

AUTHOR'S NOTE

This study integrates three issues: tax evasion, corruption and privatization. It addresses the question: can the problem of tax evasion in a corrupt tax bureaucracy be tackled through privatization? The answer that it comes up with is 'no'. In a pervasive moral hazard situation private firms will engage in malfeasance as well as the corrupt tax officials. However, the crucial point is that the severity of the problem will be substantially different under a privatized regime. With private firms, tax evasion will be institutionalized and the transaction costs of negotiating and perpetrating a deal in evasion will be greatly reduced. This will ensure highly efficient operation of the market in corruption around revenue administration. The efficiency of the market in corruption will shoot up as the barrier of structural and moral-psychological constraints will be slackened under a private regime. Consequently, the supply of corruption and demand for evasion will be higher than under the bureaucratic mode of tax enforcement.

In a bureaucratic regime, the level of evasion remains relatively low as bureaucrats tend to minimize costs associated with participation in corruption. It should be observed that corruption takes place at the individual level and despite venality, tax-officials exercise self-restraint in the face of prohibitively high costs of

negotiating and perpetrating corrupt deals as well as the probable consequence of detection. For a tax official, retention of the job is critically important and, accordingly, maximization of the quantum of bribe is not the prime concern. The result is lesser demand for corruption and lower level of evasion.

This paper is a revised version of my dissertation submitted to the Department of Government, London School of Economics and Political Science (LSE). The data presented in this have been collected through primary research including interviews and personal correspondence, and examination of official papers, documents and newspaper reports.

Bangladesh privatized part of its customs department in 1992. For the government, it was a matter of trade facilitation rather than privatization. However, it effectively privatized a crucial part of the customs services and, by the end of 1994, established private firms as a parallel customs functionary. Privatization of the revenue administration as such went unnoticed and remained largely undocumented. In terms of result it backfired. The private firms known as PSI agencies proved to be more helpful than their bureaucratic counterparts in perpetrating evasion. Within two years, evasion of customs duty through underinvoicing and misdeclaration of product description and quantity reached unimaginable heights.

The unexpected outcome was quite intriguing. The case can be analyzed as how policy makers arrive at 'fatal remedies' [Sieber, 1981]. Alternatively, the case can be used to illustrate limitations of conventional cost-benefit analysis in evaluating proposed public policies. Or the dissertation could be titled 'Limits of Privatization: the case of Customs Privatization in Bangladesh' to emphasize that privatization is not an all-purpose or fool proof remedy for bureaucratic failure. Needless to say that escalation of evasion after privatization may be analyzed from different perspectives.

On the first look, the Bangladesh case appears much like a case of government's failure to manage the post-privatization era, and hence, could be also used to emphasize the importance of an appropriate regulatory mechanism to accompany a privatization programme. However, the point that the private firms proved to be more corruptible than individual customs officials deserves particular attention. Private firms looked like maximizing evasion through corruption in contradistinction to tax officials. I was anxious to have a realistic explanation of the phenomenon. Intuitively Murray Horn's transactions cost analysis seemed to have relevance [Horn, 1995], and I started to work on that line albeit with scepticism. However, a re-reading of Margaret Levi's *Of Rule and Revenue* supplied the missing link.

Levi [1988] developed a theory of predatory rule for 'understanding revenue production historically and comparatively'. It was a powerful theoretical framework that convincingly explained ruler's dependence on 'tax farming' for revenue generation and its subsequent abandonment in ancient Rome. But my real debt to her is in forming the idea of combining structural and moral-psychological factors in the same model for explaining and comparing individual action and organizational behaviour. Such a model enables to explain why a corrupt firm under the privatized regime should in effect be more corrupt than corrupt tax officials and allow higher levels of evasion.

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