

Corruption and Private Sector Development: Bangladesh Case Study

Mushtaq H. Khan

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1. Introduction

The Bangladesh economy has been growing at around 5-6% per annum since the 1990s, in a context of relatively weak governance, high levels of corruption and political instability. This gave rise to the discussion of the so-called Bangladesh paradox: a combination of sustained levels of moderate to high growth with persistently poor performance in governance. However, it is widely recognised that this combination of growth with poor governance is not sustainable. Economic growth has been driven by sectors like garments and textiles that have kept millions out of poverty even though the jobs have been poorly paid. The challenge for the Bangladesh economy is to diversify its economy and to move up the value chain into more skilled, higher productivity and therefore higher wage sectors. The governance challenges that this transition faces are relatively well understood but progress in making any significant progress on governance reforms has been very slow.

The prospects of progress on appropriate governance reforms faced a significant setback as the country went through a traumatic year in 2013 when the two main political parties were engaged in a debilitating standoff over the conduct of the forthcoming elections. The result of the impasse was the controversial election of January 2014 which the main opposition alliance boycotted, leading to continued concerns about political stability in the country. The year 2013 was also marked by a spate of industrial accidents including the tragic Rana Plaza collapse where more than a thousand people died, mostly garments industry workers. This accident, like others in the industrial sector, was largely due to failures of regulation and widespread corruption. Although business suffered greatly from the political uncertainty and the loss of reputation due to industrial accidents, the economy continued to grow at between five and six percent through 2013. Unfortunately, this served to strengthen the perception of the government that business as usual was an option. In fact, in addition to the old problems, new governance problems are emerging, in particular the creeping growth in political violence and the growing politicisation of all branches of government (Transparency International Bangladesh 2014). There is also a risk that the loss of reputation suffered by the country as a result of the events of 2013 may eventually have an effect on export markets, as buyers reconsider their options. This may be particularly relevant if political conflicts erupt once again as a result of a failure of the main parties to reach an agreement about the timing and organisation of new elections.

The aim of this report is to identify a number of critical areas of corruption affecting business where corruption has the dual characteristic of having a big impact on private sector performance (defined as the growth of output, investment or employment) *and* being relatively amenable to policy responses that seek to mitigate some of these negative effects. The corruption ‘flashpoints’ identified here were selected to satisfy these two criteria. The feasibility question is important because there are many types of corruption that arguably have a significant impact on business, but which are unlikely to be effectively addressed given the political and institutional context described by the contemporary political settlement.

We limited our attention to short to medium-term reform strategies that donors and civil society organisations could promote and we defined feasibility in terms of the chances of such a policy getting broader support within the business community, the state or broader society sufficient for a reasonable chance of its eventual implementation. Judgements about feasibility are always relative as even the most ‘feasible’ anti-corruption strategies are still likely to face significant implementation problems and political obstacles in countries like Bangladesh. The dual objective forced us to make explicit trade-offs in policy recommendations in a transparent way. The challenge was therefore to identify policy-relevant anti-corruption strategies that target types of corruption that have significant impact but that are also *relatively* feasible to attack in terms of policy. The thinking underpinning this is elaborated in section 4.4.

Our exercise adds to the policy-oriented work on corruption in Bangladesh in a number of ways. First, many types of corruption that are often identified as having a high impact on performance do not score highly in terms of feasibility. This is not a new observation. It is well-known that many conventional anti-corruption efforts have not produced significant results. This is usually because many high impact types

of corruption interface with political corruption and involve processes through which the ruling coalition consolidates its power. Attacking these types of corruption is not very feasible. Secondly, however, we could identify policy-relevant flashpoints where corruption did have a large impact but where responses are likely to be *relatively* more feasible. These areas may not at first sight appear to be the most significant. The approach followed in this work does however suggest that these areas, and others that may be identified using the methodology in the paper, may have a better chance of translating into feasible anti-corruption policies. The underlying motivation of this work is that by beginning to tackle *feasible* problems that have a significant impact, anti-corruption strategies can be put on a more promising trajectory in countries like Bangladesh.

2. Methodology

The broad features of corruption in the business sector in Bangladesh and the types of problems the private sector faces are well known in general terms. A number of agencies, including Transparency International Bangladesh provide periodic assessments of these general features. As this type of overview is readily available for Bangladesh, for reasons of space we will not summarise again the broad features of political clientelism, the weak rule of law, limited political accountability, the weak enforcement of property rights, weaknesses in the capacity of the bureaucracy, and the politicisation of the bureaucracy and judiciary. Our goal is to go beyond a general assessment of the significance of corruption in different agencies of government to identify and investigate the significance of *particular* corrupt processes affecting private sector development. The important aspects of our methodology are summarised below.

1. First, in an economy like Bangladesh we expected different business sectors and firms to be affected by different developmental challenges and to face very different types of corruption problems. The first methodological step was therefore to distinguish between a number of key sectors, and types of firms within these sectors, with the expectation that the type of corruption problems we were looking for may be different. A limited number of issues were then selected from an initial investigation of these sectors based on an assessment of their likely significance for the Bangladesh economy, the quality of the respondents available in different sectors and the limitations of time and resources available for this study.
2. Second, 'impact', 'feasibility' and 'confidence levels' were defined for the analysis. The policy relevance of the analysis depends on the credibility of our assessments of the impact of different corrupt processes and the feasibility of reform in particular directions, together with an indication of the confidence we have in different parts of the analysis.
3. Third, we know from the analytical literature that there are different types of corruption. Each is likely to have a different impact and anti-corruption strategies addressing them are likely to face different problems of feasibility. It was therefore useful to have a categorisation of different types of corruption so that their impact and feasibility could be broadly compared.
4. Fourth, the methodology for selecting interviewees and conducting the interviews was critical given that we wanted to achieve significant insights with a high level of confidence from a relatively small number of interviews with business and government insiders. This required access to respondents who would not only have a high level of practical knowledge but also and more importantly, the confidence in our research team to talk as candidly as possible about sensitive processes in which they are very likely to be involved themselves. Respondents in business and government were approached through highly placed businessmen previously known through prior work in Bangladesh. During the three-week mission in May 2014, eighteen primary respondents, in senior positions in business, business associations, government etc. were interviewed. Many more individuals were spoken to during the course of this mission. Both impact and policy feasibility were assessed through these interviews. Comments were triangulated with other stakeholders involved in these transactions (to ensure we heard all available sides to any viewpoint), and cross-checked with our broader understanding of the political economy of the

country. The interviews and discussions were therefore informed by our reading of the background research on corruption, governance and economic development in Bangladesh and other developing countries.

Analysis based on detailed interview techniques can add a critical dimension to the policy discussion by identifying the drivers of different types of corruption and the types of constraints that corrupt processes are responding to or creating. This can help to identify the relative impact of different types of corruption in different sectors, shed light on the types of issues that a feasible reform process has to address, and tell us something about the feasibility of reform by identifying the factors that are driving the corruption and therefore the likely responses of different stakeholders to particular anti-corruption strategies. These types of insights can only come from detailed small-n analysis and can help policy-makers assess the importance of intervening in particular areas and the likelihood of feasible policy responses emerging.

3. Constraints to Private Sector Development in Bangladesh

Although Bangladesh is a poor economy in terms of its overall per capita income, its growth over the last three decades has been creditable and this has resulted in the emergence of an economy with very different types of sectors. A few sectors like garments and textiles have achieved global competitiveness and are able to export in competitive global markets. These sectors and firms have adapted to existing governance problems in the economy and have evolved methods of dealing with their infrastructural and governance environments in ways that enable them to survive in international competition and indeed to grow rapidly.

The next three tables show the levels of growth and structural transformation achieved in Bangladesh over the last three decades to underline the importance of differentiating across different types of sectors within the country. Table 1 shows the growth acceleration in South Asia after the 1980s. Growth in Bangladesh dramatically increased by about two percentage points in the 1980s, at about the same time as in India and Pakistan. While growth later faltered in Pakistan, growth rates kept rising in India and Bangladesh till the 2010s. After the global crisis of 2008, growth rates in India have come down faster than in Bangladesh, and in 2013-14 Bangladesh's growth rates were comparable or slightly higher than that of India, at around five to six percent per annum.

Table 1 Comparative Growth in Bangladesh, India and Pakistan 1960-2010

Annual Growth Rates %	India	Pakistan	Bangladesh
GDP			
1960-80	3.5	5.5	1.7
1980-90	5.6	6.1	3.6
1990-00	5.8	3.7	4.7
2000-05	6.7	4.9	5.3
2005-10	7.8	3.9	6.0
Per Capita GDP			
1960-80	1.2	2.6	-0.8
1980-90	3.4	3.5	1.2
1990-00	4.0	1.2	2.6
2000-05	5.2	2.4	3.3
2005-10	6.4	2.1	4.9

Source: Based on data from World Bank (2008, 2012, 2013)

While growth in India was driven by capital and skill-intensive sectors like pharmaceuticals, automobiles, software and iron and steel, in Bangladesh, growth was driven by low wage labour-intensive sectors like garments and textiles. The focus on low-wage manufacturing has meant that the growth in wages and value-added in Bangladesh was slower than in India, but the country has been relatively more successful in creating jobs in manufacturing. The rapid growth of industry in Bangladesh since 1980 has resulted in a significant structural transformation of the economy, as the share of agriculture in GDP rapidly declined and that of industry increased. This is shown in Table 2. The rapid structural transformation was driven by the growth of new sectors like the textile and garments industry and other labour-intensive sectors that added to growth and employment in the economy.

Table 2 Structural Transformation in Bangladesh 1980-2010

Sectoral shares in GDP	1980	1990	2000	2010
Agriculture	31.6	30.3	25.5	18.6
Industry	20.6	21.5	25.3	28.5
Services	47.8	48.3	49.2	52.9

Source: Based on data from World Bank (2008, 2012, 2013)

Table 3 shows that the structural change in the Bangladesh economy was comparable to that in India. The critical column here is the share of industry in the economy, which is a rough indicator of the growth of modern competitive sectors. The share of industry in Bangladesh is comparable (and even slightly higher than) in India, which corroborates the rapid growth of labour-intensive manufacturing sectors in the country. The general point that emerges from these broad figures is that some sectors in Bangladesh are indeed growing rapidly. There is significant potential for accelerating growth by expanding the already competitive sectors, upgrading the technology and productivity in these sectors and moving into entirely new relatively higher productivity sectors like electronics, shipbuilding, small engineering, motorcycles and so on, all of which have a presence in the manufacturing sector in the country and are potentially promising sectors for the future (Khan 2013b).

Table 3 Structure of the Economy 2010: Bangladesh relative to Comparators

Shares of GDP 2010	Agriculture	Industry	Services
China	4.5	44.6	45.9
India	16.2	28.4	55.4
Bangladesh	18.8	28.5	52.6
Pakistan	21.8	23.6	54.6

Source: (World Bank 2013)

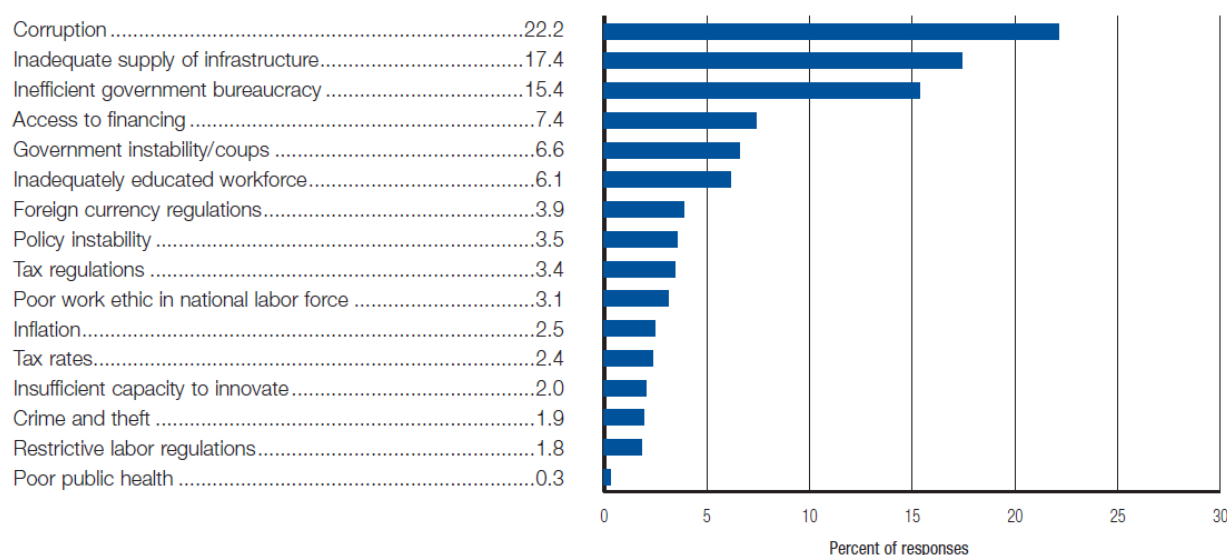
At a general level, both business and civil society organisations in Bangladesh have been very vocal about corruption as a major impediment to economic development in the country. For instance, while political uncertainty probably dominates current business concerns, the World Economic Forum's survey of Bangladeshi business just before the political crisis of 2013, reported in the 2013-14 edition of the *Global*

Competitiveness Report, shows that corruption and infrastructure were the most important concerns of business in the run-up to the elections (World Economic Forum 2013: 118).

Corruption came out at the top of the weighted average of responses identifying the most important constraints to doing business in Bangladesh. The paradox of rapid growth driven by globally competitive business sectors in a country where corruption, poor infrastructure and the inefficiency of government are identified as major constraints to business has been noted by many observers (World Bank 2007). The apparent ‘Bangladesh paradox’ can be better understood if we distinguish between different types of business sectors and the differences in the problems they face. In particular, sectors that have already become globally competitive have adapted to governance and corruption problems in particular ways. Some types of corruption in these sectors solve short-term problems that firms face, say with inefficient financial institutions and bureaucratic procedures, but at the cost of impeding the enforcement of regulations and policies necessary for long-term viability. In contrast, emerging sectors or new entrants face a very different set of corruption problems. The importance of distinguishing between business sectors and types of firms to understand different types of corruption problems was confirmed in our detailed discussions with respondents in different sectors and firms.

Figure 1: Business Perceptions of Constraints to Business: Bangladesh 2013

The most problematic factors for doing business



Note: From the list of factors above, respondents were asked to select the five most problematic for doing business in their country and to rank them between 1 (most problematic) and 5. The bars in the figure show the responses weighted according to their rankings.

