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RESEARCH ARTICLE

Appraising the Impact of Rule of Law, Control of Corruption, And Govt. Effectiveness on Inflation: An Empirical Case of Bangladesh

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Abstract
This study is an effective initiative to find out the impact of noneconomic determinants as well as the importance of noneconomic determinants on inflation in Bangladesh. Time series data was used from 1996 to 2020. The unit root test, on the other hand, indicates that the stationary at the first difference of all variables indicates I(1). Cointegration results ensure long-run associations among variables. The econometric methods apply the Generalized Linear Model (GLM) technique for measuring the importance of noneconomic determinants for controlling inflation. Findings show the importance of noneconomic determinants to controlling inflation, where the controls of corruption, the rule of law, and government effectiveness have influenced the reduction of inflation in Bangladesh. It should be focused on improving the quality of noneconomic performances and emphasizing the significance of those factors through the implications of rules and regulations, digitalization, and ensuring open-door services and accessible information for all consumers of goods and services. Further study may consider the other noneconomic as well as macroeconomic determinants that have a large contribution to determining inflation in Bangladesh.

Keywords: Control of Corruption; Government Effectiveness; Inflation; Role of Law

Introduction

In recent years, the price level has been getting higher and higher due to the rising rate of inflation, which has become a major concern in Bangladesh. Despite being one of the fastest-growing economies in the global economy, analysts warn that rising inflation and growing prices could hamper economic recovery and possibly lead to food shortages in a country already hit by severe weather and pandemic-related disruption. Here, the term "inflation" refers to the constant upward movement in the general price level of goods and services that causes a reduction in the standard level of purchasing power over time. In Bangladesh, the current rate of inflation has gone up to 6.17 % from 5.86 % in February of 2022, which is the highest rate of inflation since October 2021 (Bangladesh Bureau of Statistics (BBS) Report, 2022). Such high inflation could seem like a temporary blip but can spiral out of control if adequate measures are not taken. According to Ashraf et al. (2016) and Islam et al. (2022), inflation can negatively impact macroeconomic performance because it disrupts the exchange mechanism. Asako (1983) also found that inflation can cause slower capital accumulation during the transition under certain situations. Apart from that, inflation adversely affects a country's underprivileged population due to pricey groceries, commodities, and other necessities (Rahman et al., 2022; Elahi & Rahman, 2021; Rahman & Habib, 2021; Majumder & Rahman, 2022). As the prices of essentials go up, so does the cost of living, causing suffering for most people. Therefore, inflation control is one of the primary objectives of monetary policy in Bangladesh.

The reasons behind inflation in Bangladesh are multidimensional and dynamic here, both economic determinants and non-economic determinants such as the rule of law, control of corruption, and government effectiveness influence the rate of inflation (Rahman & Majumder, 2021; Majumder et al., 2022; Rahman et al., 2023; Rahman & Majumder, 2022; Rahman & Majumder, 2020). Irregularities, unrest, and political instability can also cause inflation. For example, since economic determinants for inflation have always gotten more focus compared to the non-economic determinants, the rule of law, control of corruption, effective government, and other crucial factors were overshadowed despite having an impact on controlling inflation. As per Coase (2005), economists did not even take into account the importance that lies between the economy and the state of law until recently. Even though non-economic determinants like control of corruption and the rule of law positively affect economic growth (Majumdar, 2022). Hence, the impact of the rule of law, control of corruption, and government effectiveness on inflation is yet to be discussed broadly in the research field. Therefore, to combat the adverse effects of inflation, maintaining a steady inflation rate while considering economic and non-economic determinants is now necessary. As per economists, a low-inflation environment accelerates economic growth. At the same time, a country also needs good governance for its economic development (Grindle, 2012; Rocha & Jotty, 2022). And good governance covers non-monetary aspects like the rule of law, control of corruption, and government effectiveness (Kaufmann et al., 2009). Ensuring the rule of law, controlling corruption and government effectiveness will eventually affect a country's economy, including the inflation rate. Thus, in this study, these three key non-economic indicators have been critically reviewed through general analysis and discussion to measure the impact they pose on inflation in Bangladesh. No one is above the law in a society where the rule of law prevails. It ensures accountability of the government as well as obedience to regulation by the citizens, providing the rights guaranteed by the constitution of a country. The rule of law has a direct influence on sustainable economic growth, particularly for countries with years of monetary instability (Barro, 1996; Fischer, 1984). Therefore, there is a good possibility that the rule of law can also influence economic growth indirectly by reducing the inflation rate to an acceptable level. As economists such as Majumder and Rahman (2020); Dilanchiev et al. (2021) put importance on transactional rites and conviction as factors in the cost of production of goods and services, which depends on acquiescence with the rule of law. On the other hand, corruption is a threat to the state that hinders the efficient operation of the market. Corruption occurs when public power is exercised for private gain. Markets get out of control due to careless responses by corrupt businesses. Corrupt business people are a small group of traders who want to create a monopoly, influence, and control over the market prices. They sell out or stock up on commodities with their syndicate. All these illegal practices in the market increase the price level. In this case, the government's policies, commitment, and efforts to eradicate corruption can widen the scope for major investments, especially from foreign countries where control of corruption can influence inflation (Braun & Tella, 2004; Uroos et al., 2022).

