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Ineffective Privatization of Public Enterprises: The Case of Bangladesh. Part II

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Abstract

This paper analyzes some of the limitations of the public enterprises privatization in Bangladesh, focusing on the debt-default status and the tax registration profile of privatized firms. Detailed analyses of the debt-default status and the tax registration profile of privatized firms are presented by using unique data sets obtained exclusively for this paper from Bangladesh's central bank and the national tax authorities. Many privatized firms have substantial overdue loans. A great number of privatized firms have been able to evade tax registration. The post-privatization experience of Bangladesh lends credence to the view that in some developing and transition economies debt-default and tax non-compliance are routes by which privatized firms' budget constraints are often softened in spite of privatization.

Key words: privatization, Bangladesh, debt default, tax evasion.

1. Introduction

This essay examines the limitations of the privatization program in Bangladesh. The question of public enterprises privatization arises because of their poor financial and operating performance. Public enterprises in Bangladesh incur chronic losses, require state financed equity injections and credit from the banking system. Privatization, which is used to mean the transfer of both ownership and control of the firm from the public sector to the private one, has been viewed as a possible remedy to overcome the malaise of the public sector. It is believed that privatization will reduce the role of the state, lessen the state's fiscal deficit by decreasing the demand for continued financing of firms from the exchequer, and improve the asset quality of the banking system.

The Scope and the Objectives of the Essay

Bangladesh is one of the pioneers in the privatization of public enterprises. It has privatized a large number of firms. The set of privatized firms chosen for investigation here covers all the major industrial (manufacturing) and commercial firms privatized in Bangladesh since January 1, 1979 till 1995. Binayak Sen (1997) undertook a survey of these privatized firms. The Bangladesh Institute of Development Studies (BIDS), under the authority of the Ministry of Finance of the Government of the People's Republic of Bangladesh, conducted out the survey. Sen's survey sample consisted of 205 privatized firms. In the present study, four firms have been excluded for one reason or another: for instance, three firms mentioned in Sen's list have merged into one. Sen's (1997) list of privatized firms includes the 35 jute and 29 cotton textile firms that were returned to their former (or "original") Bengali owners. The present study does not incorporate the enterprises privatized since 1996.

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Nationalized commercial banks and state-owned development financial institutions dominate the financial system. The Bangladesh authorities have privatized two commercial banks and opened to private entrepreneurs sectors previously reserved only for public investment. Here industrial and commercial enterprises privatized in the period of 1979-1995 are studied. Detailed analyses of the debt-default status and the tax registration profile of privatized firms are presented by using unique data sets obtained exclusively for this paper from Bangladesh's central bank and the national tax authorities. The empirical findings suggest that privatization in Bangladesh has been ineffective. The case of Bangladesh illustrates that state-directed financing obtained by firms may not decline in spite of privatization. The softness of the budget constraint may still remain after privatization. As implied in the model of ineffective privatization, constructed in this paper, perverse outcomes of privatization might occur in regimes characterized by widespread corruption and poor governance.

This essay points out the limitations of the privatization in Bangladesh. The analysis presented here of various dimensions of post-privatization enterprise performance and behavior such as debt-default and tax compliance is not only of theoretical interest but also of some policy concern as the privatization of public enterprises is likely to gain greater momentum in the near future. This issue is on the policy agenda of the Bangladeshi authorities and the international donors.

An Outline of the Essay

The first section of the paper briefly reviews the literature on privatization with emphasis on studies related to Bangladesh. The second section provides an overview of the debt-default status of privatized firms using data obtained from Bangladesh Bank, the country's central bank, exclusively for this paper. The third section presents the results of an empirical investigation of the tax registration records of privatized firms in Bangladesh. This investigation is based on data obtained through exclusive access to two different tax databases of the National Board of Revenue, the country's tax authority. It also provides the patterns of tax non-registration in three different sectors. The fourth section concludes the paper.

2. Short Literature Review

This section *briefly* reviews the following: (a) the literature on public enterprises and privatization in Bangladesh, and (b) selected papers from the analytical and the empirical literature on firms' post-privatization performance.

Despite the importance of public enterprises for Bangladesh's economy, the literature on public enterprises in Bangladesh is quite limited. The major study of public enterprises in Bangladesh is by Sobhan and Ahmad (1982). It discusses the problems of public enterprises in the 1970s from the planners' viewpoint. Islam (1975), Yusuf (1985), and Ahmad (1987) give overviews of the nationalization and the performance of public enterprises. Mahmood (1989) provides an in-depth analysis of the financial and the operating performances of selected public enterprises from 1972 to 1985.

Although there is no comprehensive study of privatization of public enterprises in Bangladesh, the number of academic and policy papers on privatization and post-privatization experience is growing. Muhith (1993) focuses on the evolution of policy changes and the process of privatization. Humphrey (1992 [1990]) provides a detailed inside account of the origins, implementation, and scope of the privatization program, but does not evaluate the post-privatization performance of firms. Mallon and Stern (1991) present the background to policy reforms in the early 1980s, dissecting, in particular, the roles of various interest groups and how policies are formulated in Bangladesh.

Sobhan and Mahmood (1991 [1986]) analyze and compare the performance of nationalized and privatized firms in the jute and the textile sectors. They do not find convincing evidence of superior performance of privatized firms. Lorch (1991) studies the post-privatization operation of the textile industry; he, too, does not detect any indication of improved productivity, profitability, or performance. Bhaskar (1993) relates Bangladesh's experience of privatization to some policy problems of privatization in developing countries. Bhaskar and Khan (1995) analyze the post-

privatization employment patterns of white-collar and blue-collar workers. They argue that the excess employment in public enterprises is because of patronage, and show that post-privatization labor restructuring led to the dismissal of excess white-collar workers and an increase in the employment of part-time and blue-collar workers. Sen (1997) reports the results of a useful survey of privatized firms in Bangladesh. Dolwah (1997), presenting a case study of firms privatized in the period of 1991-1996, claims that privatization has brought about definitive improvements in performance and productivity. None of these previous studies of privatization in Bangladesh has investigated the debt-default or the tax compliance of privatized firms.

The literature on the international experience in the privatization of public enterprises is diverse and extensive. There is also literature on the ownership of the firm (Hansmann (1988)), in industrial organization theory. While there are many examples of successful privatization, it is by no means established that the change of ownership will inevitably improve performance, particularly when other institutions and policies remain unchanged. Privatization is not a substitute for the growth of the private sector and the emergence of new firms. A number of lessons can be drawn from the international experience of privatization (Kay and Thompson 1986; Kikeri et al., 1992; Vickers and Yarrow 1988; Vickers and Yarrow 1991; and Yarrow 1986). Favorable macroeconomic circumstances, liberal economic policies, competitive input and product markets, and a prudential regulatory framework are conducive to successful privatization. Many observers of privatization argue that successful privatization also depends on well-defined objectives, sound preparation for sale, appropriate pricing and valuation, and transparency in transactions.

Galal et al. (1994) maintain that privatization generally brings about substantial benefits. Sappington and Stiglitz (1987) argue that the state's promise of non-intervention has greater credibility under private ownership of the means of production than under state ownership. Perotti (1995) provides a formal model of a successful state-designed privatization program constructed to reap maximum benefits. Megginson, Nash, and van Randenborg (1994) examine the post-privatization performance of 61 firms from different sectors and different countries. They report that after privatization these firms have achieved more sales, greater investment, higher operational efficiency, lower debt, and higher dividend payments without sacrificing employment security. The findings regarding post-privatization performance in Bourbakri and Cosset (1998) are similar. Drawing on the results of a survey of privatized East German firms, Dyck (1997) argues that if a privatization program facilitates managerial change, firm performance can be improved significantly. In a study using British data, Cragg and Dyck (1999) find that four years after privatization, privatized firms exhibit a significant negative relation between improved performance and the probability of top management resignation. D'Souza and Megginson (1999) present evidence of significant improvements in profitability, output, operating efficiency and dividend payments, and decrease in leverage ratios following privatization.

Boycko, Shleifer, and Vishny (1996) argue that state ownership is an effective way to subsidize select groups. Under public ownership, politicians seek more spending on labor than the optimal level. Such political control leads to inefficiencies that harm the public interest. Privatization, they hold, can "de-politicize" the firm. Thus, the level of employment after privatization is closer to the optimal level. In their model, after privatization, there is a greater restraint on the authorities to tamper with the firm's expenditures because the political cost of subsidizing the private firm is higher than the political cost of squandering its profits in a public enterprise regime. In their view, privatization generates efficiency by raising the cost of political interference. The *institutional change* caused by the transfer of ownership brings about efficiency gains.

However, the impact of privatization on welfare is not always unambiguously positive. In many cases, the full potential gains of privatization are far from being realized. Nellis (1999) reports that in many transition economies privatization has not led to corporate restructuring, and that enterprises' financial and operational performance, productivity, and profitability may not be improved if the institutionalized practices of the public enterprise regime persist. Russia's "loans for share" privatization has been widely criticized. Insider privatization and incorrect modalities of privatization have been held responsible for failing to bring about efficient corporate governance and better performance. The experience of the former Soviet Union, some transition economies,

and low-income countries show little evidence of higher growth or productivity even after several years of liberalization, privatization, and macro-economic stabilization and structural adjustment. The fiscal burden of financing enterprises may continue after privatization. The varied experiences of privatization provide impetus for a critical examination of and cautious reflections on privatization in economies with weak institutions.

3. The Debt-Default Status of Privatized Firms in Bangladesh

One of the principal reasons for privatizing public enterprises in Bangladesh is to reduce the fiscal burden that their losses and their subsidization impose on the state. The losses of public enterprises are substantial. In 1996-97, the aggregated losses of public manufacturing enterprises were Taka 8,231 million ($175 million) and the aggregated losses of public enterprises were Taka 14,117 million ($300 million). In 1997-98, the aggregated losses of public manufacturing enterprises were Taka 5,489 million ($116 million) and the aggregated losses of public enterprises were Taka 7,549 million ($160 million).[1] Public enterprises receive little direct subsidies and grants from the state budget. In 1996-97, direct subsidies amounted to merely Taka 610 million ($12 million) and in 1997-98, they were only Taka 634 million ($13 million). Public enterprises rely on *indirect funding* in the form of *equity injections* from the state and continued *borrowings* from the nationalized commercial banks. Public enterprises received Taka 11,592 million ($247 million) in 1996-97 and Taka 17,438 million ($394 million) in 1997-98 as *equity*, and borrowed Taka 16,585 million ($352 million) in 1996-97 and Taka 18,531 million ($394 million) in 1997-98 as *loans* from the banks. In December 1997, the *outstanding loans* of public enterprises amounted to nearly Taka 42,987 million ($915 million), of which Taka 15,057 million ($320 million), nearly 35 percent, was overdue.[2] The public enterprises paid only Taka 1,879 million ($40 million) in 1996-97 and only Taka 1,645 million ($35 million) in 1997-98 as dividends. Most of these dividends originated from profits of the state monopolies in the oil and gas sector. The rate of *return* on capital or the *rate of profit* for most public enterprises is, thus, either fairly low or negative. Table 1 below provides the consolidated financial status of non-financial public enterprises in Bangladesh from 1992-93 to 1998-99. Table 2 below shows the profits/losses of non-financial public enterprises from 1993-94 to 1998-1999.

