A better investment climate for growth and poverty reduction

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MOST countries strive to improve living standards and reduce poverty, but China, India, and Uganda stand out for their achievements. China's growth over the last 20 years has been unprecedented, lifting 400 million people out of poverty. India has more than doubled its average growth rate since the 1970s, making big inroads into poverty. Uganda achieved a growth rate from 1993 to 2002 that was eight times the average in Sub-Saharan Africa, also slashing poverty.

How did they do it? The *World Development Report 2005: A Better Investment Climate for Everyone*, shows that a large part of the explanation lies in the progress each country has made in improving its investment climate -- the opportunities and incentives for firms to invest productively, create jobs, and expand. The Bank's recent *Doing Business in 2005* report highlighted the heavy burden imposed on firms by outmoded or ill-conceived regulation. The *World Development Report 2005* shows that regulatory costs are part of a larger problem, and outlines strategies for governments to broaden and accelerate improvements to their investment climates.

Driven by the quest for profits, firms of all types -- from farmers and micro-entrepreneurs to local manufacturing companies and multinationals -- play critical roles in development. They create most of the jobs needed to increase incomes. They provide most of the goods and services needed to improve living standards. They pay most of the taxes needed to fund public investment in health, education, and other services. But the size of these contributions depends largely on the investment climate. Too often, governments undermine their investment climates by creating unjustified risks, costs, and barriers to competition.

Policy-related risks cloud opportunities and chill incentives to invest. Surveys of over 30,000 firms in 53 countries show that uncertainty about the content and implementation of government policies is the top concern of firms in developing countries. Macroeconomic instability, weak protection of property rights, and arbitrary regulation add to those risks. More than 80 percent of firms in Bangladesh and over 62 percent of firms in Pakistan lack confidence in the courts to uphold their property rights. Nearly 65 percent of firms in India and Pakistan find the interpretation of regulation unpredictable. Improving policy predictability alone can increase the likelihood of new investment by existing firms by 30 percent.

Governments saddle firms with high costs that make many potential ventures unprofitable. Firms everywhere complain about taxes, but they are often not the biggest burden. Weak contract enforcement, unreliable infrastructure, onerous regulation, crime, and corruption can impose costs amounting to over 25 percent of sales -- or more than three times what firms typically pay in taxes. In India, losses from unreliable electricity supply are equivalent to 11 percent of sales, and firms spend more than 15 percent of their time dealing with officials. Almost all firms in Bangladesh report that bribes are needed when dealing with officials -- to the tune of 3 percent of sales.

Barriers to competition dull incentives for firms to innovate and increase their productivity, which is the key to long-term growth. Stronger competitive pressure can boost the probability of innovation by more than 50 percent. Yet unjustified regulatory barriers are pervasive, and efforts to curb anticompetitive behaviour by firms remain weak in most developing countries.

Weak investment climates tend to hit smaller firms and those in the informal economy the hardest. These firms have more difficulty gaining access to finance and public services, have less confidence in the courts, and find the interpretation of regulation less predictable. Constraints that involve fixed costs -- such as the need to self-generate electricity -- also impose a disproportionate burden on smaller firms. There are also big differences across locations within countries, underscoring the important role of subnational governments.

Why are some governments making faster progress in tackling these problems than others? It's not just about money: many improvements demand little from the budget, and faster growth increases tax revenues. Rather, governments need to address deeper sources of policy failure. They need to restrain corruption and other forms of rent-seeking that distort policies and push up costs, and to build policy credibility to give firms the confidence to invest. They also need to foster public support to enable and sustain reforms, and to ensure their policy responses fit with local conditions.

The agenda is challenging, but everything does not have to be done at once. Impressive results can be achieved by addressing individual constraints, and by sustaining a process of ongoing improvements. China began by enhancing the security of property rights, India by easing red-tape and trade restrictions, Uganda by restoring macroeconomic stability and building credibility through a series of hard-won reforms. But sustaining progress is no less important, and requires commitment. Many governments are maintaining momentum through effective public education and through the creation of specialist institutions to engage stakeholders and review constraints. The pace of improvement in many countries in East Asia and Central Europe is breathtaking -- the same cannot yet be said of the countries in South Asia. Will they rise to the challenge and seize the benefits of faster growth and less poverty?