Source: World Economic Forum (2013: 118)

A fairly good mapping of corruption in different agencies of government is available as a result of ongoing survey-based studies in Bangladesh. The 2014 National Integrity System Assessment by Transparency International Bangladesh is an excellent example (Transparency International Bangladesh 2014). We also have a good knowledge of the structure of the Bangladesh economy and the sectoral drivers of growth in the country (see for example the survey in Khan 2013b). Our aim was to add to this knowledge of the broad features of corruption in Bangladesh by looking at the effects of corruption on specific business sectors. On the basis of our background knowledge of the economy and its governance problems, we began by distinguishing between five types of business sectors in Bangladesh which were likely to face different types of corruption issues, with further distinctions between types of firms in some cases. We began by investigating the types of corruption problems each of these sectors suffered from, including any cross-cutting types of corruption that affected more than one sector, to select a few sectoral and

cross-cutting corruption flashpoints that satisfied our dual criteria of impact and feasibility. The five business sectors were:

1) High growth sectors which are already globally competitive in some areas. Examples of such sectors are garments, textiles, and some types of pharmaceuticals. Firms in these sectors have adapted to the overall context of weak governance, infrastructure and bureaucratic inefficiency. Corruption here does not significantly constrain horizontal expansion as there is substantial new entry and replication. However, corruption clearly creates high transaction costs, and is associated with serious regulatory problems that were highlighted by tragic building collapses and fires in 2013 that severely affected the reputation of the garments and textile sector in Bangladesh. In addition, there are problems with technology upgrades and productivity growth. There is also likely to be a distinction within the sector between compliant and non-compliant firms, defined as firms that have the capacity to comply with global standards, say on health and safety, and those which can only survive by evading compliance because their underlying productivity is too low, or they lack the capacity to invest in appropriate technologies and management systems or appropriate internal managerial capacities are missing. Potentially compliant and non-compliant firms within these sectors may be engaged in different types of corruption processes.

2) Infrastructural sectors. These refer to power generation and infrastructure construction where the investments are 'lumpy', involving relatively large investments, and where the government is in a monopsony position in determining the beneficiaries of contracts and the enforcement of contractual conditions. This combination of conditions results in serious governance problems and poor outcomes in Bangladesh. The poor availability of infrastructure and power is repeatedly identified as an important constraint to development as in the survey conducted by the World Economic Forum (2013). Large infrastructure projects like major bridges and roads require significant capital and are dominated by four of five national firms and a number of foreign firms, mostly from China. Smaller infrastructure projects like rural roads and government buildings are subject to fierce competition between contractors with political connections. Significant political rents are allocated through all construction contracts and the allocation of smaller contracts is a major way of accommodating supporters of the ruling party. This often results in intense violence between ruling party factions. All of these processes affect the scale and efficiency of investment in these sectors.

3) Emerging sectors with strong growth potential. These include sectors like electronics and electrical appliances (refrigerators, air conditioners), shipbuilding and motorcycles which have already set up production in Bangladesh but have not as yet achieved a significant global presence. They also include microenterprise sectors like machine parts manufacturing. These sectors are different from already well-established sectors for a number of reasons. First, by definition, established networks between business and government have not yet emerged making entry more difficult. Smaller firms are more likely to enter a sector if the informal rules of operation are well known. In a largely informal business environment like Bangladesh transaction costs for new entrants can be very high in new sectors where informal systems are not yet well established. An even more important problem is that firms in these sectors lack global competitiveness. They do not yet have the organisational and technical capabilities required for competing in global markets and by definition cannot readily imitate existing firms because the latter are themselves evolving. The processes of enhancing competitiveness in these sectors involve experimentation and learning-by-doing that usually requires different forms of government support to overcome market failures facing the financing of learning (Hausmann and Rodrik 2003; Khan 2013a, 2013b, 2013c). Corruption can play a particularly damaging role in these contexts by subverting existing government policies of support for emerging sectors, or blocking the emergence of such policies and thereby preventing the entry of potentially competitive firms.

4) Sectors potentially subject to significant political extortion. Sectors that could potentially be affected by this problem include parts of the wholesale and retail trade, particularly the informal segments within these sectors. The Bangladeshi media often covers stories of extortion by the police and other agencies

from street-sellers and traders of different types. This is a difficult area because traders who suffer from extortion are often also breaking the law, for instance by setting up stalls on pavements or other areas without permission or selling smuggled goods. However, if extortion is widespread, it can affect the retail and wholesale mark-ups on goods and thereby affect the profitability and growth of domestic agro-industries and other sectors that rely on low cost domestic marketing networks to sell their goods.

5) Foreign-owned firms. Foreign-owned firms are important in some sectors and in export processing zones. Most foreign firms in Bangladesh are Asian: South Korean, Chinese and Indian firms operate in sectors like garments and footwear even though overall Bangladeshi-owned firms dominate in these and other sectors. The entry of foreign-owned firms can be beneficial to the local economy if the technology and organisational skills they bring can be copied by domestic firms. The benefits are less obvious if foreign firms tightly control access to their technologies or if their internal organisations are so different that rapid emulation by domestic firms is not feasible. The weakness of formal institutions and the prevalence of corruption make Bangladesh a difficult country for western firms given the anti-bribery legislation in their home countries. An improvement in the legal framework and a reduction in corruption could attract more foreign direct investment from western countries, and this may have significant technological and organisational spill-over effects under the right conditions. While the general problems of corruption facing foreign firms are well known, the interview-based approach proved to be less useful in this sector as foreign firms that were operating in Bangladesh were the least willing to talk about the types of corruption that directly affected them.

We began by identifying individuals covering these categories with the exception of foreign-owned firms. We were unable to find any high-level respondents in the foreign-owned sector willing to talk to us candidly about their ongoing business operations in Bangladesh so this sector was dropped at the outset. The reluctance here could be explained by the greater vulnerability foreign businesses perceive in engaging in frank discussions about their experiences with corruption. We found high-level respondents who were willing to talk freely about the operation of corruption in infrastructure projects but we soon found that these processes involve political corruption very closely. Effective strategies would therefore have to tackle the allocation of political rents. For reasons discussed in the next section, anti-corruption policies of these types were not judged to be feasible in the short to medium term. Political extortion was more difficult to penetrate. Respondents from the retail and wholesale trade denied it took place but the media regularly covered stories of intense mafia-like violence involving ruling party members. Addressing these types of corruption would require targeting political processes even more directly. To maintain policy-relevance, our subsequent investigation focused on corruption affecting already competitive sectors and emerging sectors with a strong growth potential. Political corruption is involved in these areas too, but to a lesser extent. We also looked at corruption affecting land transactions as cross-cutting issue, as this was identified as a critical flashpoint by all respondents.

4. Anti-Corruption Strategies in Bangladesh: Impact and Feasibility

Corruption can be associated with different underlying drivers and therefore different types of corruption can vary in terms of their impact on business and the feasibility of anti-corruption policies. We find it useful to distinguish between four types of corruption associated with different types of underlying drivers. We first define impact and feasibility as used in this report. We then discuss four broad categories in which we classify different types of corruption.

4.1 Impact of Corruption

An attempt to quantify the likely economic impact of a particular type of corruption on the basis of a small number of interviews is likely to be too subjective to be useful. A number can give a false sense of objectivity. There are numerical estimates of the magnitude of bribes in different sectors in Bangladesh

provided by organisations like Transparency International Bangladesh on the basis of surveys. However, the magnitude of these bribes is often not very high relative to the turnover of different businesses (and we will refer to some of these numbers in our case studies). The main problem, however, is that the numerical magnitude of *bribes* does not translate into a measure of their *economic impact* unless we have a credible economic model for that sector that shows how bribes of a certain magnitude associated with particular corrupt transactions result in outcomes for business with a known probability that in turn affect output, profitability, investments or employment. In the absence of such credible models for each sector and type of corruption, the perceptions of potential impact should be treated as informed guesses by a few informed participants. We believe a qualitative scale of high, moderate or low impact, defined in qualitative terms is a more honest description of the information we can gather, provided we can define these appropriately.

We defined impact in terms of the likely effect of mitigating a particular type of corruption on economic performance but we refrained from asking our respondents to quantify the impact. To simplify these judgements we restricted our discussion of impact to a few indicators like output and employment, which are in most cases closely correlated with other outcomes. We found that it was not useful to ask respondents to rank the impact of removing or mitigating a particular type of corruption with reference to a specific numerical outcome (like more than a 3% effect on the growth rate). This is because these types of judgements are not meaningful given the complexity of factors that determine the effect of particular institutional changes on growth rates, investment rates or other economic outcome indicators. Moreover, a figure that may be significant in one sector may not be in another.

In contrast, business respondents usually had a deep tacit knowledge of the complex interactions in their sector and were able to provide judgements about the types of policies that were likely to have the greatest impact on the performance of their sector and those that would have the least impact. It was this knowledge that we drew on to provide a ranking of impact.

We found it much more useful to ask our respondents to think of the *set of policies* which would have the *greatest possible impact* on the performance of their sector. If the removal or significant mitigation of a particular type of corruption was included as one of these policies, then we judged *that* type of corruption to be a **High Impact** type of corruption in that sector. Note, therefore, that a high impact type of corruption could have different effects on outcomes in a sector that was already growing at 10 percent per annum, compared to a sector that was stagnant, and this is exactly the flexibility that we want our definition to have.

Low impact corruption was defined as corruption that was judged by industry insiders to have such a negligible effect on the economic performance of the sector that it was not a policy priority for them. Obviously it was also our task to cross-check these responses to ensure that some respondents were not describing corrupt practices that they may be particularly involved in as low impact types of corruption.

Moderate Impact corruption was a residual category that described types of corruption with outcomes in between these two poles.

The ranking that we finally gave to different types of corruption was not just based on what our respondents said, but also on our assessment of the credibility of the respondents, on cross-checking with stakeholders on different sides of potentially corrupt transactions and the consistency of these judgements with our analytical expectations given our background knowledge of cross-country corruption experiences. We discuss the process of attributing levels of confidence to all of our results later in this section. **Table 4** summarises the qualitative definitions of levels of impact of the type of corruption being considered.

Table 4 High and Low Impact Corruption

High Impact Corruption: Corruption is judged to have a high impact if industry insiders believe that an effective policy of removing or mitigating this type of corruption belongs to the set of policies that would have the greatest positive impact on sectoral performance.

Low Impact Corruption: At the other end of the scale, a low impact type of corruption is one which in the opinion of informed insiders would have a negligible effect on the performance of their sector if it could be mitigated or removed.

Moderate Impact Corruption: Describes the range of types of corruption that would have an impact somewhere in between these poles.

Source: Author

This qualitative classification of levels of impact has the merit of not offering a number that gives a false sense of objectivity based on quantitative judgements that are not very meaningful. At the same time, it gives us a way of ranking impact that has policy usefulness.

4.2 Feasibility of Anti-Corruption Strategies

Feasibility was defined as the likelihood that a particular policy can be *effectively implemented*. This judgement depends on a number of factors. First, the political settlement at a macro-level defines the interests and political capacity of the ruling coalition to implement particular kinds of policies. This is particularly relevant for assessing the feasibility of major macro-level governance reforms that could significantly affect powerful constituencies at the macro-level. Second, the bureaucratic competence and enforcement capabilities of the government can make the enforcement of particular types of policies more or less likely. Third, at the micro-level, looking at particular policies in particular sectors, feasibility depends on our assessment of the causal drivers that led to those types of corruption. These determine the interests ranged at the sectoral level for or against particular reform strategies, the relative power of the respective groups and the chances of coordinating collective action in favour of particular policies through the relevant industry associations, civil society groups and so on.

No anti-corruption policy is likely to be 'very feasible' in terms of ease of implementation and so there is not much point in defining such a category. There is likely to be strong opposition to *any* anti-corruption policy from adversely affected quarters and we can expect more or less serious attempts by the beneficiaries of corruption to modify any anti-corruption policy at the implementation stage. The weak technical capacities within the bureaucracy and the weak enforcement capabilities of the Bangladeshi state are well known. The choice is therefore between classifying potential anti-corruption policies as either 'low feasibility' or 'moderate feasibility' in terms of resistance to implementation. **Table 5** summarises the two categories of feasibility that are discussed below in greater detail.

Table 5 Feasibility of Anti-Corruption Strategies

Moderately Feasible Strategies are strategies that are not likely to face much resistance at the level of the ruling coalition because they do not significantly threaten the political settlement, that require bureaucratic competence and enforcement capabilities that can be feasibly acquired and that are likely to be supported by important sectoral stakeholders.

Low Feasibility Strategies are strategies that are likely to face strong resistance from powerful organisations because they threaten to disrupt the political settlement, or that require significant bureaucratic competence and enforcement capabilities that do not exist, or that are likely to be resisted at the sectoral level because stakeholders in favour of these strategies are relatively weak and their collective action is difficult compared to the resistance.

Source: Author

Moderately Feasible Strategies: To be moderately feasible a strategy should not seriously threaten coalitions that are powerful organisations in that political settlement. Many macro-level governance reforms fail this test because they threaten to disrupt the political corruption that keeps particular political settlements together. The strategy should also not require significant bureaucratic capacities and enforcement capabilities that are unlikely to be feasibly developed within the time frame of the policy. And finally the strategy should enjoy some level of support from significant stakeholders at the sectoral level. Nevertheless, any anti-corruption strategy is likely to face opposition from some powerful groups that feel threatened. The judgement of moderate feasibility is therefore based on the assessment that supporters of the reform could potentially engage in effective collective action to neutralize this resistance.

Low Feasibility Strategies: Here one or more of the conditions outlined earlier do not hold. Clearly, the greater the number of conditions that do not hold, the less feasible the strategy becomes but we did not find it useful to grade different levels of low feasibility. Anti-corruption policies have low feasibility if they threaten powerful organisations within the political settlement, or if they require bureaucratic capacities and enforcement capabilities that are unlikely to quickly emerge, or if they target types of corruption in particular sectors where the forces supporting these policies are weak relative to those that are likely to oppose the implementation of these policies.

4.3 Confidence Levels

Our analysis was not just based on what our respondents said, even though they were selected carefully and a high degree of trust was established to conduct the discussions. Even the most candid respondent is likely to present their understanding of corruption from a particular perspective. For instance, respondents from the private sector can be expected to blame government and vice versa for the worst aspects of corruption. To construct a credible analysis of the transactions, we listened to both sides separately and tried to see if a mutually compatible analysis was possible given our knowledge of the structural features of the sector. The degree of confidence we express in particular results was based on our assessment of a number of factors:

- 1) The credibility of our respondents based on their experience, access to information and the openness that they felt they could risk with us. Most of our respondents were in very high-level positions in business or government. However, they differed in terms of their credibility according to these criteria. In most cases our respondents were high-credibility respondents.

