Governance Challenges for Inclusive Growth in Bangladesh

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• There is widespread agreement about the long-term objectives of governance and development: governance should support the development of broad-based economic activities.

• The consensus view is that societies with accountable democracies, low corruption, stable property rights and an effective rule of law are likely to be more efficient at solving their economic problems and are more desirable places to live in.

• The debate is i) do these ‘good governance’ characteristics emerge gradually or are they preconditions for development and

• ii) When ‘good governance’ characteristics are weak, are there are other governance capabilities essential for sustaining development?
The dominant governance agenda is aligned with popular demands for better governance: focusing on anti-corruption, democratic accountability, strengthening property rights and the rule of law.

Supported by the New Institutional Economics developed by Douglass North and others: these reforms promise to make markets more efficient.

They are often referred to as ‘Good Governance’ reforms.

The distinctive feature of these reforms is that they are *rules-based*: they intend to institutionalize and enforce generalized rules of public conduct, and the aim is to improve growth and development by making markets more efficient.
An alternative view is based on the experience of rapidly growing developing countries and the governance capabilities that sustained their growth and development.

This focuses on capabilities for ‘Developmental Governance’ with a focus on administrative and political capacities to address specific problems in a context where markets are structurally inefficient.

Instead of general rules, this approach focuses on processes and capabilities of critical agencies for solving particular problems and for maintaining political stability.

Developing countries that succeeded in sustaining inclusive growth often did not have rules-based ‘good governance’ but always had strong ‘developmental governance’.
• The two perspectives obviously have some overlaps: for instance both would agree that predatory corruption, the politicization of the bureaucracy or the failure to include large groups of political opinion in the ruling coalition can be very damaging.

• But there are important differences of emphasis.

• The first approach focuses on institutionalizing general rule-following behaviour and building the appropriate governance organizations to enforce this behaviour.

• The second focuses on building a necessary political consensus and problem-solving capabilities based on the capacities and legitimacy of critical agencies to solve specific problems.
The ‘Rules-Based’ Good Governance approach

- Rent-Seeking and Corruption
- Contested/Weak Property Rights and Welfare-Reducing Interventions
- Economic Stagnation
- High Transaction Cost Markets
- Unaccountable Government
The Rules Based Good Governance Agenda

- Anti-corruption and Anti-Rent Seeking Strategies
- Stabilize Property Rights through ‘Rule of Law’ Reforms
- Promotion of pro-poor service delivery
- Market-promoting strategies
- Democratization, Decentralization and Accountability Reforms
- Economic Prosperity
Cross-Country Evidence

Composite Good Governance Indicators and Per Capita GDP
1990/2000

Logs of per capita GDP in US$ 2000

Rich countries

Poor countries

Low scores on 'Good Governance'

High scores on 'Good Governance'

Average of World Bank Good Governance Indicators in 1990 (ranges from 0 to 50)
Composite Good Governance Indicators and Growth Rates
1990-2003

Average of World Bank Good Governance indicators in 1990 (ranges from 0 to 50)

- High scores on 'Good Governance'
- Low scores on 'Good Governance'

Diverging Developing Countries
Composite Good Governance Indicators and Growth Rates
1990-2003

-9 -7 -5 -3 -1 1 3 5 7 9

0 10 20 30 40 50

Average of World Bank Good Governance indicators in 1990 (ranges from 0 to 50)

Growth Rate of Per Capita GDP 1990-2003

Advanced Countries

Diverging Developing Countries

High scores on 'Good Governance'

Low scores on 'Good Governance'

High Growth

Low Growth
Composite Good Governance Indicators and Growth Rates
1990-2003

Average of World Bank Good Governance Indicators in 1990 (ranges from 0 to 50)

Advanced Countries
Converging Developing Countries
Diverging Developing Countries

High Growth
Low Growth
Low scores on 'Good Governance'
High scores on 'Good Governance'
Growth-Enhancing (Developmental) Governance versus Good Governance

Reforms suggested by Good Governance

Regression Line

1. Diverging Developing Countries
2. Converging Developing Countries
3. Advanced Capitalist Countries

Developmental Governance Capabilities to trigger and sustain growth

‘Good Governance’ Reforms that are feasible in upper middle income countries

Good Governance Score (Democracy, Corruption, Stability of Property Rights)
Successful developing countries did not have high scores on good governance from the beginning, because institutions and policies have a large element of informality in developing countries. But not all societies without good governance and informality do well!