Table 1

Consolidated Accounts of Non-Financial Public Enterprises, 1990/91-1998/99 (in billion Taka)

	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99
Operating Revenue	105,2	123,8	144,6	143,5	156,1	163,8	169,1	194,2	214,9
Operating Expenditure	97	117,0	138,9	132,4	152,1	161,8	176,2	192,9	211,7
Wages and Salaries	11,8	12,9	15,2	14,6	14,6	15,6	15,4	16,9	18,2
Purchase of Goods and Services	74,4	92,5	111,4	102,9	119,2	134,1	145,7	160,7	177,3
Depreciation	10,8	11,6	12,3	14,9	18,3	12,1	15,1	15,3	16,2
Operating Surplus	8,2	6,8	5,7	11,1	4,0	2,0	-7,1	1,3	3,2
Non-operating Income	1	-2,3	-2,3	1,0	-0,2	5,3	2,8	2,9	2,3
Interest Payments	10,8	11,0	12,1	7,7	8,0	7,5	8,4	9,2	9,3
Income before Taxes	-1,6	-6,5	-8,7	4,4	-4,2	-0,2	-12,7	-5,0	-3,8
Profit Distribution	2,6	3,6	4,1	4,9	2,2	2,3	1,7	3,3	4,3
Dividends	2,5	3,5	4,0	4,8	2,0	2,1	1,5	3,1	4,0
Profit Sharing	0,1	0,1	0,1	0,1	0,2	0,2	0,2	0,2	0,3
Income Tax	3,9	5,3	4,9	5,5	2,1	1,5	1,0	1,3	1,6

[1] Monitoring Cell, Ministry of Finance, Government of Bangladesh (1998); Taka 50 = US$1 (June 1998).
[2] Bangladesh Bank (1998).

After-tax retained Income	-8,1	-15,4	-17,7	-6,0	-8,4	-4,0	-15,4	-9,6	-9,7
Gross Savings	2,7	-3,8	-5,4	8,9	9,9	8,1	-0,3	5,7	6,5
Gross Fixed Capital Formation	41,3	32,2	27,6	22,9	24,3	26,2	24,8	37,7	48,4
Financing	38,6	36,0	33,0	14,0	14,4	18,1	24,9	31,8	41,8
Net Long-term Borrowing	11,1	18,3	7,1	4,9	1,2	9,4	4,5	2,2	9,0
Drawings	17,9	27,4	18,7	15,9	14,7	21,2	14,9	15,9	21,3
Repayment	6,7	9,1	1,6	11,0	13,5	11,8	10,4	13,7	12,3
Equity Injection	4,6	4,1	6,3	9,1	9,1	6,8	10,8	13,4	20,0
Finance Deficit	22,9	13,6	19,6	0,0	4,1	1,9	9,6	16,2	12,8
Memorandum Items									
Total Assets	418,3	497,7	528,3	602,8	631,8	631,1	634,0	680,0	777,3
Equity	98,5	128,5	117,6	197,8	212,4	214,6	231,3	238,6	251,8
Debt	319,8	369,2	410,7	405,0	418,7	419,4	448,7	469,9	525,5
Employment (thou-sands)	321,9	313,3	292,5	269,0	256,9	258,4	253,4	242,3	244,0
Profitability (in percent)									
Op. Surplus/Op. Revenue	7,6	5,5	3,9	7,7	2,5	1,2	-4,2	0,7	1,5
Op. Surplus/Total Assets	2,0	1,4	1,1	1,8	0,6	0,3	-1,0	0,2	0,4
Other ratios									
Debt-Equity Ratio	3,2	2,9	3,5	2,0	2,0	2,0	1,9	2,0	2,1

Table 2

Profits of Non-Financial Public Enterprises, 1993/94-1998/99 (in million Taka)

	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99
Manufacturing						
BTMC	-1 529	-1 169	-1 343	-1 246	-102	-380
BJMC	-640	-314	-962	-1 005	-480	-1 975
BSEC	-903	-684	-645	-694	-442	-971
BSFIC	-150	78	-378	-678	-642	-324
BCIC	255	-755	-1 214	-2 658	-2 190	-620
BFIDC	-112	11	30	132	139	71
Electricity, Gas, & Water						
PDB	-3 892	-6 469	-765	-3 211	-1 105	-3 434
DESA	-1 851	-1 986	-1 392	-1 574	-1 622	-1 652
CWASA	-27	-26	-33	-43	-30	-24
DWASA	36	-29	-67	14	28	63
BOGMC	1 002	1 204	1 443	1 099	1 062	2 844
Transport & Communication						
BSC	-158	-129	-149	57	110	51
BIWTC	-25	-7	17	100	109	18
CPA	484	641	924	491	467	641
MPA	154	203	204	123	129	105
BIMAN	714	719	496	408	925	552
BRTC	-113	-88	-54	-49	-23	-49
Commercial						
BPC	4 713	1 427	973	-4 299	-4 747	352
BJC	-75	-63	-19	-18	-16	-9
TCB	179	16	-14	23	43	6
Agriculture & Fishery & Construction						
BFDC	1	-10	1	-30	-10	-13
BADC	-130	-9	-134	-234	-227	-293
CDA	31	-118	38	17	52	616
RAJUK	200	39	174	47	50	41
KDA	20	192	43	26	17	111
RDA	12	68	7	2	0	4
Services						
BFDC	17	25	2	10	12	12
BFFWT	5	60	77	74	133	67
BTB	-3	-6	4	2	3	7
BIWTA	-51	-166	-215	-9	-16	-76

Table 2 (continuous)

BPRC	19	24	12	36	57	37
BWDB	31	93	32	31	32	39
REB	166	170	239	192	218	191
BSCIC	-34	-7	-19	-32	-34	-63
EPZA	29	52	90	72	48	69
CAAB	525	616	717	630	669	616
BHB	2	2	0	0	0	0
BSB	-14	-12	-14	-14	-20	-2
Total	-1 111	-6 405	-1 893	-12 206	-7 406	-3 372

Source: Government of Bangladesh, various years.

Private ownership is supposed to lead to better management. Privatization in Bangladesh can be regarded as successful if it raises the firm-level productive efficiency, financial and operational performance and, thus, improves profitability. If, under private management, the loss-making enterprise would start earning profits, it would be able to borrow on a commercial basis and raise equity from the capital markets and foreign investors. Successful privatization would reduce, if not altogether eliminate, the need for continued subsidized credit from the public banks and the reliance on the state for continued equity injections. After privatization, the state would be able to devote its funds to social expenditure and investment. The replacement of soft-budget constraints, characteristic of public enterprises (Kornai, 1986), with hard budget constraints is an indispensable feature of a successful privatization program. This section investigates how many privatized firms rely on financing from the state-dominated banking system. This investigation will make use of a unique data set obtained exclusively for this paper from the Credit Information Bureau of the Bangladesh Bank, the country's central bank. It presents the amount of outstanding and overdue loans of the 201 firms that have been privatized, and analyzes their debt-default status. It shows that many privatized firms rely on loans from the banking sector and that most of these loans are overdue.

The state-owned banks, which are the most important source of credit to the public enterprises as well as privatized and private enterprises, are beset with bad loans. Table 3 provides the time series of the stock of outstanding loans of the scheduled banks in Bangladesh from December 1991 to June 1997. The table shows that credit advanced to the private sector has grown rapidly, whereas credit advanced to the public sector has been stagnant.

Table 4 testifies to the rise of the private sector in Bangladesh's economy. It gives the level of public and private investment in Gross Domestic Product (GDP) and the share of public and private sector investment in GDP. As shown in the table, both the level and the share of private sector investment have increased rapidly. Whereas in 1990-91, private investment constituted merely 5.8% of GDP, it amounted to 10.2% of GDP in 1997-98.

Table 3

Outstanding Advances of the Scheduled Banks (in million Taka)

