ECONOMIC DEVELOPMENT & INSTITUTIONS

Appraising institutional challenges in the early stages of development

Chapter 4: Case studies on Bangladesh and Mozambique

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Chapter 4: Case studies on Bangladesh and Mozambique

4.1 Bangladesh

Is the 'Bangladesh paradox' sustainable?

The Bangladesh paradox consists of the apparent contradiction between the superior growth performance of the country over the last two or three decades and the dismal state of its institutions, at least as gauged by most international governance indicators. The Institutional Diagnostic Project (IDP) case study on Bangladesh attempts to explain this paradox and address the issue of its sustainability.

What follows is a short summary of this case study conducted according to the methodology described in Chapter 2. It starts with a brief presentation of the geographical, demographic, and historical context of development in Bangladesh, before focusing on its economic achievements but also on its challenges going forward. Institutional issues are then taken up, before presenting a full institutional diagnostic of Bangladesh's development perspectives and then concluding.

The geophysical and population context

Occupying the delta plains of major South Asian rivers – the Ganges, the Brahmaputra, and the Meghna – Bangladesh covers a 150,000-square-kilometre tract of land surrounded by India, except for a short border with Myanmar in its southeast. With 165 million inhabitants, it is the most densely populated country in the word (excluding city-countries like Hong Kong and Monaco). It has a tropical monsoon climate with heavy seasonal rainfall, hot temperatures, and high humidity. The combination of its climate, its dense river network, the low elevation of most of its land above sea level, and its geographical position at the very back of the Bay of Bengal make it prone to frequent natural disasters, including floods, cyclones, and tidal surges. For the same reason, it is one of the countries that is most threatened by climate change.

These natural conditions affect the country’s development potential and some of its development features. The scarcity of land is especially important since it affects agricultural production and constrains the extension of cities and non-agricultural activity. Over time, arable land as a proportion of total land has shrunk, the average farm size has fallen – it is today around 0.6 hectares – and landlessness has increased in rural areas. Meanwhile, urbanisation has progressed rapidly – at an annual rate of almost 1% of the population – so that the competition between agriculture and other activities for land is fierce.

Land scarcity would be even more worrisome if the rate of population growth had not fallen in a rather spectacular way over time. The fertility rate was above six children per woman at the time of independence in 1971. It is now close to two. Consequently, the annual population growth rate has declined from 3% to less than 1%. Ethnically, the population is extremely homogeneous: 98% of the population belong to the Bengali ethnic-linguistic group, while the remainder comprise several tribal groups in the hilly parts of the country.

The same homogeneity is observed with regard to religion, with more than 90% Muslims and 8% Hindus.

This religious homogeneity, as compared to Bangladesh’s neighbour India, is mostly due to the historical origins of the country: as the isolated eastern part of Pakistan, itself the result of the partition of the Indian provinces of Punjab and Bengal along religious lines at the time of India's and Pakistan's independence in 1947. Today's Popular Republic of Bangladesh thus results from a sequential process of independence: from India or the United Kingdom at the time of the partition, and from West Pakistan 24 years later, after a short but deadly war in which dissident Bengali forces defeated local West Pakistani forces thanks to the support and very effective involvement of the Indian army.

A short political history of Bangladesh[1]

Independence was proclaimed on 16 December 1971. Since then, however, the political history of Bangladesh has been rather turbulent, at least until a little more than 10 years ago. As it had a clear impact on development, and on the evolution of institutions in Bangladesh, it is worth briefly listing the main episodes in that history, and the enduring struggle between the two main political parties, the Awami League (AL) and the Bangladesh National Party (BNP).

- **The difficult advent of democracy (1971–1990)**

The AL had been in existence practically since the creation of Pakistan, at the time of partition. Of a clear socialist bent, the party relentlessly pursued autonomous status for the eastern part of the country, starting with the right to use the Bengali language rather than the Urdu spoken in the western part. Mujibur Rahman joined the League shortly after its creation and soon became its main leader, attracting as much popular support for himself personally as for the League itself. This backing was so strong that the AL won the 1970 national election against the main western party. Violent repression by the defeated government followed, which triggered the independence war, which was deadly but short. The East defeated the West with Indian support. In 1971, Mujibur Rahman became the president of the now independent East Pakistan, which was renamed Bangladesh – 'Bengali land'. At the same time he won the title of 'father of the nation'.

After a violent war, which had followed a devastating cyclone, Bangladesh was in a dire state. Mujibur Rahman almost had to reconstruct the country. His period of leadership was short but intense. Guided by four fundamental principles – 'nationalism, secularism, democracy, socialism' – he laid the foundations of a new state along socialist lines, including the nationalisation of many industries and businesses abandoned by the West Pakistanis after the war, land reform and the introduction of agricultural cooperatives, and the expansion of primary education and other public services. Time was too short for Rahman to see the result of these initiatives. Showing a personal inclination towards religious movements, Rahman’s rule was soon violently opposed by Communists, while, paradoxically, Muslim extremists reproached him for the secularist principle he had enshrined in Bangladesh's constitution. Sheikh Mujib, as Rahman was known, ruthlessly repressed these movements, jailing and often eliminating opponents to his rule,

[1] This section borrows from Raihan *et al*. (2000), Chapter 1, as well as from Lewis (2011) and Riaz (2016).

progressively transforming a liberal parliamentary political system into a single party (AL) authoritarian regime.

Rahman was assassinated in a coup managed by young army officers in November 1975. A period of disorder comprising various coups, countercoups, and assassinations followed, until army chief Ziaur Rahman ('General Zia') took power in 1976. After running the country as 'chief martial law administrator' for some time, amidst continuing disorder and coup attempts, Zia overwhelmingly won the presidential election that was called in 1978. Soon after, he founded the BNP with a view to uniting people behind principles different from those promoted by the AL, particularly secularism and socialism. He also reinstalled the religious Jamaat-e-Islami party, which had been banned after independence on charges of complicity with West Pakistan.

Zia's rule was short too, though less disorderly than Sheikh Mujib's. In effect, he put the Bangladeshi economy back on track. On the economic front, he focused on boosting agricultural and industrial production by promoting private sector development, export growth, and the reversing of farm collectivisation. Production quotas and other restrictions on economic activities were lifted. A rural development programme was implemented which comprised innovative social aspects, as well as measures to control population growth. Major infrastructure projects were launched, including irrigation canals, power stations, and roads. On the political front, Zia reversed the strong secularist principles imposed by Sheikh Mujib, giving more public space to religion and a greater voice to Islamic movements in a restored multi-party system. Once elected as president, he normalised political life, re-established public order, and tried to rein in the military.

Zia, too, was assassinated in 1981 by a previously high-ranking officer who had been demoted. The rebellion was quickly put down and a civil caretaker government was put in place. Yet the army was not willing to step aside. Another coup soon unfolded, and power fell into the hands of General Ershad, the very officer who had subdued the uprising that followed Zia's assassination.

When he declared himself president in 1983, Ershad immediately faced violent protests from most political parties, as well as from university students and the civil society in general. Thanks to the army's support, he managed to stay in power; he created his own political party, the Jatiya Party, and called a parliamentary election in 1986. The AL, small left-leaning parties, and Islamic parties participated in the election, but the BNP boycotted it. The election was won by the Jatiya Party, amidst allegations of election-rigging and manipulation.

In 1989, General Ershad passed through parliament an amendment to the constitution that made Islam the 'state religion'. Protests amplified, huge marches took place in the later months of 1990, and eventually the military also withdrew their support for the general. Ershad resigned and handed over power to a neutral interim caretaker government, which was mandated to hold free and fair national parliamentary elections within the next three months. This was the end of the military rule in Bangladesh and the beginning of democracy. But politics did not become more peaceful.

- **The competitive democratic era (1990–2011)**

Two strong personalities have marked Bangladeshi political history since the return to democracy and the 1991 election, who perpetuate the dichotomy that appeared soon after independence between the two differing approaches of Sheikh Mujib and General Zia to the economy and the society. In the post-1990 period, the daughter of the former, Sheik Hasina, headed the AL, whereas the widow of the latter, Khaleda Zia, led the BNP. The political history of history of Bangladesh in the 1990s may be summarised as a continuous struggle between these two personalities who democratically succeeded each other at the helm of the country but, at the same time, did all they could, often undemocratically, to eliminate their competitor from the political map. One of them eventually won.

It cannot be said that the struggle between the two parties had greatly to do with different views of, or strategies for, Bangladesh's development, rather it had to do with personal animosity between the party leaders and, more decisively, the control of the society and sources of rent within it. All means to win the fight were used, from organising violent protests, to election-rigging, to jailing opponents, to boycotting elections with the hope of nullifying them, to buying support. If the regime was officially democratic, political practices were not.

The BNP won the 1991 election and Khaleda Zia became prime minister after a vote on the constitution transformed the presidential system set up by General Zia into a parliamentary regime. Accusations of election-rigging in the replacement of one particular MP triggered a protest and a general boycott of parliament by the opposition, led by the AL. Likewise, the 1996 election, initially won by the BNP due to the opposition boycott, raised so much protest that the government had to accept new elections under the aegis of a caretaker government. The AL won, and Sheikh Hasina became prime minister. The economy of Bangladesh grew steadily during Sheikh Hasina’s tenure as prime minister, yet politics remained very tense, with several protests and strikes led by the BNP, political violence in the streets, and boycotts of parliamentary proceedings.