According to the World Bank (2021), government effectiveness means the government's commitment to policies like public service, civil service, etc., and the implementation of such policies. It mainly depends upon the ability of a government to make democracy through intelligibility, accountability, and public involvement (Kosac & Fung, 2014). It builds people's trust in the government. And that eventually leads to law enforcement and less scope for corruption, indirectly contributing to a reduction in inflation in the country. Besides, the government can use a variety of policies and efforts to limit inflation, such as preserving law and order, ensuring effective resource allocation, resolving budget concerns, addressing trade deficits, etc. In addition, the government must limit the rate of population growth as well as the actions of middlemen to keep inflation under control. This study aims to provide and analyze empirical evidence of the impact of the rule of law, control of corruption, and government effectiveness on inflation in Bangladesh, which will aid in the implementation of a low-inflation strategy. As a result, considering the legal aspects affecting inflation particularly alters the approaches to studying inflation factors in general, removing the difficulties of excessive reliance on abstract theory. However, given the importance of the study in the context of Bangladesh, the influence of legal factors to ensure a stable economy with low inflation must be brought under the spotlight. The study adopted an analytical approach based on secondary data from World Bank.

However, the central focus of this study is to determine how non-economic determinants such as the rule of law, control of corruption, and government effectiveness influence inflation in Bangladesh. The specific objectives of the study are as follows: to analyze the importance of the rule of law, control of corruption, and govt. effectiveness for economic stability and control of inflation. Another objective is to measure the impact of the rule of law, control of corruption, and govt. effectiveness on inflation in Bangladesh.

The results can also be used to look into non-economic factors that contribute to low inflation and the creation of a well-organized legal system. As a result, the study makes an effort to assess how corruption, the rule of law, and government effectiveness affect inflation in Bangladesh, which will give the body of literature a new perspective. The remainder of the section is divided into five sections: Section 2, the literature review; Section 3, the methodology

section; Section 4, the result analysis and discussion; and Section 5, the conclusion and recommendation.

Literature Review

Over the last decade, the factors of inflation have gotten a lot of attention. A lot of research has been done on the determinants of inflation. However, most of the studies were based on the economic determinants behind inflation. Hence, this section of literature is focused on the three vital non-economic determinants of inflation, namely: rule of law, control of corruption, and government effectiveness, to identify the relationship and effect of these determinants on inflation. Shevchuk et al. (2020) used annual data for the period of 2013 to 2019 of the Rule of Law Index from the World Justice Project (WJP) for 40 countries. The estimates of cross-regression and panel data found a favorable anti-inflationary impact of the rule of law for the overall group of 40 countries. Therefore, the rule of law can have a positive impact on reducing the high rate of inflation. Again, according to Acemoglu (2008), empirical evidence discovered that the impact of the rule of law on inflation is nonlinear, and the degree of public control over power may be an influencing factor in such cases, which must be taken into consideration. Moreover, various research findings indicate that the central bank can take institutional decisions with a stronger anti-inflationary impact more independently when democratic institutions and the rule of law are present, as in Bodea (2015), Nurbayev (2018) and Garriga (2020). As a result, it proves that there is a far-reaching consequence of the rule of law on inflation in a country.