	Dec.91	June 92	Dec. 92	June 93	Dec. 93	June 94	Dec. 94	June 95	Dec.95	June 96	Dec.96	June 97
Public Sector												
Government	2 014,8	2 413,3	1 776,2	1 347,0	1 697,1	1 727,5	1 649,5	2 071,9	1 983,6	4 374,7	3 017,2	4 853,4
Autonomous and Semi-Autonomous Bodies	4 627,6	4 736,4	5 260,3	5 536,8	6 327,5	5 666,3	6 548,6	8 686,9	5 749,4	5 694,6	5 999,8	8 077,7
Financial Institutions	42,2	422,2	30,5	1 351,7	39,8	1 341,7	403,4	28,5	163,3	44,3	130,2	1 795,5
Non-Financial Public Enterprises	37 093,9	39 026,8	35 696,0	43 150,4	45 646,8	32 550,6	30 908,6	35 193,0	30 315,3	27 933,7	29 483,6	32 807,9
Nationalized Sector Corporations	36 203,9	38 120,0	34 773,4	42 371,3	44 742,8	31 888,6	29 747,2	33 840,1	28 625,4	25 987,8	27 599,7	30 458,2
Others	890,0	906,8	922,6	779,1	904,0	66,2	1 161,4	1 352,9	1 689,9	1 945,9	1 883,9	2 349,7
Local Authorities	434,8	516,1	352,2	463,0	434,1	1 193,7	605,9	632,2	718,7	715,2	1 676,8	1 798,8
Total	44 213,3	47 114,8	43 115,2	51 848,9	54 145,3	42 478,9	40 116,0	46 612,5	38 930,3	38 762,5	40 307,6	47 333,3
Private Sector												
Agriculture	31 955,8	36 117,3	37 607,0	38 672,9	40 040,9	42 867,5	45 012,3	47 593,6	49 338,2	53 005,3	53 726,0	55 403,2
Manufacturing	59 892,4	62 237,7	71 388,1	72 863,3	75 837,9	83 614,9	87 889,8	94 567,5	106 942,9	116 779,8	124 215,4	133 160,3
Commerce & Trade	57 403,4	63 018,4	67 935,7	74 035,8	78 501,3	78 745,8	90 078,9	98 134,2	108 379,7	114 300,3	122 203,2	123 227,2
Transport & Storage	4 105,7	4 780,3	4 394,1	4 325,6	4 307,6	2 573,4	3 993,2	5 729,0	5 723,1	11 516,0	6 464,6	7 036,7
Construction	5 725,2	6 330,5	6 448,6	6 810,9	7 278,4	7 930,4	8 527,8	7 946,9	8 236,8	8 595,6	9 110,4	9 092,8
Private Trust Fund & Non-Profit Organizations	683,3	686,6	715,3	799,4	761,5	336,8	298,8	256,4	169,7	155,5	148,9	100,8
Private Financial Institutions	1 698,1	1 780,5	2 188,8	2 146,2	2 350,6	2 820,9	3 899,2	4 802,3	5 451,2	4 417,6	6 127,0	5 538,4
Professionals & Self-Employed	5 368,5	5 730,6	6 049,3	6 835,1	8 044,1	7 648,7	8 097,8	8 742,1	8 567,6	11 076,0	11 673,9	13 495,0
Foreign Official Sector & Foreign	2 899,1	2 722,9	2 627,8	2 575,5	2 888,1	3 088,1	3 684,9	3 808,2	3 836,4	3 729,7	4 005,5	3 639,6
Others	5 660,6	5 175,9	6 628,9	7 380,1	7 978,1	11 166,0	11 403,0	11 601,9	13 109,3	9 322,1	17 702,4	19 618,6
Total	174 892,1	188 580,7	205 984,0	216 444,8	227 988,5	240 792,5	262 885,7	283 182,1	309 754,9	332 897,9	355 377,3	370 312,3
Grand Total	219 105,4	235 695,5	249 099,2	268 293,7	282 133,8	283 271,4	303 001,7	329 794,6	348 685,2	371 660,4	395 684,9	417 645,6
Memorandum Items												
Credit to Public Enterprises/Credit to Private anufacturing Firms (in percent)	61,9	62,7	50,0	59,2	60,2	38,9	35,2	37,2	28,3	23,9	23,7	24,6
Credit to Public Sector/Credit to Private Sector (in percent)	25,3	25,0	20,9	24,0	23,7	17,6	15,3	16,5	12,6	11,6	11,3	12,8

Table 4

Public and Private Investment in Bangladesh, 1990-91 to 1997-98

	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98
In Million Taka								
Investment	95 955	109 851	135 214	158 927	194 651	221 200	242 427	250 507
Private	48 562	60 063	74 406	80 676	110 172	139 343	151 263	157 064
Public	47 393	49 788	60 808	78 251	84 479	81 857	91 164	93 443
As percent of Gross Domestic Product								
Investment	11,50	12,12	14,26	15,42	16,63	16,99	17,29	16,26
Private	5,82	6,63	7,85	7,83	9,41	10,71	10,78	10,19
Public	5,68	5,49	6,41	7,59	7,22	6,29	6,50	6,06

Source: Bangladesh Bureau of Statistics, various years.

Table 5 gives the summary position of outstanding and overdue loans of over Taka 100 million ($2 million) and above to the public sector as well as the private sector in Bangladesh as of March 31, 1998. The total amount of outstanding loans greater than or equal to Taka 100 million ($2 million) to the public sector is Taka 25 billion ($532 million), of which Taka 21 billion ($426 million), approximately 82%, is overdue. The total amount of such outstanding loan to the private sector is Taka 43.7 billion ($930 million), of which Taka 36.7 billion ($781 million), about 84%, is overdue. The amount of credit extended to the private sector is higher than that given to the public sector. The aggregate debt-default ratio of the private sector is not lower than that of the public sector, which *prima facie* may suggest that in Bangladesh the private sector is no better than the public sector in repaying loans obtained from the banking and non-banking financial sector. Table 6 gives the outstanding and the overdue loans which the public enterprises obtained from the nationalized commercial banks.

Table 5

Summary Position of Outstanding and Overdue Loans. Taka 100 Million (US$2 million) and above (in million Taka)

Sector	No of Borrowers	Total Outstanding	Total Overdue	Share of Overdue
Public	27	24 970	20 550	82,3
Private	165	43 720	36 720	84,0
Total	192	68 690	57 270	83,4

Source: Bangladesh Bank (1998).

Table 6

Outstanding and Overdue Loans of Public Enterprises from Nationalized Banks.
Stock (December 1997), in million Taka

Sector	Corporation	Outsanding Loan	Overdue Loan	Percent Overdue
Manufacturing	BTMC	6 341,2	5 503,3	86,8
	BSEC	7 986,5	4 779,5	59,8
	BSFIC	1 942,9	294,6	15,2
	BCIC	1 408,0	370,3	26,3
	BFIDC	0,0	0,0	na
	BJMC	16 237,6	772,7	4,8
	Sub-total	33 916,2	11 720,4	34,6
Utilities	BOGMC	0,1	0,1	100,0
	PDB	315,3	14,8	4,7
	DESA	0,0	0,0	na
	CWASA	0,0	0,0	na
	DWASA	0,0	0,0	na
	Sub-total	315,4	14,9	4,7
Transport	BSC	1 174,2	769,1	65,5
	BIWTC	1,0	0,1	10,0
	Biman	0,0	0,0	na
	BRTC	120,8	120,8	100,0
	CPA	0,0	0,0	na
	MPA	0,0	0,0	na
	Sub-total	1 296,0	890,0	68,7
Commercial	BPC	4 922,5	1,9	0,0
	BJC	0,0	0,0	na
	TCD	0,0	0,0	na
	Sub-total	4 922,5	1,9	0,0
Agriculture	BADC	1 934,3	1 933,8	100,0
	BFDC	4,8	0,0	0,0
	Sub-total	1 939,1	1 933,8	99,7
Services	BSCIC	133,2	133,2	100,0
	BIFDC	354,0	307,6	86,9
	BWD	39,9	4,2	10,5
	BTB	50,7	50,7	100,0
	BPC	15,1	0,0	0,0
	BFDC	0,6	0,6	100,0
	BSB	2,5	0,0	0,0
	REB	2,7	0,0	0,0
	Sub-total	598,7	496,3	82,9
Total		42 987,0	15 057,3	35,0

The classification of non-performing debts in Bangladesh does not meet conservative and prudential Basle standards generally accepted among international banks. Thus, the list of firms with overdue loans is constructed on the basis of fairly "liberal" and possibly lax standards. If more conservative principles of loan classification are applied, an even larger number of privatized firms would be regarded as defaulters and the volume of classified loans would be much higher. Firms that already have overdue debt may be unable to service their outstanding loans. Hence, incidences of both outstanding and overdue loans of privatized firms are reported here. The set of privatized firms chosen for investigation is the same set and subset of firms used in Sen's (1997) survey of privatized firms in Bangladesh. The set, consisting of 201 firms, covers all the major industrial (manufacturing) firms privatized from 1979 to 1995.

Data provided by the Credit Information Department of Bangladesh Bank, the country's central bank, shows that as of December 31, 1997, out of 201 privatized firms, information is available on 128 firms. Of these 128 firms, 77 ones have overdue and outstanding loans; 33 firms have outstanding loans but no overdue loans; and only 18 firms have neither outstanding nor overdue loans (Table 7). The total volume of outstanding loans given to 110 firms amounts to Taka 15.35 billion ($327 million); the average (mean) amount of outstanding loans is nearly Taka 140 million ($3.1 million) per firm. The 77 firms that have overdue loans owe Taka 12.65 billion ($269 million) of which Taka 5.7 billion ($121 million) is overdue. The ratio of overdue loans to outstanding loans to these firms is 37%. The average (mean) amount of outstanding and overdue loans of the 77 firms is respectively nearly Taka 164 million ($3.5 million) and nearly Taka 74 million ($1.6 million) per firm. Table 8 provides the subclass interval ranges of outstanding and overdue loans, and reveals that a few privatized firms have substantial amounts of overdue and outstanding loans.

Table 7

Debt-Default Status of Privatized Firms (in million Taka)

	No of Firms	Loan Amount	Av. Amount
Total number of firms	201		
Firms for which information is unavailable	73		
Firms for which information is available	128		
Firms with overdue loans	77	12652,0	164,31
Firms with outstanding but no overdue loans	33	2697,8	81,75
Firms with neither overdue nor oustanding loans	18	0,0	0,0
Firms with overdue and outstanding loans	110	15349,8	139,54

Source: Bangladesh Bank (1997).

Table 8

Outstanding & Overdue Loans of Privatized Firms (in million Taka)

Oustanding Loans of Privatized Firms			
Range	No of Firms	Amount Outstanding	Av. Amount
1.0 - 5.0	13	28,2	2,17
5.1 - 10.0	4	29,4	7,35
10.1 - 20.0	11	164,8	14,98
20.1 - 50.0	15	497.7	33,18
50.1 - 100.0	19	1,495.7	78,72
100.1 - 500.0	44	10,522.4	239,15
500.1 - 1,000.0	4	2,611.6	652,90
Total	110	15,349.8	139,54
Overdue Loans of Privatized Firms			
Up to 5.0	10	26,3	2,63
5.1 - 10.0	11	79,2	7,20
10.1 - 20.0	7	105,8	15,11
20.1 - 50.0	20	720,4	36,02
50.1 -100.0	15	1 057,3	70,49
100.1 -500.0	14	3 707,5	264,82
500.1 - 1,000.0	0	0,0	na
Total	77	5 696,9	73,99

Source: Bangladesh Bank.

The World Bank (Dowlah, 1997) have recently conducted a study of 13 selected privatized firms. Although the study regards the privatization experience in Bangladesh as successful, and the Bank's economic advice to the authorities endorses rapid and extensive privatization, it does not analyze the debt-default status of privatized firms. This is a serious gap, given the importance of the loan defaulting phenomenon in Bangladesh. Thus, information concerning those firms as of March 31, 1998 is obtained from the central bank and analyzed here. Information on 11 of the 13 firms is available. According to Table 9, 5 firms out of 11 have overdue loans; three firms have outstanding loans but no overdue loans; and only three firms have neither overdue nor outstanding loans. The total amount of loans given to 8 firms is over Taka 1 billion ($21 million), of which Taka 793 million ($17 million) is overdue. The ratio of overdue to outstanding loans is 79%. The average (mean) amount of outstanding loans per firm is Taka 126 million ($2.7 million). The total sum of loans given to the 5 firms with overdue loans amounts to Taka 825 million ($17.8 million), of which nearly Taka 793 million ($16.9 million) is overdue. The average (mean) sum of loans given to the firms with overdue loans is Taka 165 million ($3.5 million), of which Taka 158 million ($3.4 million) is overdue. The three firms that have outstanding but no overdue loans have outstanding loans of Taka 189 million ($4.2 million); the average (mean) amount of outstanding loans owed by these firms is Taka 63 million ($1.3 million) per firm. The range breakdowns of outstanding and overdue loans are given in Table 10. Some of these firms have a fairly large amount of loans. The first firm has an outstanding loan of Taka 507 million ($10.8 million), of which Taka 504 million ($10.7 million) is overdue. The second firm has an outstanding loan of Taka 224 million ($4.7 million), all of which is overdue. The third firm has an overdue loan of Taka 61 million ($1.3 million). Two other firms have small amounts of overdue loans. The inability or the unwillingness of the privatized firms to service their debt suggests that these firms have not had any profound improvements in performance after privatization.