The rotation in regard to which party held power continued. The BNP prevailed in the 2001 election, organised again by a caretaker government. Khaleda Zia returned to power with a strong anti-corruption programme, which led to her government jailing Sheikh Hasina for a while on corruption charges. Towards the end of 2006, as new elections approached, the country again witnessed serious political unrest, with a demand for a ‘free and neutral’ general election under a neutral caretaker government. This led to the formation of a ‘civil’ caretaker government backed by the military in January 2007, which ruled for the next two years while trying to 'normalise' the political game, including through a failed attempt to exile the two 'begum'[2] contenders.

In the December 2008 national election, the AL returned to power, with 230 out of 300 parliamentary seats, and Sheikh Hasina returned as prime minister. In May 2011, the Supreme Court ruled that the system of the interim caretaker government was unconstitutional – a decision that was motivated by the experience of a two-year period during which the caretaker government practically abolished political parties and launched policy reforms, which was not within its formal mandate. This ruling *de facto* reinforced the party in power. The BNP boycotted the 2014 election, fearing it would be fixed and amidst

[2] This was the popular title given to the two ladies at the head of the two main political parties. Begum, originally an Indian name for princesses or kings' spouses, is a Muslim honorific title for a respectable lady.

severe repression by the AL government. It failed in imposing a caretaker government arrangement for that election. Consequently, the AL found itself with an overwhelming majority of seats in parliament. It has remained in power until now.

- **The era of the dominant party**

After again winning the election in 2020, Sheikh Hasina has now run the Bangladeshi government for 14 years. The question then arises of whether this longevity is the result of an effective steering of the economy and the society, or of specific policies implemented by the AL, or the vanishing of the main opposition party.

Most Bangladeshi political commentators seem to agree on the fact that ideological differences between the two parties are small. The AL is considered to be positioned on the centre-left, with possibly more liberal views than the BNP, which is more centre-right and conservative, in part because it is closer to Islamic values. However, this can hardly be taken as the reason why the latter has lost traction with the public. Doubtlessly, being in power helped the AL weaken the BNP – for instance, by jailing Khaleda Zia, whose son seems not to have been an effective substitute for his mother. But it is equally certain that the BNP has made political mistakes that have progressively driven it away from its electoral base. In fact, many people feel that the two parties are equally corrupt, undemocratic, and ideologically neutral, but also that Sheikh Hasina has been smarter and shrewder than her opponent.

In any case, since 2008, Bangladesh has clearly entered into an era of a dominant party whereby the AL not only steers the country but also exerts tight control over the whole society, thanks in particular to a ubiquitous presence in rural areas and effective networking in urban areas. With Khaleda Zia jailed on corruption charges for several years since 2018 and her son Tareqe in exile, and also sentenced to multiple years in prison in Bangladesh, the BNP has been decapitated. In the absence of effective and dynamic substitutes for the historical leaders of the main opposition party, the AL seems to have few obstacles to a long tenure in power.

Compared to the tumultuous past, this dominant party regime provides a degree of stability in the political system never seen since independence. This has undoubtedly had a favourable impact on economic development, even though, interestingly, growth was apparently little affected by the political turbulence of the competitive democracy era. However, this political stability should not be confused with progress towards democracy. Recent national elections, and many local-level elections, aroused allegations of irregularities. A decline in participation in elections is observed. There are concerns that the national parliament is dysfunctional when it comes to having meaningful debates on development issues, democratic rights, and freedom of expression. There are also concerns among civil society about the squeezing of the democratic space. It remains an open question the extent to which this state of affairs threatens political stability and the AL's dominance in the future.

Sources of, and challenges to, economic growth

Bangladesh's experience in regard to economic growth and development over the five decades since independence has generated much interest among academics and development practitioners, both at home and abroad. From its war-torn economy of 1972 until now, Bangladesh has been able to increase its per capita GDP in real terms 3.7 times (from US$ 460 in 1972 to US$ 1,700 in 2018),[3] cut the poverty rate from as much as 71% to 20.5% over the same period, become the second largest exporter of ready-made garments (RMG) in the world, and registered some notable progress in social sectors. In 2015, it graduated from the World Bank's low-income category to lower middle-income country category. Also, Bangladesh is now on track to meet the criteria for graduating from least developed country (LDC) status by 2024. At the same time, however, Bangladesh's development has happened in a widely recognised context of weak institutions. It has always been ranked in the very bottom of most international rankings of governance indicators. As was just seen, up to the late 2000s, its political climate was extremely tense, unstable, and often violent. All of these factors have prompted some analysts to term Bangladesh's economic development success as the 'Bangladesh paradox' or the 'Bangladesh surprise'.[4] The rest of this short summary of the IDP Bangladesh case study is devoted to explaining this paradox and, most importantly, to assessing whether it can be sustained: namely, whether growth can continue at the same speed without a major change in the institutional setting.

- **Growth performance**

GDP growth in Bangladesh has accelerated continuously since the days of independence. From an annual rate of around 3.7% in the 1970s, it reached 4.7% in the 1990s, and has gained 1% every decade since then. It was close to 7% just before the break caused by the COVID-19 pandemic in 2020. With an annual population growth rate now of around 1%, GDP per capita has followed a growth trend of 6% over the last 10 years or so. Few countries can boast such performance.

From an accounting point of view, roughly two-thirds of the increase in GDP per worker results from capital accumulation and one-third from total factor productivity. Within a causal perspective, however, three main factors are behind Bangladesh's growth performance: a) RMG exports; b) hard currency remittances from the huge and growing population of Bangladeshi workers abroad, predominantly in the Gulf countries; and c) a reasonable macroeconomic management.

- **The key role and challenges of the RMG sector**

The growth of Bangladesh's RMG exports has its origins in the international trade regime in textiles and clothing, which, until 2004, was governed by Multi Fibre Arrangement (MFA) quotas. This quota system restricted competition in the global market by providing reserved markets for numerous developing countries, including Bangladesh, where textiles and clothing items were not traditional exports. Bangladeshi entrepreneurs were smart enough to seek help from South Korean companies in setting up their operations and making sure they would reach their quota. They were also able to make deals with the government to obtain exceptional facilities. Yet the real surge in RMG exports took place after the MFA regime ended, when the international market was liberalised and the RMG Bangladeshi sector appeared as particularly competitive, partly because of its previous experience within the quota system and partly because of its very low labour cost, relative to other producers in

[3] At constant domestic prices in 2018 US$.
[4] See World Bank (2007), World Bank (2010), and Mahmud *et al*. (2008).

developing countries (outside China). RMG exports thus increased from US$ 5 billion in 2003 to US$ 40 billion in 2019 (at 2015 prices), an annual growth rate of 13%.

The growth of RMG exports has been one of the main growth drivers of Bangladesh's economy over the past three decades. By its forward and backward linkages, and by the hard currency it provides to the whole economy, its contribution is much larger than a simple calculation based on its GDP share would suggest. An econometric exercise has suggested that the elasticity of GDP to the volume of exports is around 22%: more or less three times its GDP share. Since 2004, it would thus have contributed almost 3 percentage points to overall GDP growth – about half of it.[5]

Despite this impressive growth record, it bears emphasis that the export base and export markets have remained rather narrow, which is a matter of great concern. Undiversified exports, both in terms of market and product range, are likely to be much more vulnerable to external and internal shocks than well-diversified exports. Despite repeated government statements, and even commitments, Bangladesh's diversification of manufacturing exports seems to have failed. UNCTAD's[6] export concentration index even suggests that, instead, export concentration has increased over the last two decades. It is higher today than in the average low- or lower middle-income country. The performance is equally dismal with respect to the Economic Complexity Index, thought to be related to the process of economic growth.[7]

This situation is still more worrying today as graduation from LDC status will terminate the trade preferences Bangladesh enjoys in advanced economies' markets, as pressure increases internally to improve the conditions of RMG workers, and as technological progress drastically modifies production conditions in the RMG sector.

- **The role of migration**

It is estimated that 10 million Bangladeshis are working abroad today, three-quarters of them in the Gulf countries. They send home some US$ 22 billion in remittances. This is approximately half the export revenue of the RMG sector. Unsurprisingly, the amount remitted, and, presumably, the number of migrants closely follows the level of economic activity in oil-exporting countries. Remittances rose from US$ 2 billion in the early 2000s to US$ 16 billion in 2014, as the price of oil roughly doubled during that period. They then stagnated, before recently rising again.[8]

In the econometric exercise referred to earlier, which estimates the sources of growth in Bangladesh, the elasticity of GDP growth to remittances, after deflating them by the appropriate price index, turned out to be 0.14. Given an average growth rate around 11%, real migrant remittances explain approximately 1.5 percentage points of the annual growth rate of GDP over the last two decades or so. Together with RMG exports, they thus represent practically two-thirds of overall GDP growth performance.

[5] See Raihan *et al*. (2020: Chapter 2).
[6] United Nations Conference on Trade and Development
[7] See Hidalgo and Hausmann (2009).
[8] See Raihan *et al*. (2020: Chapter 2, p. 13). On the correlation between migration and oil prices see Bossavie *et al*. (2020)

There are no precise data on the gross or net annual flows of migrants from Bangladesh and back. From the national economy perspective, it is the net flow that matters. Based on rough estimates of the number of Bangladeshi workers abroad, the average net outflow might have been as high as 400,000 workers a year over the last two decades.[9,10] Such a figure suggests that roughly 30% of the net annual increase in Bangladesh's labour force is employed abroad. In other words, the increase in the local labour force would have been 40% without the migration outlet. The stock figure is a little less alarming: if all Bangladeshis working abroad were to return, the labour force would grow by 15%.