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Solution to floods: Cordon approach or open approach?

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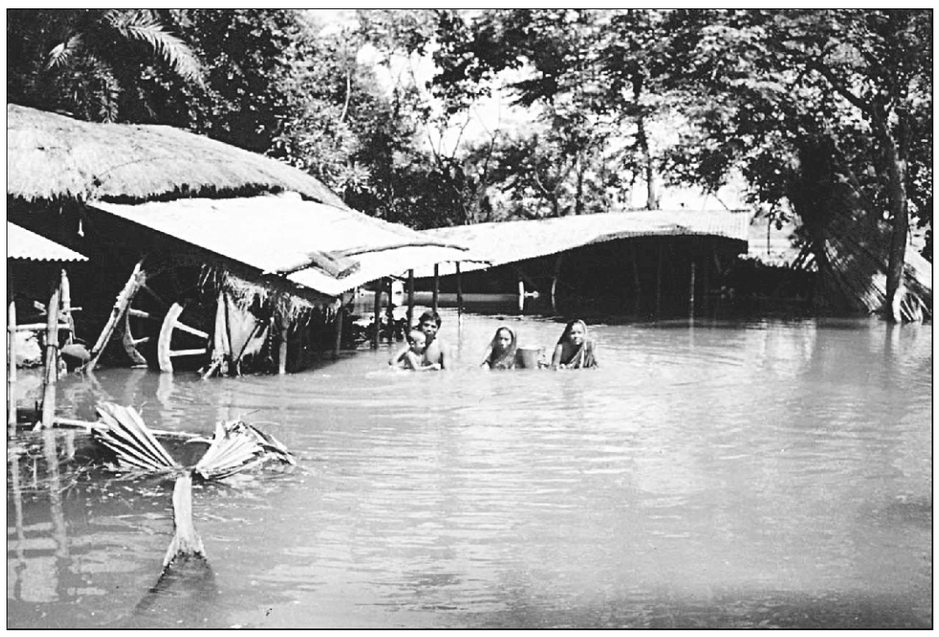
Flood is a complicated, multidimensional issue. It is connected with production, settlement, communication, health, population, environment, culture, etc. Grappling with the flood issue therefore requires deep and comprehensive thinking. The recent deluge of the Dhaka city, severe waterlogging within DND project, collapse of the Gumti and Kikri embankments, etc. will make the perils of the Cordon Approach amply clear. The sooner we abandon this approach and



THIS year's flood has evoked a number of Op-Ed pieces. However, these have been mostly speaking past each other, and the discussion thereby has not crystallised into a debate. It is therefore welcome that Engr. Md. Amirul Hossain has written a response (Daily Star, August 13) to my article, "A Permanent Solution to Floods" (Daily Star, August 10). It will be nice if the current exchange leads to a productive debate.

Most of Engr. Hossain's points seem to have arisen because of the cryptic nature of my newspaper article. However, details of the arguments against the Cordon Approach and for the Open Approach are available elsewhere. (Interested readers, for example, can see my journal articles (i) "The Open Approach to Flood Control: The Way to the Future in Bangladesh," (*Future*, 2002), (ii) "Flood Control in Bangladesh: Which Way Now?" (*Journal of Social Studies*, 1999), (iii) "Let the Delta Be a Delta!" (*Journal of Social Studies*, 1991), and also in my book "*The Development Problem of Bangladesh"* (Jatiya Shahittyo Prokashoni) published in 1987. Another good source of these details is the report, "Flood Plans or Floodplains?" written by Prof. Shapan Adnan and his associates after the 1988 flood.)