- 2) The consistency of different respondents of the same type. Our confidence in a process was enhanced if, say, different business respondents described largely similar corrupt processes and conversely, our confidence declined if two similar respondents contradicted each other.
- 3) The compatibility of the responses of different sides, in particular business and government. We did not expect respondents on different sides to provide the same analysis, but our confidence was increased if the insights were complementary rather than contradictory. Sometimes we reverted to a business respondent if we were given contradictory information by a government respondent and vice versa, and raised our confidence if this resulted in convergence. Conversely, we lowered our confidence if despite a process of iteration we were unable to identify the drivers and interests that could explain different dimensions of a problem.
- 4) The compatibility of the analysis emerging from the interviews with our background knowledge of political economy. Responses were sometimes not compatible with what we expected given our prior knowledge of the political economy of Bangladesh. In these cases we went back with more questions and attributed high or low confidence depending on how satisfied we were with plausibility. This does not mean that our prior political economy knowledge was necessarily correct, but if interview results appeared implausible, the lower level of confidence signals that further investigation is required.

Based on our assessment of these characteristics, we attached one of three confidence levels to our analyses. These are summarised in **Table 6**.

Table 6 Levels of Confidence in Assessments

High level of confidence: More than one high-credibility respondent on one side (business or government) and at least one high-credibility respondent on the other side offering a compatible overall analysis of a process, consistent with our broader understanding of the political economy constraints in the country.
Moderate level of confidence: Only one high-credibility respondent on each side; but offering a compatible overall analysis consistent with our understanding of broader political economy; or More than one high-credibility respondent on one side but without corroboration on the other side or corroboration by less well-placed respondents; but the analysis is consistent with our understanding of the political economy of the country.
Low level of confidence: Only one high-credibility respondent with no corroboration from the other side but the analysis is consistent with our understanding of broader political economy; or More than one respondent on one or both sides of moderate to low credibility; but the analysis is consistent with our understanding of broader political economy; or One or more respondents on both sides but regardless of their credibility the analysis is not consistent with our understanding of the broader political economy of the country.

Source: Author

When parts of our analysis scored a 'high' in terms of our confidence scoring criteria, we believed that we were unlikely to have misunderstood the significance of the impact or feasibility of reform in those cases. For the parts of the analysis where our confidence level was 'moderate' we would still be willing to defend our analysis as fairly credible and worthy of being taken seriously by policy-makers. We are confident that the parts of our analysis that scored moderate to high in terms of our confidence scoring are more or less accurate representations of processes in the economy. However, analysis that scored a 'low' level of confidence indicates that more investigation is warranted. We probably identified important aspects of

impact and feasibility but we would not argue the case strongly on the basis of the evidence we have. For reasons of space we report only those parts of the analysis that scored a high in terms of our levels of confidence.

4.4 Impact and Feasibility of Addressing Different Types of Corruption

At a general level we know the broad features of corruption in Bangladesh as a result of ongoing surveys and analysis done by various agencies over the years. Transparency International Bangladesh carries out regular household surveys recording the extent to which households are exposed to corruption in different service-delivery agencies of the government, as well as surveys of corruption in particular areas, like land administration and tax administration (these are available on the TIB website). Similar surveys have been done by other agencies including the World Economic Forum, referred to earlier. Using this background information and on the basis of detailed discussions with our respondents, we outline the broad features of corruption in Bangladesh before going on to a detailed discussion of sectoral corruption.

4.4.1 Market-Restricting Corruption

Some corruption is associated with business attempts to by-pass market-restricting government regulations that are unnecessary and do not serve any compelling public purpose. Here the underlying problem is the presence of market-restricting regulations that have damaging effects like preventing firms from entering markets or expanding their scale of production. All regulations inevitably restrict the freedom of businesses, but the characteristic of market-restricting regulations is that they serve *no economic or social purpose*. Examples of such restrictions are red tape and delays in getting permissions, or unnecessary requirements of getting multiple permissions from different agencies and unnecessary entry and exit regulations. The presence of such market-restricting regulations can induce corruption as businesses may be willing to pay to evade or by-pass these restrictions.

This type of corruption can appear to help business to evade damaging restrictions, but the effect of the restrictions and the corruption together is always worse than if the restrictions did not exist in the first place. Indeed the possibility of extracting revenue can create incentives for government to create further market-restricting regulations. The appropriate policy response is to roll back the damaging restrictions. Bangladesh scores poorly in terms of unnecessary regulations but not as poorly as India. The World Bank's Doing Business rankings look at a number of factors but primarily at the numbers of procedures that are required to set up a business, get construction permits, register property, trade across borders, pay taxes and so on. Excessive regulations in these areas are often market-restricting regulations. In terms of these rankings, Bangladesh ranked a dismal 130 in the world in 2014, but it ranked higher than India at 134, while of the three large South Asian countries, Pakistan ranked the highest at 110 (World Bank and International Finance Corporation 2013). If market-restricting regulations were the most important factor affecting business performance, Pakistan would be the best performing country in South Asia and India the worst. But the reverse is the case (**Table 1**). Our respondents confirmed that while market-restricting policies and the corruption associated with it had damaging effects on their businesses, these were less damaging than other types of corruption. Nevertheless, conventional anti-corruption strategies like improving transparency and simplifying and improving regulatory procedures in critical areas can have a moderate economic impact on business by mitigating market-restricting corruption.

The resistance to policies attacking this type of corruption is likely to come from the public officials who benefit from this type of corruption and occasionally from businesses that benefit from market-restricting policies that create monopolies. Bureaucratic competence and capacity do not constrain these anti-corruption strategies because the goal is to reduce interventions, but some capacity may be required to implement the changes. And finally, the resources generated by this type of corruption are unlikely to be significant for powerful groups in the political settlement. *Market-restricting corruption is likely to have low to moderate impact and anti-corruption strategies are likely to be moderately feasible.*

4.4.2 State-Constraining Corruption

This type of corruption is associated with situations where the state lacks the capacity to perform *necessary* functions. The underlying state capacity failures can range from the failure to provide public goods like the protection of property rights¹, the failure to provide services such as infrastructure or power, or the failure to adequately address market failures constraining the private sector, for instance affecting skills development, investment, and so on.

The impact of state-constraining corruption can therefore vary quite a lot. In some cases the state lacks the capacity to *enforce* necessary policies, and here corruption can be associated with policy distortion. In other cases the state may even lack the capacity to provide the necessary policy or service, and here corruption *may* be associated with second-best solutions to the deeper problem. An example of the latter would be a situation where a state lacks the capacity to protect property rights and the private sector makes informal (corrupt) payments to the police or to politicians to purchase the protection of their rights. Here too the corruption is associated with an inferior outcome but in the second case, anti-corruption strategies have to be carefully calibrated to match the pace of development of state capacities to provide the public good. The impact of removing state-constraining corruption can therefore sometimes be very positive (if the corruption was preventing a necessary policy being implemented) but sometimes it can make things worse in the short run if the private sector was using corruption to access ‘services’ that the formal state was unable to provide. However, this type of corruption is still state-constraining in the longer run because it can constrain the development of the necessary state capacities over time.

We will see in our sectoral analysis that our respondents systematically identified different variants of state-constraining corruption as the highest-impact types of corruption in their sector. Apart from the more complex assessment of impact in this case, the feasibility question here is also more complex. Anti-corruption strategies here have to improve bureaucratic competence and enforcement capacities and may face opposition from powerful organisations whose access to significant rents may be affected. In some cases, if anti-corruption strategies aim to remove this type of corruption without ensuring that the private sector gets the public goods and services it needs in some other way, the strategy may have little political traction as it may be difficult to find private sector stakeholders who will seriously push for a reduction in these types of corruption.

State-constraining corruption is therefore more difficult to fight, even though its impact may be much higher compared to market-constraining corruption. Even so, if important sections of business are losing out, reforms could be feasible if these groups can be mobilised. *Some types of state-constraining corruption are therefore likely to have both a high impact on the private sector and the anti-corruption strategies may be moderately feasible, but some types of state-constraining corruption may be less feasible to attack.* In our assessment, identifying the state-constraining corruption that is feasible to attack is particularly important for policy-relevant anti-corruption strategies.

4.4.3 Political Corruption

Political corruption refers to personalised and often illegal political allocation of resources that often sustains the political settlement² in developing countries. This makes political corruption very difficult to attack, and there is a growing recognition of this in the work on Limited Access Orders (North, et al. 2013) and political settlements (Khan 2010). Political corruption is likely to be significant in all developing countries and is well-known to be very significant in Bangladesh. The most recent National Integrity

¹ Public goods are goods that are (at least partially) non-rival and non-excludable, so that public provision is efficient, provided the state can solve the relevant issues of information, taxation and enforcement.

² The ‘political settlement’ is the distribution of power and resources across organisations in a society, which underpins its level of political stability and its economic performance (Khan 2010).

System Assessment by Transparency International Bangladesh shows that political intervention and political corruption have expanded in recent years and has now intruded into the higher judiciary and indeed every government agency (Transparency International Bangladesh 2014). The deep political instability in the country is directly related to conflicts over the distribution of and access to these politically allocated rents. Without exception, our respondents identified these political conflicts and the politicization of the administration as high impact problems for Bangladesh. However, attacking political corruption with the policy tools available to development partners is not likely to yield any results. The structure of rents and therefore of corruption that sustains the political settlement is different across countries and can change over time as the configuration of powerful organisations changes. These changes can have significant implications for economic performance (Khan 2010). Addressing political corruption requires changing the political settlement. Unfortunately, political settlements change slowly and in response to social mobilisations and political movements, and it is usually not feasible to change them using the policy instruments that we are discussing. Underlying changes in the political settlement in Bangladesh are making political corruption and political instability more difficult to address. These problems have to be publicised and broader policy approaches targeting the political settlement could be considered by development partners like DFID.

Even though targeting political corruption was not the main focus of this study on the grounds of immediate feasibility, it is useful to have a picture of the structure of political corruption because it reveals the power of different organisations in a society. Solutions to other types of corruption have to take this distribution of power into account. The design of anti-corruption programmes requires a map of the political settlement to assess the feasibility of different strategies. Our assessment of the feasibility of different reforms drew on our background knowledge of the evolving political settlement in Bangladesh (Khan 2012; Hassan 2013; Khan 2013b).

Political corruption has a significant impact on private sector development both directly and because it overlaps with and sustains other types of corruption. But strategies targeting political corruption without changing the political settlement have a low feasibility of success.

4.4.4 Predatory Corruption

Predatory corruption involves extortion, and this often has the most damaging impact on the private sector. Extortion happens when the private sector has to give up resources under threat of violence or serious damage. Powerful organisations engage in predatory corruption when they have very short time horizons. Typically this indicates that the ruling coalition has fragmented and its higher levels are unable to control lower levels, and is unable to control groups outside the ruling coalition. If a ruling coalition has the capability of enforcing some discipline, it is likely to try and limit predatory corruption in its own self-interest because predatory corruption can damage the reproducibility of the economic system and result in an unravelling of the political settlement.

Predatory corruption can take a variety of forms including extortionate ‘donations’ collected from businesses by political parties and local mafias, tolls and security payments collected by local strongmen to allow travel or do business across regions, theft of public property (like natural resources, land or tax revenues) by coalitions of local or regional politicians, bureaucrats and private businesses, and so on. Some predatory corruption exists in all developing countries, but if it goes beyond a tipping point, societies can begin to unravel, as in Somalia, Afghanistan or the DRC, where competing warlords organise the predatory corruption. Unfortunately, there are indications that predatory corruption is growing in Bangladesh. During our fieldwork in April-May 2014 there were several high profile multiple murders in Narayanganj, Feni and other places where a number of senior ruling party leaders were killed, allegedly by other ruling party factions, in internal gang wars³. This represents a significant escalation of the type

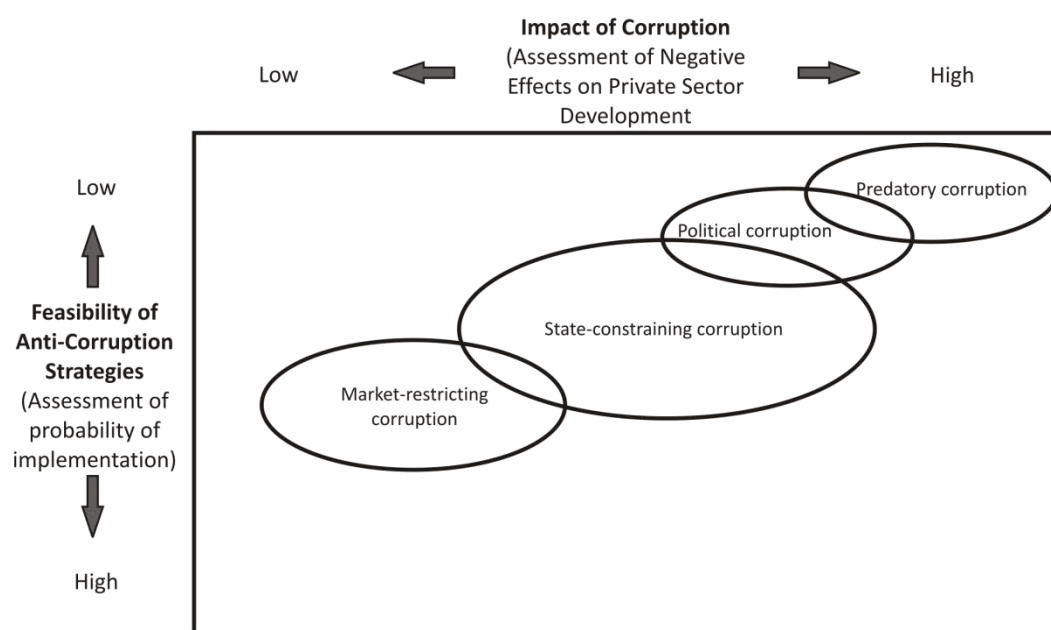
³ See for instance *Daily Star* 23rd May 2014, <http://www.thedailystar.net/what-next-after-feni-and-narayanganj-25240>

of inner-ruling party violence that has traditionally marred the allocation of construction and other contracts to party supporters. It is widely believed in Bangladesh that many government contracts have an element of predatory corruption as they allow the 'managed' theft of public resources. The intensification of violence within the ruling party is *prima facie* evidence that internal discipline is breaking down and that predatory corruption is becoming more 'unmanaged' and is possibly growing. Our attempts to get more concrete evidence on the factors driving the escalation of high-level political violence were abandoned because this was too risky to investigate in depth and there was not much point in reporting unsubstantiated rumours. Predatory corruption can potentially have very negative impacts on the private sector, but here the usual policy instruments for fighting corruption are even less likely to work. Tackling predatory corruption involves state-building and party-building strategies, including improving the competence and capacities of enforcement agencies but also political strategies to create a more cohesive, legitimate and effective ruling coalition. This too is outside our remit because we are not discussing these types of political reforms. *Predatory corruption can potentially have the biggest impact on private sector development but it is also the most difficult type of corruption to address as it involves state-building and political coalition-building strategies.*

4.5 Trade-offs between Impact and Feasibility

Figure 2 summarises some of the trade-offs we expect to see between the impact of different types of corruption and the feasibility of the associated anti-corruption strategies. The diagram is a simplification because all instances of each type of corruption may not fit the locations shown in the diagram. Moreover many instances of corruption are in reality combinations of more than one type of corruption: for instance some state-constraining corruption shares features of political corruption. But in general, market-restricting corruption is potentially the easiest type to attack because many more stakeholders can typically be found to support the implementation of these anti-corruption policies. However its impact is also relatively low because while the removal of unnecessary restrictions is always helpful, it typically does not address the most important problems of development, which are associated with the failure of the state to carry out *necessary* functions.