A study by Inim et al. (2020) showed that in Nigeria, other than money supply, inflation is also determined by other factors like corruption, government expenditure on security, political instability, etc. The word corruption is defined as "the abuse of entrusted power for private gain" and more often indicates the abuse of public office for private gain (Gray & Kaufman, 1998; Rose-Ackerman, 1999; Lambsdorff, 2007; Rahman et al., 2022; Islam et al., 2022). On the other hand, Mauro (1995) demonstrated that corruption has negative consequences not just on economic development but also on investments and the structure of official institutions, based on a study of 68 countries. According to Braun et al. (2004), inflation variability can lead to higher corruption and less investment. In a sample of 75 economically significant countries, the study discovered a positive association between corruption and inflation fluctuation. As per the findings, a one standard deviation increase in inflation over the median increases corruption by 12% and decreases economic growth by 0.33 percentage points, which shows the influence occurs in both ways.

According to Piplica (2011), corruption increased inflation after the analysis of 10 transitional economies in Central and Eastern Europe. Yousefi (2015) used data from 164 nations between 1995 and 2010 to test her hypothesis that corruption leads to an increase in monetary expansion and, therefore, the inflation rate. For the overall sample, the study's findings revealed a substantial positive link between corruption and inflation. Similarly, the findings of Abed (2002), Smith (2007), and Samimi et al. (2012) are some who say that there is a positive relationship between inflation and corruption. As a result, necessary steps to reverse the increase in corruption must be taken to balance the inflation rate. In this association, Becker (1974), Mookherjee (1989), Png (1995), Besley (1993), and Andreoni et al. (1998), among others, have given a theory that "control" can reduce corruption. Thus, control of corruption can significantly reverse the effect of corruption on inflation.

Apart from the rule of law and the control of corruption, government effectiveness also helps maintain social equality as well as the economic growth of a country. As per Kaufmann et al. (2008), the deciding variables of government adequacy are view of the nature of public administrations, the nature of common administrations, and the level of their autonomy from political tensions; furthermore, the nature of strategy planning and execution; and the believability of the public authority's obligation to such policies. Hence, government effectiveness ensures proper distribution of resources through the implementation of policy, transparency, and accountability to gain the trust of the people. But, the absence of government effectiveness may lead to autocracy, resulting in inflation (Adam & Alhassan, 2021; Raihan et al., 2022). As per Bueno (2005), autocracies by nature depend on a small number of elites in whom political and economic resources are disproportionately concentrated. Apart from this, Khalid (2015) has used an econometric model to examine the short-run and long-run relationships between inflation and each of the important dimensions like government effectiveness, rule of law, and corruption control in Pakistan. It was found that there existed short-run as well as long-run relationships among the dependent and independent variables according to the Engle-Granger methodology. But, research on government effectiveness is still rare from Bangladesh's perspective, which can prove beneficial to altering the high rate of inflation to a stable one.

Lastly, in the case of Bangladesh, only a few studies have examined the role of determinants on inflation. For example, Chowdhury (1995) notes that the inflationary process in Bangladesh cannot be explained exclusively by the monetarist or the structuralism explanation of inflation, but it does have a strong but relatively short-run impact on inflation. Hossain (2013) found that there is a positive relationship between money supply and inflation in Bangladesh. Uddin (2014) indicated that the GDP, money supply, and interest rates have contributed to increasing inflation in Bangladesh. Also, a few other studies have tried to examine the process of inflation in Bangladesh on

the economic determinants that affect the inflation rate, such as Uddin et al. (2014), Islam et al. (2022).
However, the above studies are mostly focused on economic determinants and lack knowledge of the influence the non-economic determinants have specifically on Bangladesh, without which it is difficult to explain how political instability, rule of law, control of corruption, government effectiveness, and other crucial determinants impact inflation. This particular study fills the gap in the literature by developing an empirical case of Bangladesh that captures some of the necessary features that can lead to a robust change in how economists perceive inflation in an aspect of Bangladesh's economy.

