

Research Brief**Governance and Growth: Is Bangladesh an ‘Outlier’?**

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The quality of governance reflecting institutional development has been increasingly recognized as an important ingredient of economic growth. It is also recognized that low levels of income and poor governance may perpetuate each other. How can low-income countries come out of this trap? If some headway can be made in institution building despite low income, the resulting “governance surplus” may enhance the effectiveness of economic reforms in accelerating economic growth. Pre-reform India or China are possible examples. The other path to come out of the trap could be to achieve by some means accelerated growth despite poor governance, which in turn may eventually create demand for better institutions of governance; but this will mean that governance will act as a hindrance to growth rather than being a facilitator.

Bangladesh has in recent decades achieved reasonably rapid economic growth and significant progress in social development indicators. This has been possible despite many impediments: the desperate initial conditions following the liberation war, lack of resources and extreme land scarcity, vulnerability to natural disasters, widespread corruption, and a record of systemic governance failure. Some have called this a “development surprise” (Mahmud *et al.* 2008). If Bangladesh is really an “outlier” in the growth-governance relationship, it should be a test case for the current consensus that countries’ development hinges on governance improvements.

We first look at the evidence on trends in economic growth and the quality of governance in Bangladesh. The studies in this literature utilise data from the World Governance Indicators (WGI) which is available from the mid-1990s and is composed of six dimensions of governance: rule of law, control of corruption, political stability, voice and accountability, regulatory quality, and government effectiveness (e.g. Kaufmann *et al.* 1999). To reconstruct the historical evolution of governance quality, we also use another set of governance measures which has been used in long-run growth regressions, namely, the International Country Risk Guide (ICRG) database spanning from 1982 to 1997 (Keefer and Knack 2005). Like the WGI, the ICRG measures also have several component indices, all perception-based, regarding corruption in government, rule of law, bureaucratic quality, expropriation risk, and risk of government repudiation of contracts

Table 1 shows the trends in Bangladesh’s governance score according to the two sets of measures and in relation to the average and the bottom quintile of all developing countries. Only overall measures of governance, derived as the average of the sub-indices, are shown here; the value of the ICRG index ranges from 0 to 50 and that of the WGI is centred on 1.

According to the ICRG measure, there was a clear improvement in governance in the 1990s compared to the 1980s, reflecting the positive impact of the transition to democracy followed by wide-ranging economic reforms. Yet, Bangladesh still ranked near the bottom quartile of all developing countries, since the improvement in governance in the 1990s seems to have taken place across the developing world as a whole. According to the WGI measure, Bangladesh's governance score in the 1990s was above the bottom quartile, though still lower than the average of the developing countries. But this score has deteriorated almost continuously since then; and since 2004, Bangladesh has again ranked near the bottom quartile of the developing countries.

In contrast to the relatively poor governance performance, the annual growth in per capita GDP in Bangladesh during 1980-2007 is significantly higher than the average of developing countries (Table 2). Although this growth advantage has been somewhat eroded in the recent period because of the generally higher growth in the developing countries, Bangladesh indeed appears to be an outlier in cross-country comparisons relating governance to economic growth. This is particularly so if we consider the governance indicators of the 1980s and of the more recent years after the 1990s.

Table 1. Trends in governance measures, 1985-2008; Bangladesh compared to developing countries

	ICRG governance index (average of five sub-indices), 1985-1997				WGI governance index (average of the six sub-indices), 1996-2008						
	1985	1990	1995	1997	1996	1998	2000	2002	2004	2006	2008
Bangladesh	10.93	10.60	25.67	28.97	-0.53	-0.59	-0.67	-0.80	-1.00	-0.92	-0.92
<i>Developing countries:</i>											
Mean	22.58	22.82	30.43	31.13	-0.40	-0.46	-0.47	-0.48	-0.47	-0.45	-0.46
Bottom quartile	17.00	18.00	26.33	28.00	-0.94	-0.89	-0.90	-0.94	-1.02	-0.94	-0.96

Table 2. Levels and growth of per capita real GDP, 1980 – 2007; Bangladesh compared to developing countries

	Per capita GDP (1995 PPP \$)				Real per capita GDP growth, 1980-2007 (percent annual)		
	1980	1990	2000	2007	1980-2007	1980-1994	1995-2007
Bangladesh	696	1233	1635	2471	1.86	1.27	2.67
<i>Developing countries:</i>							
Mean	2055	3095	4290	6577	1.64	0.54	2.83
Bottom quartile	804	1090	1539	2209	0.26	-0.98	1.06

Next we look at how Bangladesh is positioned in the relationship between the levels of governance and per capita real GDP as obtained from cross-country comparisons. This could help in assessing how far

Bangladesh has been able to break out of the trap of low income and poor governance by achieving economic growth that is higher than what would be expected with its initial poor governance indicators. Figures 1 and 2 show the scatter diagrams of countries showing this relationship (along with simple regressions of log of per capita real GDP on the overall governance index). The positions of Bangladesh and India are highlighted.

The figure based on the ICRG index shows that by 1990, the end-year of the Ershad regime, Bangladesh had reached a level of per capita income that was higher than expected at the prevailing quality of governance. But, in the mid 1990s following the democratic transition and introduction of economic reforms, the country had a “governance surplus”. One could thus speculate whether growth could be accelerated since the 1980s had the governance quality remained unchanged. However, the country seems to have had lost this advantage by 2004, as can be seen from the figure based on the WGI governance measure. We are back to a situation where governance quality may increasingly prove a growth-retarding factor. True, the current position represents a higher income, and perhaps better governance, compared to the end-1980s, but it has taken a substantial positive shift in governance in the 1990s to come this far.

