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Political Economic Strategy during Crisis**

Khan, Haider

University of Denver

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Bangladesh: Towards a Non-partisan Search for a Pro-people
National Political Economic Strategy during Crisis

Haider A. Khan

Professor of Economics(Former Senior Economic Adviser, UNCTAD, Geneva, Chief
International Adviser, Arab Trade and Human Development, UNDP, Distinguished
Visiting Scholar, ADBI, Tokyo)

Josef Korbel School of Int'l Studies

2201 S. Gaylord St.

University of Denver

Denver, CO 80208

phone 303-301-4426(cell)

720-748-2555(Land)

fax 303-871-2456

hkhan@du.edu

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Abstract:

Bangladesh is potentially capable of rapid, self-reliant and equitable development under a committed development-oriented leadership. The crucial tactical question right now, is how the currently successful policies can be continued and even better policies devised for the future.

Thinking strategically for the medium to long term, the combination of strategic openness and self-reliance requires firm, skillful and committed leadership at all levels. Our current situation is perilous precisely because the tentative moves towards a self-reliant and pro-people political and economic system under the dedicated leadership of patriotic elements have not been a consistent feature since liberation. In addition to confronting the current political challenges tactically, our medium to long run strategic perspective must involve a genuine private-public partnership with proper incentives for patriotic elements in the private sector and for efficient and equitable delivery of services by the public sector. At the same time our economic advisers must think seriously about gradual reduction of reliance on the undesirable and burdensome elements of the so-called foreign aid, much of which has created political and economic dependence and a domestic parasitic clientalism for big capital from advanced countries. While we must be open towards genuine development projects funded by donors who will build our domestic capabilities (for example, building the Padma Shetu and other infrastructural projects), we must reject the Trojan horse of aid that forces the adoption of neoliberal policies and weakens our sovereignty.

While acknowledging and encouraging the work of genuinely good NGOs for human development in Bangladesh, we must also reject the manipulative use of big NGOs to sabotage the authority of a people's government in Bangladesh led by patriotic popular pro-liberation forces. On the positive side, we must emphasize the building of governance institutions according to the ideals that reflect the will of the people who fought for our liberation--- particularly, secularism, democracy, sovereignty and social justice. Nine specific strategic areas ranging from strategic openness to innovation and building up of human resources through progressive educational and other policies are discussed in this pro- people position paper.

Keywords: Development Strategy, Bangladesh, Foreign Aid, NGOs, Private-Public Partnership, Strategic Openness, Heterodox Policies, Learning and Innovation

JEL Classifications: P1, O1, O53

Introduction:

With an ongoing global financial and economic crisis with tepid recovery at best at the time of this writing (August, 2013) as well as the still unfolding ecological crisis, the 21st century presents an even greater challenge for self-reliant industrialization in the developing world than the post-WWII period. The changed global economic and ecological environment will shape the emergence of new technological and industrial paradigms and trajectories in significant ways (Dosi 2000, Khan 2004a). From this perspective, Bangladesh has a challenging task ahead. However, it is also possible for Bangladesh to leverage the advantages it has and achieve at least close to a middle level developing country status in the first quarter of this century.

On the positive side, since the mid-1990s, Bangladesh's growth performance has been widely recognized to have gone through some major transformations. It is undeniable that the rate of growth has steadily increased. At the same time, to Bangladesh's credit also, agencies like the World Bank have given it high marks for poverty reduction. Other macroeconomic indicators such as rates of savings and investment have increased rapidly and export growth has been substantial. It is legitimate to ask if the country is poised to take-off into an East-Asian type of growth path, widely recognized now as the best-practice development path in the post World War II period and very different from a simplistic type of Washington Consensus story. Therefore it is necessary to first identify the main strategic features of this type of development. A prior task is to clarify the concept of development itself. Also, occasionally I will refer to the Southeast Asian economies such as Thailand, Viet Nam and Malaysia which may have relevant lessons for Bangladesh.

1. Defining Development and Stages of Development for Bangladesh and Some Strategic Features

At this point some clarification of the key term "development" is necessary in order to avoid ambiguities and confusions. In the rest of this paper, I will be referring to three concepts of development that are implicit in much of the discussion in the field of industrialization and development. The first is the idea of development as growth with some structural change or at least the idea that this type of growth is the most crucial necessary condition for development. The second concept is derived by adding explicit distributional elements to growth--- particularly inequality and poverty. Both these ideas are shared by the development economists today ---at least implicitly.

The third--- and the broadest approach to development discussed here--- is in terms of Sen's idea of capabilities and its further extensions. In this view, development is really an extension over time and space of freedom, particularly the positive freedom to lead a certain type of life an individual has reasons to value. In technical modeling of industrialization and development (including my own models---see appendixes) often this normative view is not adopted explicitly. Yet, in so far as there is a normative aspect about development being a "(public) good" that is a premise for the whole project of industrialization and development such a view is consistent with the modeling approaches as well. In a recent essay on South Korean development, prepared for WIDER, Keun Lee's perceptive comments on the possible role of democracy in development extends considerably the terrain of discussion in the direction of the "development as freedom" perspective when he writes:

We see obvious advantages in democracy, amongst which is the convenient feature that citizens are not subject to arbitrary arrest and torture. Truly strong states get it wrong

more often than they get it right. Thus the military dictatorships of Latin America left little in the way of legacy ,whereas the military dictatorships in Korea and Taiwan (while not on anything like the same scale of brutality) left a powerful legacy of development. The difference lies clearly in strategic orientation and in institutional capacity in formulating and implementing a program of national industrial development. Our point is that this is an option available to the political leadership of any developing country today. On top of this, the key to the Korean or Asian success was institutional longevity. (Lee 2008, p. 13)