Table 9

Debt-Default Status of 13 Selected Firms (in million Taka)

	No of Firms	Amount	Av. Amount
Total number of firms	13		
Firms on which information is not available	2		
Firms on which information is available	11		
Firms with overdue loans	5	814,7	162,94
Firms with outstanding but not overdue loans	3	189,8	63,27
Firms with neither outstanding or overdue loans	3	0,0	0,00
Total	8	1 004,5	125,56

Source: Bangladesh Bank (1998).

Table 10

Outstanding and Overdue Loans of Selected 13 Firms (in million Taka)

Range	No of Firms	Amount Outstanding	Av. Average
Outstanding Loans			
1 to 5	0		
5.1 to 10	1	8,4	8,40
10.1 to 20.0	1	13,8	13,80
20.1 to 50.0	2	75,5	37,75
50.1 to 100.0	1	61,4	61,40
100.1 to 500.0	2	338,0	169,00
500.1 to 1,000	1	507,4	507,40
Total	8	1 004,5	125,56
Overdue Loans			
Range	No of Firms	Amount Overdue	Av. Average
Upto 5.0	2	3,6	1,8
5.1 to 10.0	0	na	na
10.1 to 20.0	0	na	na
20.1 to 50.0	0	na	na
50.1 to 100.0	1	61,4	61,4
100.1 to 500.0	1	223,7	223,7
500.1 to 10,000.0	1	504,2	504,2
Total	5	792,9	158,58

Source: Bangladesh Bank (1998).

The authorities have recently published, in response to a parliamentary question, the set of debt-defaulter firms, each with overdue loans of at least Taka 10 million (approximately $200,000). Sen's (1997) survey provides the set of 201 privatized firms. Intersecting these two sets shows that out of the 201 privatized firms, 63 firms (nearly 30%) are also in the list of defaulters. The author submitted the list of these firms to the central bank to analyze their debt-default status. As of March 31, 1998, according to the central bank, information on 59 out of 63 firms was available, and information on 4 firms was not available (Table 11). Of these 59 firms, 51 have both

outstanding and overdue loans, 8 firms have outstanding but no overdue loans, and there is no firm in the set without either outstanding or overdue loans. The 51 firms with overdue loans have outstanding loans of Taka 9,433 million ($201 million), of which nearly Taka 4,900 million ($104 million) – approximately 52 percent – is overdue.

Table 11

Debt-Default Status of Selected Privatized Firms (in million Taka)

	No of Firms	Amount of Loans	Av. Amount
Total	63		
Firms for which information is not available	4	na	na
Firms for which information is available	59	na	na
Firms with overdue loans	51	9 433,0	184,96
Firms with outstanding but not overdue loans	8	875,3	109,41
Firms with neither overdue not outstanding loans	0	na	na
Total	59	10 308,3	174,72

Source: Bangladesh Bank (1998).

State-owned development financial institutions have been key suppliers of industrial credit to private enterprises, including privatized ones, in Bangladesh. Table 12 and Table 13 given below represent the industrial loan recovery profiles of the two main development financial institutions in the country, the Bangladesh Industrial Bank (BSB) and the Bangladesh Industrial Loan Institute (BSRB), from 1992-93 to 1997-1998. The Bangladesh Industrial Bank's (BSB) ratio of loan recovery to total due credit declined from 7.6% in 1992-93 to 2% in 1997-98, while the ratio of overdue credit to outstanding one increased from nearly 52% in 1992-93 to almost 62% in 1997-98. The Bangladesh Industrial Loan Institute's (BSRS) ratio of loan recovery to total due credit declined from 3.2% in 1992-93 to 1.5% in 1997-98, while the ratio of overdue to outstanding credit rose from 60% in 1992-93 to 87% in 1997-98. Both these industrial banks were already in a fragile financial condition in 1992-93. By 1997-98, their financial conditions and asset qualities had progressively worsened.

Table 14 below provides data about the share of overdue loans in percentage of total loans by types of domestic commercial banks, and the distribution of nationalized commercial banks' and private commercial banks' overdue loans by types of debtors. It shows that the problem of overdue loans is not solely confined to nationalized commercial banks, but is endemic to private commercial banks too. It suggests that privately owned banks are not better in selecting borrowers or recovering loans from borrowers. The share of non-performing loans of domestic commercial banks, both nationalized and private ones, is very high, as shown in Table 15 and Table 16 below. Both the public sector's and the private sector's non-performing loan ratios are high. The ratio of non-performing loans of the development financial institutions is even higher than commercial banks and has been rising in recent years.

Table 12

Industrial Loan Recovery. Bangladesh Shilpa Bank (in million Taka)

	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98
Overdue at the Beginning of Period	3 226	3 784	4 952	6 325	7 504	8 638	9 316	10 367
Principal Due in Current Period	451	542	817	778	649	590	726	371
Total Due	3677	4 326	5 769	7 103	8 153	9 228	10 042	10 738
Amount Recovered	450	282	438	518	637	488	609	226
Rescheduling, Adjustment, and Transfers	258	192	196	298	220	338	288	24
Accrued Interest	815	1 107	1 190	1 217	1 342	914	1 222	803
Overdue at the End of Period	3784	4 952	6 325	7 504	8 638	9 316	10 367	11 291
Gross Disbursements	815	354	662	306	647	1 132	203	256
Total Outstanding Credit	9507	10 875	12 259	13 607	15 608	16 586	17 501	18 322
Memorandum items (in percent)								
Recovered/Total Due	12,2	6,5	7,6	7,3	7,8	5,3	6,1	2,0
Overdue/Outstanding (end of period)	39,8	45,6	51,6	55,1	55,3	56,2	59,2	61,6

Source: Bangladesh Shipa Bank (BSB).

Table 13

Bangladesh Shilpa Rin Sangstha Bank (in million Taka)

	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98
Overdue at the Beginning of Period	3 739	4 526	5 511	5 906	5 100	4 636	4 582	13 068
Principal Due in Current Period	1 276	1 361	148	98	192	93	318	160
Total Due	5 015	5 887	5 659	6 004	5 292	4 729	4 900	13 228
Amount Recovered	258	207	182	301	475	404	291	194
Accrued Interest and Adjustments	-231	-169	429	-603	-181	257	8 459	690
Overdue at the End of Period	4 526	5 511	5 906	5 100	4 636	4 582	13 068	13 724
Gross Disbursements	433	273	45	44	40	19	114	121
Total Outstanding Credit (end of period)	8 608	9 450	9 897	9 026	8 484	8 369	15 510	15 827
Memorandum items (in percent)								
Recovered/Total Due	5,1	3,5	3,2	5,0	9,0	8,5	5,9	1,5
Overdue/Outstanding (end of period)	52,6	58,3	59,7	56,5	54,6	54,7	84,3	86,7

Table 14

Domestic Commercial Banks: Overdue Loans, 1995-1997

Type of Banks & Type of Loan			
Overdue loans in percent of total loans			
	Dec. 95	Dec. 96	Dec. 97
Domestic Commercial Banks			
Public Sector loans	36,8	41,9	34,9
Private Sector loans	34,4	38,8	36,7
Total Overdue loans	34,7	39,1	36,4
Nationalized Commercial Banks			
Public Sector loans	32,5	38,1	32,0
Private Sector loans	32,7	40,2	40,4
Total Overdue loans	32,7	39,8	38,9
Private Commercial Banks			
Public Sector loans	70,7	75,0	65,9
Private Sector loans	37,6	36,4	30,4
Total Overdue loans	39,2	37,8	31,6
Distribution in percent of Overdue loans			
Domestic Commercial Banks			
Public Sector loans	14,1	12,6	12,6
Private Sector loans	85,9	87,4	87,4
Total Overdue loans	100,0	100,0	100,0
Nationalized Commercial Banks			
Public Sector loans	17,3	15,1	14,9
Private Sector loans	82,7	84,9	85,1
Total Overdue loans	100,0	100,0	100,0
Private Commercial Banks			
Public Sector loans	8,4	7,2	7,0
Private Sector loans	91,6	92,8	93,0
Total Overdue loans	100,0	100,0	100,0

Source: Bangladesh Bank (1998).

Table 15

Summary Performance Indicators of Banks in Bangladesh (%)

	Dec. 94	Dec. 95	Dec. 96	Dec. 97
Classified loans by groups of banks	34,8	32,0	31,5	32,7
Domestic Banks	36,3	33,9	33,3	34,8
Nationalized Commercial Banks	32,1	31,1	32,6	36,6
Private Domestic Banks	44,5	39,4	34,8	31,4
Foreign Banks	8,8	5,4	4,7	3,4
Specialized Development Banks	..	..	50,9	65,7
Classified Loan Rations by Debtors				
Public Sector	..	24,6	41,3	32,4
Private Sector	..	33,1	30,3	32,8
Distribution of Classified Loans by Sectors	..	100,0	100,0	100,0
Public Sector	..	9,3	14,7	12,1
Private Sector	..	90,7	85,3	87,9
Total Classified Loans by Categories	34,8	32,0	31,5	32,7
Substandard	19,2	13,1	13,4	10,6
Doubtful	17,6	12,4	12,3	15,7
Bad	58,6	69,8	74,3	73,8
Total Adjusted Classified Loans by Sectors	31,4	25,6	24,8	25,7
Domestic Banks	32,8	27,2	26,4	27,5
Nationalized Commercial Banks	26,5	25,3	26,6	29,9
Private Domestic Banks	44,2	31,3	26,0	23,0
Foreign Banks	8,8	3,5	3,1	1,9
Specialized Development Banks	..	..	28,9	55,2

Source: Bangladesh Bank, 1998.

