effect of control of corruption on the rise in TFP in East Asia.

The aforementioned analysis implies that, in the cross-country contexts, while better investment profile and better law and order are essential for both capital accumulation and the rise in TFP, bureaucracy quality and control of corruption are more important for capital accumulation. Democracy has a negative impact on capital accumulation, and has a positive effect on the rise in TFP. Though government stability is not critical for capital accumulation, it is important for the rise in TFP. In most cases, South Asia and East Asia behave differently from the cross-country estimated relations, and institutions have larger positive impacts in these two regions. However, positive effects of institutions appear to be larger in South Asia than in East Asia.

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The ICRG Rating System of Political Risks

Mit Tanzim Nur Angkur

The ICRG (International Country Risks Guide) rating covers three categories of risks namely political, financial, and economic for 140 countries. The aim of the political risk rating is to provide a means of assessing the political stability of the countries covered by ICRG on a comparable basis. This is done by assigning risk points to a pre-set group of factors, termed political risk components. In every case the lower the risk point total, the higher the risk, and the higher the risk point total the lower the risk.

There are 12 components of political risks: Bureaucracy Quality, Government Stability, Democratic Accountability, Corruption, Law and Order, Military in Politics, Investment Profile, Internal Conflict, External Conflict, Religious Tensions, Socioeconomic Conditions and Ethnic Conflicts. The score values of these variables are available since 1984. Bureaucracy Quality shows the quality and the strength of the bureaucracy to carry out policies even if government changes and is calculated in the range of 0 to 4. Government Stability refers to the government’s ability to carry out its declared programs and is calculated in the range of 0 to 12. Democratic Accountability shows how responsive the government is to its people and is calculated in the range of 0 to 6. Corruption refers to financial corruption that hampers investment and is calculated in the range of 0 to 6. Law and Order signifies the strength and impartiality of the legal system and is calculated in the range of 0 to 6. The military’s involvement in politics is a diminution of democratic accountability, and is calculated in the range of 0 to 6. Investment Profile refers to the risks that may affect the investment, and is calculated in the range of 0 to 12. Internal Conflict is an assessment of political violence in the country, and is calculated in the range of 0 to 12. External Conflict is an assessment of the risk to the incumbent government from foreign action, and is calculated in the range of 0 to 12. Religious Tensions is an assessment of risks associated with religious conflicts and is calculated in the range of 0 to 6. Socioeconomic Conditions is an assessment of the socioeconomic pressures at work in society that could constrain government action or fuel social dissatisfaction, and is calculated in the range of 0 to 12. Finally, Ethnic Conflicts is an assessment of the degree of tension within a country attributable to racial, nationality, or language divisions and is calculated in the range of 0 to 6.

Source: https://www.prgroup.com/

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Review


The authors propose and implement a new technique for measuring the total magnitude of a growth episode: the change in output per capita resulting from one structural break in the trend growth of output (acceleration or deceleration) to the next. The magnitude of the gain or loss from a growth episode combines (a) the difference between the post-break growth rate versus a counter-factual “no break” growth rate and (b) the duration of the episode to estimate the difference in output per capita at the end of an episode relative to what it would have been in the “no break” scenario. The top 20 growth accelerations have Net Present Value (NPV) magnitude of 30 trillion dollars – twice US GDP. The top 20 growth decelerations account for 35 trillion less in NPV of output. Paraphrasing Lucas, once one begins to think about what determines growth events that cause the appearance or disappearance of output value equal to the total U.S. economy, it is hard to think about anything else.

South Asian Network on Economic Modeling

Volume I Issue 5 October 1, 2014

“..‘bottom up’ view has more salience for countries like Bangladesh..”

SANEM interviews Dr. Kunal Sen, Professor of Development Economics at the IDPM at the University of Manchester, UK. Prof. Sen is also the Joint Research Director of ESID (Effective States and Inclusive Development), a research centre at the IDPM. His main research areas are economic growth, the analysis of poverty and labour markets, international trade and finance. His current research examines the political economy determinants of economic growth, and the role of institutions in economic development.