It would seem, therefore, that there is an implicit agreement in at least the post-1970 thinking that development is "growth plus" other things. While the list of "other things" may vary somewhat, none of the researchers in the field today would equate growth and development. Yet, almost all would agree that generating high growth may be a useful means towards development. Many thoughtful researchers also pay some attention to what can be called "the political economy of growth and distribution"

Synthesizing the Experiences of the high growth Asian economies further reveals some common strategic orientations as well as the effects of changes in external environment and shifts in policies over time. This is consistent with the characteristics of complex economic systems which are nonlinear with multiple equilibria and path dependence. Over time, one may observe the emergence of structural shifts in some cases, stagnation in other cases depending on initial conditions, strategies, policies and external environment among other things. In the Asian cases discussed here, there are many specific variations within each. However, they also share to various degrees many specific features listed below.

1. Strategic Openness to various degrees with Hong Kong, Singapore and Thailand being the most open and Viet Nam¹ the least. But in all cases there is a strategic commitment to export promotion beyond an earlier period of strategic import substitution (SISI)² and further goals of moving up the value added ladder. It should be kept in mind however, that there can be a "fallacy of composition" (Cline 1982, Khan 1983, Mayer 2002, Razmi and Blecker 2006) in claiming that all developing countries need to do is to pursue an export-led growth policy. Reciprocal demands may not exist sufficiently and the ensuing competition for export markets in developed countries may create winners as well as losers. Therefore, what may be needed in the future for other aspiring countries is a strategic approach including the development of national and regional markets and the creation of dynamic comparative advantage along with a number of other policies and institution building processes described below.

2. Heterodox macroeconomic policies for stability³---Here China and India have been the most heterodox. But Taiwan, Malaysia, Viet Nam and Korea display more of a mix of heterodox policies than Thailand. Even Hong Kong and Singapore at times have followed heterodox policies, esp. on the fiscal side. It seems that the rigidity of Washington consensus particularly in this area is rejected by the experiences of developing economies like China, India, Korea, Malaysia and Viet Nam.

3. Creation of institutions for productive investment---this exists in all cases, but Korea seems to have gone much further than the others much earlier. Starting with the

¹ However, see Thoburn et. al. (2007) for an insightful and nuanced discussion of Viet Nam's trade-orientation and policies for the textiles sector.

² On what I have called SISI, see Amsden (2008) and the references therein, Bruton (1998) Khan (2004a,b; 1997, 1985, 1982a,b)

³ See Jomo and Nagaraj (2001) for a good discussion of heterodoxy in this context.

reforms in the 1960s, it moved through several successive stages and is now trying to find appropriate technological niche in a world that is moving towards a convergence of information, bio and nano technologies by 2050. The role of state in the creation of these institutions is still very prominent. In this respect, China perhaps has the most ambitious agenda which is discussed as a special case study later.

4. Agricultural development--- all of them put enough of an emphasis but China and Viet Nam probably put through the most egalitarian pro-peasant development policies earlier. Korea and Taiwan also had an egalitarian land reform after the end of Japanese colonialism.

Warr(2008:p.12) describes the importance of agriculture in the Thai case:

The results of the analysis indicate that agriculture's contribution to economic growth in Thailand included impressive rates of TFP growth. But its main contribution occurred through releasing resources which could be used more productively elsewhere, *while still maintaining output*, rather than through expansion of agricultural output. It is seriously wrong to characterize Thai agriculture as 'stagnant', based merely on the fact that output growth is slower in agriculture than in other sectors. If agriculture had really been 'stagnant' economic growth would have been substantially lower because it would not have been possible to raise productivity significantly within agriculture or to release resources massively while still maintaining moderate growth of output

Viet Nam's reforms in Agriculture are evaluated by Thoburn(2008) in the following words:

Rice, indeed, is the great success story of the agricultural reforms. Vietnam changed from being a net importer of rice in the 1980s to the world's third largest exporter (after the US and Thailand) in the mid-1990s, though there has been little further export growth since the late 1990s, particularly compared to other products This lack of growth is not necessarily surprising or a sign of failure. In the late 1990s, when rice export growth was peaking, less than 15% of output was being exported In an

economy where around 70% of households were both consumers and producers of rice, rises in rice output were important primarily for raising rural incomes and for food security, with the surplus available for export varying with fluctuations in domestic production.

The state has played a role in encouraging new crops such as cashew, and later coffee Coffee is not straightforwardly a success story, though, as the expansion of Vietnam's coffee exports in the mid-1990s was a factor in causing a substantial fall in the world price.

5. Industrial development and structural change-- the strategic perspective in this important area suggests that the successful countries to various degrees pursued a continuously unfolding and dynamic set of policies with much trial and error. The retrospective attempts to tell a coherent story have often led to an overly deductive picture where good performances supposedly follow from a few , usually neoclassical economic principles. The Malaysian case study by Jomo and Wee is a good and convincing counterexample. Amsden(1989, 2008), Khan(1982a,b;1983,1997,2004a,b) and Wade(1990) discuss the cases of Korea and Taiwan in the general East Asian context.

Jomo and Wee(2008:p.10) describe some changes in strategy and policy for Malaysia within specific time-sensitive contexts:

Over the years, the government has changed its industrialization strategy. In response to problems and new priorities, the government announced the Second Industrial Master Plan (IMP2) for 1996-2005 in December 1996 to replace the (first) Industrial Master Plan (IMP) for 1986-1995. In September 1996, the government had set up the Multimedia Super Corridor (MSC) to promote certain information technology investments. The government committed over RM50 billion for infrastructure development to support this initiative. At the same time, the government strengthened

intellectual property laws to reassure foreign investors and provided more generous incentives for new investments in this area.

