Implementation of Privatization Policy: Lessons from Bangladesh

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Abstract
The study is an attempt to explore and examine different aspects of policy implementation regarding privatization of state-owned enterprises (SOEs) in Bangladesh. For this purpose the study sheds light on the theoretical and conceptual issues of policy implementation, actors and factors that contributed to the initiation and persuasion of privatization policy regarding SOEs in Bangladesh, organizational and procedural arrangements involved in the implementation process, strategic tasks related to privatization of SOEs, output of policy implementation (implementation result), and major impediments of policy implementation regarding Privatization of SOEs in Bangladesh. This paper also identifies the prospects, problems, and pitfalls of privatization programme in Bangladesh.

Key Words: Privatization, Bangladesh.

Introduction
This paper analyzes some of the limitations of the privatization of public enterprises in Bangladesh. Bangladesh is one of the pioneers in the privatization of public enterprises. The question of privatization of public enterprises 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 sector, has been viewed as a possibly 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 empirical findings suggest that privatization in Bangladesh has been ineffective. The case of Bangladesh illustrates that state-directed financing obtained by firms might not decline in spite of privatization.

Conceptual Net
Privatization is one of the most critical and politically sensitive government activities. It has led to fundamental shifts in the relationship between the private and public sectors of the jurisdictions of many countries. The role and scope of privatization have increased dramatically in the last ten years both in the form of contracting out of public services and in the outright purchase of government enterprises by the private sector on the national and international levels (Hodge, 2000, Prizzia, 2001).
Persistent financial losses of public enterprises in Bangladesh suggest that these firms have severe management problems. The heavy losses are a symptom of the malaise that affects public enterprises. Besides losing money and earning low rates of return, every year most public enterprises in Bangladesh obtain equity injections from the state and substantial amount of loans from the nationalized banking sector.

Public enterprises are also responsible for a large share of the public sector’s loan default: the public enterprises’ outstanding and overdue loans amounted to 81% and 78% of public sector’s outstanding and overdue loans respectively.

**Short Literature Review**

Bangladesh has been pursuing privatization for over two decades. This policy has been shaped by numerous economic and extra-economic factors and actors. Until now, there have been very few studies of privatizations in Bangladesh.

This section briefly reviews the following: a) The literature on public enterprise and privatization in Bangladesh, and b) selected papers from the analytical on privatization performance.

Although there is no comprehensive study of privatization of public enterprises in Bangladesh, the number of academic and policy papers on privatization experience is growing.

As part of its research program on governance and development, the centre for policy dialogue (CPD) has initiated a research project on privatization.

Akram (1999) provides a review of the literature on the political economy of privatization in Bangladesh. Monem (2005) examines very fruitfully how ruling politicians in Bangladesh turn the process of privatization to their own political advantages.

**Reasons for Privatization: Inefficiency of Public Enterprise**

It is often argued in the context of Bangladesh that unlimited political maneuvering has directly contributed to the public sector’s chronic inefficiencies, huge financial losses and rampant corruption over the years. 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 was taka 14,117 million ($300 million). Based on an exchange rate of taka 68 = $1 US (June, 2006), in 1997-98, the aggregated losses of public manufacturing enterprises were taka 5,489 million ($116 million) and the aggregated losses of public enterprises was taka 7,549 million ($160 million). Private ownership is supposed to lead to better management.

Public enterprises have proved to be unsuccessful firms as their financial performance demonstrates. Public enterprises incur chronic losses and continue to rely on state-funded equity injections and credit from the banking system. Losses and reliance on the state for equity injections and credit are symptoms of weakness of the public enterprise regime in Bangladesh. Since public enterprises are unable to secure profits, there is no surplus generated from capital invested in public enterprises to be used for social expenditure.

While scanning through all the rationale advanced in planning documents in the sub region, it seems that there are three general reasons why privatization is being pursued:

- greater economic democracy through increased private initiatives in economic activities;
- achieving higher levels of economic growth and employment;
- reducing budgetary deficits.