Methodology

Model Specification: Generalized Linear Model

The GLM model permits us to fabricate a direct connection between the response and indicators, in spite of the fact that their veiled relationship isn't straight. This is made conceivable by utilizing a connection capability, which interfaces the reaction variable to a straight model. In contrast to linear regression models, the error dispersion of the reaction variable need not be regularly conveyed. The mistakes in the reaction variable are accepted to follow a thespian group of circulation (for example, normal, binomial, and other distributions). Since we are attempting to sum up a straight relapse model that can likewise be applied in these cases, the name "Generalized Linear Model" which was developed by Nelder and Wedderburn (1972) However, the functional form of this model is represented in equation 1.

$$\text{Inflation} = \text{f(Rule of Law, Control of Corruption, Govt. Effectiveness)} \quad (1)$$

$$INF_t = \propto_0 + \propto_1 ROL_t + \propto_2 CC_t + \propto_3 GE_t + \omega_t \quad (2)$$

For the simplicity of estimated model, log transformation is a necessary step. The log form of this model is presented in equation 3.

$$Ln(INF)_t = \propto_0 + \propto_1 Ln\,(ROL)_t + \propto_2 Ln\,(CC)_t + \propto_3 Ln\,(GE)_t + \omega_t \quad (3)$$

Where, $\propto_0$ represent the intercept, $\propto_1$ to $\propto_3$ represent the coefficient of the estimation, ω_t represent the error estimation tenure and t indicates time.

The GLM permits us to sum up a wide assortment of assessment results (Le et al., 2020; Liu & Lu, 2018). The serious issue for the analyst who utilizes the GLM is model detail. The specialist is liable for determining the specific condition that best sums up the information for a review. On the off chance that the model is miss-specified as well as small sample, the assessments of the coefficients such as $\propto$ values are probably going to be biased and the subsequent condition won't depict the information precisely. In complex circumstances, this model determination issue can be a serious and troublesome one. The GLM is quite possibly of the main device in the measurable examination of information. It addresses a significant accomplishment in the headway of social exploration in the last couple of decades.

ADF Unit Root Test

Since the purposes of time series analysis, recognizable Augmented Dickey Fuller (ADF) test is one of the most outstanding techniques for testing the unit root of a variable. In this cycle, the unit root has been analyzed by thinking about the slacked request of chosen factors and mistake or residuals assessments. Stationarity tests permit checking regardless of whether a series has unit root problems or not. There are two unique methodologies: stationarity tests, for example, the ADF test that considers as H0 that the series is nonstatiorany with the presence of unit root.

$$\Delta W_t = \beta_1 + \beta_{2t} + \tau(W_{t-1}) + \gamma_t \sum_{i=1}^{f} \Delta W_{t-1} + \varepsilon_t \quad (4)$$

Where; ε_t are an error component and ADF term W_{t-1} is the lagged order criteria, Δ indicates the change and t presents the time.

Result Analysis

In Table 1, the study of descriptive statistics shows that all the variables associated with this model are measured in terms of mean, median, maximum, minimum, standard deviation, skewness, kurtosis, Jarque-Bera, and probability. In the case of the measure of central tendency, it is estimated that the average of government effectiveness, inflation, control of corruption, and rule of law are-0.70, 5.58, -0.97, and -0.84 respectively. The average inflation rate, which is a dependent variable in this model, is the highest among the other variables. Also, after sorting the observations, the median value of variables including GE, INF, CC, and ROL is presented. The range, which is the dispersion, is presented by the minimum and maximum of the variables. Moreover, st.dev, which shows how far each data value is from the mean, of GE and ROL, is 0.11, which is the lowest compared to the other two values. It means that these values are more consistent and less spread out from the sample average. In addition, in the case of skewness, which measures the degree of asymmetry, it is seen that the values are positive except for control of corruption. In this table, GE shows normal skewness but not a symmetric or bell-shaped curve as it shows higher