Thus, the policy changes of the mid-1980s appeared successful in reviving growth and industrialization. Confirmation of the new policy direction from the mid-1980s came with the 1991 enunciation of Vision 2020, favouring growth, modernization and industrialization. Although FDI began levelling off in the mid-1990s, increased domestic investments – inspired by greater domestic investor confidence – sustained the momentum of rapid economic growth until the 1997-1998 regional crisis. The gravity of the crisis and the difficulties of recovery were exacerbated by injudicious policy responses, compromised by cronyism, though there is little persuasive evidence that cronyism itself precipitated the crisis.

They also point out changes in the sixties and seventies as well in response to changing global economic environment:

The decline of rubber prices in the 1960s must surely have affected economic performance and policy. Malaysia's experiment with import-substituting industrialization under foreign (principally British) auspices was quite different from most other developing countries where state-owned enterprises played leading roles as well as Northeast Asian experiences where effective protection was conditional on export promotion. Malaysia's transformation from net oil importer to exporter in the mid-1970s, when petroleum prices rose sharply, allowed the government to spend much more, while the recycling of petrodollars later allowed it to borrow from abroad at low cost until the Volcker intervention of 1980 raised real interest rates and precipitated a global recession, bringing commodity prices down. (Jomo and Wee 2008:p.14)

The case study of Viet Nam also confirms the suspicion that there is much that is improvised and *ad hoc* during the earlier phases of apparently successful development cases. The lesson here is perhaps to avoid major resource allocation distortions(as documented by the Thai case discussed by Warr also) and constant monitoring and policy revisions when existing policies do not work well.

6. Creation of technological capabilities--- here the Korean case stands out as a very apt illustration of creating technological capabilities throughout the entire growth and development trajectory in definite stages.⁴

As Lee(2008,pp.4-5) points out:

Among various aspects of capacities, emphasis should be on technological capabilities because without these, sustained growth is impossible. In this era of open market competition, private companies cannot sustain growth if they rely upon cheap products; they need to be able to move up the value-chain to higher-value added goods based on continued upgrading and improvement and technological innovation. Furthermore, private companies had better be “local” companies, whenever possible, including locally controlled JVs, not foreign controlled subsidiaries of the MNCs. MNCs subsidiaries are always moving around the world seeking cheaper wages and bigger markets. Therefore, they cannot be relied upon to generate sustained growth in specific localities or countries although they can serve as useful channels for knowledge transfer and learning.

The Malaysia case study by Jomo and Wee also recognizes this essentially strategic aspect of creating technological capabilities during medium to long run development. It is also clear from the China, Thailand and Viet Nam cases that strategic concerns with the creation of appropriate technological capabilities have been and continue to be very important.

7. Technological learning and innovation--- creating national innovation systems in particular requires the creation of specific institutions and technological learning over time. Ultimately, if development is to continue beyond the catching up phase, this may present the most crucial set of policy challenges. Here, the paper on Korea by Lee(2008)

⁴ See also Lee(2006) for a contrast of Korean experience with the Washington consensus and Khan(2008, 2002,1998 and 1997) for a discussion of the Korean (and Taiwanese)case(s) in the context of a distributionally sensitive growth model for positive feedback loop innovation system(POLIS). One possible nonlinear model of POLIS is discussed in the appendix.

is an admirable attempt to sum up the lessons. There are specific features here to which Lee(2008,p.5) draws our attention.

Therefore, while the ultimate goal and criterion of development is to raise the capabilities of local private companies, the process needs pilot agencies to guide and coordinate the whole process. Such needs exist because key resources are so scarce, and thus had better... be mobilized for uses in sectors or projects with greatest externalities. As understood by Gerschenkron, who analyzed the latecomer industrialization of Germany and Russia, and identified latecomer agencies, such as large state-owned investment banks to drive the process in these countries, it is such agencies that can make up for gaps or lacunae in the country that is seeking to industrialize. All the east Asian countries built specific state-agencies that played a role of guiding the process of industrialization. In Korea the institutions established in the 1960s under the Park regime included the Economic Planning Board to set economic plans; the Ministry of Trade and Industry to support industrial policy and export; and the Ministry of Finance to finance economic plans.

Both state and civil society have to play important roles. At an earlier stage, the state necessarily plays a large and activist role . At a later stage, however, the creation of technological capability has to rely on a private-public partnership at both the precompetitive and the competitive phases of innovation(Khan2004a).

8. Direct Foreign Investment and Foreign Aid--- these factors have played a role for all three but perhaps more so for Thailand, Viet Nam and Malaysia. Investment from abroad has perhaps been more significant than aid per se. However, internal generation of investible funds and public sector support have also played a crucial role---particularly in Korea, Taiwan and China. DFI in manufacturing sector can be important as the Viet Nam (and also the Thai and Malaysian cases) case shows:

Sectorally, manufacturing has been the most important area for DFI, with 51% of accumulated registered foreign capital over the 1988-2006 period, followed by transport, storage and communications (9.6%), mining and quarrying (8%) and real estate (8%) . (Thoburn 2008, p.8)

Not everything has to be of the best practice genre for DFI to come in as Thoburn shows for Viet Nam:

Paradoxically, Vietnam scores badly on conventional measures of competitiveness and investment climate, yet is highly regarded by foreign investors who operate in the country. The World Bank's *Doing Business* survey ranks Vietnam as 104th out of 175 countries as a good place to do business. In contrast, the *VDR* for 2007 claims that Japanese inward investors see Vietnam as the third most attractive investment location in the world. It seems that Vietnam's stable macroeconomic environment, high quality and low cost labour, and low levels of crime are more important considerations for investors than the details of bureaucratic procedures which are often included in international surveys. (Thoburn 2008 p.9)

Foreign Aid-- particularly Japanese aid--- has played a role in the development of Thailand and Malaysia but in the Asian cases the leveraging of aid for domestic development has perhaps been more important than the actual quantity of aid.⁵

9. Poverty reduction strategies-- these are a varied set of policies that are necessary in addition to growth. Although growth is a very important component of such a strategic approach to poverty reduction, in all cases specific policies targeting both rural and urban poverty were undertaken. Although in China, the period from 1995 on was a case of neglect or even reversal; but the current leadership seems to be aware of the political economic issues raised by such neglect and is committed publicly to reverse the reversal. In case of Thailand and Viet Nam, it can be argued, such attention for some time to come is still a necessary part of a coherent pro-poor development strategy. This suggests a "growth plus..."(Weiss and Khan2006) strategy for development.

⁵ This is not to say that the quantity does not matter. Also for very poor countries today, aid can fill crucial financing gaps. See Khan(2003b) on these issues. For Japanese aid to China in infrastructural and energy related projects, see Khan(forthcoming,2009).

In addition to the nine sets of factors discussed above, there are also somewhat random, historically contingent factors. The case study on Malaysia acknowledges the presence of such factors explicitly. But even a quick look at the other cases will reveal historically contingent events ranging from momentous events such as wars and revolutions to more usual changes in domestic and international political factors and changes in policies that depended on crucial personalities such as that of President Park in Korea in the 1960s. As Jomo and Wee (2008,p.14) indicate in summing up the lessons from at least five different policy periods in Malaysia:

It is difficult to evaluate policy success or failure simply in terms of subsequent economic performance. Malaysia's very open economy has often been subject to circumstances not of its own choosing or making.

The decline of rubber prices in the 1960s must surely have affected economic performance and policy. Malaysia's experiment with import-substituting industrialization under foreign (principally British) auspices was quite different from most other developing countries where state-owned enterprises played leading roles as well as Northeast Asian experiences where effective protection was conditional on export promotion. Malaysia's transformation from net oil importer to exporter in the mid-1970s, when petroleum prices rose sharply, allowed the government to spend much more, while the recycling of petrodollars later allowed it to borrow from abroad at low cost until the Volcker intervention of 1980 raised real interest rates and precipitated a global recession, bringing commodity prices down.

The Plaza Accord of September 1985 led to the strong yen just as Malaysia's sovereign foreign debt became yen-denominated. The mid-1980s' recession precipitated a banking crisis, which led to the 1989 banking reform to the seeming success of earlier deregulation facilitated financial liberalization, culminating in the 1997-98 crisis. The late 1980s' regulatory reforms encouraged further limited private foreign borrowings from abroad before that, limiting vulnerability on that front. The East Asian economic recovery from the last quarter of 1998, following the Russian and LTCM crises, similarly does not allow proper evaluation of the impact of Mahathir's controversial measures of early September as he moved to politically eliminate his deputy.

What follows from the above identification of both the relatively necessary as well as the more contingent factors that have played a role is, I think, the need for taking a pragmatic and diagnostic approach to the problems of development and industrialization in the 21st century. It is necessary to identify distortions. It is also equally necessary to identify market failures and other institutional failures. Instead of taking a grand, presumptive approach to development, the role of a mix of heterodox policies with the willingness to revise policies before the cost gets too high seems to be the best recipe for avoiding failures.

In looking at institution building in the Asian cases, it is also clear that generally, it is easier to list the functions that good institutions perform than it is to describe the shape they should take. In fact, consistent with the complexity approach outlined here, there may be a wide variety of institutions serving roughly the same function. From the Asian cases, it is apparent that the desirable institutions provide a rough and ready type of security of property rights, enforceability of contracts and lead to a gradual and strategically conceived integration with the world economy. In addition, they also help maintain macroeconomic stability without a necessarily rigid conservative fiscal stance. Over time and given sufficient financial development, the state and private sector institutions should be able to manage risk-taking by financial intermediaries. In order to promote equitable growth there will also need to be institutions that can supply social insurance and safety nets, and create a democratic space for voice and accountability. But there is no one-size-that-fits-all for any of these functions.⁶

2. Where is Bangladesh in Comparative Terms?

⁶ See Chang (2007) for a number of thoughtful contributions on this topic among other things.

2.1 Broad Political Economy Look---strengths and weaknesses from a strategic perspective

In spite of serious mismanagement in the past, the annual economic growth has generally been (in GDP) of 5% or higher during more than a decade. During my time at the Asian Development Bank, I wrote several reports on the economic prospects of Bangladesh. On the basis of these close studies, I can write with some confidence about the development prospects. Along with efforts such as a successful population planning policy, grass roots development efforts by some patriotic activists and the dedicated AL cadres and their allies recent initiatives have enabled the country to outperform other developing countries in poverty reduction. Bangladesh is making progress towards meeting at least some of the UN's Millennium Development Goals.

I will outline briefly these and some other strengths of Bangladesh before moving on to a discussion of the more serious problems that have impeded its political, economic and social development so far.