Based on these estimates, not only did migration contribute to growth through remittances it also considerably eased the pressure on the supply side of the labour market, especially for low-skilled work.

- **Structural economic transformation in Bangladesh**

Bangladesh may be considered the typical country as regards the Kuznets/Lewis theory of dual development. Overpopulated, with huge pressure on land, without natural resource rent, the economy is divided into two sectors: a traditional, mostly agricultural, sector that is home to a majority of the population, but with surplus labour, low marginal productivity, and low average income; and a modern or formal sector employing people at a higher level of productivity and with higher wages but where employment is limited by available equipment. Capital accumulation in that sector, most often assimilated to manufacturing and associated upstream and downstream sectors, is the engine of growth of the economy. It generates both aggregate growth and structural transformation by employing a rising share of the labour force, thus reducing the employment share of the agricultural sector, lowering the extent of surplus labour, and increasing average income. If accumulation takes place at a rate that is fast enough, a time comes when surplus labour has been eliminated from the traditional sector, the marginal labour productivity gap with the modern sector starts to shrink, and the traditional sector modernises. At the same time, clear improvements take place in terms of poverty and income distribution.

Such a view of development is extremely schematic. Actual development processes are much more complex than this simple accumulation and sectoral transformation mechanism. Moreover, there are many factors that may derail this mechanism, starting of course with a low accumulation process in the modern part of the economy. Yet this model provides a simple benchmark by which to evaluate development progress: in particular, the capacity of the economy to absorb the huge pocket of poverty in the traditional sector.

Where does the economy of Bangladesh stand on this dualistic path? Without any doubt the structure of the economy has drastically changed over the last two or three decades. The GDP share of the agricultural sector fell from 32% in 1991 to 13% in 2018, whereas its employment share plummeted from almost 70% to 40%. Overall labour productivity thus increased thanks to this major structural shift. An interesting feature of that process, however, is that within-sector productivity also increased at a fast speed. This is true of the

[9] This is based on the stock of workers abroad having increased from 2 to 10 million between 2000 and 2014 – see Raihan *et al.* (2020: Chapter 2, p. 12).
[10] A recent official statement refers to a plan to 'export 1 million migrant workers to different countries around the world' in 2022, and boasts a successful COVID vaccination programme that can help reach that goal. 'Bangladesh sets target to send 1 million workers abroad in 2022': www.arabnews.com/node/2051236/world.

manufacturing sector, where it was multiplied by almost eight, in part thanks to the increasing specialisation in RMG, but also in agriculture, where average labour productivity was multiplied by four.

The possibility that the average labour productivity gains in agriculture might be essentially the reflection of less underemployment in farming has to be examined. In fact, something of this type may have occurred in the early 2000s, when the absolute number of people employed in the agricultural sector declined rather sharply, at the same time as average productivity was increasing. From the mid-2000s on, however, the number of workers has remained approximately constant, while productivity continued to increase at a fast speed. This logically leads us to conclude that surplus labour was eliminated around that time in Bangladesh. Even though the productivity gap between agriculture and manufacturing keeps widening, this is not the case when the comparison is made between agriculture and the rest of the economy: here, the gap is closing.

This apparent success of the Bangladeshi economy in completing the first step of the structural transformation while recording substantial progress in productivity across sectors must nevertheless be mitigated by the key role played by migration. Per se, it is unlikely that the dynamism of the manufacturing RMG sector and its backward and forward linkages would have been strong enough to achieve the structural transformation just described. In the absence of migration, and over two decades, the non-agricultural sector should have absorbed 8 million more workers – roughly a third of the jobs that were actually created.

As for overall growth, Bangladesh’s success in triggering this structural transformation of its economy, and the subsequent drop in poverty, is, in major part, the result of RMG exports and migration. Yet the fragility of this twofold engine of growth and structural transformation cannot be underestimated. On the one hand, remittances depend on oil and gas price cycles in Gulf countries at a time when efforts will be made in the world to reduce fossil fuel dependency. On the other hand, RMG exports may be affected by the loss of LDC status in a few years, by harsh competition in the world, and by the need to lift the pressure on labour cost that has led to an almost continuous increase in income inequality over the last three decades.[11]

Social and institutional challenges of Bangladesh's development

Bangladesh’s undeniable success in terms of economic growth and structural transformation, particularly over the last two decades, hides not only some fragility but also deep weaknesses, which may develop into a true handicap in the future. As is well-known, Bangladesh ranks near the bottom of most international governance scales, be it in terms of the control of corruption, state capacity, or the rule of the law. In-depth analysis of several sectors, as conducted in the IDP case study of Bangladesh, makes it possible to document more precisely the flaws in the management of the economy that lie behind this dismal ranking. Such flaws can be observed in most sectors, from infrastructure, to tax collection, to the disastrous regulation of the banking sector, to the judiciary, and to the state bureaucracy, as exemplified in the educational sector. It is fair to say that some progress is being made in some domains, in particular in the provision of energy and the electrification of rural areas, and in school enrolment. It is also the case that, in social matters, an extremely dynamic

[11] See Raihan *et al*. (2020: Chapter 2, p. 27).

non-governmental organisation (NGO) sector, some parts of which have a worldwide reputation, like Grameen Bank and BRAC, is partly remedying the weaknesses of the government's management, especially in the fields of health, education, and the fight against poverty in general. Yet huge progress is still to be accomplished, as can be seen from the few examples briefly summarised below.

Little will be possible, in fact, if public resources remain as limited as they are today. With total *tax receipts* below 9% of GDP (among the lowest in the world) and limited non-tax public revenues, Bangladesh's public sector suffers from severe atrophy and has a restricted capacity to provide the public goods and services that are needed to extend the industrialisation process beyond RMG exports and to cover basic social needs in the areas of education and healthcare.

On several occasions, the present government has explicitly mentioned the need to raise taxation. Analysis shows that a large part of the problem comes more from tax collection than from too low tax rates or too narrow a definition of taxable assets. No reform has been implemented so far. An ambitious reform of VAT collection was proposed a few years ago but was cancelled at the last moment. The blockage seems to come from an implicit coalition between tax personnel and politically powerful taxpayers, which successfully prevents the introduction of automated procedures that would improve asset transparency, both for direct and indirect tax, and therefore tax collection. The consequence of this situation is not only a dearth of public services, but the informalisation of the economy, since a majority of small and medium firms are able to evade taxation.

The *banking sector* is another area where corruption is a source of inefficiency. Bangladesh is at a stage where this sector, which was initially completely state-owned, has been substantially privatised, with several new banks recently licensed. Yet some important banks and financial institutions remain in the hands of the state, leading to a dual structure of the whole sector. If, overall, the sector has been, and still is, effective in supporting the development of the RMG and other sectors, most often through exclusive deals made between powerful entrepreneurs and private banks, it also shows major weaknesses and exhibits serious failures of regulation, most notably apparent in recurrent excessive non-performing loans (NPLs). Often caused by fraudulent behaviour rather than problems of profitability, NPLs exert adverse effects on the efficiency of the economy, reinforce the culture of corruption in the country, and contribute to rising inequality. Several major scandals have occurred, showing how deep corruption may be entrenched in this sector, despite, paradoxically, its capacity to finance the dynamic part of the economy.

A major institutional weakness of the banking sector is the lack of autonomy of the central bank in regard to regulating the sector, because of the clear subordinate position of the governor with respect to the government, and, through political links, private bankers. In this respect, the Bangladesh Association of (private sector) Banks, and the increasing political support it can command, represents a major obstacle to effective regulation.

Primary schooling in Bangladesh may serve as a good illustration of the issues that are typical of the delivery of public services in Bangladesh: positive efforts are made but their results fall short of what is expected. In primary education, the government boasts an impressive record in regard to increasing enrolment and achieving gender parity. But this is tempered by the growing body of evidence showing that learning outcomes for many children are extremely poor. The main systemic challenges in this sector can be categorised as follows: (i) a complex coexistence of various actors faced with confusing and sometimes conflicting divisions of responsibility; (ii) a lack of resources – Bangladesh devotes only 0.8% of its GDP to primary education, infrastructure is poor, and teachers' salaries are abnormally low, being slightly under per capita GDP; and (iii) in regard to teacher recruitment and management, recruitment is flawed, with corruption problems including political influence and bribing, while the monitoring of teachers (absenteeism or performance) is weak.

Although the problems in Bangladesh’s education system, and indeed in its public services more generally, are both severe and deep-rooted, there are various reforms which could and should be undertaken but which have been set aside. The historically low budgetary allocation towards primary education suggests that an increase in resources to the sector ought to be a major political priority, even though it will not solve all the problems.

Land markets raise important institutional issues in many developing countries but especially so in Bangladesh, as land is so scarce and the population is so large. The way they function in Bangladesh leads to two major difficulties: an inequitable and not necessarily more effective distribution of land, and constrained industrial development. The growing inequality in the distribution of land results from arrangements that involve corruption, nepotism, and the interference of business elites acting through political parties, rather than neutral market operations. Consequently, the land administration has not only been captured by elites but has also become resistant to reform or effective regulation, and the more the system works in their favour the greater their resistance to reform. The same analysis applies to Bangladesh's attempt to use Special Economic Zones (SEZs) to attract industrial investors despite the scarcity of land. The institutional mechanisms for acquisition and compensation are subject to a range of corrupt practices, which in turn create vested interests that resist change and a bias towards politically connected purchasers, or towards those who are willing and able to pay bribes. Such an environment is inimical to a good business climate and undermines the potential industrial incentives provided by the SEZs.

