ECONOMIC DEVELOPMENT & INSTITUTIONS

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Understanding institutional barriers to economic growth in Bangladesh

New diagnostic exercise provides first steps to building a comprehensive analytical framework that identifies institutional constraints to growth.

We are pleased to announce the completion of a comprehensive new study into the relationships between institutions and development in Bangladesh. The study is the third in a series, following earlier studies in Tanzania and Benin. It aims to develop an 'institutional diagnostic', a methodology that makes it possible to identify both the main institutional features that delay faster development and poverty reduction in low/lower middle-income countries or threaten their sustainability over time, and explore directions of reform. No such instrument currently exists in the literature. Previous approaches, based on indicator analyses, have been sufficient to establish that institutions matter but have little to say on *how* they matter, or how they might be reformed. These are precisely those questions that the diagnostic seeks to address.

The study comes at a critical point for Bangladesh. Since independence, the country has experienced a remarkable and sustained period of economic growth and poverty reduction. It has seen improvements across a wide range of social and economic indicators and is poised to graduate from Least Developed Country status. Yet, despite these successes, the sustainability of Bangladesh's development model, in which growth has, for the last three decades, been largely driven by a single sector (the Ready-Made Garment (RMG) sector) and overseas remittances, faces serious questions, not least from the profound shock of the COVID-19 crisis, but also due to increasing pressures on the growth sectors and from a seeming inability to develop others. Paradoxically, the improvements in economic and social outcomes have not been accompanied by institutional development, and Bangladesh's institutions remain weak. In the face of such weak institutions and economic pressures, the challenge that Bangladesh faces in plotting a new and sustainable development path is daunting.

The key to unlocking this puzzle, according to the diagnostic, lies in understanding the causal connections that link economic and social outcomes to institutional features, and then looking deeper at the proximate causes and deep factors, such as political economy, which underlie them. Moreover, in analysing the political economy conditions that produce particular institutional configurations, it is possible to obtain an understanding of the barriers to reforming those institutions – the vested interests in maintaining the *status quo*. It is these two features – the emphases on causality and political economy – that make the diagnostic both theoretically innovative and policy relevant.

Selim Raihan, Principal Investigator of the Bangladesh study and Executive Director of SANEM, a Dhaka-based research organisation, says:

"Bangladesh's economic growth and development performances over the past five decades have been impressive. With the poor quality of institutions, such performances have often been termed as 'development surprise' or 'Bangladesh paradox'. But is it at all a 'surprise' or a 'paradox'? This study tries to provide an elaborated and convincing answer to this question by analysing the characteristics of growth and development processes of the country, exploring the major institutional features in these processes, unearthing the areas of major institutional weaknesses and proposing associated reforms for future sustained and inclusive development."

In practical terms, the diagnostic proceeds in several stages. First, after an extensive analysis of Bangladesh's development challenges combined with qualitative research into the opinions of key stakeholders, a set of critical areas that help understand the development-institution relationship in Bangladesh are identified. These are the RMG sector, and, most importantly, the lack of progress in export diversification, regulation of the banking sector and the problem of non-performing loans, the tax system and the exceedingly low capacity for revenue mobilisation, primary education as a major component of public expenditure, but also as a key part of human capital investment, the management of land issues, in particular the administration of Special Economic Zones, and the judiciary, especially its limited capacity to handle land grabbing cases. Each of these areas is then the subject of a 'deep-dive' thematic study conducted by Bangladeshi academics and presented in the later chapters in this volume together with discussions by international experts.

It is in the final synthesis chapter, that the diagnostic combines these findings to examine the causal connections that determine how institutions work in Bangladesh. Three generic institutional weaknesses are identified (the supremacy of the 'deals environment' over co-ordinated industrial policy; the ineffectiveness of regulation, and the weakness of state capacity). These are interpreted in terms of inter-related proximate causes, which include: the relationship between politics and business (the elite capture of government); the weakness of labour organisations; the lack of resources and skills in the public sector; the culture of corruption; inadequate legislative frameworks; and a pervasive culture of opacity and unaccountability. Lastly, these proximate causes are themselves linked to the deep factors: the political settlement between political and business elites, nature of political contestation between and within the main political parties (which has led to the current dominant party mode of politics), dynamic civil society and physical factors, such as the scarcity of land. The final piece in the puzzle is to use these causal connections to identify those reforms which would have the greatest impact – a summary is presented in a concluding annexe.

François Bourguignon, EDI Research Director and former Chief Economist of the World Bank says:

"Bangladesh is a fascinating example of how it is possible to grow and develop at a vigorous pace while bypassing formal economic and policy institutions that are standard in more advanced economies. The Institutional Diagnostic of Bangladesh suggests such a situation is unlikely to last, however. Its institutional framework will have to be seriously straightened up if development is to

continue at the same pace or if the consequence of the ongoing global sanitary and economic crisis are to be minimized"

In presenting this institutional diagnostic of Bangladesh and its accompanying reform agenda, there are no illusions as to how difficult it will be to implement them, especially at this time of crisis. However, the diagnostic also highlights Bangladesh's many strengths: extraordinary resilience through many hardships; remarkable progress in certain economic and social areas; a vibrant and engaged civil society; and, despite the lack of democratic debate at the level of mainstream politics, deep public commitment to the values of solidarity and democracy. Bangladesh can draw on all these to realise the institutional reforms set out in this volume and to meet the challenges of today and of the post-COVID 19 future.

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The Benin institutional diagnostic elaborates on these ideas, showing the channels through which the two key factors mentioned above, together with fierce political struggle, curb development through confusing and changing laws and policies, a lack of attention to general public goods, poor investment climate, an excessive vulnerability to external shocks and chronic aid dependence.

The report then reflects on ways to remedy such challenges while recognizing the heavy constraint and uncertainty arising from the political economy context, including the evolving structure of political power.

It is this positive note that Romain Houssa, a Beninese economist who teaches at the University of Namur in Belgium and a co-editor of the Benin institutional diagnostic, emphasizes:

"Benin has major cards in its hands: entrepreneurial people, well-experienced traders and merchants, and a comparative advantage not only in traditional products such as cotton, but also in new agricultural products that can be processed locally to be sold at a profitable price in domestic, regional and global markets. In short, Benin has great potential for development that could be unleashed with a better institutional and policy environment."

NOTES FOR EDITORS:

Economic Development & Institutions (EDI) is a collaborative research programme launched in 2015 that will run until 2021 and is funded with UK aid from the UK government. The EDI programme directorate is based in Oxford, UK. www.edi.opml.co.uk | edi@opml.co.uk

The completed institutional diagnostic studies are available for download at:

- Bangladesh institutional diagnostic (launched June 2020): https://edi.opml.co.uk/research/bangladesh-institutional-diagnostic/
- Benin institutional diagnostic (launched August 2019): https://edi.opml.co.uk/research/benin-institutional-diagnostic/
- Tanzania institutional diagnostic (launched September 2018): https://edi.opml.co.uk/research/tanzania-institutional-diagnostic/

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