SANEM: Why are institutions important for economic growth?

KS: Institutions such as the protection of property rights allow investments to take place and innovations to occur – so institutions are important for economic growth both by influencing the rate of capital accumulation and total factor productivity growth. Other institutions such as well-functioning courts and a well-designed legal system is essential for economic exchange to occur. While there is considerable debate on the extent to which institutions affect economic growth as the relationship is clearly two-way, it is difficult to identify a growth success story where institutions (both macro and micro) have not played an important part in the growth process.

SANEM: What kind of institutions affect economic growth more than others?

KS: An issue that has been of considerable interest is the role of formal versus informal institutions in economic growth in developing countries. Recent experience of transition and developing countries with market-based reforms suggests that these reforms are unlikely to be successful if the appropriate institutions that ‘support economic activity and dispose its fruits’ are not in place. However, there remains considerable debate on what the right institutions are for economic development to occur. This debate is to a large extent on the role of formal institutions – laws and regulations, the court system, written contracts – versus informal institutions – unwritten rules of behavior, kinship ties, social norms – in bringing about economic growth, especially in low income countries. An influential school of thought has argued that well-functioning formal institutions are necessary if not sufficient for economic development. It argues that a functioning legal system matters significantly for growth in the long run. According to this view, informal institutions can play a complementary role to formal institutions in supporting economic activity by making the latter function more effectively. In contrast, there are others who have argued that strong informal institutions such as social and business networks can help solve the problems of economic exchange, even in contexts where formal institutions do not exist or are ineffective. Finally, even among those who agree that strong informal institutions can contribute in the early stages of economic development by being a substitute for ineffective formal institutions, there is disagreement on whether these informal institutions will play an equally important role as the economy in question matures over time and continues to grow. One view is that as economic exchange becomes more complex with the process of economic development, informal institutions wither away as more efficient formal institutions take their place. An alternate view, most clearly articulated by Douglas North, states that informal institutions are slow-moving, and that while as Douglas North argued ‘formal rules may change overnight as a result of political or judicial decisions, informal constraints embodied in customs, traditions and codes of conduct are much more impervious to deliberative policies’. Thus, there is disagreement on whether informal institutions persist or wither away in the process of formal institutional change. In my view, informal institutions matter in the early stage of economic growth, but the emergence of well-functioning formal institutions is essential for growth to be sustained.

SANEM: In your view, what kind of institutional reforms are needed in countries like Bangladesh for economic growth to sustain?

KS: There are two contrasting views of the world exist in the policy community on institutions. The ‘top down’ view sees institutions as being determined by laws written by political leaders while the ‘bottom up’ view sees institutions as emerging spontaneously from the social norms, customs, traditions, beliefs and values of the individuals within the society. Historical evidence and contemporary research suggest that the ‘bottom up’ view has more salience for countries like Bangladesh, and that attempts at rapid, top down change can have negative consequences.

SANEM: Thank you so much.

KS: My pleasure.

The interview was conducted by Ahmed Tanmay Tahsin Ratul, Research Associate at SANEM.
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Dhaka College participated in this Olympiad. The Bangladesh Navy College, Saint Gregory School and Cross School, Adamji College, Notre Dame College, Viqarunnisa Noon School and 29-30 August, 2014 at the Notre dame college Business Olympiad titled “Business Genius- 2014” on SANEM. The study was initiated by the Working Group Regional Trade Facilitation (WG-RFT) of SAARC Trade Promotion Network (SAARC-TPN) in late 2012. Dr. Selim Raihan (Team Leader of the study) presented the study findings. The other members of the study, Mr. Shaquib Quoreshi (MCCI) and Dr. Mostofa Abid Khan (BFTI), were also present during the launching event.