As development is often constrained by the failure of states to provide necessary public goods and address critical market failures, policies that address state-constraining corruption can often have a significant impact on business. However, as we have discussed, addressing some variants of state-constraining corruption requires simultaneous strategies for enhancing state capacities so that states can legally provide the missing services and functions for the private sector. Over the longer term, the payoffs from dealing with state-constraining corruption can be very significant. However, we also expect the resistance to anti-corruption policies to be higher in this case because of the symbiotic nature of this corruption and the greater likelihood that the private sector is dependent on some of these types of corruption for their everyday activities in contexts of weak state competences and capacities.

Figure 2: Impact and Feasibility of Anti-Corruption Strategies

Source: Author

Finally, both political and predatory corruption can have a large impact on the performance of the private sector as these types of corruption can ultimately lead to economic implosion and the emergence of a warlord economy. The feasibility of the relevant anti-corruption policies depends on strategies to change the political configuration of power but this is not feasible with the types of policy instruments that we focus on in this study. **To summarise, we expect the most useful focus of feasible anti-corruption strategies is to target variants of state-constraining corruption where the potential payoffs from effective reforms are likely to be high and policy feasibility is moderate.** Addressing some market-restricting corruption can also have significant payoffs.

What follows in the subsequent sections are summaries of our analysis of corruption problems in a number of sectors where we were able to achieve high levels of confidence in our results. The aim is not to provide a comprehensive summary of the characteristics of different sectors, or to provide a full account of the governance and reform challenges they face, but to focus on the processes surrounding types of corruption that our respondents identified as having moderate to high impact and where policy responses were judged to be feasible.

5. Assessment of Key Sectoral Corruption Flashpoints

The focus on state-constraining corruption fits in with our expectation that different sectors in Bangladesh face different types of corruption problems. This makes particular sense when we focus on state-constraining corruption because the relevant state failures and missing capacities are different given the types of sectors and firms we are looking at. Instead of economy-wide corruption flashpoints for the business sector in a country like Bangladesh, we expect to identify sectoral corruption flashpoints, where particular processes of corruption are likely to have a significant impact on business outcomes and we are particularly interested in the subset of these processes that it is most feasible to address. The detailed discussions that we engaged in aimed to identify some of these potential sectoral corruption flashpoints.

After a preliminary round of interviews with our respondents, we further narrowed our focus to three areas where responses were more detailed and appeared to be more policy-relevant. These were aspects

of corruption affecting the garments industry as an example of an established sector, corruption affecting emerging sectors, particularly electronic consumer goods and small machine parts, and the cross-cutting issue of corruption in land administration that all businesses identified as a serious constraint. Infrastructure was identified as a cross-cutting issue by all our respondents but the infrastructure sector is diverse, with very specific regulatory and corruption issues, and we decided to drop this discussion from this study because of reasons of space (some of these issues are discussed in Khan 2013b).

5.1 Corruption in an Established Sector: the Garments Industry

The garments industry in Bangladesh is the country's biggest single exporter and employer, accounting for around ten percent of GDP (almost 15 percent if supporting industries are included), almost 80 percent of exports and around four million direct jobs, mostly for women (Transparency International Bangladesh 2013). If indirect jobs that depend on the garments industry are included, the total employment dependent on the industry possibly exceeds ten million. Thus, the significance of the performance of this sector for the health of the Bangladesh economy and for keeping poverty in check cannot be overstated.

Despite a series of setbacks like the Rana Plaza collapse of 2013, the industry has grown at double digit or close to double digit rates since the 1980s. Ironically, this has created a false sense of complacency in policy circles that has not been very helpful for addressing issues that are very urgent. The industry suffers from serious problems of regulation and governance so that even though it has solved some operating problems, it finds it very difficult to respond to new challenges. This could have sudden and precipitate effects in the future. For instance, the failure to respond adequately to major accidents could result in a sudden and significant loss in orders if reputational loss becomes too severe for major buyers.

Clearly as far as rapid growth through horizontal expansion is concerned, the sector has adapted to governance failures and limitations in state capacity and found ways of operating in an otherwise adverse governance context. This has included developing a capacity to organise investments in this environment and to find solutions to the limited capacity of the state to provide public goods like low cost financing, property right enforcement, rule of law and adequate infrastructure. At the same time, some of the strategies used by the sector to deal with these shortcomings have allowed less scrupulous businesses (which may be numerous) to cut corners, and to evade regulations on labour laws, environmental laws and building construction to an extent that sometimes leads to tragic consequences.

Breaking the cycle of regulatory failures is the foremost challenge here and our discussions revealed some of the reasons why progress has been very slow. Many of the types of corruption here are state-constraining corruption, where the ultimate problem is a weakness of state capacity to provide public goods. The responses of industry to by-pass these problems in turn create more problems but the solution is not as simple as may appear at first sight. Once we understand all the drivers of different types of corruption in the sector, some types of anti-corruption reforms that appear to be reasonable are likely to face strong resistance from those who appear to be beneficiaries of these reforms. More roundabout routes to attack these types of corruption and governance problems have to be sought.

Some of the general assessments of our respondents were not at all surprising. They identified a number of major governance and corruption issues that had a high impact on business prospects but these were general governance problems that were not limited to the sector. First, an important failure of governance was the political uncertainty driven by the culture of confrontation in politics (all business respondents in every sector that we spoke to identified this as the critical problem at this time). The year 2013 was a particularly bad one for the garments sector. The political confrontation through the year had very high costs for the sector. Strikes and blockades led to lost orders and congestion in the ports led to air-freighting that often resulted in significant losses. Firms were forced to air-freight entire shipments to keep customers even when the result was a significant loss.

Second, the weakness of public infrastructure like roads, railways and ports was identified as a high impact governance failure for the sector. The growth of the sector would be much faster if land for garments villages could be allocated with appropriate electricity and gas connections and access to transportation.

Third and related to this was the governance failure in ensuring that land rights were well-defined and enforceable. The contested nature of land rights meant high transaction costs of acquiring land for expansion and this has a significant impact on growth. Many large garments owners had to operate three or four plants because they could not acquire land to construct an integrated plant, considerably raising costs and overheads. The governance of land rights is a cross-cutting issue that affects all business sectors in Bangladesh (and residential owners and farmers) and we will discuss corruption and reforms in this sector later.

However, none of these important governance and corruption constraints were limited or internal to the sector. Tackling them involves significant state-level reforms and the development of state capacity in different areas. All of these major reforms have a low feasibility of implementation in the short to medium term though as we will argue, some steps need to be taken in some of these areas rather quickly. The political instability is a characteristic of features of the distribution of power within the political settlement and is unlikely to change as a result of any feasible institutional changes without an acceptance of live-and-let-live strategies by the contending political organisations (Khan 2012).

Significant *general* improvements in the state's capacity to deliver public goods and infrastructure also go against the interests of powerful groups within the political settlement and the appropriate bureaucratic competences and enforcement capabilities will take time to develop. These factors affect all of the major reform issues identified by our respondents. A number of more limited sectoral corruption problems were also identified that were internal to the sector. Their impact ranged from low to high, but they scored higher in terms of feasibility than the major corruption issues discussed earlier. We discuss two variants of these types of corruption: the corruption involving customs officials clearing duty-free imports of inputs for garments factories, and the corruption driving violations of regulations.

5.1.1 Customs Clearances and Corruption

Our garments industry respondents, in line with the secondary literature on the sector, identified important governance and corruption problems in the Customs Department, which created impediments for import and export transactions. The industry depends on duty-free imports of raw materials through bonded warehouses. There is no duty payable if the products are re-exported but firms have to establish they have utilised the imported inputs for exports and have not sold it in the domestic market. As businesses need these bond licenses to continue doing business, withholding or delaying renewals allows customs officials to threaten high costs on businesses and extract speed money for license renewals.

The corruption problem here has a *low to moderate impact* on business outcomes but we discuss it because it shows how a relatively simple problem can actually be quite entrenched and difficult to address without a nuanced understanding of all its drivers. However, a properly designed anti-corruption strategy here is *moderately feasible*. While the impact may not be high, this is an area of corruption that all business respondents talk about, and effective reforms in this area could be justified in terms of helping to improve the formalisation of the sector and introducing a more rules-based institutional structure.

The right to enjoy duty free imports of inputs requires a validation process where customs officials check whether the utilisation of inputs matches the exports of the firm. Around a decade ago, in the face of repeated complaints by garments factory owners that customs officials were engaged in corruption in the granting of the Utilization Declaration (UD) certificates, an innovative step was taken by the then head of the National Board of Revenue (NBR) to transfer the power to issue utilisation certificates for bonded imports from customs officials to the industry association, the BGMEA. Although this decision is now criticised by many commentators as evidence of the overweening power of the BGMEA, the policy was

actually driven by reform-minded bureaucrats like Akbar Ali Khan who understood the implications of the limited competences and capacity within the Customs Department.

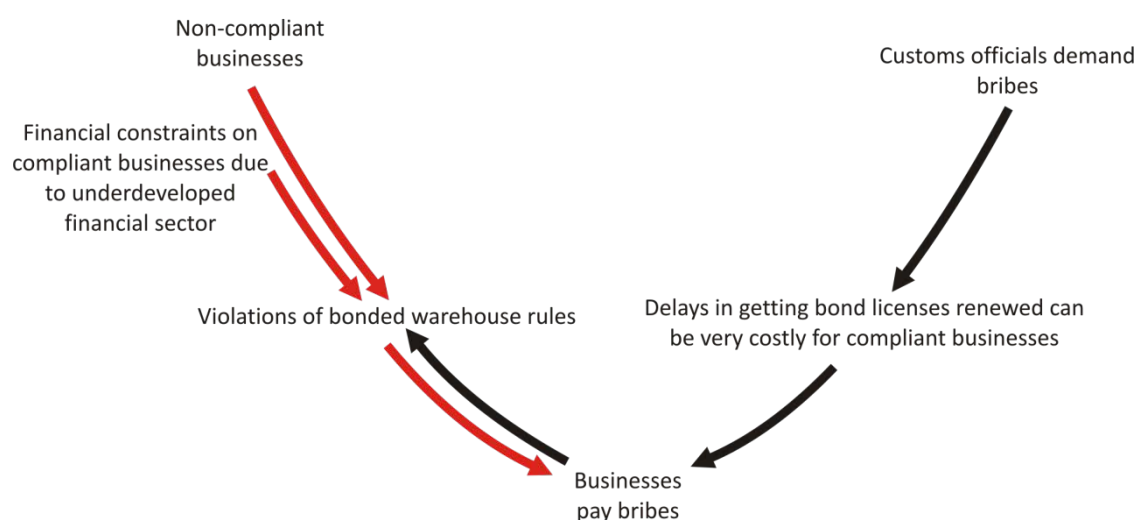
Once the authority to issue UD certificates passed from Customs to the BGMEA, this reduced the transaction costs of organising bribes over the year, but customs officials still conduct an annual audit checking the annual utilisation against other evidence of imports and exports, to renew the bond licenses that firms have to have. Significant corruption continues though the bribes here are relatively small compared to the turnover of the typical firm.

The owner of a garments company with 5000 workers and annual sales of around USD 50 million reported the annual bribe for their bond license renewal was in the region of 500,000 taka, around USD 6500. Clearly, this is a small figure relative to the firm's turnover and it seems the bribes demanded by customs officials are calibrated according to the ability of owners to pay and the relative standing of the owner, with more established and powerful businesses having to pay less. However, given that there are 4000 or so garments factories, the figure suggests that customs officials could be collecting tens of millions of dollars a year just for renewing this particular license.

Although the sum paid by this factory was not large compared to its turnover, the owner strongly resented the payment, particularly because the figure had suddenly more than doubled from its rate of 150,000 takas the previous year. The direct impact of this particular type of corruption was judged to be low, but once delays and negative effects on smaller firms and new entrants are taken into account, the impact could be moderate. Moreover, a deeper investigation showed that this was more than just market-restricting corruption, and was ultimately driven by weak state capacities in other areas. An understanding of how both potentially compliant and non-compliant firms can become embroiled in corruption in these areas is also useful for understanding the challenges in dealing with the more important problem of regulatory enforcement discussed later.

The different drivers involved in this process of corruption are summarised in Figure 3. Discussions with representatives of business and government revealed at least three superimposed processes that make this corruption problem deeply embedded and difficult to fight. A strategy for addressing this type of corruption only has a chance of success if all the important drivers are taken into account in the design of an anti-corruption strategy.

Figure 3: Drivers of Customs Corruption in the Garments Industry



Source: Author

First, the line of causation shown by the arrows originating at the upper right hand corner of Figure 3 shows one driver of this corruption originating in the power of customs officials to impose large costs on businesses, even if they are compliant, by delaying the renewal of their licenses or carrying out lengthy audits. Garments industry representatives say that there is never a good match between the figures for imports and utilisation because the wastage of fabrics varies from year to year, and there is internal pilferage and theft of fabric within firms that is difficult to eliminate. Some margins are allowed by customs rules but they are often exceeded. In any case a lengthy audit can delay shipments and the cost of that can be very large. As a result, many businesses that may otherwise have been compliant are forced to pay speed money to have their licenses renewed in time. Since all or most firms have to pay bribes for renewing their licenses regardless of compliance, they then have a strong incentive to violate bonded warehouse rules by selling some of their imported inputs in the local market as a source of easy money. This is shown by the arrows from the top right hand corner continuing to the outcome of bond violations even by companies that did not want to be non-compliant.

If this was the only driver of this type of corruption, it may have been relatively easy to organise collective action on the part of garments producers to put pressure on the government to improve governance in this area. After all, the industry succeeded in lobbying to transfer the responsibility for granting utilisation certificates to the industry association. However, there are two other drivers that complicate matters and where policy attention is simultaneously required to achieve a successful anti-corruption strategy.