Another consequence of the way land reallocation operates is the dispossession of some landowners, who then become pure land tenants. Landlessness has greatly increased in rural areas, with the proportion of pure tenants surging from 45% to 65% since 2000.[12] Moreover, a survey conducted by the Manusher Jonno Foundation in 2015 found that around 70% of households reported losses of land in the previous 10 years, with 17% reportedly the victims of land grabbing.[13] Such a situation reveals not only illegal land acquisitions but also the incapacity of the judiciary to handle such abnormal behaviour. *Weak judiciary systems* are a feature of most developing countries, if only due to a lack of resources and a lack of human capital. In the case of Bangladesh, however, the situation is worse because of an implicit coalition of most actors within the judiciary, from clerks to lawyers to judges, in delaying the conclusion of cases, and repeatedly bribing plaintiffs to supposedly accelerate procedures. Meanwhile, land grabbers exploit the lands they have seized.

One could multiply the examples of ill-functioning public entities. What is surprising is that these are often well-documented in the media and yet do not arouse any real corrective

[12] Sen (2018).
[13] MJF (2015).

reaction by those government agencies that are supposed to control, in an independent way, behaviour that deviates from legal norms. The reason is that those agencies are, in effect, tightly controlled by the government. As an example, the head of the Anti-Corruption Commission is appointed, and may be dismissed discretionarily, by the government. In addition, the Commission must obtain the government's permission to investigate or file any charges against bureaucrats or politicians. Even when granted such permission, the Commission may end up declaring suspected government members innocent, against existing evidence. This has recently occurred in the case of a widely publicised scam.[14]

An interesting question in view of this situation is why such scandals do not help the opposition parties gain more support. One reason is their present weakness. Another is the conviction among the public that they were equally corrupt when in power, and would still be if they were to come back. This kind of affair is therefore considered something almost 'ordinary'.

One could also consider that the abnormally low level of governance quality in Bangladesh is of lesser importance in the public opinion that the good performance of the economy. After all, incomes are growing and poverty falling, and even though inequality is increasing, most people have seen their standard of living improve. Thus, why should they care about poor governance?

Of course, this is fine as long as growth continues to be strong, with more RMG exports and more people going to work abroad. The challenge is that this may not last if no action is taken to diversify the economy and to prevent the growth engine slowing down in the coming years. Ill-functioning institutions may hinder a positive turnaround. This is one of the key elements of the institutional diagnostic that was established for Bangladesh.

The Bangladesh institutional diagnostic

Medical diagnostics start with listing symptoms, before elaborating on the proximate causes of those symptoms and then identifying the deep factors that may permit or prevent correction of them. Our institutional diagnostic follows the same logic.

- **Institutional weaknesses and their economic consequences**

In establishing an institutional diagnostic of economic development in Bangladesh it is first necessary to identify the obstacle that prevents the implementation of a strategy of diversifying manufacturing exports, which will avoid a future slowdown of the pace of growth and structural transformation. It should be noted, moreover, that this diversification should take place as much within the RMG sector, the production of which remains extremely concentrated around a few limited ranges of products, as in other labour-intensive sectors like footwear or leather products. The in-depth analysis led in the IDP case study of Bangladesh suggests that, following Hassan and Raihan (2017), this obstacle is to be found in the culture of 'deals' that characterises policymaking in Bangladesh. To be sure, planning exercises are undertaken at five-year intervals, and these prioritise manufacturing export

[14] In 2016, the World Bank cancelled a US$ 1.2 billion loan for the construction of a bridge because of some evidence that the Canadian company which had won the bid had bribed Bangladeshi officials. The case was investigated by the Anti-Corruption Commission, which finally declared the suspected government members innocent despite the evidence against them.

diversification through a list of sectors supposed to benefit from the same advantages as the RMG sector. There were some 15 such sectors in the last five-year plan. Practically speaking, however, decisions about implementation are taken based on arrangements between the political elite in power and dominant entrepreneurs, or sectoral representatives in the case of the RMG sector, without real consideration in regard to the priority list. As a result, most support to exporting activity and infrastructure investment is concentrated in the latter.

Although this **supremacy of deals over formal industrial policymaking** has worked in the past, as exemplified by the phenomenal development of the RMG sector, it has now become an institutional obstacle to the diversification of the economy. This is due to a kind of capture of the government by part of the business elite, and the short-sightedness of both sets of actors.

A second generic institutional weakness that comes out of the analysis in the previous section is the **ineffectiveness of the regulation** that the state is supposed to exert over economic activity to prevent inefficient and inequitable outcomes. This is evident in the dysfunction of the banking sector, the failure to regulate labour conditions in a key sector like RMG (as evidenced by the Rana Plaza accident[15] and the downward pressure on wages), the dismal performance in regard to taxation, and the poor performance in many other areas, including transport, drug administration, and, of course, the Anti-Corruption Commission.

The third major institutional weakness is **state capacity**. This major governance failure in Bangladesh takes different forms. Some are readily apparent, such as the lack of public resources and therefore the limited provision and low quality of public goods, the lack of skills in public service, and an inefficient administrative organisation. These are common across low- and lower middle-income countries. Other forms of governance failure are more obscure, though equally devastating. This is the case of the high level of corruption found in most administrative clusters, which tends to make the delivery of public services both inefficient and inequitable, reduces revenues, and often discourages economic initiatives.

These generic institutional weaknesses of the Bangladeshi economy are not independent. Moreover, they must be considered more as the symptoms than the causes of ill-functioning institutions. A more complete picture of the institutional diagnostic appears in Table 1 below, which tries to put the preceding weaknesses in a double perspective: it shows, on the one hand, the social and economic consequences of the preceding weaknesses, and, on the other hand, the proximate causes and deep factors behind them. In reading this table, though, it is important to keep in mind that there is no one-to-one relationship between items at the same level in various columns. Causality must be understood as proceeding from column to column rather than from item to item.

Table 1: Institutional diagnostic table for Bangladesh

Deep factors	Proximate causes	Institutional weaknesses	Economic and social consequences
Political settlement (political and industrial elites	Elite capture of government (e.g. RMG entrepreneurial	***Supremacy of 'deals'***	Past successful development based on RMG exports but

[15] In April 2013, a Dhaka garment factory collapsed causing the death of more than 1,000 workers.

against labour) Winner-takes-all electoral democracy Vertical structure of political parties Vibrant civil society Population pressure on land (migration) Role of donors	class) Weakness of labour organisations Lack of resources and skills in the public sector Corruption equilibrium – anti-reform coalitions – clientelism Inadequate laws and administrative organisation Opacity and unaccountability	***over formal industrial (and development) policymaking*** ***Ineffective regulation*** – banking system – tax system – labour conditions ***Weak state capacity*** – weak delivery of public goods and services – corruption – ineffective and corrupt judiciary	threats to future growth Excessive export concentration Suppressed labour regime Gender discrimination NPL leakage of resources Misallocation of investments Unattractive investment climate Abnormally low tax revenues Limited quantity and quality of public goods (education, infrastructure) Rising inequality and slowing down of poverty reduction Compensation for limited public goods by, and poverty reduction role of, NGOs

- **Proximate causes**

Six items appear in the 'proximate causes' column. Some of them are rather obvious. *The lack of resources and skills* or the *culture of corruption*, where every actor expects others to behave in a corrupt way, are directly responsible for the weak state capacity and the ineffective regulation of the economy by the state. In bears emphasis in the case of Bangladesh that the lack of resources is partly self-inflicted since it is largely due to the abnormally low level of taxation. There is thus a circular relationship between the proximate causes and the symptoms of institutional flaws. It is also clear that the *elite capture* of the government by the entrepreneurial class, particularly from the RMG sector, explains the supremacy of deals over formal industrial policy. As the sector gained in importance, both through its size in the domestic economy and its dominant role in exports and general economic growth, it quickly acquired considerable leverage over the government, whichever party was in power at the time. Equally clear is the role that the *weakness of labour organisations* and their acceptance of low wages play in helping the RMG sector maintain its global competitiveness, and therefore its dominant position in the home economy. Here, too, the relationship is circular.

Several *laws and administrative organisations* are obsolete or inadequate, and weaken the institutional framework. This includes some land laws inherited from the colonial or the pre-independence period, and overlapping administrative responsibilities in land matters, primary education, and the regulation of banking. The independence of regulatory agencies from central power is another area that needs reform. As they presently stand, these agencies favour the *'opacity and unaccountability'* of the public sector and severely limit its exposure to the public opinion, despite a vibrant private mediatic context.

- **Deep factors**

Deep factors are those factors that constrain reforms that would remedy the proximate causes of basic institutional weaknesses. It bears emphasis that the term here refers to institutional factors that may hinder development, and not to development itself. For instance, the geopolitical location of Bangladesh is a deep factor that influences its development, but it is not clear that it plays a direct role in explaining the basic institutional weaknesses or the proximate causes set out in the diagnostic table above. Unsurprisingly, many of these deep factors are thus of a political economy nature.