**Privatization in Bangladesh**

The privatization process in Bangladesh evolved gradually before taking concrete shape in 1993. The switch from a state-sponsored capitalist mode of industrial development to private sector-led industrial growth in Bangladesh began in the mid 1970s. With the famine of 1974, rising prices and a dwindling economy led to gradual shifts in the government’s policies toward encouraging private sector participation in manufacturing and reducing the role of the public sector through disinvestment (see Investment Policy 1974). After the political change in August 1975, the new government declared a revised industrial policy, through which the public sector-led industrialization strategy was
abandoned. Between 1975 and 1981, a number of important changes in the policies and institutions were introduced (i.e. declaration of Industrial Investment Schedule 1976, withdrawal of the private investment ceiling in 1978, etc.) to broaden the scope for private sector participation in the industrialization process. The major elements in the policy to bring about a decisive shift toward a private sector-driven industrialization during this period included: (i) elimination of ceiling on private investment, (ii) reduction in the reserve list of industries under the public sector and creation of “free sectors”, (iii) relaxation of investment sanctioning procedures, (iv) amendment of the Constitution to allow disinvestment and denationalization of both abandoned and taken-over industries, (v) establishment of a Disinvestment Board in 1975, (vi) reopening of the stock market, (vii) shift to a floating exchange rate, and (viii) introduction of various export promotion measures.

The most significant move in the privatization process occurred in 1982 with the announcement of the New Industrial Policy (NIP). The government introduced fundamental changes in the industrial policy environment and the adoption of various promotional measures, designed to accelerate the pace of private sector-led industrial growth. A number of large industries in the jute and cotton textiles sectors (33 jute mills and 27 textile mills) were returned to their owners under the auspices of the NIP. In order to encourage foreign private investment, the Foreign Private Investment (Promotion and Protection) Act of 1980 was promulgated and a “One-Stop” service agency, i.e. Board of Investment (BOI), was set up, commencing its operations in January 1989.

The Government announced the Revised Industrial Policy (RIP) in 1986 with a view to further expanding, relaxing and strengthening the measures required to provide further impetus to the privatization process through a deliberate denationalization programme. The RIP provisions also encouraged foreign private investment, provided export incentives, and allowed the liberalization of import regulations as well as fiscal and monetary measures. The government’s strong commitment towards rapid expansion of the private sector through progressive deregulation, liberalization, trade policy reforms and encouragement of foreign private investment was reiterated through the declaration of yet another industrial policy in 1991. Indeed, privatization of the loss-making SOEs was one of the major objectives of the 1991 policy in order to increase the efficiency and productivity of the industrial sector. Thus, the gradual but definite move toward privatization policies continued throughout the 1990s. A brief discussion on the regulatory reforms to stimulate growth of the private sector and also privatization may be relevant here.

**Assessment of Privatization**

Public enterprise financial losses, poor performance, inefficiency and subsidization create pressure on the national exchequer, weaken the country's financial system and reduce the competitiveness of the country's private sector. Committed to a free-market economy and liberalization (donors are tired of handing out aid), the government is pursuing privatization, though political sensitivity and trade union pressures slow down the reform. The Privatization Board has been revamped, and its mandate and technical capabilities
updated. Hundreds of loss-making state owned enterprises has been put up for sale. Because the country has so few resources, the government is mainly going after foreign direct investments. Although privatization is a critical part of the economic reform policy, it has not been made sufficient progress to attract many foreign investors. Some view the government’s privatization efforts as the barometer of the official attitude towards the private sector. The privatization process is likely to continue to be painfully slow in Bangladesh, as the political leadership in Bangladesh partially consists of people who have been and continue to be primarily interested in appropriation of national wealth and self-perpetuation, instead of the creation and equitable distribution of national wealth. The bureaucracy, in the process of losing its grip on the economy in the era of global preference for the increased role of market mechanism, is also often corrupt, inefficient and weak.

As in most developing countries, privatization is a much-debated subject in Bangladesh. In many countries, privatization is incomplete. It may be years before developing and transitioning countries achieve complete privatization. Complete privatization is difficult to attain; however, while many developing countries have moved fast, despite such debates, to privatize state-owned enterprises, Bangladesh has already been relatively slow in privatization. There is some irony in this for Bangladesh was one of the pioneers in this area. The privatization process will continue in Bangladesh, for better and worse, at a slow pace. In many developing economies, including Bangladesh, privatization has been unable to deliver the promised benefits. Meanwhile, thankfully, Bangladesh is slowly opening up other major sectors for private entrepreneurs, both domestic and international. For example, the present government has already declared a policy of allowing private sector power generation companies to set up, produce and sell power to the government. Approval for two such companies has already been given and more may come in the future. The natural gas and oil exploration business has been offered to the private sector entirely, and it appears that this sector will attract substantial foreign investment in the longer run, as major international oil and gas companies have expressed some interest in Bangladesh already. The telecommunication sector is also being privatized slowly and a number of private sector telecom operators (mobile only) are already opening. Recent studies on sectoral reforms identified suitable privatization prospects in both roads and the inland water transport system for contracting out the existing operations and maintenance functions to the private sector, and these appear to be a mid-term possibility. Besides these, private shipping lines and vessel services in the private sector are already permissible. The government is also considering private sector participation in improving the existing ports, developing new ports and in handling container services in the ports. Airline operation in the domestic routes is open to the private sector and the tourism sector does not have any restrictions for private sector investments. Reforms are underway for privatizing public sector banks and insurance.