The second and third drivers come from the business side of the equation and are shown by the arrows originating at the upper left hand corner of Figure 3. Some businesses are non-compliant because their profitability is too low and they *intend* to violate bonded warehouse rules to generate extra income. The duties on imported fabrics mean that the domestic prices of fabrics are higher than the import price so selling duty free fabrics in the domestic market is an easy source of additional income. These businesses are happy to pay customs officials to enable this to happen. This is different from the first case because these businesses would not be compliant even if there was no pressure from customs. The problem is that it is impossible to distinguish between businesses in the first and second categories because in the end, many if not most garments factories end up engaging in some domestic market sales.

The real complication is a third driver also originating from business. There are many potentially compliant firms in the industry that engage in local market sales because they suffer from serious temporary cash flow problems as a result of credit market failures. The income flows for garments firms can be very irregular due to delays in shipments or in payments coming in. But all firms have large monthly cash commitments in the form of significant wage and utility bills. Companies that are profitable can still have several months every year or every few years when they face severe cash shortages. The institutional failure here is that the financial system is not geared to provide short-term cash to viable garments firms facing payments problems. Our respondents told us that it was quite common for fairly viable firms to have to borrow short-term cash on the kerb market to pay wage bills during lean months at exorbitant interest rates of around 10 percent *per month*. In fact, the inefficient financial sector and high interest rates in general were identified as a significant constraint on business by business respondents in every sector including garments.

This underlying market failure can drive many firms to use partial sales of their bonded stocks to ease occasional cash crunches, though evidently even this is not sufficient in many cases to avoid the curb market. Thus, potentially compliant firms facing temporary cash shortages also end up bribing customs officials to raise money through local market sales. Both sides in these transactions agreed that across the industry around five percent of duty-free imported fabrics are sold every year in the domestic market as a way of raising extra cash. The significance of this driver is that as a result of a credit market failure, many potentially compliant firms can engage in these violations, and many potentially compliant firms will therefore not support a strict anti-corruption drive targeted at customs unless the deeper market failure is simultaneously addressed.

5.1.2 Feasible Strategies for Targeting Customs-Related Corruption

An understanding of these parallel drivers shows why a feasible anti-corruption strategy targeting corruption by customs officials has to have several parallel components. First, the policy has to address the weaknesses in the internal management of the Customs Department that allows officials to demand payments from compliant firms. This may involve standard measures like improving salaries, and improving internal monitoring and procedures for removing officials with persistent complaints against them. It would also involve procedural measures to prevent customs officials from imposing large costs on firms by holding long audits or delaying the renewal of licenses. The regulations already allow a temporary renewal of licenses while an audit or investigation is taking place so that firms cannot be threatened with large losses, but firms told us that even these renewals take time and they are prepared to pay speed money because the absence of proper paperwork affects their access to bank credit for importing inputs. An effective anti-corruption strategy would therefore have to give attention to these procedural details so that for instance licenses are automatically renewed and the company is only penalized if an audit eventually proves definitively that a violation has taken place.

However, our analysis of drivers suggests why this may be insufficient for an effective anti-corruption strategy. Both compliant and non-compliant businesses may want corruption to continue, but for different reasons. In practice it is difficult to distinguish between potentially compliant and non-compliant firms by looking at their behaviour *ex post*. This means that a sufficient coalition of support cannot be created within the industry for a strong anti-corruption drive against customs officials. Under present circumstances, both compliant and non-compliant firms are likely to collude with customs officials to ensure that an anti-corruption strategy is not implemented unless the deeper problems driving non-compliance by many firms are simultaneously addressed.

A second plank of an effective anti-corruption strategy must therefore address some of the relevant market failures that drive this corruption. This requires building state capacity in an apparently unrelated area. An important driver here is the non-availability of short-term financing to cover mismatches in operating costs over the year. Given the general weaknesses in enforcement capacity in the country, it is

too much to ask firms who want to be compliant to borrow money at 10 percent a month from the curb market when they have bonded fabrics they could immediately sell to raise money.

Development partners like DFID are likely to be already engaged in reforms of the financial sector to make the financial sector better able to finance business at lower cost. The dialogue on these reforms can be linked to various anti-corruption strategies, including the corruption affecting customs. In particular, the process insights provided by our respondents suggest very specific market failures in the financial markets that need to be looked at more closely.

One way to split a potentially large group of compliant firms from a minority of non-compliant firms in this context would be to address the huge market failure in raising short-term operating credit. The availability of a dedicated short-term credit facility for export-oriented firms could potentially have a significant impact by reducing the opportunity costs of compliance. This is just an example, but a successful strategy would have to address the important market failures that drive this type of state-constraining corruption. Public funds are not necessarily required for developing such credit facilities. The central bank could use its regulatory powers to address this market failure by making it more attractive for banks to develop such a facility.

This is an example of state-constraining corruption where a complex symbiotic relationship emerges between business and government-driven corruption because of weak capacities of the state not only to enforce rules but also to address related market failures. These types of issues become much more significant in the important area of enforcement of regulations which has attracted a lot of attention after the building collapses and fires of 2013.

5.1.3 Corruption and the Enforcement of Regulations

The Rana Plaza collapse of 2013 brought to the fore serious lapses in the enforcement of labour, building and environmental regulations in the garments sector (Transparency International Bangladesh 2013). Corruption is both cause and consequence of this extensive failure in enforcement, and once again there are deeper failures in state capacities and failures in effectively addressing market failures that drive these types of corruption. This means that reforms are only likely to be feasible if the strategy is properly designed and the improvements in anti-corruption measures and necessary improvements in state capacity and competence are properly identified and realistically aligned.

The corruption associated with regulatory failures is clearly *high impact* not only because of its impact on the welfare of workers and the environment, but also because a loss of reputation beyond a point can result in a collapse of the sector itself. This is clearly an urgent area for reform, and is recognised as such by critical observers within and outside the industry. Once again, the problem has several layers of drivers and focusing only on one set of causes is unlikely to result in effective policies. However, our overall assessment is that a properly designed reform strategy here is *moderately feasible*.

The first driver of corruption of this type is that the regulatory structure is far too ambitious and complex given the available competences of the bureaucracy and the enforcement capacities of the state. Weaknesses in enforcement capacity and the complexity of regulations have been repeatedly identified as part of the problem. The existence of a large number of regulations that cannot be enforced can be expected to result in corruption of the market-constraining type.

For instance, around seventeen licenses from different agencies are required to start a garments factory and many of these require periodic renewals. Around seven steps of approval are required from the initial building permission for a factory to the final approval of the building construction by Rajuk, the Capital City Development Authority, which has to authorise building work in a broad belt in and around Dhaka.

The requirement of getting permissions from so many different authorities who do not have the capacity to check the degree of compliance or enforce restrictions simply results in corruption to get things moving.

This type of corruption inflicts large transaction costs, particularly for new entrants who have to figure out who and how much to pay, even though the direct financial impact is again relatively small. Our respondents classified these bribe costs as irritations though when we put the package of problems together, we get a high impact type of corruption that leads to regulatory failure.

The relatively small size of the bribes involved is corroborated by survey evidence on the magnitude of the bribes necessary to get permissions provided by Transparency International. According to respondents they surveyed in the garments industry, the seventeen permissions required for starting up a garment factory required bribes that added up to Tk. 1,365,000, if we assume businessmen had to pay bribes in the highest range in every category (Transparency International Bangladesh 2013: Table 3). This is roughly equivalent to USD 17,700. Given the scale of financing required to acquire the land and machinery and finance the initial wages and salaries to set up even a medium-sized garment factory, these setup bribes are trivial, possibly less than one to two percent of the initial cash flow required. Similarly, the bribes required to get Rajuk building approval add up to Tk. 359,000 if bribes at every stage are at the top end of the range, equivalent to roughly USD 4600.

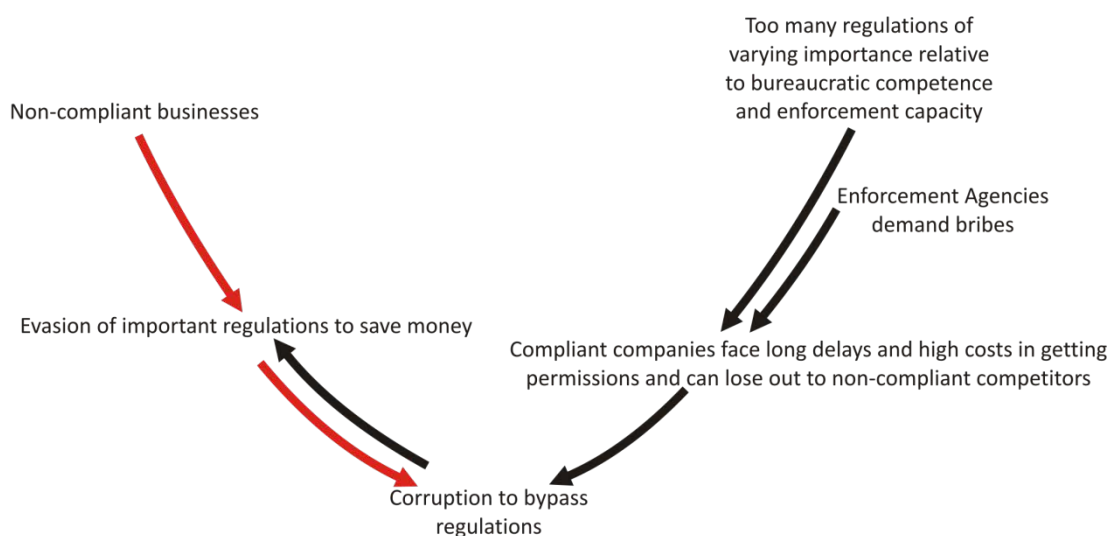
The deeper problem is that the state's capacity to regulate and enforce is weak, and this is part of its general low capacity to provide public goods. The enforcement of useful regulations is actually a mechanism through which an effective state provides important public goods, like a clean environment or workplace safety. However, enforcement has a cost which society has to pay to get the public goods it wants. The question in a country like Bangladesh is what are the basic public goods that society wants *and* can pay for? Enforcement is not free, and providing public goods through this mechanism is not necessarily less costly than if the state chose to subsidise some companies to improve their workplace safety. It appears that this fundamental question has not really been tackled at a policy level and instead regulations have been incrementally added on, in the hope that more regulation will lead to some public goods emerging.

In the shock after the Rana Plaza collapse the demand for enforcing regulations has become stronger, and many campaign groups want even more stringent and detailed regulations to prevent these kinds of disasters in the future. Well-meaning campaigners may not welcome being told that demands for better enforcement and adding to the list of regulations are not necessarily consistent given the limitations in bureaucratic competence and capacity that is a reality in the short to medium term.

The result of having a long list of regulations that the public agencies do not have the *capacity to effectively monitor and enforce even if they wanted to* is to create the compulsion for widespread corruption and enable the evasion of even the most essential regulations. Once again, an important source of this state-constraining corruption (many of the regulations are potentially necessary) is weak state competence and capacity to carry out its *necessary* functions.

The key drivers of the corruption associated with regulatory failure are summarised in Figure 4. The arrows beginning at the top right hand corner show two separate causal factors emanating from the government side of the equation. First and most important, the limited competence and capacity of the monitoring and enforcement agencies are entirely out of line with the regulatory tasks they are formally required to perform. The result is that *even if* the officials concerned were attempting to do their job properly *and* businesses wanted to be compliant, the time it would take to get permissions would be totally unviable for any business.

Figure 4: Corruption and Regulatory Failure in the Garments Industry



Source: Author

A few facts and figures can provide an idea of the empirical magnitude of this problem. The Office of the Chief Inspector of Factories and Establishments is charged with monitoring company adherence to a complex and growing set of labour laws. In 2013 this office had a total staff of 314 covering a country of 150 million. In Dhaka district, which had 17,000 factories registered with this office in 2013, there were 22 inspectors. These 22 people are supposed to audit and approve certificate renewals of these factories. Apart from the fact that this would be physically impossible to achieve on the basis of site inspections given the numbers of inspectors involved, most of the inspectors also lack the training and skills to do their job properly, lack adequate vehicles and do not have any computing facilities. It is not surprising that certificates are typically renewed without factory visits, in exchange for money (Transparency International Bangladesh 2013: 25-29).

Similarly astonishing figures for numbers of inspectors and inspection capacities go across all the agencies involved in regulating and certifying industries. For the thousands of factories in Dhaka district which need fire safety inspections and certificate renewals, there were 15 fire inspectors in 2013 with limited training and equipment. Rajuk, the Capital City Development Authority charged to approve building plans and land use for both residential, commercial and factory buildings in the 590 square miles of greater Dhaka (where around 10 million people live) was reported to have had a staff of 117 in 2013 with 15 inspectors (Transparency International Bangladesh 2013: 29-33).

As a result of these extremely severe capacity and competence constraints, many businesses have to engage in corruption to acquire the certification they need to operate. This does not mean there are no compliant businesses in Bangladesh. There are many excellent companies with high labour, building and environmental standards. But they are compliant because their owners want to be, or because they are large factories that are subject to international inspection, not because of the local regulatory and certification regime. There was no disagreement on this issue across our respondents.

However, the problem is that if a business has to pay for the certification it requires to operate, and it knows that there is no capacity on the part of the state to monitor and enforce regulations, there is a strong incentive to not comply with costly regulatory requirements in order to save money and to ensure that the business does not lose out in competition with less scrupulous competitors who could undersell them. Thus, this causal chain takes us not only to corruption, but also continues to regulatory failure and

possibly very undesirable outcomes, with regulatory violations by firms who would possibly have been compliant if every other business was.

The second causal driver, again from government, is the more usual one that bureaucrats and agencies with the power to delay and withhold licenses from businesses may want to collect bribes even if they had the capacity to monitor and enforce properly. While the policy response to block the first arrow is to develop the necessary competences and capacities, blocking the second arrow requires standard anti-corruption measures of improving monitoring and disciplining capacities within these agencies. Both these arrows result in business paying bribes and then violating regulations even if they may have been willing to be compliant businesses in the first place.

The third driver represents the possibility that some businesses do not intend to be compliant and want to evade important regulatory conditions. These businesses are willing to pay inspectors and in the absence of a strong regulatory authority that can limit this source of corruption, non-compliant businesses can push out compliant ones through unfair competition. As with the case of corruption in customs, anti-corruption strategies can become almost impossible to implement if multiple factors result in almost all firms becoming non-compliant for one reason or another. In this scenario it is impossible to tell companies apart, but a feasible anti-corruption strategy requires some mechanism of splitting the interests of companies, so that some, and perhaps most, begin to support an anti-corruption strategy.

