

Chapter - I : Introduction

In the recent times, researchers have looked mainly at the privatization of state-owned-enterprises and public services. Despite vigorous pursuance of privatization programme in many countries around the world since 1980s, governments' other activities largely remain outside the privatization agenda. Apparently, the proponents of free market economy do not have much to complain against hard core government activities like tax enforcement.

In fact, any proposal to privatize tax systems may at first appear bizarre since privatization normally refers to transfer of ownership of public organizations to the private sector [Brauers, 1995, p. 1995]. In that way, privatization of tax-systems would mean privatization of government itself which would appear a contradiction in terms. However the proposal would no longer remain bothersome if, following John Commons [1934], we consider 'transaction' as unit of analysis, rather than organization. A tax system involves a number of separate activities or transactions including 'identification of taxable activity', 'appraisement', 'assessment', 'collection', 'audit', 'enforcement', 'adjudication' and 'appeal'. In the modern era, an integrated tax bureaucracy carries out all these activities. Nevertheless, it is possible for each one to be carried out by different agents.

Increasing devolution in modern tax systems from official assessment to self-assessment of tax liability by the taxpayer himself bears out this point.

In fact, since the 1980s, many developing countries have quasi-privatized *identification of taxable activity* and *appraisal* for collection of customs duty, by allowing private inspection firms to verify commodity description, quantity, quality and value of import consignments – a task so far exclusively carried out by government customs officials. Can then privatization of a tax system be considered a viable proposition? Would a private tax regime enhance taxpayer compliance and be more efficient than a bureaucratic tax system? Can the problems of a bureaucratic tax system such as evasion through corruption be overcome through privatization?

In an era of privatization boom, the belief in the relative efficiency of the private sector is so widespread that there no longer appears to exist any controversy over the justification for privatization. Currently the important question seems to be how far should privatization be carried out and in what order [Chen, 1996, p.223]. Nevertheless, the saga of privatization is not one of unmixed success. Contrary to expectations, initiatives for privatization of tax systems have produced a regressive outcome in some cases. For example, the problem of tax evasion dramatically expanded during the privatized regime compared to the traditional bureaucratic mode of revenue generation. The private regime caused such a high level of revenue leakage in Bangladesh around the mid-1990s that ultimately the government found it prudent to consider gradual policy reversal. In this situation, it is only reasonable to agree that “bureaucratic inefficiency is an empirical issue which cannot be assumed but needs to be tested on a case-by-case basis” [Spencer, 1980]. This brings back the issue of ‘bureaucratic inefficiency’ and the question of the viability of wholesale privatization programmes.

The commonplace presumption that bureaucratic inefficiency is an inherent *condition* rather than *pathology* is erroneous and misleading. Indeed, bureaucratic inefficiency is a comparative claim [Dowding, 1995]. Why does bureaucracy often fail to perform as efficiently as the private firms? In the traditional understanding, bureaucracy is inefficient because in absence of a bottom line such as normal profit there is no urge for cost minimization. This explanation is bolstered by the positive theories of bureaucracy according to which a bureaucratic mode of production is inherently cost-inefficient due to the self-interested behaviour of the bureaucrats. In the real world, bureaucracy is often constrained to optimize its activity because of the self-interested behaviour of its members. This is borne out by the widespread practice of corruption in public administration in many developing countries. Corruption can continue unabated as the ability of the government to control it is constrained due to information asymmetry.

It may appear from the above that, first, employees in a private firm do not show any self-interested behaviour and, secondly, if there is any, owners of the firms are informed enough to control such behaviour, and this is why private firms operate more efficiently than public bureaucracy. However, there is no inherent reason as to why would the private entrepreneurs also not face the problem of control. The problem of control due to information asymmetry may arise in any organization, public or private, wherever there is delegation of authority and functions from the principal to the agent. After all, the problem of control is a matter of contractual hazard, and so, it may show up in any type of contract irrespective of the category of the agent.

In carrying out its activities, government may enter with the private sector into three types of contract : wage, rent and share. It is the wage contract that constitutes a bureaucratic mode of production. Both rent and share contracts imply a private or market

regime of operation as opposed to bureaucratic regime. Then, three types of contractual relationships offer two categories of institutional choice for government. The problem of moral hazard may develop in all of them, and at the worst, may cause acute contractual hazards like opportunism and corruption.

However, there are a number of constraining factors that operate differently under different institutional arrangements. Consequently, the impact of moral hazard will differ depending upon the choice of the institutional arrangement. To what extent the problem of control due to moral hazard may persist in the private sector relative to that in the public sector is a contentious point but is not at issue here. From the perspective of privatization, the real issue is how would the problem of control caused by moral hazard be alleviated if government switches from public bureaucracy to private firms for carrying out its activities. Will a private firm prove a more loyal agent compared with government employees? Is government better equipped to control a private firm compared with its own employees? Will privatization certainly prove productive and cost-efficient?

Viewing the choice of institutional arrangement as a government's alternatives between the levels of the problem of control offers a useful framework for analyzing privatization cases. This is particularly so in societies characterized by acute and pervasive moral hazard. A pervasive moral hazard situation is one where almost all economic agents, public or private, will tend to be opportunistic in behaviour most of the time.

In this scenario, privatization of a government activity also implies privatization of any associated moral hazard, and so, governments will continue to face moral hazard problems even with the privatized regime especially in the face of information asymmetry. The merits of introducing a private regime would, therefore, depend on whether private organizations will pose to the

government a lower or greater problem of control relative to that of a public bureaucracy. The objective of this book, in sum, is to identify the factors that affect the problem of control faced by government under different institutional arrangements, and to examine the decision to privatize a tax system in a pervasive moral hazard situation as observed in Bangladesh during the last decade of the twentieth century.

As a background to the issue, the question of bureaucratic inefficiency is taken up first. So, in Chapter II, the focus is on how efficiency of tax bureaucracy is affected by the opportunist behaviour of tax-officials. In Chapter III, the problem of control faced by government with a corrupt bureaucracy is analyzed. Structural and other important constraints entailing transaction and opportunity costs of engaging in corruption and the impact thereof particularly on the efficiency of the market in corruption around revenue administration are examined.

The case of partial but critical privatization of customs in Bangladesh, by way of the introduction of 'comprehensive pre-shipment inspection programme for imports', is described in Chapter IV. The impact of the same is described and analyzed in Chapter V. Notably, the puzzle of the rise in tax evasion under the private regime is explained in this chapter in the light of the analytical framework developed in Chapter-III. The book essentially ends in Chapter VI that contains a summary along with a brief discussion of the significance of the theoretical framework developed and applied in this study.

However, soon after the first draft of the book was written, PSI agencies staged a come-back in Bangladesh defying the history of corruption and proven complicity in tax evasion. So, an Epilogue follows the concluding chapter that deliberates on government's decision to repose trust in PSI agencies and its consequence despite good regulatory framework.

Finally, the *Report of the Committee on estimation of costs and benefits of pre-shipment inspection* containing cost-benefit analysis of introducing pre-shipment inspection system in Bangladesh is annexed. Unfortunately, all recommendations of the committee proved erroneous when implemented.