SANEM Sponsors Business Genius Bangladesh-2014

Notre dame Business Club organized the first ever Business Olympiad titled “Business Genius- 2014” on 29-30 August, 2014 at the Notre dame college premise in Dhaka. More than 700 students from Notre Dame College, Vigarunnisa Noon School and College, Rajuk Uttara Model School and College, Holy Cross School and College, Adamji College, Bangladesh Navy College, Saint Gregory School and Dhaka College participated in this Olympiad. The seminars and workshops of the Olympiad were conducted by Dhaka University and IBA students. SANEM was one of the sponsors of this event.

RMMRU Workshop on Migration

Dr. Selim Raihan presented a paper titled “Estimating the impact of international remittance on households’ expenditure in Bangladesh” at the RMMRU (Refugee and Migratory Movements Research Unit) workshop on “The impact of migration on poverty and development” held on August 31, 2014 at the BRAC Centre INN in Dhaka.

Impact Evaluation Conference in Manila, Philippines

The Asian Development Bank (ADB), International Initiative for Impact Evaluation (3ie) and the Philippine Institute for Development Studies (PIDS) jointly organized an international conference titled “Making Impact Evaluation Matter” on 3-5 September, 2014. It was preceded by 2.5 days of pre-conference workshops on impact evaluation from 1-3 September. Over 500 participants from around the world comprising of policymakers, program managers and researchers participated in this conference. Different Government and Non-government organizations including SANEM, BRAC, RCDDR, B and Ministry of Planning and Finance from Bangladesh presented their research findings during the conference. Dr. Abu S. Shonchoy (Research Fellow, IDE-JETRO and SANEM, Adjunct Assistant Professor, University of Tokyo), Md. Ashadul Islam (Program Manager, GKU), Md. Sujan Uddin (Research Associate, SANEM) and HM Masudur Rahman (Research Associate, SANEM) participated in the conference as representatives of SANEM. Dr. Shonchoy made a presentation on SANEM’s ongoing research with IZA and IDRC at the opening session of the main conference. Dr. Abu S. Shonchoy was awarded two prizes for his presentations; first place for Best Presentation by a Young Researcher and second place for Best Overall Presentation.

Forthcoming Event: 7th CGE Modelling Training

The annual South Asian Training Program on CGE Modelling being organized in Kathmandu jointly by South Asia Watch on Trade, Economics and Environment (SAWTEE) and South Asian Network on Economic Modeling (SANEM), in collaboration with several institutions (currently the Centre for WTO Studies (CWS), New Delhi), has entered its seventh year. The seventh edition of the training program is scheduled to be organized on 20–24 November, 2014 in Kathmandu. Dr. Selim Raihan will conduct the training program. The objectives of the training program are to impart basic knowledge of theory and applications of CGE modelling to South Asian researchers and enhance policy research capacity using CGE models on issues relating to the interlinkages between trade, climate change and food security.

Labor Force Workshop for BBS

SANEM, in collaboration with the International Growth Centre of the London School of Economics, conducted a three-day training workshop on “Labor Force Participation Projection” on 14-16 September, 2014 for the officers of Bangladesh Bureau of Statistics (BBS). Dr. Sayema Haque Bidisha (Associate Professor of Economics sat Dhaka University and SANEM Fellow), Mr. Nafiz Ifteakhar (Lecturer of Health Economic sat Dhaka University and SANEM Research Associate) and Dr. Selim Raihan conducted the training program. The workshop focused on analyzing labor force surveys of 2005 and 2010, understanding the changing nature of labor force and ways to increase labor force participation to reduce poverty in Bangladesh.

Stakeholder Consultative Workshop in Kolkata, India

Fatima Tuz Zohora, (Research Associate, SANEM) participated Stakeholder Consultative Workshop on “India-Bangladesh Economic Cooperation: Trade and Investment, Prospect and Challenges with reference to West Bengal and Northeast India” organized by The Maulana Abul Kalam Azad Institute of Asian Studies (MAKAIAS), Kolkata, an autonomous body under the Ministry of Culture, Government of India in collaboration with the Centre for Policy Research (CPR), an independent think tank located in Delhi on 18th July, 2014, at Azad Bhavan, Salt Lake, Kolkata.