Table 16

Bank Loan Classification 1994-1997 (in billion Taka)

	Dec. 94	Dec. 95	Dec. 96	Dec. 97
Total Commercial Bank Loans	262,9	310,3	351,0	395,8
Domestic Banks	248,8	290,5	328,8	369,6
Nationalized Commercial Banks	164,7	192,1	217,9	243,5
Private Domestic Banks	14,1	19,8	22,2	26,2
Foreign Banks	..	..	84,0	66,5
Total (incl. Specialized Banks)	..	..	435,0	462,3
Bank Loans by Debtors				
Public Sector	..	37,5	39,4	48,4
Private Sector	..	272,7	311,6	347,4
Total Adjusted Commercial Bank Loans	249,7	283,5	319,8	358,3

Table 16 (continuous)

Domestic Banks	235,6	264,1	298,0	332,5
Nationalized Commercial Banks	152,1	177,3	200,3	220,2
Private Domestic Banks	83,5	86,8	97,7	112,3
Foreign Banks	14,1	19,4	21,8	25,8
Total (incl. Specialized Banks)	..	..	377,8	409,2
Specialized Banks	..	..	58,5	50,9
Total Classified Loans by Sectors	91,6	99,4	110,5	129,6
Domestic Banks	90,3	98,4	109,5	128,7
Nationalized Commercial Banks	52,9	59,5	70,9	89,1
Private Domestic Banks	37,4	38,8	38,6	39,6
Foreign Banks	1,2	1,1	1,0	0,9
Total (incl. Specialized Banks)	..	..	153,3	173,3
Specialized Banks	..	..	42,8	43,7
Classified Loans by Sectors				
Public Sector	..	9,2	16,3	15,7
Private Sector	..	90,2	94,3	113,9
Total Classified Loans by Categories	91,6	99,4	110,5	129,6
Substandard	17,6	13,0	14,8	13,7
Doubtful	16,1	12,3	13,6	20,3
Bad	53,7	69,4	82,2	95,6
Interest Suspense	13,1	26,8	31,2	37,5
Total Adjusted Classified Loans by Sectors	78,4	72,6	79,4	92,1
Domestic Banks	77,2	71,9	78,7	91,6
Nationalized Commercial Banks	40,2	44,8	53,3	65,8
Private Domestic Banks	36,9	27,2	25,4	25,8
Foreign Banks	1,2	0,7	0,7	0,5
Total including Specialized Banks	..	..	96,1	120,2
Specialized Development Banks	..	..	16,7	28,1

Source: Bangladesh Bank, 1997.

The reasons for the widespread overdue loans of banks are weakness in the regulatory and supervisory system, defective corporate governance of banks, lack of internal bank control, poor accounting and auditing systems, poor risk management, and the political power of key defaulters. The weakness of regulatory oversight, poorly managed banks and deficient legal institutions, enable borrowers to default debts without the fear of retaliation.

The data on the overdue and outstanding loans to privatized firms indicates that inability to repay loans is a major problem of privatized firms in Bangladesh. The poor record of the financial institutions' loan recovery reinforces the notion that privatization does not prevent the perpetuation of "soft" government. These firms are unwilling or unable to service their loans because of either the failure to realize profits, managerial inefficiency, or diversion of profits for personal gains rather than servicing debts. Their unwillingness to repay loans is a failure of development administration or "governance." If the firm's management expects that the banks will not force it to repay, then it has no incentive to repay its debt. The authorities have been, for the most part, either unwilling or unable to retrieve debts from firms that have borrowed heavily and exceeded the time limit to repay. The failure to recover loans has hurt the reputation of the bank authorities.

The lack of credible threats prompts firms to default loans because they know that such default will not incur any major penalty.

Some owners of privatized firms often argue that they are unable to service the firm's debt because it was accumulated during the period of public ownership. Since they are not responsible for borrowing prior to privatization or for past public sector inefficiency, they cannot be held accountable for debts incurred in the past. Therefore, some have claimed that they are neither obliged nor willing to repay such loans. However, this proposition fails to take into account the fact that the price at which the buyer bought the firm reflects the servicing costs of the debt, which is part of their contractual obligation. The sale price reflects the fact that a firm is supposed to repay its loan. The sale price will be lower if the expected burden of repaying is higher, and vice versa.

In itself, a high amount of debt does not signal about firm inefficiency. If the firm has marketable collateral that can be sold to meet its obligations, it should be able to sell debts (bonds), "purchase" credits, or secure loans from commercial banks or the capital market. Even if the firm does not have any marketable collateral, but if capital market participants expect the firm to produce commodities that will generate sufficient profits to be able to repay its debts, it may be able to borrow heavily. Firms with the potential to generate future profits are able to obtain funds for fixed and circulating capital by issuing high interest-bearing "junk" bonds, or by relying on venture capital. The debt holders of such firms assume a high risk because of the possibility of high returns. Such debts are rarely bought or subsidized by the state in advanced capitalist economies. Instances where the owner of privatized firms has bought public enterprises with borrowed public funds can be regarded as publicly sponsored leveraged privatization of public enterprises. Both publicly sponsored leveraged buyout of public enterprises, or publicly leveraged privatized firms are contrary to the essence of privatization, since the objectives of privatization are to reduce the state's fiscal burden and state subsidies, and, indeed, the role of the state in the economy. Publicly sponsored leveraged buyout and cheap public credit for privatized firms not only distort the markets; such state interventions are also likely to promote *rentier* class than productive activity.

Unless compelling evidence to the contrary is provided, the rationale for the state in Bangladesh to use its scarce resources for publicly leveraged buyouts or public leverage of privatized firms remains suspect. The state's development funds should be used for providing public goods, social expenditure, improving primary education, basic health care, and other appropriate investment and expenditure, justifiable on the basis of social and economic calculations. The firm is privatized precisely because of the authorities' conviction that the firm would be better managed under private ownership, subject to capital market discipline and the possibility of bankruptcy. The state continuing to subsidize the private owner would entail not only the transfer of public wealth to private agents, but also the undermining the objectives of privatization. A firm that has perpetual access to state funds is not subject to capital market discipline and the possibility of bankruptcy. The management of a publicly leveraged privatized firm has hardly any incentive to improve performance because it has such easy access to state funds and does not have to subject itself to the competitive forces in the loan funds market. Due to poor surveillance of the banking and non-banking financial system, some private agents can resort to "insider lending," misrepresentation of material facts, or other such subterfuge to obtain loans for the privatized firm. Many of these loans are unjustifiable on the basis of economic calculation.

The absence of financial sector discipline and the incomplete nature of privatization are major stumbling blocks to successful privatization and private sector development in Bangladesh. Establishing financial sector discipline would set the ground for obtaining the benefits of private ownership of the means of production and shrink the opportunities for rent-seeking activities. The appropriate action on the part of the authorities would be to compel the firm to meet its obligations to its creditors, employees, suppliers, and customers to accordance with the provisions of the law. If the firm is unable to meet its obligations, it should, after due process, be sold off to (a) pay its creditors and employees and (b) be transferred to its new owners who are expected to provide the firm with a more effective management and, thus, face positive profits. Such action can be re-

garded as "re-privatization" of the privatized firm. If the firm cannot be sold because it is not economically viable, it ought to be liquidated according to the standard practice of market economies.

4. Tax Registration Profile of Privatized Firms

Tax evasion is a serious problem in many developing countries, such as Bangladesh. Polyconomics Inc. (1990) reports that 25 percent of the Mexican economy is "off the books." Bagachwa and Naho (1995) estimate that the unofficial segment of the Tanzanian economy has *increased* over the years, from 10% of the national income in the late 1960s to 30% in the late 1980s. Das Gupta et al. (1995) claim that the improvement of tax compliance in India could raise tax revenue by 75%. Schaffer (1998) finds that the tax arrears of privatized firms in many transition economies are quite high. Given the widespread tax evasion in developing countries, an examination of tax compliance of privatized firms in Bangladesh is warranted. In this section, the tax registration records of the set of privatized firms in Bangladesh are examined in order to investigate their tax registration profile. As McLaren (1996) summarized in a survey of the analyses of tax evasion in developing countries, there exist three major approaches to detect and determine the level of tax evasion. The first approach is the *survey method*, for example as in Gauthier and Gersovitz (1997). The second technique used to determine tax evasion is the *"gap" approach*, such as in Alm et al. (1991). The third method is the *monetary approach*, like in Polyconomics Inc. (1990).

This section uses a survey, conducted specially for this paper, to provide exploratory knowledge of the extent of tax non-registration among privatized firms. Whereas Gauthier and Gersovitz (1997) use a self-reported survey to detect and analyze tax evasion, avoidance, and exemption, this study uses a directly verifiable approach to determine tax evasion and avoidance. In their survey sample, participation of the firms was voluntary. Undoubtedly there can be a self-selection bias in such surveys, besides the problem of relying on self-reported answers to survey questions despite surveyors' guarantees of full confidentiality. In the present survey, objective and verifiable information on privatized firms' tax registration status is obtained *directly* from the authorities' tax databases. Similar to Gauthier and Gersovitz's (1997) survey, which uses different kinds of taxation on businesses in Cameroon to find out their compliance, this section uses two different taxes on Bangladeshi businesses to determine the extent of their tax registration. Non-registration is only one form of tax evasion or avoidance. Other kinds of tax evasion and avoidance in Bangladesh are, for example, under-valuation, misrepresentation of material facts, inappropriate classification, and legal subterfuge. A unique data set, consisting of privatized firms' tax registration records maintained by the authorities, is used here. It was obtained from the national tax authorities exclusively for this paper.

Empirical investigation of privatized firms' tax registration would indicate the extent of their tax compliance because registration is the *minimum* necessary requirement for certain tax payments to the state. A firm is required to not only register for the appropriate taxation procedures but is also supposed to periodically file tax returns and pay the due amount of tax. The non-registration for taxation by privatized firms, which often implies failure to comply with tax regulations, can reduce financial (revenue) gains of the state from privatization of public enterprises.

In order to comply with tax regulations, firms are required to be registered with the authorities in accordance with procedures laid down by law. A firm is required to be registered to obtain a Business Identification Number (BIN) for Value Added Taxation (VAT). It also has to be registered to obtain a Taxpayer's Identification Number (TIN) for corporate and/or income tax. The National Board of Revenue (NBR) of the Ministry of Finance has the state's authority to issue these registration numbers. Each registration process is completely separate and does not depend on the other one. The numbers are given separately by different and autonomous offices of the NBR upon processing of the registration forms.

All firms must be registered for a TIN and use it to file tax returns in each financial year even if no corporate and/or income tax is due that year. Firms subject to the payment of Value Added Taxation are required to be registered for VAT and obtain a BIN. A BIN is also required to receive tax credit for the cost of inputs. However, unlike TIN, only firms above a fixed amount of

turnover (Taka 15 million ($300,000)) are subject to VAT. Firms below the given size are subject to "turnover tax." The rate of turnover tax (4%), is lower than that of VAT, which is 15%. Thus, valuation of the turnover of the firm exists because of contests and disputes between the management of the firm and the authorities. If a firm is classified as a "small" business it pays a lower rate of tax while the authorities are deprived of revenue. Certain sectors, such as "cottage industry," cold storage, and retail trade (except for 69 items), are exempt from VAT. Thus, firms in those sectors do not have BIN.