The *'political settlement'* between the industrial elite and the political elite, whatever the government in place, is a case in point. This factor echoes the elite capture proximate cause discussed above but is more fundamental. The political settlement factor refers to converging interests between whoever is in government and the industrial elite, especially the RMG business leaders. The implicit agreement provides that the government will provide strong support to the rapid development of RMG exports, at the cost of repressing labour, a condition that may be necessary to maintain the global competitiveness of the sector. Overall economic growth is the government’s reward, the growth of their profits is the industrial elite’s reward. As long as growth prospects remain favourable, and in the absence of major political change, this settlement may persist.

A second deep political economy factor refers to the *'winner-takes-all'* type of political confrontation between the two main parties in Bangladesh during the so-called competitive democracy regime described earlier. It may explain the absence of long-run structural reform during that period, as parties in government were too busy reinforcing their political base to win the next election. It is now the third time in a row that the AL has won elections, so that one may reasonably question whether a profound change has taken place in Bangladeshi politics. It must be recognised, however, that democratic debate about long-run development objectives has always played a limited role in Bangladesh. This is even more true today, when the party in power has been able to successfully weaken and repress the opposition. Nor is a democratic debate taking place within parties. The two leaders have managed their respective parties with the same iron fist for the last 30 years, with little space left to dissenting minorities. The dynastic nature of power within the two parties does not suggest that this state of affairs is about to change.

The existence of a *vibrant civil society*, most notably NGOs, is another factor that has sometimes been proposed to explain the relative inertia of successive governments on the social front. Yet the substitutability between the government and NGOs is necessarily limited. The size of needs in areas like education and healthcare is such that NGOs can only play a marginal role, even though that role is crucial for the poorest segment of the population.

The inclusion *of population pressure* among the deep factors is meant to stress the high specificity of Bangladesh in this respect, and, implicitly, the major role of migration in reducing that pressure from an economic, social, and political point of view. Likewise, the mention of *donors* is made to recall the role they played in the past in financing the development of the economy, and, in several instances, guiding its macroeconomic policy. Bangladesh’s aid dependence has been limited over the last decade – i.e. 1% of GDP on average.

In the field of medicine, a diagnostic normally ends with a prescription. In the present case, the prescription would consist of those reforms meant to correct for the causes of institutional weaknesses, as identified by the diagnostic. The nature of reforms that would improve state capacity and the delivery of public services, modify inadequate laws, fight rent-seeking and corruption, and efficiently regulate the banking sector are rather evident. They are listed and discussed in the IDP case study of Bangladesh. More important is the political feasibility of these reforms, which depends on the deep factors that have just been listed but which may take on a different aspect in the particular context that characterises Bangladesh today.

Conclusion

The preceding diagnostic may seem unduly negative. This is essentially because it is in the nature of a diagnostic to identify existing flaws and potential obstacles to progress, rather than positive factors. Despite an institutional framework that is extremely weak by international standards, the Bangladeshi economy has been able to grow at a fast pace, to reduce poverty, and even to undertake important reforms in the past decades. Even within a turbulent political context, Bangladesh's governments have shown a strong political will for reform on multiple occasions in the past, such as when they supported the RMG sector at an early stage, when they opted for rigorous macroeconomic policies, when they invested massively in power generation or liberalised imports, and when they opened up the economy. Political power, political determination, and policy wisdom were present in many uneasy but key decisions, as, for instance, when food rations were abolished on the grounds that they were a costly way of supporting the urban middle class, rather than the poor, or in the case of the pioneering introduction of food and, later, conditional cash transfers to accelerate universal primary school enrolment. In one way or another, the main question that arises from the preceding diagnostic is thus whether reforms aimed at eliminating notorious rent-seeking opportunities are much more difficult to achieve. Is the present Government of Bangladesh in a situation to undertake them, and is it willing to carry them out?

That the government is in the hands of a strongly dominant party ensures that political leverage for reforms does in principle exist. But at the same time the weakness of the opposition is a disadvantage because the threat it can issue against a wavering government is weak. Up to now, moreover, the economy has done well, with solid growth benefiting most of the population, though more so those at the top of the income scale, and without preventing part of the population having to go abroad to support their family. On grounds of pure political strategy, the incentives for reform may thus seem relatively weak. However, the present diagnostic has exhibited the serious risks to the future rate of growth in Bangladesh. At the top of the list, the COVID-19 pandemic has already slowed down growth and potential geopolitical tensions in the post-COVID world add to the uncertainty arising from too specialised a development strategy. Taking advantage of the present political situation to launch reforms and to show results regarding both economic diversification and governance would do much to reinforce the party in power. If a power rotation takes place, on the other hand, these reforms would constrain the new government to follow the same principles of good governance and a sound rule of law, thus weakening its control over the opposition. For the party presently in power, and for the whole society, this is clearly a win-win strategy.

As mentioned at the beginning of this summary, the dichotomy observed in Bangladesh between weak institutions and robust growth was termed the 'Bangladesh paradox' or 'Bangladesh surprise'. At the end of this diagnostic one may ask whether such a paradox or such a surprise will persist. The answer is most probably not. Either growth will slow down without institutional improvement, or growth, and the transformations that come with it, will continue at the same pace but institutions will have been reformed. It behoves the present government to decide which direction to choose, considering that the political opportunity for ambitious institutional reforms may not last.

4.2 Mozambique

Defining the question behind the institutional diagnostic

Mozambique is a large, sparsely populated country with 25 main rivers that empty into the Indian Ocean and that physically divide the country. The main river is the Zambezi, which is navigable for 460 km out of a total of 820 km and flows eastwards across the territory. Located on the east coast of southern Africa, Mozambique, whose population is around 30 million, borders six other countries: Tanzania in the north, Malawi, Zimbabwe, Zambia, and Swaziland to the west, and South Africa to the south.

There are several reasons why Mozambique is worth studying, and some of these reasons have no doubt contributed to making it an aid darling for many donors. First, the country attained its independence late in the process of decolonisation, in which respect it is similar to other Portuguese colonies in Africa (Angola, Cape Verde, and Guinea Bissau). Moreover, it started from a very low base in terms of infrastructural development, education, and levels of living of the autochthonous population. Outright chaos broke out at the time of independence (in 1975), following the massive outflow of Portuguese settlers, who had occupied central positions in every layer of the economy. The country was then the poorest in the world and was in blatant need of external assistance. Second, like Angola, Botswana, Namibia, and Zimbabwe, Mozambique has been governed by the same party that took over after white rule ended (Frelimo). This party historically enjoyed huge prestige and legitimacy, and therefore embarked on a nation-building process under auspicious circumstances. At the same time, however, it quickly declared itself a Marxist-Leninist vanguard party, dedicated to central planning and opposed to private sector development. Third, because it has a long coastline and has enjoyed the presence and influence of Arab traders for a long time, Mozambique has potential in terms of developing trade links, while the proximity of South Africa, and its sizeable and more sophisticated economy, offers many attractive opportunities.

To date, however, the hopes placed in Mozambique’s development have largely been disappointed: economic growth has been below potential, social progress has been slow, structural transformation of the economy has barely begun, growth has been unequally distributed across the national territory, and dependence on external financing (development aid in particular) has not abated. Regarding the first point, it is noticeable that until the early 2000s, the donor community generally considered Mozambique a development success story: after the end of the internal war (between the ruling Frelimo and the opposition party, known as Renamo) in 1992, real GDP growth (per capita) was vigorous, easily outstripping the global average and surpassing many other countries in the region. This performance reflected the combination of a return of displaced people to their homes, the rebuilding of private and public infrastructure, supported by foreign aid, and private investment (domestic and foreign).

The trend was not sustained, however: the pace of real aggregate growth peaked at the turn of the new millennium and then slowed moderately during the 2000s (when the rate of real per capita growth was equal to 3.4% per year). As a result, Mozambique is no longer a star growth performer and lags behind its peers in the region (Ethiopia, Ghana, and Tanzania). Similarly, if particularly strong gains were obtained on the poverty front in the immediate post-conflict period, less impressive gains have been recorded since then. Mozambique thus remains a very poor country by any measure. In 2017, it ranked 180 of 186 countries in terms of real GDP per capita, and 180 out of 189 on the United Nations' Human Development Index.

During the decade starting in the late 1990s and ending in the late 2000s, Mozambique showed a promising trend, characterised by vigorous growth in the manufacturing sector, dominated by large-scale capital-intensive investments (particularly in the Mozal aluminium smelter), and by robust service sector growth. Then a turning point was reached, which was triggered by important foreign direct investments in the natural resources sector, mainly coal extraction and natural gas development, following the discovery of abundant reserves in Cabo Delgado. The same period also witnessed a rapid growth in private services, financial services included, but a declining trend in the contribution of agriculture to growth.

Much of Mozambique's growth has been fuelled by significant inflows of foreign exchange, both public and private. These inflows have generated spillovers, either directly into consumption – total consumption has consistently equalled about 90% of GDP– or indirectly into income through investment. Moreover, their pattern has shifted increasingly towards capital-intensive natural resource investments, and it seems highly likely that this trend will persist in the foreseeable future. What is worrying is that the economy seems to have become less diversified over time, as revealed by the shifts in the composition of its exports. Thus, manufacturing exports (aluminium) plateaued by the later 2000s, while, starting roughly in 2010, natural resources exports (mainly coal) have quintupled in value and now account for around 50% of all exports. Correspondingly, there is a relative shift towards lower value-added exports.

Finally, the authorities, in spite of the consistent political domination of the Frelimo party, have signally failed to reduce regional disparities and to therefore tame the resentment of people who do not live in the country's prosperous south. This failure is tragically attested to by the insurgency that broke out in Cabo Delgado in 2018.