Strengths of Bangladesh

- 1. Relatively homogeneous population—with some important minorities whose rights need better protection.**
- 2. Largely secular & tolerant of others historically with some problems that are of largely post-1975 origin.**
- 3. A generally growing and diversifying economy with natural gas deposits (which must be used properly)**
- 4. Good progress in communications & gradually improving physical infrastructure**
- 5. Success of micro finance and other poverty reduction policies, relatively speaking.**
- 6. Success of population control policy**
- 7. An increasing number of semi-skilled workers inside Bangladesh & large number of skilled and semi-skilled workers abroad**
- 8. Accumulated knowledge and experience domestically, human resources in national and international NGOs, in various academic and other professional fields.**
- 9. From a historical perspective, the popular culture, consciousness and social**

practices have on the whole been and largely remain even today free from dogmatism, rigidity and intolerance. For Bangalees, these negative traits have characterized to this day only a minority. Unfortunately, such a minority with power and means of destruction can be quite oppressive. However, it is only fair to say the majority of Bangalees do not support such destructive oppression. This statement is supported by the evidence of recent overwhelming support for effective anti-corruption policies.

10. A history of struggling against superior but unjust state power both during the British Raj and the Pakistani regime. The fact that these struggles were successful in large part suggests that Bangladesh has the resources for political renewal within the polity and society. However, we must ask seriously what the preconditions for such renewal are.

3. Some Strategic Problems of Development in Bangladesh

3.1 Five Key Strategic Problems

Turning now to the problems, I will first list five problems that I consider to be of great strategic importance. I then discuss one issue regarding the existing political culture that is of strategic importance as well in moving beyond crisis-driven solutions. Finally, I raise ten questions which suggest some strategic areas of focus for our progressive civil society and political forces.

My strategic list of problems is as follows:

1. **Problem of parliamentary constitutional politics – representative democracy and its limits;**
2. **Problem of economic justice, class, gender, ethnic and religious minorities;**
3. **Problem of social stratification & differentiation including the divide among the newly rich and those who are being left behind;**
4. **Problem of creating a vigorous Civil Society;**
5. **Problem of linking with the democratic forces internationally and delinking with the antidemocratic forces.**

All these problems have remained unsolved or very partially addressed at best in the last few decades for many complex historical reasons that are subjects of intense debate.

Without engaging in this exercise (which is valuable, but not central to my purpose here), I want to draw attention to the problem of creating the right “political and civic culture” without which democracy can not function anywhere in the world. I do this not because I believe that culture is fixed as our genes are, but in the knowledge that however difficult it may be to create it, such a culture is a human creation . Furthermore, there are indigenous resources including--- as Amartya Sen and others have emphasized--- a tradition of public reason and arguments.

Probably, the best characterization of this problem at a visceral level comes from Prof. Ahrar Ahmad. As he puts it:

The “problem” of Bangladesh is not one about which party governs, but what political class most of our leaders come from, and the behavioral/attitudinal patterns they represent. We live in an environment of conspicuous consumption by the elite, a culture of arrogance, cynicism, and bullying where the ability to circumvent the laws is claimed as a hallmark of status and power, an atmosphere that has led to the criminalization of politics and the politicization of crime. Our leaders impugn the patriotism of anybody who disagrees with them, use the word “conspiracy” as a weapon in their demagogic repertoire, and hound the opposition (whoever it may be) with sneering impatience and petty vengefulness.

There is often a contradiction between the rhetorical flourishes they employ and the personal example they set. For instance, they will speak about the need to preserve the Bangla language and culture with seeming passion, but will send their children to English medium schools; they will cry themselves hoarse warning us about environmental crisis, but build high-rise buildings without any concern about their impact on urban blight; they will be eloquent about the need for moral clarity, but will have no problems winking their way through the ethical thicket of institutionalized graft and bribery; they will decry the politics of agitation, confrontation and brinkmanship, but engage in it themselves at the first opportunity; they will glorify the democratic process, but then undermine the parliament; they will loudly proclaim that religion is a private matter and there must be a wall of separation between mosque and state, but will make sure that their visit to Saudi Arabia and their participation in religious functions are widely publicized; they will forever express their solidarity with the people, but not care about the suffering their public policies or political strategies impose on them; they will be eloquent in defense of freedom of the press, but attack journalists and file cases against them if their investigations cut close to home; they will encourage political constancy and ideological commitment in others, but themselves function in a system of shabby bickering and horse trading, fluid alliances and fungible loyalties, and be chameleon-like in their ability to change color and direction depending on immediate advantage and opportunity. The political elite dismisses concerns about intellectual honesty or charges of hypocrisy as the work of, what

else, “conspirators”. They seek power, and are not bothered that they do not have more authority. There are, of course, striking and outstanding individual exceptions ...However, generally, they have collectively helped to institute a system to “crony capitalism” through the formation of a “klepto-patrimonial”, rent-seeking predatory state, which has not “failed” but has probably been “struggling” for some time. In the hands of the same leadership class, it is destined to continue in the same direction. If we leave the foxes to guard the hen house, does it matter what party comes to power, that administrative changes are instituted, and what procedures are put in place?⁷

Unless we can find credible means to change the political culture within which we function, and affect the attitudes, values and indulgences of our political elite, the viability of democracy will be doubtful. With this in mind, I now pose ten strategic questions that we need to answer to make the prospects for sustainable democracy credible.