Even though the tax registration records in Bangladesh reflect the weakness of tax administration, they do provide one of the most well-kept sets of statistical information in Bangladesh; after all, they enable the authorities to collect revenue and to meet the preconditions of foreign official assistance. Although generally not publicly available, the authorities have made it available for this paper.

Method of Analysis and Inference

The firms in the set are searched for matches in the BIN database of the NBR. Search subroutines were specially created for this study since existing programs prove to be inadequate. First, the number of firms with BINs is recorded. Second, the BINs of the registered firms are secured to undertake further detailed investigation. A similar search is carried out separately by using the TIN database of the NBR. Besides obtaining a list of matched firms and their TINs for further investigation, the search program yields the issue data for TINs. This survey was carried out in May 1998 by using the latest data available then.

First, the results from these two searches are combined to check how many firms in the set have both BIN and TIN, or only one but not the other, or neither BIN nor TIN. Second, a more relevant list of firms, a large subset from the original set of 201 firms, is examined in a similar way. This subset is constructed by taking away firms that have been liquidated, transformed into entities outside the scope of the relevant tax, or engaged in sectors outside the relevant tax. Thus, this subset is more appropriate for checking the registration status of the firm. Third, more specific subsets of firms are constructed to undertake comparative analysis and to examine characteristics of some groups of firms.

Mere registration for a particular tax does not imply that the firm is paying any tax at all or is not avoiding underpaying the due amount of taxation. However, the *lack* of tax registration on the part of an operational firm indicates that the management of the firm is avoiding compliance with tax regulations. If it is not registered, it cannot be paying the applicable tax.

An operational firm is able to evade registration because of either weak surveillance on the part of the authorities, or connivance by rent-seeking officials. On the other hand, an operational firm being registered for one form of taxation but not registered for another when it is legally obliged to be registered for both is evidence of non-compliance on the part of the firm's management. This further demonstrates the limited computational capacity of the authorities to crosscheck among its records to detect firms engaged in tax registration evasion.

Registration Status of the Set of Privatized Firms

The set of 201 firms is checked to examine post-privatization tax registration profiles. The results obtained are as follows:

- 86 firms have obtained BIN registration.
- 51 firms have obtained TIN registration.
- 31 firms are registered for both BIN and TIN.
- 95 firms in the list are not registered for either BIN or TIN.

Construction of a Subset

The first set of results provides information on the tax registration status of the whole set of firms that have been privatized. Some of these firms have been liquidated, some ones are engaged in sectors outside the scope of VAT, some firms have been converted into non-corporate entities, etc. These companies are removed to construct an appropriate subset of firms. Firms that are reported to be shut down but have maintained some form of tax registration are retained in the constructed subset because those firms could be either engaged in some activity or might be reactivated in the near future. Moreover, for the majority of these firms, the issue date of TIN is much later than the change of ownership, which suggests that the management of a reportedly closed firm registered with a view to undertaking some activity in the near future. Therefore, incorporating such firms, though reportedly closed, with one registration or the other, is appropriate. Firms that have been closed but have not yet been liquidated and have not made *any* kind of tax registration are excluded from the constructed subset. It is assumed that these entities are not presently engaged in any economic activity. It should be pointed out that the present investigation cannot determine whether liquidated firms paid due taxes on realized capital gains or income from liquidation of the enterprises.

Registration Status of the Subset of Privatized Firms

The subset of 158 firms is checked to analyze their post-privatization tax registration record. The following conclusions can be drawn:

- 85 firms have BIN registration.
- 51 firms have TIN registration.
- 31 firms have obtained both BIN and TIN registration.
- 53 firms have neither TIN nor BIN registration though these firms are reported to be in operation.

Registration Status of Firms in World Bank Case Study

The tax registration status of the 13 firms in Dowlah's (1997) case study is given below:

- 6 firms have TIN registration.
- 6 firms have BIN registration.
- 3 firms are registered for both TIN and BIN.
- 4 firms have not been registered for either TIN or BIN.

Registration Status of Defaulting Firms

A great number of privatized firms have overdue loans of more than Taka 10 million ($200,000). Most of these loans have been borrowed from nationalized commercial banks. The central bank provided, in response to a parliamentary inquiry, a list of firms with overdue loans. Privatized firms with overdue (classified) loans have been identified. 63 privatized firms have overdue loans greater than or equal to Taka 10 million ($200,000). Since the loans have been provided mostly by the nationalized commercial banks, the authorities have considerable information on these firms. Hence, it is of interest to analyze the tax registration status of such firms. Results of tax registration status of privatized firms with overdue loans are given below:

- 37 firms are registered for BIN.
- 20 firms are registered for TIN.
- 14 firms are registered for both BIN and TIN.
- 20 firms are not registered for either BIN or TIN.

Registration Status of Jute Goods Manufacturing Firms

Among the privatized firms there are 34 jute goods manufacturing firms. The jute industry is one of the major and oldest ones in the country. The privatized jute mills are organized under

the Bangladesh Jute Mills Association (BJMA), which is the industry lobby. Results of the tax registration status of jute goods manufacturing firms are as follows:

- 21 firms are registered for BIN.
- 14 firms are registered for TIN.
- Only 10 firms are registered for both.
- 9 firms are not registered for either forms of taxation.

Registration Status of Textile Firms

Textile is another major industry in Bangladesh. Among the privatized firms there are 27 textile ones. The textile firms are organized under the Bangladesh Textile Manufacturers' Association (BTMA). The results of tax registration status of textile goods firms are as follows:

- 11 firms are registered for BIN.
- 10 firms are registered for TIN.
- 4 firms are registered for both.
- 10 firms are registered for neither BIN nor TIN.

Registration Status of Firms in the Other Sectors

Apart from the firms in the jute and textile sectors, there are 97 privatized firms in other sectors such as food and allied products, light engineering and metals, chemicals and cosmetics, leather processing, etc. The results of their tax registration status are as follows:

- 55 firms are registered for BIN.
- 27 firms are registered for TIN.
- 18 firms are registered for both.
- 33 firms are not registered for either taxation.

Analysis of Sector Dimension of Tax Registration

The above data on various sectors' tax registration levels show that among the privatized firms, the jute sector has the highest degree of compliance for both BIN and TIN. For BIN registration, the firms in other sectors are more compliant than the firms in the textile sector. For TIN registration, textile sector firms are more compliant than the firms in other sectors. Since the jute sector is the oldest industry in Bangladesh, and its presence is quite visible, the high degree of registration is understandable. The extent of registration levels in textile and other sectors' may owe to specific features of tax surveillance of the VAT and the corporate tax administration.

Reasons for Widespread Non-Registration among Privatized Firms

Under private ownership, the firm may seek to avoid and evade tax payments to the authorities if either the likelihood of detection is low or the penalty imposed in the event of detection is also low, or both. The probability of detection in the case of evasion of tax registration is very low. Although the NBR authorities are supposed to carry out routine surveys for TIN and BIN registration, the tax authorities' survey departments are weak, lack initiative, and have limited administrative capacity and resources to conduct thorough and rigorous surveys. While the potential legal measures available to the authorities are considerable, ranging from property confiscation to jail terms, the authorities rarely prosecute non-registered firms. Thus, actual expected penalty for the firm avoiding registration is low.

The authorities are unable to provide any data on the number of firms detected to have been without registration, or the amount of money generated from penalties because of the absence of any systematic records. The unavailability of such data implies – and tax officials concur with the following inference – that the number of firms detected by the authorities as evading tax registration is negligible. Because the number of firms detected evading is low, the authorities do not maintain such records. Systemic maintenance of records of this kind would enhance the tax authorities' reputation and credibility within the bureaucracy and, particularly, with multilateral and

bilateral donor agencies, which have identified loopholes and administrative weakness of the tax authorities as factors responsible for low revenue collection in Bangladesh.

The authorities do not cross-check the records and the databases to search for non-registration for various kinds of taxes. At present there is no mechanism to coordinate different offices in the NBR to undertake cross checking. It is alleged that rent-seeking officials often connive with firms that have not been registered. Instead of reporting to the authorities and collecting the due amount of taxation and fines, dishonest officials, upon detecting firms that have not registered, demand personal gratuity payments from firms and connive with the management in avoiding taxation. This may be a significant factor contributing to the low number of registrations.

The data shows that the majority of firms are either registered for only one form of taxation or none at all. The number of firms registered for both forms of taxation is small. A large number of privatized firms are not at all registered with the authorities for tax purposes. Among the privatized firms, BIN registration is more extensive than TIN registration.

The fact that a large number of firms have been able to escape *any* form of registration with the authorities suggests (a) non-compliance on the part of the firm's management, and (b) lapse and administrative weakness or connivance on the part of the tax authorities. The tax authorities' limited computational resources impair their ability to detect firms evading tax registration and to collect revenue.

5. Case Study of Tax Compliance of Privatized Firms

This section analyzes the tax compliance record of a sample of privatized firms. It investigates the tax compliance and payments history of 13 privatized firms between 1991 and 1996. These firms specifically selected in a recent World Bank study (Dowlah, 1997 and 1998). There are several justifications for conducting this case study. Firstly, as the Bank-sponsored study does not examine their tax compliance records, it is of scientific interest to extend the knowledge concerning these firms by investigating whether their tax payments have increased or decreased after privatization. Secondly, the present case study contributes to the literature on post-privatization performance in *low income developing countries*, in contrast to Galal et al. (1992), another Bank-sponsored report, which draws on case studies of 12 firms, mostly utilities and oligopolies, from *high* and *medium income countries*. Thirdly, methodologically this study proceeds from an empirical investigation of the tax compliance records of selected firms to generalized remarks about privatized firms' tax payments and post-privatization performance, rather than from the arbitrary *a priori* conviction or implicit assumption that privatization will bring about social gains. Again Galal et al. (1992) provide a typical contrast because they use the case studies mainly as illustrations of the success of privatization although such conclusions are highly dependent on the construction of counterfactuals and specific values of parameters. Fourthly, firms' tax payments for assessing post-privatization performance have been rarely used in the literature on privatization. This paper contributes to the literature by using tax payments to infer post-privatization firm performance and conduct.