**Institutional Framework of Privatization**

The Privatization Commission which came into being in March, 1993 is entrusted with the overall responsibility of privatizing State-Owned Enterprises identified for privatization, whether small, large, profitable or unprofitable. The Commission is now
headed by a chairman with the rank and status of a State Minister to the Government. The Commission consists of two full-time members and twelve part-time members including six Members of Parliament. The Commission has been placed under the administrative jurisdiction of the Cabinet Division which is headed by the Prime Minister. The Commission reports directly to the Cabinet Committee on Economic Affairs which is chaired by the Minister of Finance. Ministries having SOEs under their control have either set up or are in the process of setting up Privatization Cells for assisting the Privatization Commission in identifying, preparing, processing, implementing and monitoring SOEs for privatization.

**Preparation of SOEs for Privatization**

Before inviting tender for sale of the identified SOEs, valuations of the assets and liabilities are made by Chartered Accountant (CA) firms or by consultants engaged by the Commission. Valuation reports are examined and reviewed by the Privatization Commission and a re-valuation can be made by another CA firm/valuer firm if considered necessary. Tenders are invited after the finalization of the valuation. Valuation and other relevant documents are made available to the prospective bidders before submission of the bids.

**Tender Procedures**

1. In the case of sale of enterprises, the prospective buyers will submit quotations according to the terms and conditions of the tender. Bidders shall have to accept all long-term loans against the fixed assets.
2. The value of stocks and stores will be adjusted with the short-term bank liabilities, and the buyer will accept the bank loan equivalent to the value of stocks and stores. If the value of stocks and stores exceeds the bank loans, the excess will be payable to the government by the buyer either in cash or within one year along with a simple interest of 10% per annum. Bank loans in excess of the value of stocks and stores will be taken over by the government.
3. Value of current assets such as sundry debtors, advances etc. will be payable to the Government by the buyer either in cash or within one year along with a simple interest rate of 10% per annum.
4. In the cases mentioned above, the buyer will have to provide an irrevocable bank guarantee without recourse in case the payment is not made in cash.
5. Short-term liabilities such as sundry creditors, claims of employees and workers and income taxes, etc. accrued before the transfer of the enterprise will be taken over by the government.
6. As regards employees of the tendered enterprise (if it is an operating one), the corporation and the buyer will jointly determine the number of redundant employees in the light of technical and operational feasibility. Retained employees, however, will be offered new terms and conditions by the buyer.
7. Buyers will be liable to pursue all pending court cases.
8. Land under the enterprise will be used normally for establishment and expansion of industries. A substantial amount of unutilized but developed land can, however, be used for other productive activities.
9. In case of sale of government-owned shares in different companies, the prospective buyers will submit quotations for the total number of shares offered for sale. The company, whose shares are offered for sale, will repay all quasi-equity loans of the government and dues of the corporations within a period of ten years in six-monthly installment carrying a simple interest of 10% per annum, and will submit an irrevocable bank guarantee without recourse from a scheduled bank. In addition to the above, the buyer will also give a personal irrevocable bank guarantee without recourse for the above quasi-equity loans and dues, or will keep the share certificates of all the shares bought by him, under the custody of the government.

10. While implementing the policy of privatization, efforts will be made to make the ownership of the industrial enterprises as broad-based, as possible.

Payment Procedure
1. In case of sale of government-owned shares in limited companies, the bidder will have to pay 20% of the bid amount as earnest money. The successful bidder will have to pay the balance 80% of the bid amount within sixty days of issue of Letter of Intent.