values towards the right side of the curve. Also, INF, along with ROL, shows normal skewness. Moreover, CC shows a left-tail test in terms of skewness. With regards to kurtosis, which measures the flatness and peakness of the distribution, all variables, including INF and ROL, represent lower kurtosis values, which are less than 3, except GE and CC, whose values are higher than 3. In this perspective, both variables like INF and ROL have a platykurtic, which means more flat than the normal curve, whereas GE and CC have a leptokurtic, which means more peak than the normal curve.

Table 1: Descriptive Statistics

Criteria	GE	INF	CC	ROL
Mean	-0.70	5.58	-0.97	-0.84
Median	-0.73	5.69	-0.94	-0.83
Maximum	-0.43	8.16	-0.44	-0.64
Minimum	-0.86	3.26	-1.49	-1.02
Std. Dev.	0.11	1.47	0.26	0.11
Skewness	1.16	0.09	-0.10	0.25
Kurtosis	3.64	1.90	3.20	1.92
Jarque-Bera (JB)	6.07	1.30	0.08	1.49
Probability (JB)	0.15	0.52	0.96	0.47

Source: Author's inference

Table 2: ADF Unit Root Test Results

Variables	At Level	At 1st Difference
Ln(INF)	-1.85	-4.53***
Ln(ROL)	-3.26	-5.90***
Ln(CC)	-2.92	-4.24***
Ln(GE)	-1.90	-5.19***
Assumption: Trend and Intercept; *** tends to 1% level of significance		

Source: Author's inference

Table 3: Result of Generalized Linear Model (GLM)

Variable	Coefficient	Std. Error	z-Statistic	Prob.
Dependent Variable: Inflation (Ln(INF)				
LnGE	-4.48*	2.87	-1.56	0.10
LnCC	-0.88	1.25	-0.70	0.48
LnROL	-4.63**	2.38	1.95	0.05
C	5.50**	2.79	1.97	0.05
Model Strength				
LR statistic	12.36	Prob(LR statistic)		0.01
Pearson Chi-Square	32.55			0.05
** tends to 5% and * tends to 10% level of significance				

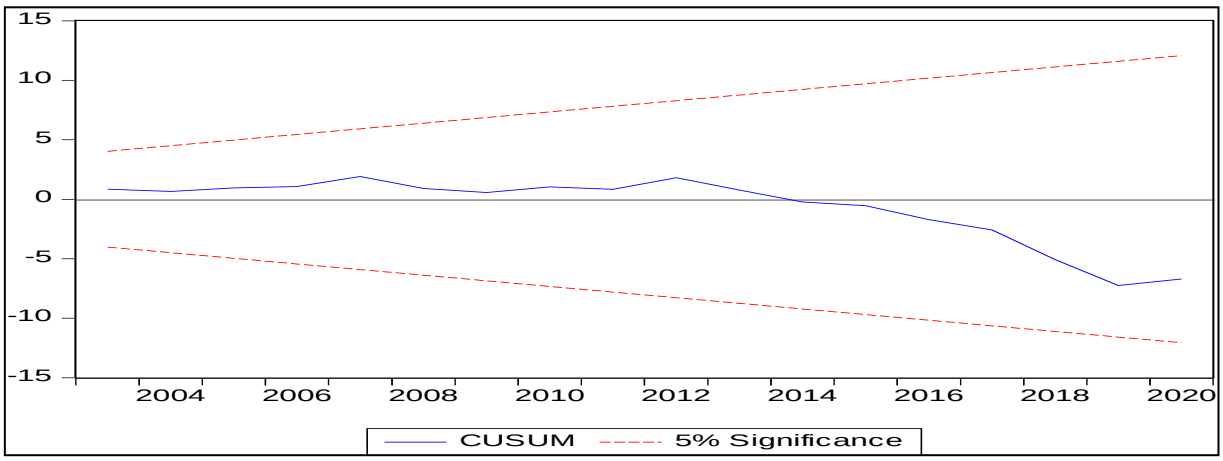
Source: Author's inference

Table 4: Cointegration Analysis by Wald Test

Test Statistic	Value	df	Probability
F-statistic	128.79	(4, 21)	0.00
Chi-square	515.16	4.00	0.00
Null Hypothesis: C(1)=C(2)=C(3)=C(4)=0			