Some Important Questions for Development and Democracy in Bangladesh

- 1. How to offer security of life, liberty, personal property of citizens and property of corporate bodies in the civil society and the state?**
- 2. How to ensure that justice is done & that the situation does not deteriorate into cycles of political retribution and revenge?**
- 3. How to establish and preserve the integrity of the electoral process?**
- 4. How to make the parliamentary process effective ?**
- 5. How to ensure optimal social investment for infrastructure, industrial and overall human development?**
- 6. How to make the bureaucracy, the armed forces and police accountable?**
- 7. How to empower people and make local government more effective in delivering services?**
- 8. How to control corruption and greed systematically by strengthening an independent judiciary and enforcement?**
- 9. How to reform the educational system so that productive and politically aware citizenship is the end result?**
- 10. How to reduce poverty through overall human and sustainable development so that the poor can participate meaningfully in the overall development process?**

⁷ Ahmad(2006), pp.32-33.

3.2 Bangladesh is not on the East Asian strategic path but it can be on such a path

From the mid-1990s if not from the mid-1980s, Bangladesh has indeed experienced quite a bit of acceleration in its growth rate; but, apart from the growth rate of 5-6 percent per year itself being significantly lower than what it historically was in East Asia, it has not so far attained the central aspect of East Asian growth: rapid structural change in the composition of both output and employment through industrialization moving through secondary and tertiary sectors. The East Asian growth has also been employment-intensive industrialization relieving agriculture of its burden of a high proportion of the workforce. Such a strategy has led to a reduction of the gap between labor productivity in agriculture and labor productivity in the rest of the economy. Even if we overlook the methodological change in national accounting that led to more than doubling of the recorded domestic savings rate and a sharp upward rise in the investment rate, the saving-investment performance of Bangladesh falls short of the record of East Asia where the opportunity for profitable investment was the driving force behind rapidly rising investment which pulled domestic savings along in a Kaleckian fashion. In case of Bangladesh, there is at least strong circumstantial evidence that weak incentive for and profitability of investment has resulted in substantial leakage of savings into capital flight. At comparable stage of development, the investment rate in the East Asia financed both the growth of the directly productive sectors and the creation of the large and productive infrastructure. Unfortunately,, in

Bangladesh inadequate investment is a major obstacle to the development of both the directly productive sectors and the overall infrastructure. Export growth in Bangladesh, as alluded to at the beginning of this essay, has been substantial in quantitative terms. But it must be admitted that it lacks the diversity and the frequent rapid structural change that characterized East Asian export growth. Indeed there are reasons to believe that the growth of garments exports was a historical accident in the protected market which can not be relied upon in the current trading environment. It could not have lasted. Furthermore, the surge of remittances and continuing foreign aid dependence may in some ways resemble the phenomenon of resource curse that economic policy in Bangladesh in the past handled inadequately.

With the exception of China, the East Asian pioneers managed to reduce inequality along with increasing the GDP per capita rapidly. However, growth in Bangladesh has been accompanied by an increase in income and wealth inequality. This also means that at any given rate of growth far less poverty can be reduced than was the case in East Asia.

On the population front, though in Bangladesh there has been a commendable reduction in fertility in recent decades, there is some uncertainty about the magnitude of this achievement. Even if this uncertainty is dismissed, a comparative look suggests that Bangladesh has not made the kind of demographic transition that the East Asian economies managed to achieve at a comparable stage of development.

It must be admitted frankly that the development path followed by Bangladesh has not been the same as the one that the East-Asian pioneers pursued. Bangladesh must abandon the non-strategy of mere incrementalism. But what would the requirements of following a more East Asia Like Strategy with Bangladeshi

Characteristics mean?

As one thoughtful observer of the Bangladesh economy has observed:

At independence Bangladesh inherited an import-substituting industrialization (ISI) regime with all its standard characteristics: an overvalued exchange rate; import quotas; high overall but highly non-uniform rates of protection to promote industries for the domestic market; strong discrimination against exports (which actually got worse as the initial devaluation was quickly eroded by high inflation and the selective promotion of exports in the pre-independence period through the export bonus scheme was scrapped). The economy also had widespread direct controls regulating the product and factor markets: public ownership of industrial and modern service enterprises was extensive; administered prices and public control over distribution were ubiquitous; interest rates and wages in the modern sector were regulated; and the private sector was subject to numerous restrictions.

It can be said fairly that the reform process that began as early as the late 1970s and accelerated in the later decades did lead to some improvements. During the 1990s the trade regime saw the abolishing of quotas, large reductions of tariff rates and liberalization of the exchange rate.

Together with this decisive break with the ISI system of incentives, Bangladesh also undertook a number of other steps such as an emphasis on the private sector and direct foreign investment, and privatization of much of the industries, banks and insurance companies. By the 1990s there was also the abolition of rationing and public distribution of food grains and agricultural inputs. On the monetary side there was an increase in the real interest rate bringing it closer to the market rate; and a reduction of agricultural subsidies. However, all these did not result in an alternative set of coherent policies and institutions. One therefore has to agree with A.R. Khan's assessment.

The reforms in Bangladesh, as in many other developing countries where they were inspired by the international development agencies, set the target of completing the demolition work and did little by

way of creating an alternative system of promotion. The orthodoxy that guided reforms actually believed that no such alternative was necessary: “right” prices, interest and wage rates would encourage right kind of savings, inflow of capital from abroad and profitability of investment to ensure growth. There have been piecemeal incentives for one activity or another and selective assistance to certain kinds of exports; but there has been little to compensate for the loss of incentives that the ISI provided in the past and to offset the generalized “infancy” that industries suffer from (see below). It is even doubtful if after all the reform of the trade regime the effective exchange rate for exports was brought up to the level of the effective exchange rate for import replacement.