2. In case of the sale of enterprises, the bidders will have to pay 2.5% of the bid amount as earnest money. The successful bidder will have to pay in cash an additional amount of 22.5% of the bid amount as down payment within thirty days of the issue of Letter of Intent (i.e., 2.5% + 22.5% = 25%). The bidder will have to pay the balance of 75% of the bid amount within five years in six-monthly installments along with a compound interest rate of 9% annually, and will also give irrevocable bank guarantee without recourse for the installment payment. A rebate of 15% will be allowed if the full payment is made within thirty days of issue of Letter of Intent.

3. In case of the sale of enterprises to associations of workers, employees and officers, all claims and liabilities with the enterprise may be adjusted with the bid amount.

4. The buyer will take over all long-term loans, and will have to negotiate a repayment agreement with the lender institutions before transfer of the enterprise.

Methods of Privatization
According to the Privatization Policy Statement, one or both of the following methods are at present being followed for privatization in Bangladesh:

Sale by international Tender: local and foreign buyers may participate in all such tenders. Association of workers, employees and officers of the tendered enterprise may also offer bid for purchase of the enterprise.

Sale by public offer of shares: government-owned shares in different companies and shares of the SOEs converted into public limited companies may be sold to the general public either directly or through the stock exchange.

Processing of Tender Bids
All tender bids received are examined by the Privatization Commission as expeditiously as possible, and its findings and recommendations are placed before the Cabinet Committee on Economic Affairs for decision.

**Implementation of Privatization Programme**
Privatization in Bangladesh has gone through various phases since the country’s independence. Just after the war of independence, on 16 December 1971, the government had to step in to fill the vacuum in the economy as the then-owners, abandoned their properties and left the country. In addition, the nationalization policy of March 1972 brought nearly 90% of major industries such as jute, textiles, chemicals and other major enterprises including DFIs, banks and insurance companies under government control. Right from inception, however, these public sector enterprises could not run profitably and efficiently, and many of them ran into severe financial difficulties and serious management problems. As stated earlier, by 1975, the government began to reverse its policy of nationalization due to the heavy burdens created by the public sector enterprises on the national exchequer. During the period 1976-1992 about 500 SOEs had been sold or returned to their former owners. Since the government’s creation of Privatization Commission in March 1993 as a special agency to implement the programme of divestiture of SOEs until now, thirty-three SOEs got the final approval for sale from the Government of Bangladesh.

**Social effects of Privatization**
When public sector undertakings are privatized largely to reduce the fiscal deficit, there is bound to be a tendency to focus on off-loading heavily loss-making enterprises as quickly as possible without much regard to long-term consequences for such privatized units. Forty to fifty per cent of the privatized units in Bangladesh closed down after privatization.

When the employment in the organized sector is limited, and private initiatives are few in developing countries like Bangladesh, failure of such privatized units to continue to provide employment or even large-scale worker redundancy can be catastrophic. Thus, the social effects of privatization have presumably been much greater than would have been the case if the privatized public enterprises not been loss-making. Therefore, the social effects of privatization in Bangladesh have resulted in:

- worker redundancy;
- retrenchment of workers;
- stagnation of employment in the organized sector;
- growing casualization of labour.

Often, loss-making public enterprises are presumed to be overstaffed regardless of the share of the wage bill. Therefore, both the government and the interested buyer of the public enterprise tend to focus on estimating worker redundancy, and attempting to resolve such redundancy through worker retrenchment. From the standpoint of the buyer, the quicker the redundancy is resolved, the quicker would be the prospects of profitability. Plant upgrades and product innovations are expensive, time-consuming and uncertain for many buyers, who may not be very familiar with the sub-sector which was previously protected. As a result of privatization, redundancies, whether in the form of retrenchment or voluntary retirement, have been evident in Bangladesh.
Politics of Privatization
The political dimensions of privatization remain an untold story. The privatization programme has been deliberately designed and executed to reward and promote the interests of key groups which developed into the main support base of three successive regimes. These groups, which have come into resemble something very like a class, were in substantial measure the creation of privatization process. In fact, within any given country, privatization always evolves and operates within its distinctive political logic and environment. In Bangladesh, this environment is dominated by five important sets of actors: politicians, business interests, bureaucrats, organized workers, and foreign aid donors. In Bangladesh, we see successful efforts by politicians to turn the process of privatization to their own partisan advantage. This occurred under the successive regimes—a military dictatorship and two different democratic governments. The public enterprises are sold to well-connected persons who funded their purchases with money borrowed from state-owned banks. In most of the cases, they then declined to repay those loans, and got away with it because they had close ties to politicians. The privatization policy is being used by the ruling politicians to distribute patronage among the party cronies. In the name of privatization and private sector development, public enterprises are deliberately under-priced to reward groups which extend support to the ruling politicians. Privatization in Bangladesh, like many other countries of the world, created more avenues for the ruling politicians to distribute patronage among their friends and supporters. Thus, what is called ‘privatization’ actually entailed the recycling of public funds.

