

## I. Strengthening public accountability and governance<sup>1</sup>

*"Lack of good governance produces disparity, injustice, deprivation and lawlessness in the society in general and for the poor in particular. In order to attain a higher rate of poverty reduction there is no escape from ensuring good governance."*

*Bangladesh: Unlocking the Potential, National Strategy for Accelerated Poverty Reduction, Government of Bangladesh, Planning Commission, October 2005: Dhaka.*

*"Governance was neglected by economists for a long time, perhaps because they expected the government to provide it efficiently."*

Avinash Dixit, "Governance and Economic Development", mimeo, August 3, 2006, ICRIER: New Delhi.

Bangladesh ranks at the bottom of Transparency International's (TI's) index of perceived corruption, but has grown at over 5 percent a year for the last 15 years, achieved universal primary enrolment, gender parity in secondary education, and lower child mortality than its South-Asian neighbors. During a 20-year civil war, Sri Lanka averaged 3 percent per-capita growth. Despite a Maoist insurgency, Nepal reduced poverty by 11 percentage points in eight years. One of India's fastest growing states, Karnataka ranks fourth-from-the-bottom on TI's corruption rankings of Indian states. In Uttar Pradesh, another low-ranking India state plagued with clientelist politics, rural poverty fell by 14 percentage points in the last 10 years.

Uneven governance performance appears not to have prevented the acceleration of growth and human development in South Asia in recent years. Does this provide grounds for complacency on governance? Or could South Asia, and in particular a country like Bangladesh, have grown even faster had it tackled its governance problems? What can we learn from Bangladesh's experience of poor governance with good growth for the future acceleration and sustainability of growth in the region?

### **Governance and growth in Bangladesh: a conundrum?**

On many measures of governance, Bangladesh ranks among the bottom quartile of all developing countries, with its performance on political stability, regulatory quality, and control of corruption worse than the average for low income countries (Figure 16). Investment climate surveys for Bangladesh paint a similar picture (Table 4). Yet, in terms of average annual per capita GDP growth over the last 15 years, Bangladesh at 3.3 percent outperformed both low income countries (3 percent) and IDA-only countries (1.8 percent). It also outperformed these countries on many social indicators (Table 5). Bangladesh's social development outcomes are not only better than the predicted levels for a country at its level of income, but its current income level is also higher than its predicted level given its weak institutional quality indicators.

Research over the past decade provides compelling evidence that good governance matters for growth (Rodrik et al 2002). But the research findings are not clear on *which* kind of governance, *why* it matters, and *how* it influences growth. This raises a number of questions. How to explain the conundrum of Bangladesh's strong growth and human development performance despite its weak indicators of governance? In looking at aggregate perception-based indicators, are we missing some key strengths in governance in Bangladesh that offset the negative effects of poor governance in other spheres? Is this sustainable? Can this provide entry points for how we might address governance issues in Bangladesh as well as other countries in the region?