Difficult initial conditions

Modern Mozambique was born in especially difficult circumstances, not only because of the sudden departure of 80% of the Portuguese settler population but also due to its geopolitical position in the context of the Cold War. The situation was complicated by the fact that Frelimo, which led the liberation war against the colonial power, came to exert a decisive political influence when the new People's Republic of Mozambique was founded and proclaimed as a one-party socialist state. This posed immediate threats to Rhodesia and South Africa, which feared a Communist presence on their borders. Furthermore, the decision of the Mozambican Government to enforce United Nations sanctions against Rhodesia in 1976 increased regional tensions, so much so that Rhodesia and South Africa moved to support and finance Renamo, the movement opposed to Frelimo's socialist orientation and whose leadership came from the centre of the country. After Zimbabwe (formerly Rhodesia) attained independence in 1980, the apartheid regime of South Africa continued to stir ethno-regional differences and grievances in Mozambique, and it turned Renamo into a significant military force capable of disrupting and sabotaging facilities in large parts of the country. The war rapidly escalated and Renamo's ruthless warfare contributed to undermining Frelimo's nation-building efforts and to destroying valuable infrastructure.

It was only in 1992, following the demise of apartheid in South Africa, that a peace treaty was eventually signed between the two contending parties, thereby opening the way to less chaotic progress and a more stable security situation. Two years later (1994), the first multi-party elections were organised, which, like all the subsequent ones, confirmed the domination of Mozambican politics by Frelimo. Simultaneously, as an aftermath of the collapse of the Soviet empire, the international environment was dramatically modified and Frelimo was forced to change course. Suddenly deprived of its main external financial support, the government had no other choice than to turn to Western donors (beyond the Nordic countries of Europe, which had been present much earlier) and to accept the free-market policies which they imposed. This implied the forsaking of the central planning strategy centred on import substitution and the forced mechanisation of agriculture, which Frelimo actively pursued after its transformation into a Marxist-Leninist party in 1977. Aid then flowed to the country which was now widely perceived as a donor darling.

Why is it that the strong growth that ensued, largely as a result of the return of a large number of refugees, did not lead to a significant structural transformation of the economy and to sustainable growth at the same level? And why is it that it did not lead to noticeable social achievements, greater national integration, and deep institutional change? This is the question which we now want to address. In order to answer it, we need to lend special attention to geographical and political factors, which appear to have had a determining impact on policies and institutions.

Geographical constraints

A basic fact about Mozambique is its low population density: equal to 40 people per square kilometre of land area, which is perceptibly lower than the average for sub-Saharan Africa (48 people per square kilometre), itself much below that observed for East Asia and South Asia (excluding high-income countries) – respectively, 131 and 389 people per square kilometre (United Nations Food and Agriculture Organization and World Bank data). An immediate consequence of a low population density is the high per unit cost of providing and maintaining infrastructure (transport, telecommunications, electricity, etc.), and of delivering public services. It is therefore no wonder that sub-Saharan Africa generally has low density of paved roads, particularly rural roads, and low density of railways links. Nor is it surprising that in remote areas the communication links that exist are often badly maintained, and, as a result, the operating costs of the vehicles tend to be abnormally high, with adverse effects on the efficiency of transport services (see Platteau (2000: Chap. 2)). Equally serious are the effects of low population density not only on the amount and quality of health and education services but also on the amount and quality of other state-provided services, such as agricultural extension, training, irrigation, and various support services to farmers and small-scale entrepreneurs. Quality is affected insofar as it is difficult to attract skilled labour to isolated places that lack many of the amenities which can be found in areas of higher population concentration.

All of these forces arising from the same fundamental cause, low population density, help explain why distant areas in which the population is highly scattered are backwards and remain so. High transaction costs – transportation and communication costs, in particular – are responsible for low human capital development and slow economic growth, which themselves tend to determine such high costs. Behind the nasty feedback effect that causes low-level trap equilibria in remote areas, (at least) two mechanisms are at work. On the one hand, out-migration resulting from a lack of economic opportunities raises the per unit costs of public goods and services even further, and, on the other hand, slow growth implies that business activities are not brisk enough to create a strong demand for transportation and communication, as well as for training, irrigation, and extension services. In rich countries, the vicious circle just described may be broken because income redistribution between different regions is both more affordable and better organised, and public service delivery to isolated areas is often subsidised by taxpayers living in thriving urban environments.

The tendency of poor countries to neglect maintenance of infrastructure, which was pointedly stressed by Alfred Hirschman (1958) a long time ago, is certainly verified in the case of Mozambique. Routine maintenance is generally delayed and migrated from the recurrent to the investment budget, where donors are more likely to help finance major rehabilitations once the infrastructure has degraded substantially. This sort of last-minute rehabilitation is a much more costly solution than regular maintenance, both in terms of the civil engineering work itself and in terms of vehicle operation costs (since the infrastructure remains degraded for a longer time). In addition, major rehabilitation work is not easily contractible to small local firms, which thereby miss precious opportunities to earn incomes and accumulate professional experience. The latter argument applies particularly to rural road networks.

In Mozambique, the problem is actually aggravated by two circumstances. First, not only is the country sparsely populated, especially in its central and northern part, but its space is also physically divided by numerous rivers. The resulting fragmentation makes its spatial integration by means of communication infrastructure comparatively costly. Second, the southern, richer, part of Mozambique, in which the capital city (Maputo) is located, is close to a large and economically more dynamic country, namely South Africa. It is no exaggeration to say that Mozambique’s south is much more tightly integrated with South Africa than with the central and southern parts of the national territory. This situation is a historical legacy of the colonial period, during which Mozambique was treated as a transit country. Since its transport infrastructure was built primarily to serve mining and farming activities in the much larger economies of South Africa and Rhodesia, the rail and road networks ran east–west, with little communication infrastructure to support north–south traffic.[16] Moreover, there were few rural roads linking farms to markets, and those that there were, were quite distant from each other.

The post-independence period did not bring any major change to the unbalanced distribution of communication links. Thus, large trunk roads in the east–west corridors were financed by donors whose priorities rested on estimates of internal rates of return, themselves narrowly dependent on vehicle operation costs. Furthermore, small rural roads and feeder roads received only a small share of the budget for the construction and maintenance of roads. After the first free elections were simultaneously held in Mozambique and South Africa in 1992 – no doubt a consequence of the end of the Cold War and the demise of the apartheid regime – borders and trade flows between the two countries were reopened, leading to increasing economic integration between southern Mozambique and South Africa. An important upshot of this is that Maputo, the capital city of Mozambique, where a modern urban elite and the country's middle class are concentrated, is much closer to the agricultural heartland of South Africa than to its own rich farmland in the central and northern provinces. Encouraged by low transportation costs (and also massive corruption in the customs services), the demand for agricultural and other consumer goods has been consistently directed towards South Africa.

Geographical factors and the absence of vigorous policies aimed at redressing the ensuing imbalances have therefore created a situation in which the interests of the domestic industrial and service sectors have been continuously disregarded. South African supermarket chains distributing South African and Asian products have thus expanded into all provincial capitals to cater to the needs of city dwellers in Mozambique, and even staple foods are imported in this way. In short, the urban middle class of the country has been de-linked from its own agriculture and this process of distorted integration is deepening over time. As a matter of fact, with infrastructure investments (especially around Maputo) concentrated at the starting point of a new corridor leading to Durban, the connection between southern Mozambique and South Africa will only become closer, at the expense of the central and southern regions. The consequence seems inescapable: inter-regional inequality is bound to grow and national integration to become increasingly difficult.

In this context, the question as to whether the recent discovery of massive reserves of natural gas in the Rovuma Basin off the coast of Cabo Delgado (in 2016) can be a game-changer appears highly critical. This external shock offers a golden opportunity to redistribute income-earning and employment opportunities towards the northern part of the country, and thereby stop the national disintegration just described. At the same time, however, we know too well that golden opportunities of this kind can easily turn into a natural resource curse, as so many African countries in similar situations have experienced.

[16] The changing locations of the capital city of Mozambique are interesting in this regard. It was first established in Ilha because of economic links with Goa (in India), which Portugal ruled for 451 years, until 1961. The declining importance of the Indian trade and the growing importance of South Africa, especially after gold was discovered in 1860, caused the southward movement of the capital city to Lourenço Marques, which is located near the southern end of the country and positioned within 120 kilometres of the borders of South Africa and Eswatini (Swaziland). After independence, in 1976, Lourenço Marques was renamed Maputo.

Unfortunately, the omens are not good because escaping the curse requires a government which will take decisions driven by long-term considerations and by the general interests of the population, rather than by the selfish interests of an elite living in the southern part of the country. The recent insurrectionary events in Cabo Delgado suggest that at least part of the local population holds a pessimistic view that sees such a requirement as unlikely to be met. In order to make our own assessment, the next step is naturally to look at the way politics functions in Mozambique, and, in particular, how it relates to business interests – and with what consequences.

Politics and business

As pointed out earlier, defining features of the post-independence political regime in Mozambique are: 1) the initial merging of the Frelimo party with the state; and 2) the continuous domination of the same party even after multi-party elections were organised. As a result, an enduring one-party state has so far presided over the destiny of the country. In theory, this could help promote development by prompting the leadership to design and implement a unified long-term strategy of investment, growth, and social advancement. But the same conditions can also have the effect of undermining this capacity if the lack of political contestation prevents the correction of wrong-headed policies, or if they cause political rulers to be more concerned with tightening their grip on power and preserving the accompanying economic privileges than with increasing the well-being of the population. To look into this matter, we need to distinguish between the period when a socialist state was in place and the subsequent period of formal democracy.