Methodology and Limitations

Firstly, data on tax registration status of the selected firms are obtained from the country's tax authority, National Revenue Board (NBR) of the Ministry of Finance of the Government of People's Republic of Bangladesh. Secondly, after securing permission to investigate the tax records of privatized firms, detailed tax information is obtained from the field offices of the relevant Tax Commissioners. Thirdly, whenever feasible, records are obtained from either public corporations of which the firms were part of during its public ownership phase or the firms' own records. Fourthly, the tax payments records are carefully analyzed in conjunction with any other relevant variables from the available information set.

The main objectives of the analysis are to determine if there has been any change in tax payments and infer, on the basis of tax payments, the change in the level of a firm's activity (output). While the amount of tax payments can be readily determined from the records, the determination of the firm's output from its tax payments is much more tenuous. Firstly, the weakness of the

tax regime enables firms to avoid and evade taxes. Thus, tax payments may understate the amount of production and actual profits. Secondly, even with reliable data, it is both difficult and tedious to calculate the value of the output because it depends on the choice of parameters, changes in output mix and product types, etc. Despite these limitations, such an exercise is not without merit; if carefully used, it can indicate the direction of change in the level of output.

For this case study, the authorities gave access only to indirect taxation data, such as customs duty, supplementary duty, and VAT. This study is based on inferences that can be made on the basis of analyzing indirect tax payments and other available information. Direct tax payments are used for the four public limited companies in the set. Direct taxation figures, which are obtained from their annual reports, are used to compare pre-privatization and post-privatization tax contributions. However, direct tax payments are not available for privately held firms. While information on direct taxes payments of all the firms would have been quite useful, this does not pose a serious limitation in positing the level of activity generated by the firm. A more serious problem for the study is that many of the firms have been unable to provide a good time series about their tax payments. Hence, conjectures about the level of activity are based on rather limited number of observations. Whenever that is the case, the author compensates this loss of data by detailed discussions with tax officials monitoring the firm and, if possible, with the firm's management to learn about the change in firm's tax payments and performance. This study was carried out during the Fall of 1998. In order to ensure privacy, the actual identities of the firms are not revealed here.

Case Study Method: Its Relevance

Case study method is suitable for this inquiry, given the small number of firms in the sample. Case by case approach allows specification of the relevant factors affecting the firm, and close observation of the firm behavior.

Before and After Comparisons: Few Caveats

Any kind of before and after comparison of pre-privatization and post-privatization variables must proceed with caution because exogenous factors, rather than the change of ownership, might be responsible of significant differences. Demand conditions can vary due to economic fluctuations, sector specific shocks in tastes, and other factors. Supply conditions also can vary because of changes in technology, cost of inputs, etc. Even if output is held constant tax payments will rise (decline) if tax rates increase (decrease) or the surveillance capacity of the tax authorities in Bangladesh improves (deteriorates) over time.

The Data Set

The sample of firms selected for analysis consists of the 13 firms that were privatized during the period of 1992-96. NBR databases are used to identify the firm's Taxpayer Identification Number (TIN) and Business Identification Number (BIN). If neither identification number is detected for the firm, then it may be inferred that the firm has been liquidated or is out of operation or has slipped out of the tax net. If the firm is missing both forms of registrations, then it is not paying the applicable taxation. If the firm is found to have either TIN or BIN or both, then a survey questionnaire is sent to the relevant Tax Commissioner's Office in the field. The author visited the relevant Tax Commissioner's Office to explain the questionnaire and objective of the inquiry. The authorities extended full cooperation to the author. An official notification, directing officials to give access to information, was issued by the tax authorities. The management of the firms also helped to complete the questionnaire. Despite full cooperation, the management of some firms was often unable to provide any pre-privatization data because they did not possess such data. In that case, the relevant public corporation was contacted through the Tax Commissioner's Office to obtain the data. In some cases, this yielded results, while in others it did not. Although the questionnaire provided the management of the firms with an opportunity to write detailed comments, most firms' officials chose not to comment. If search on the NBR databases did not yield any TIN or BIN then after a revised search with NBR database, a notice is sent to the relevant field office to

ascertain the status and the existence of the firm. The following section gives the results of the survey.

In general there was no major increase in the tax rates for the concerned firms during the period studied in this survey. However, VAT was instituted in place of most excise duty since 1991-92. The VAT regime has subsequently been strengthened and its coverage has progressively increased. Thus, some of the gains in tax payments could be due to the increased capacity of the VAT administration to obtain revenue.

Additional data regarding the firms' debt default status, obtained directly from the Credit Information Department of the Bangladesh Bank, the country's central bank, is also provided.

Tax Compliance Records of Selected Firms

Table 17 provides a summary of the tax registration status and compliance of the firms in the sample. It also provides information on the firms' debt-default status. Three firms in the sample are reported to have accumulated overdue loans equal to or greater than Taka 10 million each.

Table 17

Tax Compliance Profile of Privatized Firms

Case	TIN	BIN	Indirect Tax Reciepts	Direct Tax Payments	Production Information	Comments
Firm A	Yes	No	Up	not available	Production Resumed	Resumed Recently
Firm B	No	Yes	Up	not available	Production Resumed	Resumed Recently
Firm C	Yes	Yes	Up	not available	Production Resumed	Resumed Recently
Firm D	Yes	Yes	Up	Down	Production Declined	
Firm E	No	Yes	Down	Down	Production Declined	Major Rentier
Firm F	Yes	Yes	Down	Down	Production Declined	Managerial Problems
Firm G	Yes	Yes	Up	Up	Production Increased	Increased Demand
Firm H	No	Yes	Up	not available	Production Resumed	Production
Firm I	No	No	Zero	not available	No Production	Shut down; & Liquidated.
Firm J	No	No	n.a	not available	not available	
Firm K	No	No	Zero	not available	Outside Indirect Tax	Cottage Industry
Firm L	No	No	n.a.	not available	not available	
Firm M	No	No	Up	not available	not available	

Firm A

The firm has both TIN and BIN. Although the firm was privatized in April 1994, its production has resumed only recently. Its BIN has been approved on July 19, 1997. The firm applied for value approval in November 1998. It also recently obtained permission from the Drugs Administration approving its line of products. The firm's management has been unable to give any definitive pre-privatization tax payments data because the firm had been shutdown for sometime and the ownership changed hands. For many years the firm was not producing anything. The firm has been producing goods and paying taxes starting from the financial year 1997-98.

To the extent that even after privatization production was not resumed for a rather long period of time (1994-1997), there is clearly a loss in terms of output and tax revenue. But the enterprise had been closed down since around 1991 prior to privatization. Other data shows that firm was a losing concern from 1985 to 1990, with declining sales revenue. As a result, its tax payment was zero for many years prior to its recent reactivation.

As a result of privatization and reactivation following privatization, presently the firm is now making a contribution to the exchequer. If the management is able to ensure smooth continued production henceforth then there is a perspective of increased tax receipt from the firm.

Firm B

Database search did not yield a TIN for the firm. However, in the survey the management reported that it had a TIN and claimed that the firm filed corporate tax returns for the last financial year. But the management did not write down its TIN in the survey questionnaire. The firm has BIN and is paying VAT.

The firm was privatized in 1994. Figures for three financial years are available. For the 1997-98 figures are till March 1998. The data suggests that tax revenue has increased each year since privatization. The management was unable to provide pre-privatization tax data. The Tax Commissioner's Office was unable to provide any past records, and the relevant public corporation was contacted through the Commissioner's Office but it was also unable to give any data. The management of the firm claimed that its tax payments have increased since privatization.

Firm C

The firm was privatized in August 1994. It has both TIN and BIN. The firm has started its production very recently. It began paying VAT since the financial year 1997-98. The data suggests that the firm's level of activity is quite high. The management is unable to provide any pre-privatization tax data. But production related information made available by the Privatization Board suggests that its present output exceed production under public enterprise regime. However, it should be noted that the firm, under its former name, is listed among the leading debt-defaulting firms.

Firm D

The firm has both TIN and BIN. It was privatized in August 1993. It reported to have filed corporate tax returns for the financial year 1996-97. The management reported that its tax payments have increased following privatization. Data from financial year 1992-93 to 1997-98 (till April) is available. The data shows that following privatization indirect tax payments have increased steadily over the years. It made provision for income tax until late 1980s. Since late 1980s, it has not paid any income or corporate taxes. Other data show that the firm's productivity from 1988-89 to 1992-93 has steadily declined. Thus, tax payments have increased because either tax rates have gone up or the VAT regime has become more effective, or the prices have gone up. The industry in which this firm operates has experienced a boom due to increased demand, but it also faces more competition from foreign imports due to trade liberalization.

It should be noted that the firm is one of the leading debt-defaulting firms. Moreover, according to news reports and information provided by the Credit Information Department of the Bangladesh Bank (the country's central bank), the business group with which the firm is tied is a major beneficiary of state directed credit. It not only owes a lot of overdue debt to the nationalized commercial banks but also to its suppliers and small businesses.

Firm E

The firm has multiple BIN. Search in NBR database showed no TIN. The firm's management reported that it filed corporate tax in the last financial year but did not write down its TIN. A good time series was available for the firm from the financial years 1978-79 to 1997-98 thanks to the information provided by the Tax Commissioner's Office. There has been clear and definite decline in indirect tax payments, as acknowledged by the management and seen in the data. Output has declined sharply following privatization in 1993. The firm made direct tax payments until 1990-91 after which it has made no direct tax payments.

The firm is listed among the leading debt-defaulting firms. Indeed, this firm is widely believed to be one of the major debt defaulters with a huge overdue loan that has been intentionally incurred precisely because the owner faces no credible possibility of bankruptcy. The firm is often cited as a classic case of an entity engaged in *rentier* activities taking advantage of distorted financial system and state interventions of various kinds.

Firm F

The firm has both TIN and multiple BIN. The firm filed corporate tax returns for the last financial year. It was privatized in December 1994. Although the management reported that its tax payments since privatization has remained the same, but close analysis of the data and the comments provided by the management show a definite decline in its tax payments, compared to early 1990s. Until mid-1980s, it made small direct tax payments. However, since late 1980s, it has not paid any income or corporate tax.

The management's comments (this was the only firm that provided any additional comments) reveal that there has been a loss of output. The management blames the delay in the transfer of control as a major factor in the accumulation of debt, change from positive cash flow to negative, etc. According to the management, the firm also faced serious labor problems, desertion of clients, and legal problems. Irrespective of the cause of problems encountering the firm, the management has been unable to overcome the difficulties. The management has failed to anticipate the risks involved in dealing with the authorities and in running an enterprise in Bangladesh. As a result, output has decreased since privatization and correspondingly tax payments have declined.