Figure 16: Key governance indicators for Bangladesh and Low Income Countries

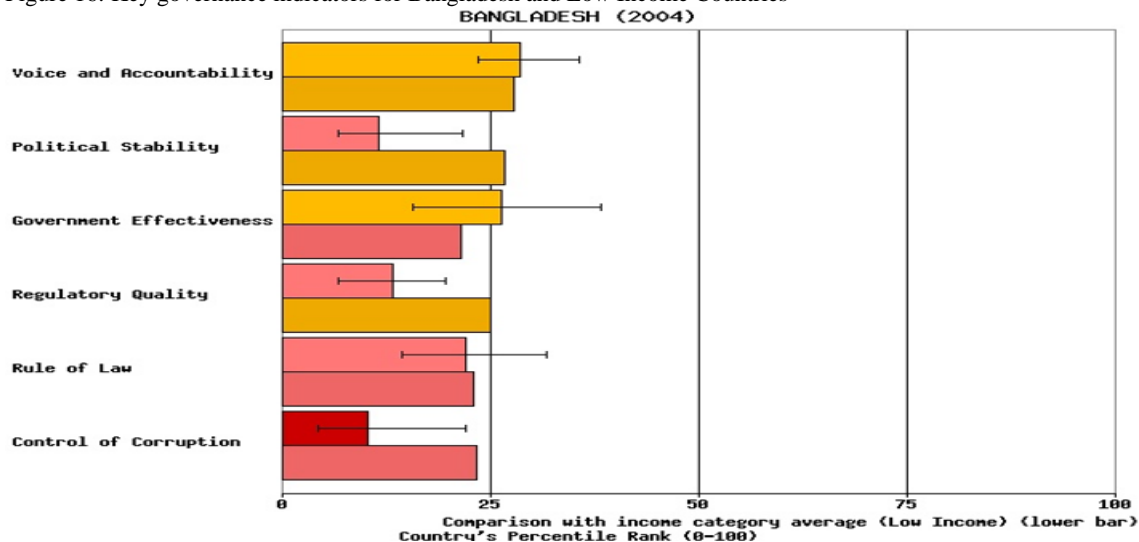


Table 4: Investment Climate Survey 2005

Indicator	Bangladesh	South Asia	All Countries
Senior Management time spent dealing with requirements of regulations (%)	4.2	8.2	8.2
Consistency of officials' interpretation of regulations (%)	78.6	52.5	46.9
Economic and regulatory policy uncertainty (%)	44.3	23.2	30.5
Firms expected to give gifts in meetings with tax inspectors (%)	85.8	44.3	21.7
Unofficial payments for firms to get things done (% of sales)	2.5	1.6	2.4
Value of gift expected to secure government contract (% of contract)	4.3	2.2	3.0
Corruption as a major or severe obstacle (% of firms)	57.6	25.4	29.9
Confidence in the judiciary system (% of firms)	17.0	48.5	56.7
Dispute resolution time (weeks)	13.0	9.2	8.8
Crime, theft and disorder a major or severe obstacle	39.0	15.0	19.7
Losses due to crime (% of sales)	0.6	0.6	1.4
Tax administration a major or severe obstacle (% of firms)	49.8	22.4	25.9
Customs and trade regulations a major or severe obstacle (% of firms)	41.9	24.8	16.8

Table 5: .Development Performance and Outcomes for Bangladesh and Selected Comparators, 1990-2004

Indicator	Bangladesh	India	Pakistan	Sri Lanka	Low-income countries	IDA-only countries
<b>Growth and structural change</b>						
GDP per capita growth, annual (% , period avg.)	3.3	4.4	1.1	3.4	3.0	1.8
Trade (exports and imports) as share of GDP (% , end of period)	30.8	25.7	37.1	79.9	38.8	64.3
Foreign direct investment, annual net inflows (% of GDP, period avg.)	0.2	0.6	0.9	1.3	1.3	2.7
Workers' remittances (% of GDP, period avg.)	4.1	2.4	2.9	6.4	..	..
Net aid flows (% of GNI, end of period)	2.5	0.2	1.3	3.7	3.0	..
Monetization of economy (M2 as % of GDP, end of period)	31.3	49.7	42.1	35.2	40.5	25.8
Agricultural value added (% of GDP, end of period)	24.7	26.4	25.4	21.2	28.1	31.0
<b>Macroeconomic management</b>						
Overall budget deficit, including grants (% of GDP, end of period)	3.2	7.4	1.8	8.2	..	..
Current revenues, including grants (% of GDP, end of period)	10.1	19.5	14.9	15.3	..	..
Total expenditures (% of GDP, end of period)	13.3	26.9	16.7	23.5	..	..
Inflation, annual (% , period average)	4.9	7.7	7.9	10.4	..	..
Current account deficit (% of GDP, MRE)	0.3	1.1	-0.8	-0.7	..	..
Total reserves (months of imports, end of period, MRE)	3.0	13.7	5.2	2.7	11.7	5.0
<b>Poverty and social development</b>						
Poverty headcount ratio at PPP\$1 a day (% , MRE)	36.0	35.3	17.0	5.6	..	..
Mortality rate, under five (per 1,000, MRE)	69.0	87.0	98.0	15.0	122.0	151.6
Ratio of girls to boys in primary and secondary education (% , MRE)	106.8	88.5	71.1	102.8	87.2	88.5
Primary completion rate, total (% of relevant age group, MRE)	73.3	80.9	..	98.2	71.5	68.3
Improved water source (% of population with access, MRE)	75.0	86.0	90.0	78.0	75.1	61.3
Fertility rate (births per woman, MRE)	2.9	2.9	4.5	2.0	3.6	4.4

.. Not available.

Note: These indicators are part of the IDA14 reporting requirements. MRE is Most Recent Estimate.

Source: World Bank, World Development Indicators database.

The simple, but important, message from the so-called "Bangladesh conundrum" is that growth, human development, and poverty reduction would probably have been faster in South Asia absent its governance problems. The more fundamental message from the Bangladesh conundrum seems to be that to solve the puzzle of good growth and seemingly poor governance, we need to get beyond the simple, perception-based indicators and examine what worked and what didn't, and how institutions performed in their particular historical, social, economic, and political settings. Unbundling Bangladesh's reasons for success on growth and human development, and the reasons for continuing concern, can not only shed light on these questions for Bangladesh, but help inform the governance challenges facing the other countries of the region.