When Frelimo acceded to political power at independence, it embarked on a programme of radical change based on Marxist-Leninist principles. Practically, this meant discouraging private initiative, adopting protectionist policies and the import substitution strategy, as well as transforming the agricultural sector into one based on large-scale mechanised farms. This approach rapidly proved to be a failure, which was officially recognised at the Fourth Party Congress in 1984. Because of the situation of war into which the country fell, however, there was no immediate effect of this reckoning. Policies were not re-orientated – in particular, the contemplated shift from socialist agriculture to a strategy centred on the development of small-scale peasant farming.

A more important turning point was reached in the 1990s when liberalisation and privatisation policies came about in the wake of the Structural Adjustment Programmes (SAPs) conceived by the World Bank and the International Monetary Fund (IMF). The separation of economic and political powers, merged by design during the immediate post-independence period, was then on the cards. Yet, instead of being mitigated or suppressed, the interpenetration of business and politics was actually reinforced. Privatised enterprises were taken over by party members, civil servants, and army officers, thereby ensuring *de facto* continuity with the previous state of affairs. This strategy was justified by the almost total absence of an experienced and independent business class in the country, and by the need to prevent the return of foreign capitalists, foremost among whom were Portuguese and South African business firms or groups. Its effectiveness was nonetheless doubtful inasmuch as a fraction of the new private entrepreneurs went broke or quickly liquidated their assets, and it is revealing that other entrepreneurs who continued their activities struck deals with foreign partners who possess the required skills and capital.

Whichever is the case, it bears emphasis that most new firm owners, some of whom acquired the public assets at very low prices, benefitted from some sort of exclusivity (such as a licence, a quota, or a contract for supplies to the government). When they were not closed down, therefore, public companies were simply transformed into private monopolies which continued to depend on government protection for the preservation of their privileges. Profits were (and remain) especially high in trade in imported consumer goods and exports of primary products, tourism, and construction activities stimulated by land development and privatised real estate. The privatisation process was questionable in terms of efficiency but equally from the standpoint of equity. This is not only because the emerging group of private firm owners was overwhelmingly made up of government officials and public servants, but also because entrepreneurs with ties to the opposition were consistently excluded.

The pattern of business–politics relationships is thus one in which big business is organised by politicians, rather than the other way around (big business exerts a strong influence on politics by financing the campaigns of politicians). As there is no credible alternative political force, Frelimo is in a comfortable position that allows it to continuously lock in the political allegiance of the business community. Being deprived of the possibility of hedging their bets by financing the campaigns of multiple political parties, members of the business elite of Mozambique have their privileges narrowly tied to Frelimo's continuing in power. The Frelimo machine is oiled by their money, which includes donations by foreign business partners and associates, but that money itself is obtained thanks to egregious advantages dispensed by the party's top brass.

Why is it that Frelimo has enjoyed, and continues to enjoy, such a strong incumbency advantage? The answer is double. For one thing, Renamo, its main rival, has difficulties attracting many voters, especially the young, owing to excessive centralisation of its party machine. And, for another thing, elections tend to be manipulated through fabrication of the list of candidates and voters register, intimidation during campaigns and on the day of the election, as well as through manipulation of the results achieved by stuffing ballot boxes and tinkering with the final tabulations. The tampering with the democratic process is made easier by the limited access of independent (external) observers to the different stages of the elections. The end outcome is that elections in Mozambique are not free and fair, and most observers agree that the situation is not changing for the better.

Does the above account mean that there is no stiff competition in Mozambique's political arena and that, as a result, its political leadership is able to ensure the continuity of the country's development strategies? The answer is negative since, inside Frelimo, various factions fiercely fight for access to power positions. Financial strength being a key determinant of the ability to rise within the party's machine, this elite rivalry creates a fertile ground for the spread of money politics and influence peddling. Thus, if the control of the state allows privileged access to capital accumulation and juicy rents, it is conditioned by the control of Frelimo, as witnessed by the fact that the president of Frelimo almost automatically becomes the president of the republic, and the party's candidates for parliament are appointed on the basis of blocked party lists. There is no such thing as dynastic power, so that the struggle between different political barons, each with his own support network of business people and other allies, is a play for high stakes.

It is thus at the level of the primaries, which is an internal affair, that economic leaders choose which alliances they wish to enter into, hedging their bets with a view to reducing future risks for their businesses. On the other side of the bargain, those inside the party who want to stay in central party organs and obtain high offices in the government need to raise funds both to finance the party and to capture votes at the primaries. Vote-buying therefore lies at the heart of primary elections in Mozambique, and it has become common practice only because of the complicity of the courts, which shut their eyes to corruption and other illegal acts. A portentous upshot of the internal tensions inside Frelimo provides an answer to a question which was raised earlier: despite the existence of a *de facto* one-party state, there is no guarantee of policy continuity over time. The possibility of the instability of development strategies is illustrated by the difficult transition from President Guebuza to President Nyusi, who was not Guebuza's preferred candidate and had a different approach to policy and reform.

Clearly, the most important potential advantage of a regime founded on an overwhelmingly dominant party has not materialised in the case of Mozambique. Changes at the level of the presidency can cause significant shifts in development-related policies, can explain the piecemeal approach to policy formulation, as well as major rotations of personnel in government and leading positions in the public administration. Moreover, in the very logic of political patronage and crony capitalism, members of the government are inclined to view their ministry as their own fief: that is, they see it as a source of rents which should naturally accrue to them for personal appropriation and for redistribution to the network of their supporters, brokers, and financiers. In these conditions, strategic information-sharing and coordination between different parts of the executive tend to be obstructed, with the effect of seriously impairing the effectiveness of development policies. To this shortcoming of political patronage must be added another one, better known among economists: it fosters pork barrel projects, private transfers, and local public goods at the expense of public goods that are in the general interest, such as education and health.

Finally, it must be emphasised that the onset of extractive industries and, subsequently, the awarding to international companies of exclusive rights to explore and exploit oil and gas reserves in Cabo Delgado (in 2006), followed by the confirmation of the existence of plentiful reserves of natural gas (in 2010), have created new rent opportunities, real or anticipated, that have considerably raised the stakes involved in the struggle for political power and influence. It is probably no coincidence that the trend of an improvement in governance indicators was reversed after the occurrence of the aforementioned shocks to the economy. More specifically, it is hard to dissociate from the 'pre-boom curse syndrome' scandals such as the hidden debt scandal (2016), which has deeply affected both the economic and political climate in Mozambique and the country's relations with the international community. Corruption, cronyism, and money politics, which pose a genuine danger to the vitality and sustainability of the economy, are unlikely to recede in the new rent-prone environment. This is especially true because of the weakness of anti-corruption institutions and their lack of independence from political influence.[17]

[17] To be more precise, in the final years of Guebuza's second term, three semi-public entities took out over US$ 2 billion in loans from private foreign banks without submitting them to the Assembly for approval, even though they greatly exceeded the limit placed on government borrowing by the relevant annual budget appropriation bill. These three entities were owned and controlled by a very small group of individuals and were very closely linked to the security sector. When the existence of the loans became public, the IMF suspended its support to Mozambique, and much foreign aid, including all direct support to the state budget, was frozen or significantly reduced.

Institutional diagnostic of Mozambique: a compact view

Having expounded the critical elements of the diagnostic, we can now take a comprehensive view in which Mozambique's institutional weaknesses are traced back to deep and proximate causes, and their economic consequences are brought into relief (see Table 2). Bearing in mind the analysis presented in the three sections above, the factors featured in the table, as well as their chosen location, are almost self-explanatory.

Table 2: A synthetic ordering of the institutional factors impeding Mozambique's long-term development

Deep factors	Proximate causes	Basic institutional weaknesses	Economic consequences
- Physical and human geography (1): low population density - Physical and human geography (2): proximity to a big and sophisticated economy - Colonial and geopolitical legacy: a one-party state, initially socialist, inheriting a situation of widespread poverty - Natural resources endowment: natural gas - Critical dependence on external finance: aid and foreign direct investment	- Large inter-regional disparities - Fusion of politics and business, with an upper hand for politics - Continuation of one-party state, with internal competitive clientelism - Weak policy continuity - Lack of separation between executive, legislative, and judiciary	- Weak national integration and strong centrifugal tendencies - Widespread corruption and cronyism, and lack of transparency and serious auditing - Low state capacity: poor coordination between departments and low administrative skills - Low state capacity: inability to implement announced plans and strategies - Lack of sufficient attention to critical public goods (e.g. education and health)	- Lack of an inclusive growth engine and lopsided development pattern - Slow poverty reduction and rising inequalities - Low level of domestic savings and inefficient financial sector - Low quality of education and health - Poor investment climate - Chronic aid dependence - Vulnerability to external shocks

The deep factors, which ultimately account for the key institutional weaknesses detected in Mozambique, can be distilled down to five. The first and second are the binding constraints born of the physical and human geography of the country, consisting of low population density and proximity (on the southern border) to a big and more sophisticated neighbour. The third factor is the legacy coming from the colonial period, and the geopolitical situation of Mozambique. What we have essentially in mind here is the one-party state born of the liberation struggle, the socialist approach to growth and development that it initially took, and the context of Cold War tensions which it had to face. The fourth factor is the presence of rich natural resource endowments, mainly in the form of natural gas reserves, which have been discovered rather recently. And the last factor is the critical dependence of Mozambique on external finance for its continuation and development. Among the sources of external financing, aid occupied pride of place until the discovery of gas resources. From then on, foreign direct investment has assumed growing importance.