5.1.4 Feasible Anti-Corruption Strategies to Improve Regulatory Outcomes

The discussion of drivers suggests the elements that a feasible anti-corruption strategy in this area needs to have. First and most important, the gap between the list of regulations and the competence and capacity of public agencies to enforce these regulations has to be significantly narrowed. Without that, no regulatory reform strategy is likely to work. Part of this process is undoubtedly to increase public investments in personnel and competences in the appropriate agencies *by orders of magnitude*. But even this is not likely to be sufficient even in the medium term given the enormous gap that exists between regulatory aspirations and the bleak reality of actual enforcement and monitoring capacities.

A necessary part of reform must therefore be to reduce the long list of regulatory requirements in different areas. Some idea of the variety of labour, health, safety and building regulations that already exist is available for instance in the Transparency International Bangladesh Report on the Garments Sector (2013). A necessary part of an effective strategy must be to reduce this to a core of absolutely essential minimum requirements that *have* to be enforced for all businesses, and that *can* be enforced with feasible improvements in competences and capacities.

This message is likely to be misunderstood and strongly resisted by campaigners and civil society groups, because it is likely to be confused with a *laissez faire*, minimal-state programme. In fact, it is motivated by the opposite objective. If Bangladesh is to eventually develop strong regulatory capacities, it has to begin by setting tasks for regulatory agencies that they can actually enforce. A handful of rules that all companies begin to follow is better as a starting point than dozens of different rules that no-one follows. Once the advantages of a rule-following industrial sector become more obvious, tax-based spending on enforcement and capacity-building will be easier to justify to the businesses that have to pay the taxes.

A necessary part of regulatory reform should therefore be to identify the core regulatory standards that can and should be immediately enforced. The existing regulations can stay on the books and even be extended, but the aim should be to identify the core standards and regulations that it is possible to imagine being uniformly enforced with feasible improvements in enforcement capacity. Putting the question in this way immediately suggests how limited the core standards and regulations have to be for the immediate future.

Improving enforcement capacity at this stage may perhaps involve a merger of the different enforcement and licensing agencies into a single high-powered industrial regulation agency tasked with monitoring and enforcing a small number of core regulatory requirements and standards. This would not preclude the garments industry having additional and special compliance requirements agreed with and monitored by global buyers. We are specifically referring here to the *national* regulatory regime which must enforce a common set of standards across all national businesses including the garments industry.

It is not within our remit to discuss what these core regulatory requirements and standards should be. That should be the outcome of a policy dialogue involving all stakeholders. But our discussions with representatives of key stakeholders and a look at the regulations and bureaucratic capacities makes it clear that this problem cannot be solved by repeated exhortations to improve enforcement. In this we take a different view from most other commentators, including the otherwise excellent Transparency International Report we have referred to, which calls for more regulations *and* for improvements in regulatory and enforcement capacities. In our judgement strengthening enforcement is not a feasible strategy on its own given the very great gap between the range of existing regulations and the enforcement capacities and competences of enforcement agencies that the report itself so clearly identifies (Transparency International Bangladesh 2013).

Development partners like DFID could potentially play an important role in facilitating a stakeholder dialogue on what this set of feasible regulatory requirements and standards can be given feasible improvements in enforcement capacities.

Secondly, internal processes and disciplining mechanisms within the agencies obviously have to be improved as well, together with changes in the regulatory structure such that regulators cannot impose costs on compliant firms by delaying the renewal of licenses or by carrying out long audits. This requirement is very similar to the Customs case discussed earlier. The default should be the automatic renewal of licenses till violations are unequivocally established. Here again, the simpler the rules are, the easier it is to establish whether there has been a violation or not, particularly in the context of the very limited competences and capacities on all sides. Without these changes, the second driver cannot be addressed and compliant firms can be compelled to bribe to continue in business.

Finally, a more credible regulatory structure that makes it possible for the majority of firms to be compliant, would split the business sector into those who would genuinely support the enforcement of rules that everyone followed, and a minority who will always want to free ride or violate regulations. The latter are the third driver of corruption. This minority has to be dissuaded using penalties as in every other country. The problem now is that penalties for violation are not credible threats in a context where almost every firm is non-compliant either by choice or by necessity.

5.2 Corruption in Emerging Sectors: Electronics and Machine Parts Microenterprises

The corruption problem in the garments industry is different from the corruption problems faced by emerging sectors which do not yet have the same political weight as the garments industry. By definition, emerging sectors have not yet established their position and importance in the economy. As a result the informal rules of doing business in that sector have not yet become established and well-known, and this creates large transaction costs for entering the sector. In a largely informal economy like Bangladesh, it is easier to enter the garments sector than other sectors simply because the informal rules for getting licenses and solving other problems relevant for that sector are at least well known in the local business community.

A second and more important problem for emerging sectors is that the organisational know-how required to manage production, quality control and inventories is not yet there because local firms have by definition not yet mastered the routines and internal-to-the-firm processes that are required to produce a product of a quality and at a price that is globally competitive. Once a number of local firms crack this organisational problem and the routines become well known, imitation and entry into the sector usually happens very rapidly. That was the story behind the emergence of the garments industry after pioneers like Desh cracked the organisational knowledge problem (Khan 2013b).

The more general problem that is now widely recognised in the literature on technological capabilities and learning is that a vitally important state capacity is to provide calibrated support to emerging sectors to help them finance their period of learning-by-doing so that global competitiveness can emerge. By definition, firms in emerging sectors that lack the organisational know-how to be globally competitive cannot compete against foreign firms that have these capabilities. They will make losses in open competition and very likely go out of business.

Some mechanisms of enabling a period of learning-by-doing have to be devised because the organisational knowledge that is relevant here cannot be taught in technical colleges and schools, but actually involves experimentation with factory layout and business organisation that has to evolve through experimentation and adaptation. The systems that work in one country will not necessarily work in others, which is why factory layouts and management structures vary greatly across countries. But this period of support should not be unconditional or for too long because it is also well-known that such 'infant industries' often do not grow up (Stiglitz 1987; Rodrik 2007; Khan 2013a, 2013c). Our discussions with representatives of these sectors confirmed the importance of these analytical arguments and identified significant weaknesses in state capacity in identifying the appropriate policies and even more so, in being able to properly implement the policies that already exist. This sector consists of hundreds of small businesses that are a repository of significant crafts-based engineering skills and know-how that could be developed into a proper competitive machine parts industry in Bangladesh with concerted policy attention. Successive governments have paid lip service to this possibility but existing policies of support are very poorly implemented.

On the basis of our assessment of the credibility of the respondents, the results of cross-checking and triangulation, and consistency with external analysis we have a *high level of confidence* in this part of the analysis. While the two sectors are quite different in terms of the technologies involved and the size of firms, the regulatory issues that affect them are remarkably similar. In the interests of brevity we will therefore discuss the drivers and policy issues for the two sectors jointly after summarising the characteristics of the two sectors. The areas of possible anti-corruption and regulatory reform that we discuss have a potentially *high impact* for the sectors concerned and have *moderate feasibility* of implementation.

The development of these sectors is affected by corruption problems that have an impact on the enforcement of supportive policies for these sectors. These variants of state-constraining corruption require (as always) a combination of anti-corruption activities but also parallel improvements in bureaucratic competence and state capacity in targeted areas. But the advantage in this case is that the private sector already has a conflict of interest, with emerging sector firms having a strong interest in the enforcement of policies that support them while others, typically importers, have an interest in distorting these policies to protect their import businesses. This is why supporting the collective action of firms in emerging sectors is likely to be an important part of a feasible anti-corruption strategy.

5.2.1 The Electronics Industry

The electronics industry is by far the more developed of these two sectors. More than 80 percent of the domestic market for fridges and around half the domestic market for air conditioners is now met by

domestic producers. Key components of these appliances, like compressors, are still imported, but the scale of production is gradually being increased for domestic compressor production to soon become feasible. Four companies dominate the domestic market but if competitiveness increases and significant exports become possible, many more could enter.

The emergence of the electronics industry was driven by the pioneering domestic producer in the sector, Walton Hi-Tech Industries. It enjoyed limited policy support when it began, but its owners decided to invest their own money in the risky task of acquiring organisational capabilities by beginning production and seeing how they could improve productivity. Walton's entry into domestic refrigerator production in 2006 forced a number of other domestic importers and assemblers to begin domestic production to compete with Walton's price advantage. This was initially based not only on the lower wages in Bangladesh relative to competitors, and savings in transportation costs, but also on a tariff-based policy of protecting domestic production based on lower tariffs on raw materials and parts relative to the finished product. This policy support was important for reducing the cost of financing the initial stages of learning-by-doing in the electronics industry when productivity was low and some protection from imports was required (Khan 2013b).

From the outset, the problem for the emerging electronics industry was to enforce these tariff rules and to prevent importers of finished products by-passing customs duties by engaging in different types of corrupt transactions with officials. The corruption here could take a number of forms. Given that imported fridges and other consumer electronics goods cannot be easily smuggled across the border, in most cases they have to go through customs posts, the only way to evade the full customs duties was to involve customs officials in corruption. The corruption here could take a number of forms: i) undervaluing imported goods with the collusion of customs officials so that the tariff is paid on a lower import value, and ii) declaring the goods to be in a lower tariff category, for instance declaring finished goods as semi-finished goods. In both cases, the collusion of customs officials is required.

In this, as in other cases discussed earlier, customs officials with the power to delay the release of goods can also insist that goods that are actually in a lower tariff category belong to a higher tariff category, and to avoid these delays many potentially compliant importers end up paying customs officials even if they are not violating the tariff codes. This type of two-way problem means that it is not always clear that an importer paying a customs official is in the wrong, and this makes it difficult to build collective action within the business community.

This was a serious problem for the emerging electronics industry in the mid-2000s but an important role was played by the industry associations. The Bangladesh Refrigerator Manufacturers Association, the Bangladesh Electronics Merchandisers Association and the Bangladesh Television Manufacturers Association, together with individual companies spent a lot of time surveying the market for cheap imported products, then following up their findings with investigations to determine whether the price demonstrated customs violations. According to industry insiders their persistent pressure on customs backed by media coverage of violations had an effect in the late 2000s in keeping some of this corruption in check.

However, the situation has not improved much in a governance sense as customs violations by importers of finished goods continues to damage the progress of the emerging electronics and other industries. According to our senior NBR respondent, improvements in automation in customs and the adoption of UNCTAD's Automated System for Customs Data (Asycuda) have made it much more difficult to declare the wrong codes. But he conceded that under-invoicing by importers with the collusion of customs officials is a widespread problem.

Our electronics industry respondent reported evidence they had collected showing imported fridges were being declared at customs at prices of USD 40 when manufacturers such as themselves were importing

compressors for their manufactured refrigerators for USD 30. Finished televisions were superficially dismantled and imported as complete knock-down kits (CKDs) which enjoy much lower tariffs. The industry also faced unfair competition because neighbouring India protected its market with many non-tariff barriers, such as interminable checking of standards of Bangladeshi fridges by the Indian standards testing laboratories.

The electronics industry has thus had some success in the past in putting pressure on the government to improve the enforcement of policies supporting the development of particular industries. However, enforcement is still very weak. The limited success achieved by the electronics industry was only possible because it used its associations, supplemented by the activism of individual firms. This example shows that mobilising domestic firms that directly benefit from the better enforcement of rules, as in the case of emerging firms potentially benefiting from the enforcement of customs and other regulations, presents a promising way of making progress towards the better enforcement of formal rules. We will discuss this further in our discussion of policy prospects.

5.2.2 Machine Parts Microenterprises

The micro and small enterprises making machine parts and small engineering products have a cluster around Dholaikhal and Jinjira in southern Dhaka but these enterprises exist all over Bangladesh. Journalistic estimates suggest there are between 4000 to 5000 micro enterprises in the Dholaikhal cluster with around 30,000 to 40,000 employees. An academic study estimated that in Bangladesh as a whole in 2006 there were 30,000 light engineering micro-enterprises employing around 90,000 people (Rabbani 2005: Table S1). Rabbani's detailed paper is interesting because it provides an insight into the diversity of craft skills in this sector, which includes the production of a wide range of machinery spare parts and light machinery. As a sector dominated by micro-enterprises with the potential to generate significant employment, not to speak of craft and manufacturing skills that can support economic development over time, this is clearly a very promising sector and one that development partners could support more actively.

Since the 1980s successive governments have introduced policies to promote this sector. A Gazette Notification of 9th October 1989 required public sector corporations and semi-government bodies to procure their required spare parts and engineering products from this sector if the quality was acceptable even if imported products were up to 15 percent cheaper. The Bangladesh Small and Cottage Industries Corporation (BSCIC) was to assist in this subcontracting by maintaining a list of local parts producers for public sector procurements by textile, jute, railway, gas and other public sector firms requiring spare parts. Tax and tariff protection was also given to these micro producers to assist them in developing their capacities. However, over time these policies atrophied and our respondent outlined some of the problems of governance and corruption that have affected the implementation of policies supporting this sector.

A critical problem for this sector is that the firms have insignificant political and financial power. These are 'firms' that employ between two to 25 people with an average capital base of a few hundred thousand takas (a few thousand US dollars). Compared to them, firms in the emerging consumer electronics sector discussed earlier are giants with significant influence. Collective action is also difficult given the very large numbers of tiny firms here, but there are associations, including the Subcontracting Industrialist Association of Bangladesh, and the Light Engineering Association, which also represents parts of the sector. Nevertheless, this sector has less capability to put pressure on the NBR and other agencies to enforce existing policies and to limit the damaging effects of the types of state-constraining corruption that affect them directly.

Rabbani's paper identifies the NBR and the processes of determining and enforcing tax codes as the most important problems affecting the growth of this sector (Rabbani 2005: 6, 25). When it comes to determining tax policy, the interests of politically weak but economically promising sectors like light

engineering micro-firms are usually neglected. However, when occasionally there is legislation of tax and tariff codes that could assist these types of sectors, powerful importers are able to by-pass or evade these tax codes in the way we have already described in the electronics industry. Finally, Rabbani provides examples to show that when supportive policies result in domestic micro entrepreneurs developing niche markets, powerful importing lobbies identify imported products that are currently cheaper and either evade the customs duties, or lobby to have them changed. This prevents domestic microenterprises getting the time to expand their scale of production and otherwise achieve competitiveness.

Our association respondent independently provided corroborative evidence along these lines, targeting not just the NBR but other agencies as well which could not resist the lobbying power and inducements to corruption provided by importers. An example was the slow attenuation of the subcontracting support that has been steadily declining in significance over time. One reason for this was the inability of BSCIC to resist the inducements provided by powerful importers to declare spare parts imported from India as the products of fake front companies in Bangladesh. This is another example of state-constraining corruption that was ultimately the result of weak state capacities in policy formulation and enforcement.