Perhaps due to its population density and homogeneity, Bangladesh is a country in which policies that worked were scaled up quickly. Recognizing their capacity limits in service delivery, successive governments in Bangladesh created space for the private sector and civil society, whose role has expanded to a degree that stands out in South Asia. There have

also been notable failures of governance—the *weak links* in the chain that could limit future growth. And there is some evidence that the institutions that made Bangladesh's past successes possible are themselves weakening. Growth is imposing more sophisticated demands on these institutions, demands that they are proving ill-equipped to handle.

*Areas of strength.* Five factors go a long way in explaining Bangladesh's experience. First, Bangladesh's evolution, from a newly-independent state born out of a civil war, to its brush with military rule, and then to a return to democracy with three heavily-contested elections with large turnouts and regime changes, has strengthened *voice*—the ability of citizens to influence and call to account their political leaders for their failure or success to deliver. Civil society has grown rapidly. Building on a cultural tradition of public debate, independent think tanks have facilitated policy dialogue. The media, particularly vernacular newspapers, are increasingly mature and some of them have taken on a watchdog role.

Second, Bangladesh has provided the enabling environment for NGOs to deliver basic services, either directly or in partnership with the government. Several NGOs in Bangladesh operate on a scale that many governments would envy. NGOs account for 10 percent of all health expenditures, equivalent to a third of public spending on health. NGOs target the poor much better. Whereas almost a third of public expenditures on health benefit the top 20 percent of the population, for NGO programs it is only 19 percent (World Bank [2006\_]). NGO schools account for only 8 percent of primary enrollment, but they are more effectively targeted to poor people, in particular, to poor girls. Microcredit, in which NGO activity is concentrated, now reaches some 43 percent of all households. It has strong positive impacts on consumption and income smoothing, thus contributing to both growth and social development.

Third, successive governments have created space for the domestic private sector. Using duty drawbacks and bonded warehouses, the government facilitated the rapid growth of the readymade garments industry. Trade policy has been liberalized (even though an anti-export bias persists). Between 1990 and 2004, the share of trade in GDP doubled. Sound macroeconomic performance has prevented crowding out of private investment, kept inflation and debt low, and encouraged remittances of some \$5-6 billion a year (substantially more than net aid flows).

Fourth, governments in Bangladesh have directed public expenditures to the poor. Military spending is less than half the regional average, freeing up resources for health and education spending. Moreover, such spending has been based on partnering with the private sector and NGOs. The bulk of funding for secondary education is through schools managed by the private sector or NGOs. Low agricultural subsidies have enabled Bangladesh to invest in rural roads, connecting some 1400 of the 2100 growth centers and markets, improving farm and non-farm productivity, employment, and incomes.

Fifth, Bangladesh has steadily improved its capacity to manage natural disasters, reducing human and financial costs. Following the floods of 1988, per capita GDP actually fell (Sen, Mujeri, and Shahabuddin [2004]). In the year following the widespread and more severe floods of 1998, per capita GDP growth only slowed down to 3 percent. The major floods of 2004 had hardly any impact on GDP growth. The factors responsible for better disaster management include reduced dependence on farm income, early warning systems, the construction of cyclone shelters, and more effective relief programs with reduced leakages. NGOs play a major role in disaster prevention, relief and recovery, partnering actively with the civil administration. A vigilant press and an alert opposition have increased the political cost of mismanaging natural disasters.

*Weak links in the chain.* Unbundling governance in Bangladesh also reveals the weak links in the chain—areas that stand out as potential binding constraints to future growth: Bangladesh's dysfunctional, confrontational politics, weak institutions of public accountability, the deteriorating quality of the civil service and the rule of law, and sectoral impediments to scaling up badly-needed infrastructure and increasing

the efficiency of the financial sector. These weak links help us understand what is wrong with Bangladesh's investment climate, why Bangladesh is still not attracting the foreign direct investment at the pace needed to meet the country's infrastructure requirements as well as to generate jobs.

Perhaps Bangladesh's most difficult governance challenge lies in tackling the confrontational politics and the high cost of financing elections, the latter opening the door to state capture and the compromise of public policies. State capture distorts trade, industry, and infrastructure policies, erodes competition, lowers revenue effort (and operations and maintenance expenditures), and dilutes checks and balances at the core of government.