Whether Bangladesh is an outlier in GDP growth and per capita income in relation to its governance ratings and other explanatory variables can be tested by cross-country regression analysis following the methodology used, for example, by Rodrik *et al* (2004), Easterly and Levine (2003), La Porta *et al.* (2004) and Keefer and Knack (1995). As expected, growth regressions provide poor fit and it is difficult to draw reliable conclusions. Even then, some evidence is there (in terms of a statistically significant Bangladesh dummy) in support of Bangladesh being exceptional in achieving high GDP growth, particularly when the regressions are run for shorter sub-periods in the new millennium (when Bangladesh’s growth was accelerating despite a worsening governance environment).

Figure 1. Regressions of per capita real GDP (log) on ICRG overall governance measure, 1990 (A) and 1997 (B)

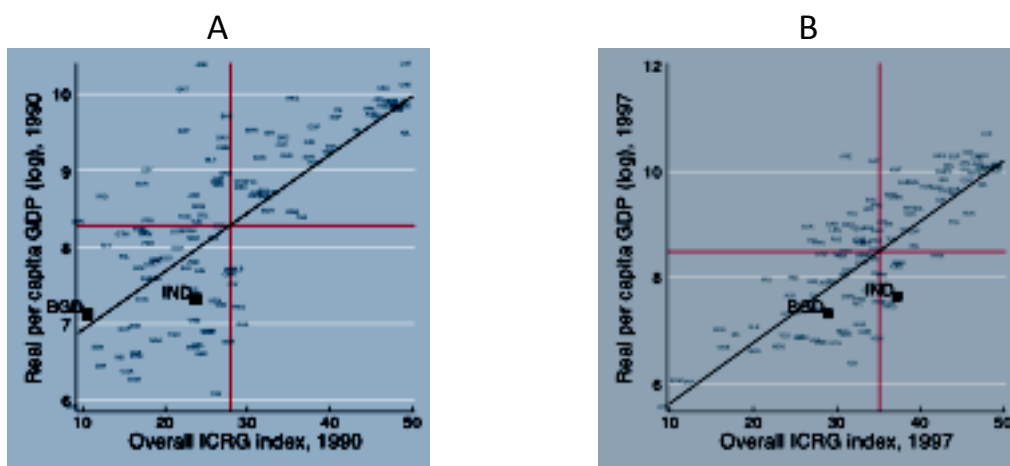
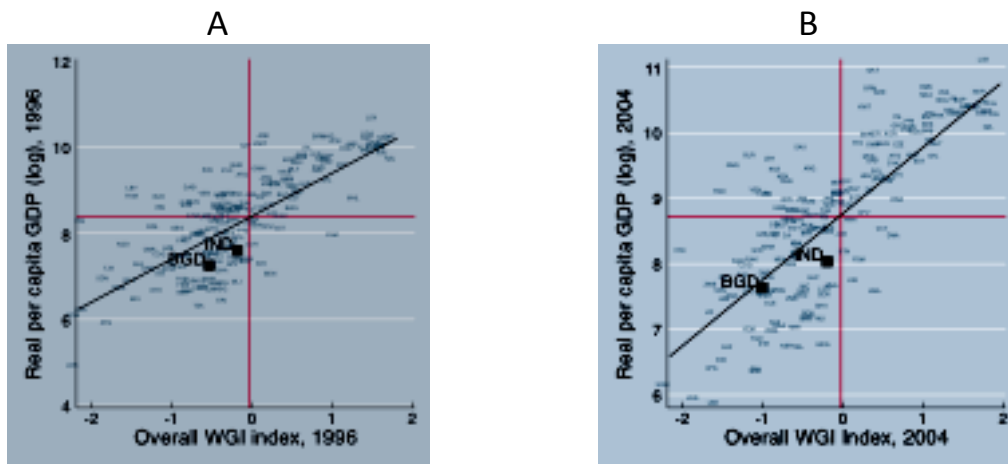


Figure 2. Regressions of per capita real GDP (log) on WGI overall governance measure, 1996(A) and 2004(B)



In contrast to the growth regressions, much more robust results can be obtained by running cross-country regressions to explain the level of real per capita GDP in terms of governance indicators along with other explanatory variables. The regression results, which reflect long-term changes, show Bangladesh to be an outlier in having unexplained high per capita GDP in 1990 (in relation to the ICRG overall governance index and, in particular, the sub-indices of corruption and bureaucratic quality). This exceptionality of Bangladesh disappears in the years of “governance surplus” in the 1990s, but tends to reappear in the regressions for more recent years. While the governance quality thus had clearly become overstretched in supporting the level of per capita GDP attained by the end-1980s, the phenomenon may reappear if the current trends continue.

Regression analysis apart, one needs to look at country-specific circumstances to better understand the growth-governance nexus. How, for example, could a governance-challenged environment be overcome by the main drivers of economic growth in Bangladesh: agricultural productivity, small-scale entrepreneurship, garment export, and remittances from workers abroad? Although the governance environment may have been barely adequate so far to cope with an economy breaking out of stagnation and extreme poverty, it may increasingly prove a barrier to putting the economy firmly on a path of modernization, global integration, and poverty reduction. This research indicates that institutional weaknesses may be reaching the tipping point beyond which they become binding growth constraints.

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