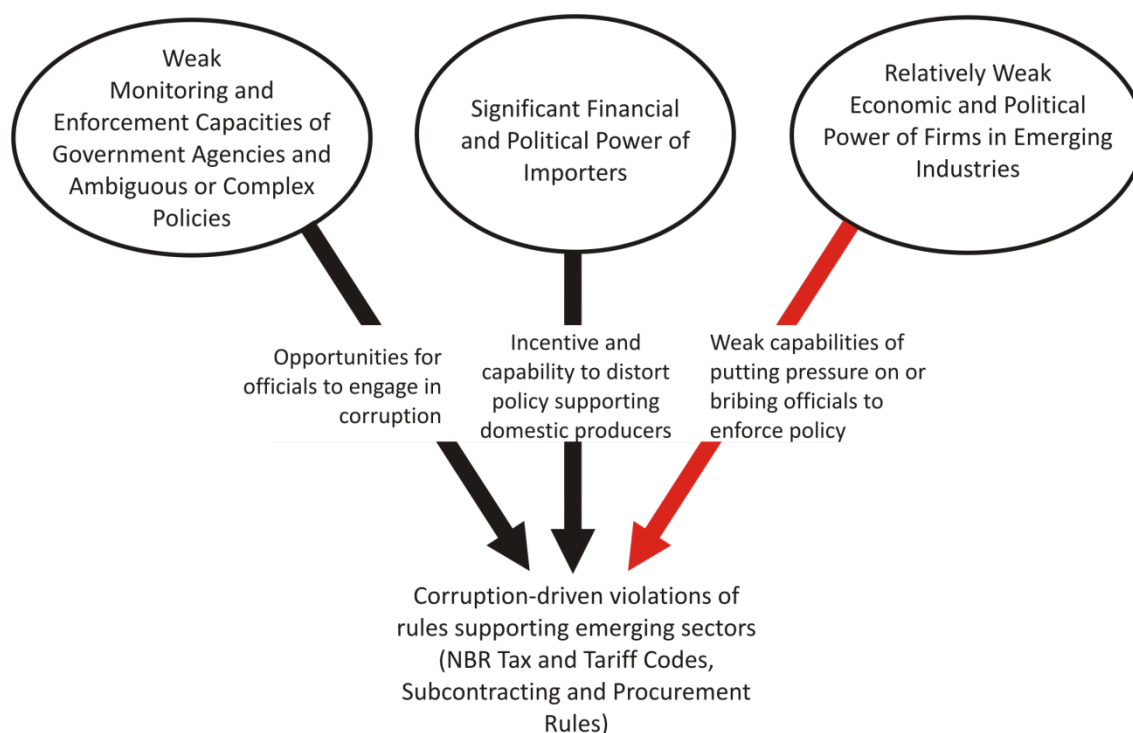
The state-constraining corruption that damages the prospects of emerging sectors is in some ways easier to tackle than the types of corruption affecting the garments sector, and in some ways more difficult to tackle. Corruption is easier to tackle here because the private sector is divided, with one group of firms benefiting from rule violation and another group trying to stop it. This conflict can create significant opportunities for developing and supporting anti-corruption strategies because external support can be provided to the group demanding rule enforcement. In the examples of corruption in the garments industry, corruption trapped compliant firms with non-compliant ones and made them indistinguishable. In those contexts fighting corruption requires strategies to induce potentially compliant firms to separate themselves from the non-compliant ones. This is not required here as compliant firms are already in conflict with non-compliant ones. On the other hand, the problem is more difficult here because emerging sectors, by definition, have low political power and bargaining capacity, and face significant collective action problems compared to the businesses that want to violate rules. On balance therefore the feasibility of reform is still only moderate, with high impact gains for the sector if the reforms can be implemented.

5.2.3 Drivers of Corruption Impacting Emerging Sectors

Corruption can damage emerging sectors in all the ways in which it damages existing sectors, but here it has a particularly serious damaging effect on the policies that are necessary for the emergence of new sectors. In this sense, corruption has an even higher impact on emerging sectors, because they may be prevented from emerging at all. The electronics and the machine parts microenterprise sectors are interesting because these sectors do exist in embryonic form but are still struggling to establish themselves, and they can therefore tell us something about the types of damage corruption can do to emerging sectors. The critical drivers of this damage are shown in Figure 5.

There are two positive drivers of corruption here, shown by the first two arrows. The first is the general problem of weak competences and capacities in the agencies tasked with enforcing the policies supporting emerging sectors. These policies could be tax and tariff policies, procurements policies or other types of policies, though the first two have been the most important in Bangladesh. The weaknesses in capacity combined with the often ambiguous, vaguely worded or excessively complex policies that they are tasked to enforce creates significant opportunities and incentives for corruption. Agencies often have little capacity to enforce the same rules on everybody but they can delay or block benefits to particular individuals, or exercise discretion in classifying imports in particular ways that benefit particular individuals, and this obviously creates incentives for corruption.

Figure 5: Drivers of Corruption-Driven Policy Damage in Emerging Sectors



Source: Author

The complexity of tax codes and the vagueness of gazette notifications such as the one that supports procurements from domestic subcontractors “if the quality is acceptable” can further help to enable adverse interpretations of policy that officials and those who can pay them can benefit from.

The second and critical driver here is the economic and political power of the interests ranged against the implementation of policies supporting emerging sectors. Importers have substantial economic and political power in developing countries because of the volume of business they do. In a pre-industrial economy most manufactured products are imported and the traders who organize this are immensely powerful. Their interest is obviously to maintain their trade by enhancing imports, and they naturally see the protection given to domestic producers as inimical to their interests because it destroys the market for some of their trade.

The third ‘driver’ is particularly interesting from a policy perspective because we can do something about it if we want to devise feasible anti-corruption strategies. This is the weakness in the monitoring and bargaining capacities of firms in emerging sectors. By definition, these firms have far less economic and political power than the traders who currently supply the domestic market through imports. In both our emerging sectors, firms and trade associations have worked hard to get state agencies to enforce the rules on which their continued operation depended. Associations have been somewhat more successful in consumer electronics, reflecting the greater size and influence of those firms, but the outcome remains unsatisfactory in both sectors.

5.2.4 Feasible Anti-Corruption Strategies in Emerging Sectors

In general, the elements of an anti-corruption strategy include: i) creating opportunities and incentives for private sector firms that want to comply with formal rules to be able to do so and to enable them to put pressure on public agencies to enforce the rules, ii) improving the competences and capacities of bureaucrats in public bodies like the NBR and BSCIC, particularly the parts of these bodies that interface

with the private sector, and iii) introducing standard anti-corruption measures like the monitoring and disciplining of public officials.

The characteristics of the drivers of corruption in this case, summarised in Figure 5, makes the first objective easier to achieve, because the relatively more compliant firms are already ranged against the firms that are engaged in corruption and rule violation. The challenge here is rather to strengthen the *collective action* of these firms, given that they are not likely to be well-organised or well-resourced, particularly in the case of relatively poor microenterprises.

In the case of microenterprise sectors, like those in the machine parts industry, it may be feasible for development partners like DFID to explore the possibility of supporting the collective action by firms or their associations to identify rule violations and organise pressure on the state to enforce existing regulations on procurements or tax codes supporting their growth and learning-by-doing processes.

Apart from a general mobilisation of private sector interests to engage in monitoring and in lobbying government for better enforcement of the rules, there are other ways in which firms in emerging sectors can be mobilised to support anti-corruption strategies. For instance, our respondent from the subcontracting association provided insightful suggestions about how private sector participation may mitigate some of the damaging effects of corruption in his sector.

An interesting strategy would be to lobby for a change in the rules so that the list of domestic firms that are available for subcontracting under government procurement rules would not be determined by BSCIC alone but jointly by BSCIC and the association(s) representing the sector. This would enable the association to vouch for the domestic production capacities of the firms getting subcontracting contracts from public sector bodies. Such an arrangement may not fully prevent importing companies getting procurement contracts through corruption but would substantially reduce the risk by making the process of identifying companies much more transparent.

A second plank of a feasible anti-corruption strategy in this sector would be to develop competence and capacity in critical government agencies. Our electronics industry respondent pointed out that when lobbying for better enforcement of customs rules, the industry association or his firm would occasionally find a good customs inspector who would follow up on complaints and then the results could be quite good. But he also pointed out that the more competent and effective inspectors were also much more likely to be close to political leaders and so their ability to influence these inspectors often also depended on the political pressures being mobilised by the importers.

This brings us back to the question of power and the weakness of firms in emerging sectors compared to their non-compliant competitors. This simply underlines once again the importance of supporting collective action by business associations in emerging sectors, particularly where microenterprises are involved. Given the strong interest of these firms to push for anti-corruption activities, supporting their collective action could help to develop a feasible anti-corruption strategy with potentially high impact.

5.3 Cross-Cutting Corruption in Land Transactions

In our discussions across business sectors a common cross-cutting issue that emerged was the problem with land market transactions and corruption in the land administration system. This resulted in very high transaction costs in land markets, due to inconsistent land records, possessions inconsistent with ownership documents, and high costs of enforcing property rights. In the past when land was not very valuable, it was not a tradable asset and only possession mattered. But as land exponentially increased in value as a result of population growth, industrialisation and the growth of a commercial economy, land transactions became important and the problems with the land administration system have come to the fore.

The contested system of land rights has resulted in very high levels of corruption at every level of the land administration with serious consequences for business prospects. Many of the larger garments factories actually comprise three or four plants that are not contiguous, because owners could not find a contiguous piece of land. This raises the costs of doing business and prevents the exploitation of scale economies. The Rana Plaza was dangerously constructed on a disputed land fill and yet had no difficulty in attracting garments factory tenants because of the extreme shortage of land. Even very large businesses like power companies have to spend months acquiring small pieces of land and often have to pay for the same land several times over to make sure all potential claimants have been taken care of and legal cases will not follow. This not only raises the investment required, but the transaction costs and delays can be even more onerous.

An investigation of the problem of land rights shows that at its heart lies a series of inconsistencies between different cadastral surveys, registration records and land tax records. The traditional way of resolving these conflicts has been a process of attrition where contesting parties spend long years in courts and political battles and the last person standing ultimately establishes uncontested (or less contested) rights over the land. In many cases where the problem is due to a substantive conflict between competing claims over the same plot of land, which are each partially valid with reference to different documents, this is a second best solution in the absence of a better and more legitimate process of resolving these conflicts.

The Bangladesh government is currently engaged in a process of digitising land records as a strategy that it believes will begin to resolve these problems. In his 2014 Budget Speech the Finance Minister announced the intention to introduce Authoritative Land Records (ALRs) across the country. The present government also began the process of digitising land settlement records in its last term and this process is continuing. The intention is to computerise existing records and update records based on digital surveys.

While there is nothing wrong with digitisation per se, our analysis of the sources of the problem suggests that digitisation by itself will not solve the problem if it simply digitises all the conflicting documents. The real danger is that digitisation may be used as a back-door way of resolving substantive conflicts of conflicting rights by recognising one or other of these substantively conflicting documents. In our opinion this would be an inappropriate and potentially highly damaging use of digitisation. For instance if the process prioritises one set of documents over others, or if digital surveys prioritise current occupants of land even if there are ongoing disputes and inconsistent records elsewhere in the system, this will not actually help to resolve conflicts, but may instead inflict great injustice on many people. More importantly, if it becomes more difficult and costly to redress these 'mistakes' in the future, the result is likely to be even more costly, corrupt and violent disputes in the future.

We do not have a feasible strategy to suggest here but it is important to point out that strategies that appear to make sense may in fact be creating much more serious problems and creating opportunities for extensive behind-the-scenes manipulation and corruption. These manipulations are very likely given our knowledge of the political economy of the country and policy-makers should assume that the probability of such manipulations at the implementation stage is very high.

Our policy recommendation is that to mitigate the possibility of future conflicts and the possibility of corruption becoming a more serious problem, the process of digitisation has to happen in a fully transparent manner, with all records and surveys being recorded, with the reasons for deciding to enter a particular record or survey as the 'authoritative' one also being recorded so that mistakes can be redressed later.

On the basis of the credibility and diversity of our respondents, and the large academic literature, we have a *high level of confidence* in our analysis. The analysis suggests that corruption related to land transactions

has a very *high impact*. However, the policy of digitisation has a *low feasibility* of addressing the core problems and has the significant danger of creating even more serious problems in the future. Our recommendation is that if the government wants to proceed in this direction, development partners should try to ensure high levels of transparency with safety measures that allow mistakes to be redressed at low cost later.

5.3.1 Sources of Conflict in Land Records affecting Land Transactions

The land record system in Bangladesh is complex and taxes the intelligence of many of the country's best lawyers. The high transaction costs reflect the fact that land rights inherited from the past were not designed to facilitate purchases and sales of land. All that mattered in a pre-capitalist agrarian economy was to protect the occupancy rights of peasants and the right of the state to collect taxes. The latter imperative led to the creation of multiple intermediaries between the peasant farmer (who had no formal property rights but had occupancy rights) and the state. Over time many of these intermediate rights became converted to property rights but ownership often did not correspond to possession, and to make matters worse, in many cases multiple documents were generated recording rights over the same plot of land.

The process of reconciling registered records of ownership of landholdings with the land records and maps that served the colonial revenue system threw up millions of disputes that continue to this day. According to one estimate, of the roughly 1.8 million cases pending in the courts in December 2000, 1.4 million were land related cases, and the average time in court for a land-related case was 7.6 years (Barkat and Roy 2004: Tables 9 and 16). These disputes take so long to resolve not because the records cannot be found, but rather because they can be found and there are conflicts between different records and between the records and possession. In other words, the problem is only partly one of shortcomings in record keeping, and is mainly to do with fundamental *inconsistencies* in the records.

A successful land transfer involves not only a legally registered transfer between the legal holder of the title and the buyer, but also a record or 'mutation' in the maps of the surveyed lands. As the plots in the two systems of record do not necessarily overlap and as border disputes between neighbours or partition disputes between heirs can be significant, the resolution of claims can be a lengthy process of attrition, typically involving long court cases and considerable corruption. The system of land rights where different records do not have a clear legal primacy is a legacy of the colonial tradition of land management established by the British whose aim in the later phases of colonial rule was primarily to avoid conflict by preserving the status quo. Attempts at resolving conflicting allocations of rights were avoided as far as possible.