Dysfunctional politics makes it difficult to separate the policymaker and provider so as to increase the latter's accountability to citizens rather than their subservience to policymakers, including politicians. It erodes the ability to build independent, credible, and predictable regulatory capacity. Bangladesh currently faces a severe shortage of electricity (of the order of 2,500MW a year), easily topping the list of "major or severe obstacles" in the World Bank's Investment Climate Assessments. The average Bangladeshi firm faces power failures two out of every three days versus one in five days on average in South Asia. Bangladesh signed and implemented six IPPs with an installed capacity of 1,260MW in the late 1990s. Since then it has failed to close a single deal. Plants have been tendered and awarded, but have had to be cancelled due to concerns about due diligence and political interference. High system losses and poor collection means that the Power Development Board is not able to pay power generators and faces mounting debts. This puts off high-quality operators, leaving the field to bidders who can "work the system." This in turn produces controversy within Bangladesh's highly contested politics, aided by an active and alert media, and eventually leads to aborted deals and the current logjam.

Similar accountability problems hobble Chittagong Port, which carries 85 percent of Bangladesh's foreign trade, but where handling costs are four times higher than in Colombo and twice as high as Bangkok. Estimates suggest that Bangladesh's garment exports could increase by 30 percent if Chittagong performed at par with other ports in the region. The costs to the economy are enormous and obvious, but working out a reform path that enables Chittagong Port to become a world-class facility has eluded successive governments, politicians, bureaucrats, and labor unions. This is the crux of Bangladesh's governance stalemate.

Politicization and deteriorating technical quality of the civil service and weak institutions of public accountability add to the problem. Watchdog bodies can be effective only if they uphold their credibility in the public eye. The Anti-Corruption Commission and the Election Commission in Bangladesh do not seem to enjoy such credibility. Around 67 per cent of the population has low confidence in the police. With the exception of the Supreme Court, all the key pillars of the justice sector are weak, inefficient, and prone to corruption.

## ***Implications for the region***

The Bangladesh conundrum and its explanation illustrate the governance challenges South Asia faces in accelerating growth and inclusion. Whether it is reliable power, efficient ports, the credibility of watchdog agencies or raising the effectiveness of the civil service, the state cannot recede from these core problems of governance as it could in Bangladesh's case by relying on NGOs for service delivery or by insulating the fledgling garment industry through bonded warehouses and duty drawbacks. What might have worked earlier to ameliorate governance problems may not work now. What still does work is a vibrant and active civil society that is increasingly demanding greater public accountability so that governance failings do not thwart or reverse the gains made in the past two decades.

Complacency in the face of this experience would be a mistake. If anything, South Asia's recent record of governance and growth highlights how much faster the region could have grown if it could have tackled its governance problems. It has been estimated that Sri Lanka's GDP would have grown 2-3 percentage points faster—the difference needed to bring its poverty rate down to single digits—without its civil war. The political violence associated with corruption and confrontational politics in Bangladesh costs the country 1-2 percentage points of GDP a year. This is growth that South Asia can ill afford to lose. The cost of poor governance, whether unenforceable property rights and contracts, deteriorating law and order, or widespread absenteeism by teachers and doctors, is largely borne by poor people. As noted in Chapter II, the widening gap between the rich and the poor carries huge risks to stability and social cohesion.

Previous successes are already pointing to future costs unless there is change. Infrastructure in most countries of the region is a binding constraint. Without improvements in accountability, scaling up public infrastructure investments could result in massive wastage and a worse investment climate. Bangladesh is experiencing difficulties in attracting much-needed foreign investment in infrastructure, mainly because of governance lapses in previous foreign contracts. New nationwide social protection programs that growth makes possible—such as the National Rural Employment Guarantee scheme in India (Chapter II)—could impose huge fiscal costs and yield far less than their full potential in poverty reduction if they are not accompanied by greater public accountability. To improve service delivery, all the countries of South Asia are pursuing decentralization. Unless governance problems at the local level are addressed, the only difference may be that corruption too is decentralized.

Rising standards of living are increasing demands by citizens for better results from governments, whether in service delivery, law and order, the courts, the right to information, budgeting and implementation of government programs, corruption, or the cost of doing business. If policymakers in South Asia respond to these growing citizen demands for greater public accountability, building on successes and learning from failures, they can help accelerate and sustain the growth, inclusion, and human development that the region needs.

## ***Meeting citizen demands for good governance***

As in Bangladesh, rapid growth and improvements in standards of living across the region, particularly for the growing middle class, are increasing citizen demands for improved governance, visible results, and greater accountability. If there is one factor that portends well for governance improvements in the region, it is this. As basic policy distortions in trade and industry are removed, citizens across South Asia are being empowered to make economic choices to their fullest capabilities. In doing so they are discovering the costs of governments' not providing governance efficiently. Meeting these growing citizen demands in sensible ways will take time—civil service or judicial reforms, for example, are complex and time-consuming. The important thing for countries is to set the right course for better governance, use the additional resources that growth provides wisely, and sequence the reforms in politically acceptable ways that ensure their sustainability and broad-based support.