Source: Author's inference

Figure 1: Stability Diagnostics: CSUSM Test



Source: Author's inference

In Table 2, it is observed that variables are non-stationary at their level after converting into 1st difference, they turn into stationary. The hypothesis has been rejected at the first difference operation where the null hypothesis is rejected. The result from Table 3 is that inflation is a dependent variable where government effectiveness, control of corruption, and the rule of law are independent variables. If GE increases by 1 percent, INF decreases by 4.48 percent, keeping other factors constant. Similarly, if ROL and CC rise by 1%, INF falls by 4.63 % and 0.88 %, respectively, assuming all other variables remain constant. The results of the cointegration test are shown in Table 4, where the null hypothesis states that coefficients 1, 2, 3, and 4 are equal to zero and the alternative hypothesis states that these coefficients are not equal to zero. The estimated probability value is less than 5%, indicating that we are rejecting the null hypothesis and that these four coefficients are not equal to zero. They are significant variables in the model, and they add value to the model by incorporating the long run association among the selected factors. The stability diagnostic shows the CUSUM test in Figure 1, where the result estimation implies the stability rules in the GLM analysis. However, this study found the importance of the rule of law, corruption control, and government effectiveness. The results support the following statements, such as the rule of law helps to reduce inflation these findings are similar to those of Grindle (2012) and Shevchuk et al. (2021). On the other hand, this study also found the fact that government effectiveness has a large impact on the control of inflation. This finding is similar to that of Soh et al. (2021) and Yousefinejad et al. (2022). In addition, this study also finds out the actuality where control of corruption has a hefty impact on control of inflation in Bangladesh, which is supported by Haider et al. (2011) for Pakistan and Ali and Sassi (2016) for both developed and developing countries.

Conclusion and Recommendations

Nowadays, inflation is one of the major concerns and challenges for Bangladesh's economy. If the high inflation rate continues, it could pose an alarming situation for the economic development of a country. Therefore, a stable inflation rate must be maintained by identifying and controlling the significant determinants of inflation. The preceding discussion demonstrates that, despite being overlooked, the rule of law, corruption control, and government effectiveness have a huge potential to influence the rate of inflation as non-economic determinants. Thus, the impact of such crucial components must be studied in the case of Bangladesh. This is an effective initiative for determining the impact and significance of noneconomic determinants on inflation in Bangladesh. However, the unit root test indicates that I am stationary at the first difference of all variables (1). Cointegration results ensure long-run association of variables. The GLM technique is used in econometric methods to assess the importance of noneconomic determinants in controlling inflation. Controlling inflation should be one of the government's priorities. The empirical studies mentioned above show that there is a significant long-run positive relationship between inflation and the rule of law, corruption control, and government effectiveness in Bangladesh. Since the study shows the rule of law has an anti-inflationary impact, more emphasis should be given to ensuring fundamental rights of people and civil and criminal justice through proper enforcement of law and regulations. The rate of inflation must be easier to keep under control in a country when the government executes the rule of law. Moreover, corruption is the greatest threat to the government, and institutional reform is required to eliminate the breeding ground for corruption. Political and economic restructuring should be carried out

in tandem. And under a democracy, the government must be more careful to increase its effectiveness. Because it is the right of people in a democratic country to criticize and question government actions, and it is the duty of the government to ensure accountability to the people. This paper highlights a new perception of how the inflation rate can be more effectively balanced by controlling regulatory and legal mechanisms, bridging the legal perspective gap between economists and legal and regulatory authorities. The analysis was limited by the small sample size, and further research may consider other macroeconomic determinants such as regulatory quality, political stability, and accountability voice, where those factors have contributed to lowering inflation in a country.

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