After the recent global crisis it is apparent that the above cavalier attitude and a naïve faith in the efficacy of markets has been tragically the cause of great suffering. Ironically, these impositions of Washington consensus have failed to meet their own target of growth through an efficient allocation of resources by the free markets. Khan goes on to argue:

Both economic theory and the history of economic development belie the pristine orthodoxy that mere reforms towards free market and free trade would ensure efficient growth. Economic theory has long argued that in reality many of the assumptions that underlie the claim that the free market and free trade automatically lead to efficient growth are not fulfilled and that “market failure” is a pervasive phenomenon everywhere, more so in the developing economies. In the entire history of development it is impossible to document a significant case of successful development that was not promoted by wide-ranging incentives to industrialize.⁸ The point is that the market reforms implemented in Bangladesh, while desirable in themselves, do not in their totality amount to a coherent system of incentives to promote industrialization and exports. The ISI regime was indeed a powerful system to promote industrialization: while accumulation was enhanced by high profitability of protected industries and the appropriation of rent that thrived under the system, the high rates of profit fostered by protection helped direct accumulated resources to investment. The problem was that it promoted inefficiency and wasteful allocation of resources due to non-uniform protection, discrimination against exports and insulation from international competition. It was therefore right to abolish ISI, but it was necessary to replace it with a system of promotion that was free of the distortions and inefficiencies that the ISI suffered from.

Furthermore, contrary to the claims of their supporters, the earlier “reforms” under the Ershad or BNP regimes did not succeed in promoting the objective that they aimed to achieve. From the historical record, it does not appear that there was a greater efficiency in the allocation of resources. As Kornai had pointed out, if the

⁸ See Chang, 2002.

institutional structure does not induce the agents to respond to liberalized prices in an economically rational manner, the price reforms can lead to perverse results. (Kornai, 1980). This is what seems to have happened in Bangladesh. As Khan points out:

He argued that it was useless to reform prices when the prevalence of "soft budget constraint" makes it unnecessary for economic agents to obey them. One could argue that in Bangladesh, as in many reforming developing countries, the preoccupation with the reform of prices and indicators of incentives was not complemented by the creation of institutions that are necessary to make economic agents act on the basis of these indicators. An example is the sharp upward adjustment of the nominal rate of interest to ensure a real price of credit that reflected its market price. The objective was to make the allocation of credit more efficient. The outcome was a massive default by the borrowers reflecting a complete disregard on their part of the price of credit. The institutional arrangements concerning borrowing from the banking system had not ensured compliance with loan obligations. For a quarter century such default has gone unpunished despite periodic rhetorical sermons by successive governments against such behavior. The history of recent decades demonstrates that the government simply does not have the institutional capability – or chooses not to develop it in deference to the preference of the groups that have the political power - to enforce the rules of the game implicit in the reform of prices and incentives. Other examples consist of the reform of prices of public services coinciding with a complete breakdown of the system of their delivery.

One of the arguments against the ISI was that the wedge that it drives between domestic prices and world prices needs to be sustained by direct controls that lead to massive rent seeking which is a source of corruption, inefficiency and high transactions cost. The abolition of ISI and the reduction in arbitrary market interventions were expected to eliminate much of the scarcity premium and wasteful rent seeking. In reality only the nature of rent seeking has changed. For example, the appropriation of the scarcity premium on import licenses has been replaced by the appropriation of huge "agency fees", mostly concealed, by the agents of foreign suppliers who compete for public imports under foreign aid, not by bidding lower prices but by the exercise of political power on the part of the local agents. Nontransparent procurement ensures huge scarcity premium on these imports. Remarkable changes have also occurred through the creation of innumerable fiefdoms controlling the delivery of public services and administering ubiquitous regulations, thereby imposing high transaction costs on investors and consumers throughout the economy. An investor is subject to these costs at every conceivable stage of operation: getting a telephone connection, obtaining a construction permit, moving goods through illegal barricades created by political hoodlums who are passively patronized by the government, settling utility bills and taxes. These transaction costs amount to a substantial proportion of potential profit and create a strong incentive for capital flight.

Although no careful quantification is possible, one gets the impression from evolving dialogue

among the civil society that in recent decades there has been an enormous expansion of this kind of transaction costs, usually described as rising corruption and deteriorating governance. The essence of the problem is a political system which permits the exercise of arbitrary power in pursuit of profit. Under ISI it took the form of appropriating the scarcity premium embodied in import licenses and distribution permits. Now that economic reforms have done away with those “conventional” forms of scarcity premium, the same arbitrary exercise of political power has invented new and more numerous forms of appropriating rent. They are far more predatory than the system under ISI. As mentioned above, despite all its inefficiencies, the system of rent appropriation that enriched politically powerful groups under ISI also had as its counterpart a strong incentive for investment in protected domestic industries. Today’s ubiquitous system of rent appropriation imposes huge transaction costs on the investors and creates a strong incentive away from domestic investment in favor of capital flight. It is this growth-hostility of corruption, rather than the magnitude of corruption itself, that I want to emphasize.

The lesson is that rent seeking, corruption and such other attributes of an economic regime do not automatically follow from the regime itself; they result from the objectives and institutional capability of the government that operates them. Thus conceivably rent seeking under ISI can be minimized by a government that has the institutional capability of auctioning import licenses and adopt other market-simulating steps. Conversely a liberal trade and economic regime does not necessarily put an end to rent seeking and corruption; it can coexist with them if the government creates opportunity for appropriating scarcity premium and makes it possible to access them by non-market methods. Experience shows that such opportunities are endless. Lest this be interpreted as a veiled defense of ISI, let me reiterate that ISI deserved to be discarded on numerous grounds including inefficiency and inequity. It is however naïve to hope that replacing it by a liberal trade and economic regime would automatically promote growth and end rent seeking and corruption.