Let me now briefly reply to Engr. Hossain's points. First, he mentions that if Cordons were bad then the people within the Cordons would themselves have destroyed them. Ironically there have been instances when local populace actually cut down ill conceived Cordons. One only needs to scan newspaper reports to see such examples. Second, Cordons are generally foisted on localities by the central government. The entire State power stands behind them. Hence it is not easy for the local populace to destroy a Cordon even if they wanted to. Third and more importantly, there is a difference between "Group Interest" and "Overall National Interest." From their narrow group interest, the people within a Cordon may feel benefited in some respects. Take the example of the DND project. Apart from the original capital costs, the government is spending millions of Taka each year in maintaining this project. All this money comes from the national budget and not from revenues generated from the DND project. This spending had some justification when DND area was agricultural, and it could be argued that the project was boosting crop output. However, DND has now become residential, and hence that justification no longer holds. If the Cordons were not there, people would have followed the time-tested, "dig-elevate-dwell" pattern of settlement. Unfortunately the Cordons created an artificial dry situation, and thus fostered a "below-flood-level" settlement. Now the national government has to bear the recurring costs of protecting and servicing this artificial settlement. Obviously, the people inside the DND project will not want to cut down the Cordons! However that does not mean that DND project is serving the overall national interest.

Engr. Hossain's second point is that the physical relationship between volume, surface and height is too simple to describe flood because dynamics are involved. First, dynamics do not negate the basic physical fact that volume is the product of surface area and height. This relationship holds both in static and in dynamic situations. Second, consideration of dynamics actually makes the Cordon Approach even more unappealing, because Cordons slow down the pace at which flood water recedes, thus forcing the country to face a larger volume of water for a longer period of time. The flood level thereby gets higher at every point of time!

Engr. Hossain's third point is that Cordons have been helpful in raising crop output. This is a contentious claim. We have already noted the DND (once the showcase of the Cordon Approach) experience. In a convoluted outcome and defeating its original purpose, DND has now become an unproductive burden on the government exchequer, so far as agricultural production is concerned. The agricultural output boosting impact of the G-K (which is not a classic Cordon) Project remains highly controversial, particularly relative to its huge capital and annual maintenance costs and in view of the very poor cost recovery.

Much of the irrigation expansion and the associated crop output augmentation in Bangladesh in the recent decades has been caused by the explosion in the use of groundwater pumps. Cordon Projects did not have much role in this explosion. Ironically, ground water pumps are extensively used for irrigation even in the G-K project and in other Cordon Project areas!

The limited contribution of the Cordon Projects to agricultural output boosting is not difficult to understand. Cordons cannot be of help in the dry season, becoming rather an additional barrier, because the water from the neighbouring river channels now needs to be carried across these Cordons, requiring higher pump-lift. In the rainy season, Cordons can prevent project areas from river inundation and thus allow cultivation of the High Yielding Varieties (HYV) of *aus* and *boro* crops. This has been the main rationale for such Cordon Projects as the Barisal, Chandpur, and Meghna-Dhonagoda Projects. However time has shown how fragile this rationale was. Scientists at IRRI and BIRI soon came out with HYV of both transplanted and broadcast *aman*, thus negating the agricultural rationale of the Cordon Projects.

The fact that Cordons are not the way to boost agricultural output should have been clear from the country's local heritage. Bangladeshi farmers over the ages have tried to boost agriculture output not by erecting Cordons, but by breeding crop varieties that can withstand and take advantage of the river inundation. They produced such miraculous varieties of *bona aman* whose stalk can float in water and grow about a foot long in twenty four hours just to keep pace with the rising level of floodwater. With the modern crop-breeding technology at hand, it is possible to progress further in this direction. Thus the proper route to boosting agricultural output is through harnessing the potential of flood-based agriculture and not through artificial separation of floodplains from the river channels by Cordons.

The effort to have flood-free agriculture on floodplains also creates a conflict between "short-term interests" and "long-term interests." This is because Cordons deprive project areas soil from silt and other nutrients that floodwater brings annually. The soil quality within Cordons thereby deteriorates with time, creating increasing dependence on chemical inputs. Yet, runoffs of these chemical inputs devastate the fresh water fish stock. Thus even if Cordon Projects appear to be of some agricultural benefit in the short run, they prove to be deleterious in the long run.