The following sources of potential conflicts generated by inconsistent records or manipulations of different records were identified in the literature and by our respondents.

i) Multiple Cadastral Surveys. A series of cadastral surveys were conducted by the Ministry of Land and its predecessors. The first Cadastral Survey (CS) was conducted over 1890-1940, the State Acquisition (SA) survey over 1956-62, the Revisional Settlement (RS) over 1969-83 and a Bangladesh Survey (BS) is ongoing. All these surveys are accepted as admissible records by courts. Registered documents of ownership can define a plot according to any of these surveys. As owners of land typically own a fraction of a plot identified in a survey, overlaying maps of different surveys to resolve conflicts of ownership and boundaries often results in anomalies. The resolution of these anomalies requires a lengthy process of comparing the history of transactions behind all documents covering the same plot in different surveys to determine the relative strength of the claims.

ii) Breaks in the continuity of ownership of many plots. When Hindu zamindars and rajas left for India in 1947, their land was often hurriedly sold or leased to tenants, or left in the safekeeping of trusted tenants.

As it gradually became clear that the zamindars would not return, the tenants who were in possession of the land 'generated' documents showing that the land had been gifted or sold to them and these gradually became recorded as registered documents. Often the fake documents exceeded the amount of actual land. With the passage of time it has become almost impossible to establish which sale, gift or transfer documents were initially valid, though lengthy consistency checks can often reveal the relative veracity of claims. Some of the disputes over conflicting claims can be traced back to the confusion created by breaks in the continuity of land rights after the partitions of 1947 and 1971.

iii) Poor demarcation of the position of state-owned land. The state owns large tracts of land as *khas* land and forest land. The ownership of this land is not based on registered documents but rather on gazette notifications. The boundaries of these lands are often not clear; the gazette notifications are incomplete and subject to modification and much of the land can be in small plots in the middle of privately owned land. The demarcation of these lands is subject to large scale corruption and political manipulation as powerful individuals can capture public land with the collusion of public officials and include them in the private plots that they own. Fake documents of purchase can also be generated to cover these encroachments, sometimes quite easily as there is often an excess supply of ownership documents in circulation. These encroachments also create opportunities for officials to extract money from genuine owners who are unable to determine the demarcation of their properties in this confusion. Forest and other officials who have allowed powerful people to encroach on public lands can make additional money by later claiming that the missing forest or *khas* land is located within the private plots of innocent parties.

Apart from that, state-owned plots can exist in the middle of privately owned plots with no access roads. Exchanges of government land for private land are generally not allowed, so contiguity cannot be established and demands for access by forest and other land administration officials can result in permanent streams of bribes being organized. In short, the current possession boundaries often have nothing to do with genuine registered documents of ownership. This is why surveys based on possession and dubious documents can become increasingly inconsistent with previous surveys unless the full documentation behind every plot is re-examined and compared to the actual area occupied. This would be prohibitively expensive and does not happen when surveys are conducted, though comments on inconsistencies are sometimes noted in the records by cadastral surveyors.

iv) Poorly recorded state land acquisitions and internal manipulations of records. The state can also acquire private land using compulsory acquisition orders recorded in gazette notifications. Once a gazette notification is issued, the land effectively becomes public property even if the state does not develop the land or take possession by compensating the owner. The latter may not even be aware of the notification as these notifications are sent by post to the last known address of the owner. Large tracts of land gazetted in the 1950s or 1960s have still not been acquired and much of this land has been knowingly or unknowingly sold on. A lot of extremely valuable land in the capital is potentially of this type, creating huge opportunities for public officials in the know to extract bribes from the owners.

As large tracts of very valuable land can be acquired by gazette notification, high level corruption is often involved in changing gazette notifications. Two of our respondents independently explained how gazette notifications can be forged by powerful individuals. As owners can be persuaded to sell gazetted land cheaply, the ability to take land into and out of the gazette can be very profitable. The process involves getting retired government secretaries who were in post in a particular year in the past to sign forged paperwork pre-dated to that year. The paperwork is then put in the appropriate places in the bureaucratic records and new gazette documents are printed to replace the original ones. The relevant documents are then swapped in the locations where they are most likely to be checked. This is an expensive process but the stakes are very high when large tracts of valuable land are involved. The individuals involved in these processes undoubtedly have to have the highest political connections.

v) Conflicts between registered ownership documents and mutation records. The record of land ownership in the registered documents maintained by the Ministry of Law may not match the record of mutation kept by the Ministry of Land (Uniconsult Ltd. 2009). This can happen because after completing the registered sale or transfer of land, many people avoid carrying out the mutation to avoid paying a transfer tax. Moreover, there is significant corruption in both the registration process and in the mutation process (CARE Rural Livelihoods Programme 2003). For instance, individuals without proper registered documents or with flawed documents can, for a price, mutate land in their favour by paying the appropriate bribes. This conflict in records can prevent the genuine owners from selling the land till an arrangement has been reached with the owner of the mutation record, even though registered ownership documents take legal priority over mutation records.

vi) Complex rules of inheritance. Inheritance rules mean that even if all of the documents of a seller are untouched by any of the above problems, an inheritor under Islamic law can turn up and claim his or her share of the property by claiming he or she has not received the share due to them by law.

5.3.2 Drivers of Corruption in Land Transactions

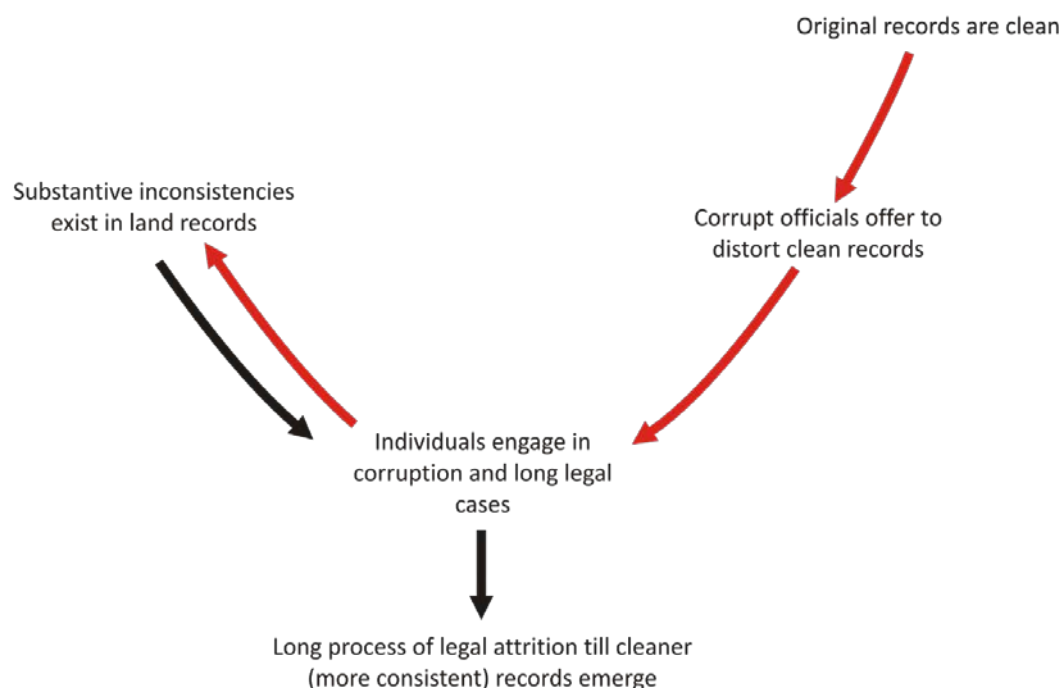
Corruption in land administration is another type of interlocked state-constraining corruption that does not have simple solutions. However, a badly thought out policy response could make the problem much worse. We know that the types of conflicts and inconsistencies in records described above have led to a massive corruption problem in the land administration system, with corruption involved in the process of registration, mutation, and in the courts, involving lawyers and judges at every level of the legal system (CARE Rural Livelihoods Programme 2003). Almost 60% of households that had dealings with the land administration system in 2012 reported that they had to engage in corruption (Transparency International Bangladesh 2012: 20). As with other types of state-constraining corruption, this is partly due to the opportunism of public officials and partly due to the fundamental problems that the state cannot resolve.

The prevalence of corruption in the land administration system means that even individuals with clean and undisputed documents are compelled to engage in corruption because other individuals can easily pay officials to distort their rights and attempt to capture their assets. When this happens, we get a locked in type of corruption where it is no longer possible to distinguish between compliant and non-compliant individuals, because everyone engages in corruption. The problem is summarised in Figure 6.

In our assessment, the more important driver of corruption is shown by the causal chain beginning at the top left hand side of Figure 6. The historical evolution of land rights has left a system of land rights that has substantial internal inconsistencies in different records and surveys. This drives many individuals who believe they have legitimate claims on the land to engage in long processes of litigation against other individuals who may also feel they have legitimate claims. In reality not all legitimate claims are equally substantive, and a process of legal testing, evidence, and the holding power to hang on in long and costly legal disputes, together with frequent recourse to corruption on all sides, eventually leads to an outcome of sorts.

The outcome is the victory of one set of records over another, and gradually a cleaner and more consistent set of records emerges. The current system of resolving these conflicts in court is far from being a rule-following system. In fact, it cannot be assumed that the conflicts will be resolved by applying the rules if the underlying documents are inconsistent. The existing corrupt legal process certainly does not ensure that the more legitimate claim or the more deserving claim always wins. But the system at least has the merit that it gives all those who believe they have a claim, and have the resources to fight it, the chance to test their claim in a (corrupt) court and keep fighting till a resolution emerges. This system provides a solution, and the question is whether there is a better solution to this conflict resolution problem.

Figure 6: Interlocking Corruption in the Land Administration System



Source: Author

Is there a better solution? In principle there is, but the fundamental problem with this driver is that a solution requires an answer to the problem of conflicting rights. The solution would require the state to find legitimate solutions to this problem, including effective and legitimate dispute resolution capabilities to address multiple claims on the same plot of land, each of which had some validity. The state in Bangladesh does not have this kind of political or administrative capacity so this is not a feasible solution in the near future.

The second driver is shown by the causal chain beginning at the top right hand corner of the diagram. In principle, as soon as the land administration system stops being a purely rule-following one, even those who have perfectly valid and legally uncontested claims may have to engage in corruption to protect their rights. Officials can distort or manipulate records; judges can give judgments inconsistent with the documents, and so on, so that even those with clean records may have to engage in corruption to protect themselves. The result is that here too, both potentially compliant and non-compliant individuals are violating rules, and some rule violators are simply unfortunate because they possess land with multiple recorded claims on it.

5.3.3 Feasibility of Digitisation as an Anti-Corruption Strategy

If the main problem in the Bangladeshi land administration system was the propensity of land administration officials to distort land records that were actually consistent (the right-hand set of arrows in Figure 6), then the digitisation solution would have been a feasible anti-corruption strategy. The propensity of land administration officials to complicate clean records is clearly a serious problem in Bangladesh, but unfortunately, it is not the only problem.

An important underlying problem is that the land records are themselves inconsistent in many cases. The most optimistic estimate from our informed respondents is that at least 25-30 per cent of the land in the country suffers from inconsistent records. The true figure could be higher. To move towards a rules-based land administration system, we have to have a system for resolving these conflicts.

If we are right about the significant presence of conflicts in the records, and all the evidence supports this interpretation, a process of computerisation that will effectively prioritise one set of records over another, or one cadastral survey over another will not achieve justice. More importantly, it may result in social instability and a spike in corruption because it would create new opportunities to distort records further. The experience of widespread corruption in land administration suggests that digitisation is open to the possibility of significant manipulation by insiders who know exactly what is at stake and the areas where manipulation can achieve significant rewards.

One of our respondents pointed out that when National Voter ID cards were being issued by the army during the caretaker government period of 2007-08, the errors in data entry were apparently internally estimated by the army to have resulted in an 82% accuracy rate. This was in a context where the army had no incentive to misspell names and addresses or otherwise let errors creep in. When hard-to-read, old and incomplete records are being entered into databases, natural clerical errors can be expected to be compounded by deliberate errors. Anyone with some knowledge of how the land administration operates in Bangladesh will agree that this is a very likely possibility. Once entered, these can lead to significant conflicts and reconciliation problems later on.

Our analysis of the drivers of state-constraining corruption in land administration suggests that to resolve this problem the state would have to have the capacity to resolve the underlying conflicts in a socially acceptable way. But this capacity does not exist. If the state tries to solve the problem in a 'technical' way, it is effectively imposing a conflict resolution system by the back door, but without the capacity or the legitimacy to enforce the outcome. Given that the losers will not have been given the opportunity to access all avenues of redress, the outcome is likely to be one of potentially high contestation which the state does not have the capacity to manage.

Our recommendation to DFID is therefore that the discussion around the digitisation process has to be much more transparent than it has been. Our discussions with stakeholders suggest that many people are unaware of the consequences of what is being proposed, or how the process will work in practice. We were unable to glean many details of the proposed process and it is possible that the government has not yet decided on the details of the procedures. If that is so, we would be reassured. There is possibly an important role here for development partners like DFID to ensure that the process is as transparent as possible, that there is no attempt at 'resolving' conflicting records and claims by the back door, that all affected parties are given a lot of warning when the digitisation is going on, that the process ensures that everyone has been able to check the records affecting them, that the data entry is done by independent third parties with opportunities for correcting data entry errors, and that if there are conflicting records, the digitisation process records the conflicting claims and the reasons why one or other claim has been prioritised as more authoritative. These steps may ensure that digitisation does not create more problems than it solves.

6. Conclusions

This report follows a strategy of identifying sectoral corruption flashpoints and identifies feasible policy responses to address particular types of corruption problems. We do not claim that these areas are absolutely the most important areas of corruption in terms of impact. Indeed, we know that there are higher-impact types of corruption but we ruled some of these out in terms of the feasibility of reform. However, we have a high level of confidence in the impact levels we identified for the sectoral corruption flashpoints and the feasibility problems that were discussed.

Apart from the specific sectoral analyses and policy recommendations in Section 5, we believe the methodology developed in this report has a wider application. We developed a methodology for identifying impact, feasibility and confidence levels based on the best use of all available data. This data

included macro-level political economy and economic data on the country, secondary political economy analyses, available studies and surveys on corruption, together with well-designed small-n interviews with well-placed individuals. The latter provided process insights critical for developing a detailed understanding of the multiple drivers responsible for high-impact corruption in different sectors. This analysis showed that corruption is particularly persistent when it has multiple drivers. In particular, both potentially compliant and non-compliant firms can appear to engage in corrupt processes that look very similar.

Successful anti-corruption strategies have to separate the potentially compliant from the non-compliant firms by addressing the deeper state capacity problems that drive potentially compliant firms to corruption. This is a necessary complement to traditional anti-corruption measures that seek to discipline and limit corruption by public officials and non-compliant firms. Focusing on the latter without making progress on the former is not likely to lead to an effective attack on corruption. Finally, it is also important to point out that some anti-corruption policies that ignore the problems of state capacity driving state-constraining corruption can actually make matters worse. Our assessment of the Bangladesh government's digitisation strategy for addressing corruption in the land administration system is an example. Here too, our analysis offers important policy suggestions for development partners.

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