The above goes a long way to explain the failure of reforms not only to induce faster industrialization and diversified export growth but also some of the causes of increased inequality, notably the rampant rent appropriation. Further explanation of disequalizing growth could be found by comparing the East Asian policies with those in Bangladesh in this regard. Unlike in East Asia Bangladesh did not begin with initial land redistribution. One often encounters justifications for this omission. For example, it is argued that conditions for land reform were far less favorable in Bangladesh than in East Asia. While this argument may have a grain of truth, it is by no means the case that Bangladesh did not miss opportunities for significant land reform.⁹ One argument that is often made to justify the absence of land reform in Bangladesh is that it is extremely land scarce, that there is too little redistributable land. Land scarcity in the Republic of Korea, Taiwan and China at the time they

⁹ See Griffin, Khan and Ickowitz, 2002 and 2004 for a discussion of these issues.

embarked on land reform was about as acute as in Bangladesh around that time.¹⁰ Egalitarian distribution of land is of much greater urgency under land scarcity than under land abundance. This is because land-scarcity results in a high factor share of land. Unequal distribution of land in this condition means that a high share of agricultural income is unequally distributed. A second argument that conditions for land reform were more favorable in East Asia than in Bangladesh cites the fact that in the Republic of Korea and Taiwan the government came to own a substantial share of total land and other assets abandoned by the former Japanese owners. Here too Bangladesh was not without an advantage compared to most countries if not compared to Korea and Taiwan. At independence Bangladesh government came to own very substantial assets abandoned by the former Pakistani owners. These assets could finance a significant program of land redistribution if not one of East Asian magnitude. In the event these assets were squandered by plunder and mismanagement that followed nationalization.

Land distribution in Bangladesh continues to be highly unequal. But during the 1990s there has been a redeeming effect due to the greater equality of access to tenanted land. As a consequence the distribution of direct farm income has improved, though its share of total income has fallen while the share of rental income, a highly disequalizing component of income, has increased sharply.

A significant policy failure is the inability to generate adequate employment and decent jobs. As Khan states:

Another factor contributing to inequality is the failure of employment to grow rapidly in industries and modern tertiary activities. As discussed earlier, wages are among the few components of income that have an equalizing effect on income distribution in Bangladesh. Not only has consistently rapid growth eluded the industrial sector, the growth that has actually taken place has been employment hostile in the aggregate.¹¹ What explains the employment hostility of industrial growth after reforms that led to freer trade when economic theory argues that such a move should promote greater employment intensity of growth for a labor-abundant economy? It seems that much of the explanation lies in the initial condition of the industrial sector which in the past, during the period of state ownership, had expanded employment far beyond what efficiency would dictate. A comparison of the Labour Force Surveys of 1990/91 and 1999/2000 shows a poor growth in employment which was due entirely to a drastic

¹⁰ Exactly comparable estimates of land per agricultural worker or land per “agricultural” population are hard to find. However see the figures in Khan, 1988.

¹¹ A cursory look at the evidence does not suggest that rapidly-growing exports like garments have been employment hostile. Much of the problem of slow employment growth in industries as a whole is due to the employment growth in these industries being offset by the fall in employment in the industries in decline.

reduction in employment in manufacturing.¹² This was substantially due to the shedding of surplus labor in the former state-owned enterprises. Carefully-designed compensatory public policy was needed to offset the adverse distributional effects of these reforms. There was little of that.

Be that as it may, the principal problem about low employment growth in industries was due to low industrial growth. The problem of transition by way of absorbing the surplus personnel on the payroll in the state-owned enterprises would have been much easier if industries had grown rapidly.

Another difference between Bangladesh and East Asia in distributional policies is the poor performance of Bangladesh in providing egalitarian access to human capital. This has proved to be an obstacle to the improvement of the productivity of the poor.¹³

There is much talk of good governance by the World Bank and various other organizations. Undoubtedly, good governance is necessary. But the challenge for a poor country like Bangladesh is to focus on concrete aspects of good political and economic governance. Although much remains to be done, the orientation of the current politically aware among the new generation in Bangladesh towards social justice, improving infrastructure, protecting energy and other natural resources and reducing foreign dependence are definitely steps in the right direction. A move towards stamping out corruption in high places, complemented by an egalitarian strategy of development geared towards poverty reduction, employment creation and support for small businesses and farmers will go a long way towards creating a healthy political economy. A new social and political movement must maintain the political loyalty of the base of urban middle and working classes, rural peasantry and patriotic elements among land and capital owning classes. With their help the tendencies towards capabilities-enhancing development need to be widened and deepened. Building up a core of younger leaders and expanding the existing bands of patriotic and dedicated cadres for nation building will isolate the anti-people elements in our society and help build the *Sonar Bangla* that millions of patriotic

¹² As noted before, the 1990/91 LFS almost certainly overstates manufacturing employment due to other reasons as well.

¹³ According to *WDI 2007* Bangladesh has made significant improvement in primary education and in closing the gender gap in primary education. By 2005 primary school completion rate for girls had exceeded that for boys. But about a quarter of boys and girls still fail to complete primary education and it is widely believed that the quality of primary education is low and has perhaps declined over time. The big failure is of course in adult literacy which prevails among less than a third of women and about a half of men according to UNDP's recent *Human Development Reports*.

Bangalees fought for during our liberation struggle.

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