Rapid growth appears to be increasing the contestability of domestic politics as citizens and politicians become more vested in one position or the other and the intrinsic value of their position increases because of better growth prospects. Greater contestability and political competition can help reduce corruption and improve service delivery if leaders create the institutional incentives for providers to improve performance—for example, with citizen report cards in Bangalore—and if their own political futures come to depend on such outcomes. But keener political competition can also lead to confrontational politics that is largely devoid of substance, masks clientelism and patronage, and spawns leaders who are not credible. This makes dealing with governance failures that much more difficult. Second-generation reforms that aim to accelerate growth and scale up human development (e.g. reforming labor markets, rationalizing subsidies, restructuring urban utilities) require consensus to sustain them until enough winners emerge, but consensus is harder to obtain when policymakers themselves are not credible.

Though the challenge is immense and much remains to be done, and even as governance and corruption problems loom larger in many countries than they did a decade or two ago, there is today a far greater public awareness of the need for action. Increasingly sophisticated electorates, strong civil societies, a lively media with growing experience in investigative journalism (especially in India, Bangladesh and Sri Lanka), and activist judiciaries are some of the forces trying to hold governments to account and demanding improved governance. Watchdog agencies such as election and vigilance commissions are seeking to cut the nexus between politics, election financing, and corruption. Oversight institutions such as public accounts committees and supreme audit institutions are being strengthened, including in their ability to interface with citizens. Policymakers are using information and communication technologies to put in place better and more transparent national systems of procurement and financial management, and to make relevant and timely information available for public scrutiny and benchmarking, for example, by making financial reports available online.

Public-private partnerships, particularly in infrastructure, hold the potential for reducing the diversion of public funds if regulation, oversight mechanisms, and client feedback are in place; if they are not, corruption can increase. More generally, support for private-sector-led growth can reduce the discretionary authority of government officials and allow for a recasting of the role of the state. All countries in the region are also turning to decentralization to produce both better performance and greater public accountability. But countries are also mindful of the need to build administrative capacity and client feedback at local tiers of government to avoid greater local capture.

Besides dealing directly with core governance issues, countries in South Asia are also responding to citizen demands for accountability by putting in place new mechanisms of information disclosure and service delivery that seek to fundamentally alter the relationship between governments and citizens. Recently-passed right-to-information (RTI) legislation in India and in other countries holds the potential for dramatically greater contestability of government decision-making and implementation. Bureaucratic efforts to limit the scope of the RTI in India have met with strong civil society opposition. When combined with a vibrant and alert press, advocacy NGOs, and watchdog agencies such as election commissions and apex courts, greater information access should lead to major shifts in how politicians and bureaucrats deliver on governance and how they are rewarded or penalized. In service delivery, countries are responding to the growing pressures for better education, health, and infrastructure by experimenting with new approaches such as vouchers, conditional cash transfers, contracting out, and benchmarking. Finally, more informed domestic public debate about what works and what doesn't and combining local knowledge with global

experience is emerging as an important force for change. Sharing experience and fostering such debate is becoming easier as countries in the region integrate more closely with the rest of the world and with each other.

### ***Role of donors***

Governance reform must be owned, driven, monitored, and evaluated by domestic leaders, service providers, and citizens. Donors can help by supporting country efforts to improve governance, by addressing corruption and fiduciary concerns and the failure to achieve stated outcomes in projects they finance, by working substantively with civil society and the private sector in each country to foster and inform the demand for good governance, by helping build capacity within government and outside for monitoring and evaluation of outcomes, by harmonizing donor strategies and practices around country systems to ensure coherence in dealing with clients, and by building global partnerships. The main messages of the Paris consensus have particular relevance in many areas of governance—it makes little sense for donors to pursue separate approaches to civil service reform, work on budget and financial management systems, and support for key anticorruption and judiciary institutions.

Much of the hard work on governance in South Asia is deeply political. The emphasis of donors more and more has to be on helping get the policy framework right so that citizens are empowered themselves to make good economic choices and, through the political process, to hold their governments accountable for delivering better services, creating jobs, and improving living standards. This is a long-haul process, but one that guarantees rich dividends for poor people in South Asia--the chance of a lifetime for them to emerge from destitution and want.

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<sup>1</sup> This chapter draws on Lateef [2006] and the 2006 Bangladesh Country Assistance Strategy.