The way the chain of causation unfolds from these deep factors to lead to the economic liabilities which we observe today can be seen in the table and directly linked to the preceding discussion. It is nevertheless important to stress that if the proximate causes can be usefully explained in the light of the deep factors, they are not mechanically determined by them. If this were the case, there would be no ground for formulating policy implications as we do in the next and last section. Thus, for example, the adverse effects of low population density on remote areas could have been mitigated if the government had chosen to take steps towards countering them, instead of letting market forces freely operate. This would have allowed the populations inhabiting these areas to benefit from better services like education, health, and agricultural infrastructure and extension. To take another example, the fusion of politics and business in the framework of an overwhelmingly dominant party could have given way to a more genuinely democratic regime if the authorities had chosen to bring more competition into the political arena, instead of confining it to the internal space of Frelimo.

As a last illustration, we can cite the country's tight dependence on external finance. Here, the government could have decided to be more autonomous vis-à-vis external forces and international organisations and donors if it had chosen to tax its well-to-do people more effectively. Admittedly, such a step would have been difficult to take soon after independence, when Mozambique was in a formation state and in the midst of a nasty war which was not of its own making. At a later stage, however, the emergence of a prosperous group of rich businesspeople, state officials, and middle class residents of big cities, such as Maputo, opened up the possibility of taxation and income redistribution to the benefit of the rest of the population, and the poor in particular. That this course was not followed can obviously not be blamed on deep factors.

Policy implications and recommendations

An important policy implication of the diagnosis proposed is the need to correct the disequalising effects of market forces in the form of growing inter-regional disparities and increasing income inequality. Two lines of reforms spring to mind. First, infrastructural investments aimed at better connecting the poor central and northern parts of the country to its much more prosperous south should become a major plank of any comprehensive development strategy. There is a strong argument for creating a single Ministry of Infrastructure Development, which would be fully dedicated to a task that is presently split over separate ministries, such as Health, Education, Transport and Communications, Agriculture, Public Works, and Energy and Mineral Resources. Such a step would help bring forth a more coherent and unified approach to infrastructure development.

Second, a core element of any growth strategy should be the active support of small- and medium-scale agriculture and agro-processing activities in areas where land is of a sufficient quality. Moreover, special attention ought to be paid to the central and southern parts of the country, where such lands exist, so that both inter-regional and personal income inequalities, as well as poverty, are simultaneously reduced. To be effective, this strategic orientation requires the reinforcement of the institutions in charge of the delivery of agriculture services, including irrigation, credit, training, supply of modern inputs, and marketing outlets, of the support for the development of appropriate technologies used in the processing of agricultural products, and of the dissemination of more efficient storage and distribution technologies.

In terms of infrastructure, priority should be awarded to the construction and maintenance of farm-to-market and feeder roads, which are presently underdeveloped. Regarding credit to smallholders, the creation of a lower-risk agricultural bank, such as is found in many developing and developed countries, must be seriously contemplated. Loan guarantees are a pivotal issue here, and it is therefore essential to analyse it carefully. In particular, are the possession rights of Mozambican farmers sufficient to enable them to use their land as collateral to obtain credit? If not, is there any conceivable alternative collateral, such as standing crops, that could avoid the costly step of formalised land titles? Regarding agro-processing, focus must be on the transformation of products, such as fruits and vegetables (baby corn, green beans, citrus fruits, bananas, and mangos), cereals (maize and related products, sesame), and cut flowers.

All of the above requirements will not be met unless competent national and regional agencies for project identification and appraisal are put in place and receive the support of local bodies and NGOs with experience of grassroots development elsewhere in Africa. In this regard, two remarks deserve to be made. To begin with, it is important that public resources are not allocated based on a mechanical fixed-rates criterion. In Mozambique, debates about the budget shares to be allocated to different sectors are often reduced to references to various international declarations, such as the 2003 Maputo Declaration and the 2014 Malabo Declaration. According to these declarations, 10% of the total state budget should be allocated to agriculture (it was 5.7% in 2018). Instead, the allocation of the budget should be based on explicit socioeconomic criteria and the ensuing analysis should demonstrate the ability to achieve targeted outcomes in line with established policy goals. This is a complex exercise since expenditures in education, health, energy, roads, bridges, transportation, communications, rural commercialisation, and many other sectors all interact with, and impact on, agriculture. For instance, the promotion of tourism and agro-tourism, the production of electricity from hydropower and natural gas plants, as well as transportation services, are activities that could easily be expanded in the wake of, or concomitantly with, agricultural growth. Finally, in a longer-term perspective, and given the risks of climate change for agricultural production, it is imperative to develop clear adaptation strategies and technologies that are environmentally friendly and resilient to climate shocks.

The second remark is related to the necessity to avoid a top-down approach. Effective development of smallholder agriculture will not be achieved unless rural communities are involved in more than perfunctory ways. More concretely, they should not only be consulted by specialised agencies in charge of agricultural development, they ought also to be key actors in the establishment and operation of local institutions intended to solve their most pressing problems, such as how to store and dispose of their harvests most profitably, how to ensure proper maintenance of local public goods (e.g. roads, irrigation and draining facilities, collective granaries), how to secure supplies of critical inputs, how to organise training in such a way that it does not disrupt their ordinary activities, etc. It is at this low but essential level that the contribution of NGOs can prove most useful.

Besides the need to correct for growing inequalities, it is hard to see how the country’s development potential could be better mobilised in the absence of serious measures aimed at combatting the most egregious dysfunction of the prevailing political system. This is the most difficult task and, obviously, it cannot be tackled upfront because any direct reforming attempt is certain to arouse the stubborn resistance of the entrenched ruling elite, whose interests would be unavoidably harmed. This said, even though it will be difficult to break the link between politics and business, the hope of mitigating its worst effects must be actively entertained. Below, we suggest some measures in this direction.

The effective separation of the executive, judicial, and legislative powers is an objective that should not be lost sight of. Limiting our attention to the judiciary, an important first step would be to create an additional post of president of the judiciary. Instead of being appointed by the president of the republic, the president of the judiciary should be elected by all judges, whose votes would have equal weight, so that no one would have special voting powers. He or she would be barred from fulfilling the standard jurisdictional function of the courts, and his or her mandate would be of limited duration (four to five years) and would not coincide with the years of presidential and parliamentary elections. A body for oversight and control could be elected for the same period as the president of the judicial power. Composed of judges acting collectively to approve the way the budget of the justice department is allocated and to manage complaints, its members would represent, in due proportions, different areas or courts, but not different categories of judge. Following this recommendation, the president of the Supreme Court would keep the position of '*primus inter pares*' but would not represent the judicial power.

As much as possible, laws should be enacted that prevent the use of public funds or resources for campaigning purposes. The best way to ensure proper law enforcement is to guarantee the freedom of the press and its right to exert pressure on the government and other public agencies for maximum transparency and accountability. This should also apply to other forms of regulation and contracts, in particular those that involve large sums of money. In this respect, it is advisable to establish a public company charged with the task of exploiting and extracting hydrocarbons on a large scale and in the general interest of the population. A competitive and transparent policy in line with best international practices should be developed to hire managers, engineers, and other professionals. Also, the public company should be managed in an autonomous manner, implying that it should be immune to any direct political interference. It should be supervised by an administrative board, which in turn operates under a transparent management system. The participation of new international companies competing in the exploration and production of hydrocarbons should be kept open.

Genuine decentralisation must be pursued on the basis of the approval by the parliament (April 2019) of three bills providing for the election of provincial governments and assemblies, and the creation of a secretary of state for each province. Since the stated goal of these initiatives is to further democratise and empower local levels, it is critical that these reforms do not end up in a situation where the position of provincial state secretary offsets the political power of provincial governors (who are locally elected).

Given the pivotal role of human capital accumulation for long-term development, efforts to improve education quality must not be spared. The present state of affairs is unsatisfactory, in part because pupils and students are too often allowed to graduate at higher levels while they do not actually satisfy the minimum standards officially required. Class and teacher attendance needs to be tightly monitored and mechanisms need to be created to allow for the denunciation of attempts to buy certificates. Mutatis mutandis, the same principles apply to the health sector where, in addition, the Ministry of Health (a normative and regulatory body) ought to be separated from the National Health Service (the implementing agency) to avoid evident conflicts of interest.

Our last point concerns the dependence of Mozambique on foreign aid. What we wish to stress is that the government must be able to assess and address the concerns of donors while taking into account the general interests of the country. This implies that it has the capacity to balance the conflicting interests of different foreign countries (as different as China and the USA) against Mozambique’s long-term goals. The possibility must therefore be accepted that aid offers are rejected when they are not in line with national policy and plans. This has concrete implications. In particular, the Foreign Service should be strengthened so that all aspects of foreign policy can be brought to bear on relations with foreign countries. Furthermore, transparent rules of the game based on clear and objective criteria must be laid down for all foreign investments (public and private), and they should be duly implemented. Such measures will not achieve their purpose if there is no strong interface, chaired by the prime minister, between key coordinating ministries and sector ministries, such as the Ministry of Industry and Trade, the Ministry of Energy and Mineral Resources, and the Ministry of Agriculture and Rural Development.