Firm G

The firm has both BIN and TIN registration. The firm was privatized in June 1992. Both the corporate tax data, obtained from its annual reports, and the indirect tax data, obtained from the survey, show that the tax payments and output has increased since privatization. Indeed, it is a highly profitable firm. Regarding the indirect tax payments, it should be noted that in some years the firm made advanced indirect tax payments which were adjusted in subsequent years. The company has been paying good amount of income tax for many years. Its income tax was decreasing from 1991-92 to 1993-94; but it began increasing in 1994-95. Its income tax provisions more than doubled in 1995-96 and rose again in 1996-97.

The firm's increase in output and tax payments is indeed impressive thanks to the boom in the construction sector as witnessed by increased building activities in the country, large import of cement, entry of new firms in anticipation of profits, etc. However, cross-sectional data from other firms seems to imply that the rise in output is due to the increase in demand, and not due to improvement in firm efficiency. The firm will face more domestic competition in the future since the industry has witnessed private sector entries.

Firm H

The firm was privatized in February 1995. It has a TIN but NBR database search did not yield any BIN. After inquiry with the relevant Tax Commissioner's Office, it was found that the firm has obtained license for Excise. Data for the firm before 1993-94 was not available. Compared to 1993-94, when the firm was under public management, the firm's tax contribution has improved substantially. But during the transition period, in 1994-95 and the first half of 1995-96, the firm was out of operation. For 1996-97 and 1997-98 there has been substantial improvement in revenue payment.

Firm I

The firm was privatized in March 1992. Search using NBR databases did yield a TIN for the firm. However, upon inquiry with the relevant Tax Commissioner's Office, it turned out that the TIN provided by NBR was spurious. The Commissioner's Office has no information about the firm: The firm is non-operational and therefore cannot be paying any tax at all. A survey questionnaire sent via post to the address of the firm was returned marked 'addressee not found,' which strongly suggests that the firm has been liquidated.

Firm J

The firm was privatized in 1994. Initial search using NBR databases showed no record of any TIN or BIN for the firm. When the relevant Tax Commissioner's Office had been contacted to inquire about the tax registration and compliance of the firm in question, the office was able to provide the firm's TIN. The firm has obtained Excise license. The firm reported filing corporate

tax returns for the last financial year. Data on the firm from 1989-90 to 1997-98 was available. The firm's tax payment had been declining in years prior to privatization from 1989-90 to 1993-94. In the year of its privatization, the tax payments fell substantially. However, its tax payments have increased after 1994-95 and exceed its record payments before privatization. Following privatization, the firm has been paying other indirect taxes besides excise.

Firm K

The firm was privatized in February 1995. Search using NBR databases showed no record of any TIN or BIN for the firm. Upon further inquiry with the relevant Tax Commissioner's Office, it was found out that the firm is producing a commodity that is not taxed under present policies. Therefore, it does not file any documents with the tax authorities on a periodic basis. But the firm is not even filing income tax or corporate tax returns.

Firm L

The firm was privatized in March 1994. Although search using NBR databases showed no record of any TIN or BIN, further inquiry with the relevant Tax Commissioner's Office revealed that the firm is registered for excise duties. The firm's management claimed that it filed corporate tax returns although it did not provide its TIN.

Data on two financial years prior to privatization was available for the firm. The records show a sharp decline in its tax payments in the year prior to privatization. In 1994-95, the financial year in which the firm was privatized, it did not make any tax contribution. Since then, however, its tax payments have been increasing although it is yet to surpass its tax payment in 1992-93.

Firm M

Search using NBR databases showed no record of any TIN or BIN. However, further effort at the relevant Tax Commissioner's Office revealed that the firm is registered and is paying taxes: It is paying Excise (turnover) taxes only.

The firm was privatized in 1994. Data on the firm prior to its privatization were not available. Its tax payments increased for two years after privatization. But its tax payments in 1997-98 declined compared to the year before.

The firm's management claimed that the firm does have a TIN but did not provide it, claiming that this information is available from the company's head office only. The survey question asking whether the firm paid any income/corporate tax in the financial year was left unanswered.

Tax Payments and the Problems of Privatization in Bangladesh

Based on the above analysis of tax compliance records, in conjunction with what is known from earlier studies of privatized firms in Bangladesh (Sen, 1997), the following observations can be made regarding tax compliance and payments of these firms.

A number of firms that were once under public ownership are not even registered for taxation. Clearly firms that have been liquidated or shut down do not register for taxation or make any tax payments. Privatization is not a remedy for non-viable enterprises, which have to be shut down. Some privatized enterprises that are shut down would be and have been transformed into service activities, outside the realms of current tax net, in accordance with the price and profit 'signals' provided by the market.[1] It is possible that some liquidated firms provide capital and labor that is acquired and absorbed by other firms that do produce goods and services which are valued by consumer and are taxed by the authorities. If the liquidation of the firm releases resources which are then used in productive activity then the authorities may obtain revenue but not otherwise. Some firms that are reported to be operating may have managed to escape the surveillance of

[1] Provided that private ownership of enterprises does not lead to the overall decline of industry, the level of activity and/or productive efficiency, the crucial issue is to attain optimal allocation of capital, labor, and other resources such that the ratio of the social marginal rates of return of the factors of production are equal throughout the economy. To allow this, there should efficient entry and exit policies. Where there are production externalities, or any strategic reasons for investment, the authorities may provide incentives and policy support to promote those activities while ensuring that such support is not 'captured' by vested lobbies and interest groups.

the tax authorities because of the weakness of the tax administration and the connivance of corrupt tax officials. It is also possible that some firms that should be paying VAT are instead paying (lower) Excise duties.

Of the 13 firms studied in this survey, indirect tax payments increased for 7 firms because many of these have resumed production after privatization. Many of these firms that had been shut down while they were in the public sector. These firms were reactivated with some delay after privatization. One firm's indirect tax payments increased although its output decreased. Indirect tax payments have decreased for at least two firms because their productions have declined considerably. One of these two has incurred a huge debt that is not being serviced, and the other has serious management problems. Another two firms are not paying any indirect taxes because one of them has been either liquidated or is shut down and the other is producing goods that are not taxed under present VAT/Excise regime. Four firms out of 13 are publicly listed ones. Thus, data on their provision for income tax is available in the public domain from the annual reports filed with the Securities and Exchange Commission. Direct tax payments have declined for three out of the four publicly listed privatized firms in this survey. The fourth firm's income tax payments increased because of a price hike of the commodity it produces.

The survey results lend themselves to a few policy suggestions and observations about privatization in Bangladesh. Firstly, if privatization is to be carried out, the process must be speedy and well-managed. Once the privatization process is set off, delays in the process can lead to production loss, accumulation of debt, exacerbation of labor problems, loss of clientage, etc. Secondly, if privatization is to be effective and welfare enhancing the transition period must be well-managed and short so that neither production process is disrupted nor there is any scope for capital depletion. Thirdly, firms that experience considerable managerial turmoil since privatization often show no increase and sometime substantial decline in tax payments. Firms that are engaged in *rentier* activities, such as obtaining loans from nationalized commercial banks with no intention repayment, do not make any effort to increase efficiency because the rate of profit from unproductive activity remains higher than that of productive activity. In such cases the firm's production falls and its tax payments decline heavily. Fourthly, firms that encounter favorable market conditions or improve efficiency raise output. The authorities may be able to obtain more revenue from such firms. It is not possible to determine how much of the increase in revenue owes to increased efficiency and how much to positive demand shock without studying and obtaining comparative cross-sectional data of similar firms.

Two crucial factors that affect the possibility of increased tax payments after privatization. They are as follows: (a) the rate of the tax and (b) the level of output. Tax revenue critically depends on both[1]. If the tax rate is held constant, firm-level performance and output would have to rise following privatization for increase in revenue. But increased firm-level efficiency is not sufficient by itself. Tax authorities must maintain proper vigilance over privatized firms to ensure their compliance with the tax regulations and to obtain the due amount of revenue.

6. Conclusion

Shleifer and Vishny (1993) argue that "soft" states suffer from insidious levels of corruption. The findings of this study can be regarded as an illustration of tax evasion in a regime of fiscal corruption and administrative deficiency in a "soft" state. The present results would support the arguments made in Boone (1994) and Marcoulier and Young (1995) that "reforms" often create new channels of *rentier* activities. The widespread tax non-registration and non-compliance may be the result of illicit "gift-exchanges" between the authorities and the privatized firms.

This essay reiterates the importance of implementing privatization as an integrated part of a liberal economic order that established fair laws and their strict enforcement, competition and prudential banking regulations, adequate tax surveillance, and that rewards productive endeavors.

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[1] Let tax revenue be tY where, t is the rate of tax, and Y is the level of activity. Therefore, d(tY) = tdY + Ydt. Suppose that the authorities hold the tax rate fixed, that is, dt = 0; hence, d(tY) = tdY. It is assumed here that Y is independent of the tax rate, that is, the tax rate has no effect on the level of activity.

It shows some of the difficulties that arise after privatization. The post-privatization experience of Bangladesh lends credence to the view that debt-default and tax arrears or evasions are routes by which firms' budget constraints are often softened after privatization. Due to the "gift-exchange" relationship between the authorities and the manager of the privatized firm, the volume of financing may not decrease in spite of privatization. Effective privatization and private sector development require legal and social institutions and institutional practices, often lacking in developing and transition countries, to secure the gains of private ownership of the firm. The outcome of incomplete privatization in many developing and transition economies has been rendered ineffective because of the failure in the imposition of a hard budget constraint on the privatized firm. The problems of debt-default or tax non-compliance are not unique to privatized firms in Bangladesh. This essay, however, shows that privatization in Bangladesh has been unable to achieve some of its goals. The empirical analysis, based on access to unique data sets, demonstrates that many privatized firms have substantial overdue loans. Their debt-servicing performance is not any better than that of public enterprises. Furthermore, analysis of data obtained from the tax authorities shows that a large number of privatized firms have been able to evade tax registration. These constitute convincing evidence of the ineffectiveness of privatization in reorienting the incentive regime or changing the firm's behavior in Bangladesh. The empirical parts of the paper, which analyze the debt-default and tax non-compliance of privatized firms in Bangladesh, support the results obtained in the model of ineffective privatization constructed here.

Privatization may not eliminate impediments to financial discipline and improved financial and operating performance of the firm. The post-privatization problems of inter-enterprise arrears, tax non-compliance and arrears, wage arrears, and banking arrears exist in many developing and transition economies. However, ineffective privatization may be a phase in the transformation of the controlled economy to a liberal economy.

Future research on privatization might attempt to determine the following:

(a) the conditions under which hard budget constraints are imposed on privatized firms and their financial and operating performance improve; and (b) the economic and welfare consequences of privatization in developing and transition economies.

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