Engr. Hossain's fourth point concerns dry season irrigation potential of the Open Approach. He thinks that flood water retained through adoption of the Open Approach will not be enough for March and April, the flowering months of *boro* crops. First, it is strange to hear this complaint from someone favoring Cordons, which would prevent floodwater reaching floodplains *altogether*! Second, whether or not floodwater retained in floodplains will prove sufficient depends on how extensive (area) and intensive (deep) the water bodies for retention are (the supply side) and how much and what type of *boro* and *rabi* crops are grown (the demand side). Given the demand, a higher retention capacity will allow more of this demand to be met. The important point is that while the Open Approach *enhances* the dry season irrigation potentiality, the Cordon Approach *reduces* it.

An additional benefit of the Open Approach is that it offers a long-term solution to Bangladesh's arsenic problem. The current dependence on groundwater has lowered the groundwater level in many parts of Bangladesh. According to the Oxidation Theory, this has allowed pre-existing arsenate compounds to come in contact with air and thus get oxidated into soluble arsenic. The Open Approach can ameliorate the arsenic problem by reducing the dependence on groundwater and enhancing its recharge.

Engr. Hossain's fifth point is that all development projects involve social conflicts, and hence the fact that Cordon projects generate social conflict should not mean that these projects are technically infeasible. There is some confusion here. My article did not say that Cordon Projects are "technically failed" *because* they generate social conflict. What it said is that *in addition to* being technically infeasible, Cordon Projects are prone to generating social conflicts.

From economics' point of view, a project may indeed create 'winners' and 'losers,' but it may pass the Pareto Optimality criterion (and thus accepted for implementation) if the sum of gain of the winners is greater than the loss suffered by the losers. Unfortunately, instead of being of the "win-lose" type, the Cordon Projects are generally "lose-lose" propositions. As noted, the people outside these projects "lose," because they now have to suffer more floods. But the people inside the projects "lose" too. Residents of urban Cordons have to face new problems of water-logging, sewage, etc., in addition to the perennial possibility of *Kiyamaat*-like deluge. The residents of the rural Cordons have to face deterioration of the soil quality, increased difficulty in dry season irrigation, etc. The nation as a whole loses, because huge outlays on the Cordon Projects ultimately prove to be counterproductive. Cordon Projects therefore end up being "lose-lose-lose" undertakings.

Engr. Hossain's final argument in favour of Cordon Projects is that these projects generate employment for the rural people and provide improved communication network. This cannot be a serious argument! Any project implemented in rural areas, such as river dredging, will also generate employment for the rural people. The question is, given similar level of current employment, which of these projects will prove more beneficial in the long run. In this respect, the Cordon Projects have proved to be very disappointing indeed.

The point concerning "communication network" can also be dispensed with easily. As I mentioned, embankments do not necessarily have to be Cordons. With enough breaks in them embankments can also serve as structures to regulate the timing and volume of water passage between river channels and floodplains, and these embankments can also serve as roads and highways. A pertinent example is the proposed Eastern Bypass Project. This Bypass can be constructed as a Cordon (as is proposed now) in order to seal off Dhaka city from its eastern rivers. On the other hand, it can also be constructed with enough breaks so that Dhaka's link with these rivers is not severed. In either case, the project can serve as a highway for the north-south traffic.

In making these decisions, the authorities can look at the example of such cities as Amsterdam. Situated in the Rhine delta, Amsterdam did not try to seal itself off from the Rhine. Instead it enhanced this connection through an extensive network of canals, which contribute so much to the life of Amsterdam. It is quite tragic that Bangladesh is moving in just the opposite direction.

Flood is a complicated, multidimensional issue. It is not simply an issue of engineering. It is connected with production, settlement, communication, health, population, environment, culture, etc. Grappling with the flood issue therefore requires deep and comprehensive thinking. I hope that all concerned will engage in such thinking before embarking on some new flood control projects.

I hope that the recent deluge of the Dhaka city, severe waterlogging within DND project, collapse of the Gumti and Kikri embankments, etc. will make the perils of the Cordon Approach amply clear. The sooner we abandon this approach and adopt the Open Approach, the better for the country.

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