Social Dialogues for Privatization
The success of privatization would depend on the extent to which the mechanism for social dialogue effectively operates between workers and employers. Bangladesh needs to promote and strenthen social dialogue so that labour-management issues can be settled through negotiations. Many disputes arising from privatization would not have been as inflamed if the dispute-settling machinery had been in place before the privatization process started. In Pakistan, an agreement was reached between the workers’ representatives and the government for workers’ protection against the loss of jobs. The agreement, however, could not ameliorate the situation with a large percentage of employees opting for voluntary retirement.

In many situations, labour unions have been weakened or abolished as a result of privatization. In Pakistan, the role of labour unions has been greatly diminished as in the case of the privatization of a public utility, WAPDA (Water and Power Development Authority) as well as some other public sector enterprises. Some buyers may have preferred such situations for short-term reasons; however, in the long run, the existence of a bargaining agent allows the labour disputes to be settled through negotiation.

Privatization Act
The authorities should make the forthcoming Privatization Act available for generating public discussion before sending it to National Parliament for approval. The goal of Privatization Act would be to strengthen the country’s privatization program. This gives
the authorities an opportunity to state clearly the objectives of the country’s privatization program, and set in motion a smooth and transparent institutional mechanism(s) for transferring enterprises from the public sector to the private sector.

The Act ought to ensure the transparency and the credibility of the privatization process. In order to achieve credibility, the authorities should be able to give sound justification for the valuation of firms to be sold and the mechanism for transfer of ownership. The Privatization Board’s decisions will be credible if it is subject to independent analysis and scrutiny.

**Summary and Conclusion**

The paper has attempted to emphasize that the rationale for privatization and the preparations for privatization are very important to minimize the social costs and dislocations caused by such initiative. Most South Asian countries have come to realize that privatization for the purpose of reducing fiscal deficits has caused them to off-load those enterprises which are loss making first. Such action has not inspired private sector confidence, and has resulted in large-scale worker retrenchment. On the other hand, the response to worker redundancy has not been very effective either.

The fact that some privatized enterprises in Bangladesh have done well while others have not should come as no surprise to those who have monitored post-privatization performance elsewhere. Variations in performance are common, both across and within countries. In Bangladesh too, we need to focus more attention on post-privatization problems faced by enterprises. All this debate on privatization in Bangladesh seems to have neglected one important set of questions. If privatized enterprises are not doing well, why is it so? What is constraining their performance? What factors determine post-privatization performance? Answers to these questions will let us evaluate better what is needed to improve post-privatization performance. Indeed, as many problems are common to all private enterprises, privatized or not, we will understand better what is required to improve performance of the entire private sector. Thus, if we are committed to private sector-led growth, it is urgent that we address these questions.

Unpredictable and poorly administered government policies also create problems. More than high taxes, frequently changing tax rates, arbitrary interpretations of tax rules and other harassment by tax authorities usually raise the cost of doing business and discourage restructuring. Lack of legal and economic information, including market studies and company diagnostics, could also be a problem. If enterprises have inadequate knowledge of existing laws and their interpretation, they could become vulnerable to the whims of government officials and prevented from implementing appropriate restructuring decisions. These problems are compounded by the fact that support institutions such as the consulting, accounting and auditing industries are underdeveloped. Where they exist, they mostly serve larger clients who can pay, bypassing small and medium-sized enterprises. In many countries, even larger firms encounter such problems.
Failure to recognize the inequities and social costs brought about by a growing global economy dominated by privatization is not only politically dangerous, it is also socially irresponsible. International studies show that social factors such as job security, occupational stress, equity, social services, the welfare of consumers, and responsibility to all stakeholders in the affected community and its natural environment should be serious considerations in privatization activities (World Bank, 1998, Hodge, 2000, Prizzia, 2001, 2002, 2003, 2004).

Martin (2000) concluded that, “if privatization is to yield strong benefits to society as a whole, it needs to be managed to ensure transparency, equity, and fairness and consideration must be given to its impact on workers, employers, owners and investors, consumers, management and all other stakeholders.”

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