In contexts of informality, the internal distribution of organizational power matters greatly in determining what the ruling coalition can enforce and how effectively:

i) Their internal political economy (in particular the distribution of organizational power or the political settlement) and

ii) political capabilities to develop appropriate institutions and policies jointly determine success in achieving and sustaining inclusive growth.
Achieving strong property rights takes a long time

The enforcement of *all* property rights and contracts assumes a rich society where all asset-holders are paying significant taxes.

No poor country scores highly on property rights because of this reason and therefore their markets (particularly land markets) have high transaction costs.

Developmental states prioritized critical *agencies*, with the political legitimacy and bureaucratic capabilities to solve problems like land acquisition, land allocation and resettlement in contexts of weak rights.

Long-lasting developmental states developed bureaucratic and political capabilities to find politically acceptable compromises for solving land acquisition problems for industry and infrastructure on a large scale.
Distinguishing and prioritizing anti-corruption goals is critical.

Standard anti-corruption measures (democratization, transparency, anti-corruption commissions, higher salaries for bureaucrats and politicians) have generally achieved very limited results.

The problem is there are many types of corruption, and it is important to identify and target the most damaging types.

Developmental states had the capacity to block predatory corruption or corruption related to infrastructure construction. China, South Korea or Tamil Nadu versus Bangladesh.

At early stages of development, rules-based approaches to corruption are less effective than a political understanding within the elites to disallow damaging types of corruption.
When growth is unsatisfactory in low-wage countries, it is usual to blame the business environment, poor property rights and contracts, poor public goods and infrastructure and the absence of ‘good governance’

However, fixing the ‘Doing Business’ conditions is not sufficient. Successful developmental states did much more: they provided support to emerging businesses but with *enforceable conditions*.

In contrast, weak states provide support to businesses that is unconditional, and results in rent grabbing. When the ruling coalition is unable to discipline its own members, support policies for new industries have much weaker or no effects.
Growth and Investment trends: Where is Bangladesh headed?
Where is Bangladesh going? Are we a developmental state?

Bangladesh has done very well in growth and poverty reduction, and in improving human development indicators but there are significant challenges

i) Growth is still high but the acceleration is slowing down

ii) Private investments have slowed down

iii) The state’s capacity to discipline the banks and businesses appears to be weak (Hallmark, Basic Bank, cost inflation in Padma Bridge, apparently unconditional rescheduling of loans to big conglomerates like Beximco). This aspect of governance is arguably the most serious

iv) Political stability has returned but there is considerable political uncertainty and there is evidence of an increase in capital flight
Some conclusions for developing developmental governance

Going back to the good governance circle, the reality of informality and low productivity in developing countries sets a different set of priorities:

i) No developing country has excellent rule-following democracy but some managed to devise rules that resulted in legitimate states with strong enforcement capabilities in key areas.

ii) Developmental states do not necessarily have low corruption everywhere, but do rule out *corruption in critical developmental areas*.

iii) They do not have strong contract enforcement and property rights everywhere but do have agencies with the legitimacy and capability to achieve fair asset transactions, and support technology acquisition and capability development.

Developmental states are not authoritarian in the sense of repressive: enforcement and stability based on repression rarely produces economic growth (Baathist regimes in Syria and Iraq for instance). Democratic states like Tamil Nadu can also have strong developmental characteristics.