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## **PRIVATISATION FOR POVERTY REDUCTION? THE CASE OF BANGLADESH<sup>1</sup>**

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The shift in the last two decades from a state-led to a market oriented development strategy in most of the developing countries under the directions of the World Bank and the IMF has had its repercussions on policy making for poverty reduction. The role of the state has been redefined both in terms of its stance in 'the market' and the ways in which it intervened in the process of redistribution.

In the meantime, the concern over the persistence and/or rise of poverty in many LDCs and transition economies in the 1980s and 1990s led various parties to reconsider the relationship between economic policies and social objectives. The two major actors of policy making in developing world, i.e. the World Bank and the IMF, revised the nature of their policy conditional lending. The primary focus on stabilization and structural adjustment (SSA) shifted in a seemingly significant way to a strategy of poverty reduction. SSA packages have been replaced by the Poverty Reduction Strategy Papers (PRSPs) after the late 1990s. Although the latter were designed by the governments in each country, they, in many ways, encompassed the standard SSA policies.

Invariably, poverty reduction strategy papers of individual economies included privatisation of state owned enterprises (SOEs) as an essential component of the poverty reduction process. SOEs have been viewed to be draining the resources of the nations (because of overstaffing, excessive budgetary support, loss making and inefficiency) which can be more productively used for crucial social purposes e.g. poverty reduction.

In this paper, we aim to revisit the process of privatisation with a view to explore its implications for poverty reduction in the context of a low-income country, namely Bangladesh. The first part presents an overview of the issues with respect to privatization in general terms. The subsequent sections evaluate the process of privatization in Bangladesh in view of its impact on employment, revenue generation and efficiency.

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<sup>1</sup> The research for this paper was carried out during my stay in Dhaka in the Summer of 2002 for a wider programme on the *Macroeconomics of Poverty Reduction in Asia-Pacific* which was commissioned and partly financed by the United Nations Development Fund.

## AN OVERVIEW

Poverty reduction in developing world until 1980s was, most often implicitly, tied to the overall economic development strategy. Higher and faster industrial growth through import substitution was a prominent feature of that strategy with states taking up the leading role in the process. The existence and expansion of state owned enterprises (SOEs) in these economies were justified on the basis of various objectives including eliminating of market failures, supporting economic development where private sector was rather weak and redistributing of income to reduce poverty and inequalities.

Widespread privatisations in the developing world have become a part of the liberalisation process which marked the shift in the development paradigm from the early 1980s onwards. The rationale this time was 'the inefficiency' of SOEs which deteriorated the growth prospects. The distributional and social welfare consequences of privatization have been largely overshadowed by almost an exclusive focus on efficiency. Departing from this, advocates of privatization outlined how expected increase in efficiency would lead to faster growth and supposedly a better social outcome. Public revenues covering the losses of the SOEs together with the sales revenues generated through privatization is expected to generate resources for poverty reducing social projects.

The problem is even if privatization leads to efficiency gains (though this is ambiguous, too) or positive revenue gains, would these automatically be translated into poverty reduction? Answering this question requires us not only to analyse the nature of these gains (i.e. do they lead to 'pro-poor' growth) but also the distributional consequences of privatization. On the latter, there has been surprisingly little research up until recent times. Ramanadham (1995), Hoeven and Sziracki (1998), Chisari, Estache and Romero (1997), Macedo (2000), Birdsall and Nellis (2002) are some to mention. A valuable contribution of these papers is the articulation of the fact that there are winners and losers in the process of privatisation. Under certain circumstances (e.g. lack of a regulatory framework, the strategy and form of privatisation), the population in the latter category is thought to be increasing.

In this paper, our evaluation is based on the framework that the impact of privatisation on growth and distribution (hence poverty) can be assessed through its effect on

- i. efficiency in production<sup>2</sup>
- ii. employment
- iii. revenue generation for government

- iv. change in the prices and quality of goods and services

One has to note that even if all these elements from (i) to (iv) see a positive change (e.g. generation of large revenues through privatisation), this in itself does not ensure a positive knock on effect on poverty levels. In general, the net effect does not only depend on the nature of the change in these indicators (i.e. negative or positive) but also on the extent to which the benefits are either directly shared by the poor or used for purposes conducive to poverty reduction.

The net distributional outcome for beneficiaries/losers would be a product of the trade-offs taking place through various channels. For instance, if privatisation is accompanied by an increase in output prices this would be a loss for consumers but a gain to the new producer. Similarly, while redundancies or retrenchment of workers during or after privatisation imply a serious loss for the workers and their dependents, it may benefit the investors of the divested enterprise through efficiency gains in production and increase in profitability.

Finally, the long-term outcomes may fundamentally be different from those of the short term and the medium term. For instance, divestment of SOEs may result in substantial retrenchments initially. In the medium to longer term, this negative outcome may be counterbalanced with increased employment following a rise in labour productivity and profitability leading to employment generating investment.

In what follows, the case of privatization in Bangladesh is presented with a focus on its implications for poverty reduction. Three important dimensions of privatization are examined for this purpose: its revenue generation, employment and efficiency impact.

## **THE CASE OF BANGLADESH**

Bangladesh is one of the poorest countries in Asia. Although some progress has been achieved over the years in reducing poverty levels, the current state of social well-being is far from satisfactory. The most recent estimates show that national poverty level in Bangladesh is close to 45 per cent with rural poverty levels being even higher than the national average (See, Table 1 below).<sup>3</sup>

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<sup>2</sup> This would be tied to the change in market structure and incentives under different forms of ownership.

<sup>3</sup> Note that the draft poverty reduction strategy paper for Bangladesh (published by the Ministry of Finance in April 2002) reports a higher poverty incidence at national level (49.8 per cent) and lower one for urban areas (36.6 per cent).

**Table 1. The Extent of Poverty in Bangladesh (Head-count Ratios)**

	National	Rural Poverty	Urban Poverty
Bangladesh (1)	44.3	52.5	42.3

(1) Bangladesh Household Income & Expenditure Survey (2000)

While elimination of poverty in many developing countries was tied to the overall growth strategy on the basis of state-led industrialisation, Bangladesh did not have a similar history in this respect. Partly because countries like India went through a relatively successful period of state-led industrialisation for about three decades since the 1950s and created a substantial productive capacity. On the other hand, the state in Bangladesh became the *de facto* owner of a large number of enterprises after independence in 1971. This was when SOEs elsewhere were beginning to encounter the greatest challenges due to the adverse effects of the oil crisis, global recession and rising indebtedness and, therefore, beginning to consider ways of restructuring. Partly as a result of this, a wave of denationalisation begun in Bangladesh shortly after the nationalisation of the so called 'abandoned enterprises'. This was followed by the most rapid divestment of SOEs initiated under the military government of General Ershad from 1982 to 1986. In this period, the share of the public sector in total industrial assets was more than halved.<sup>4</sup> There has been a significant slow down in this pace in the late 1980s and during the 1990s. While divestment has been meagre in the last decade, the commitment to withdraw public sector from real productive activities, especially from the manufacturing sector, has been maintained by ceasing its expansion in the industry. The share of public sector in the industry both in terms of employment and output declined from around 70 per cent to 10 per cent.

There are several characteristics of privatisation process in Bangladesh. First of all, there has been limited debate on this issue because of the nature of the political regime in the 1980s. The absence of debate may seem like a trivial issue. In reality, it may make a serious difference. For instance, a lively debate on privatisation has been pursued in India since the 1980s and various types of SOE reforms, including privatisation, has been considered. The use of performance contracts,<sup>5</sup> efforts to increase the autonomy of management, removal of price controls for SOE products,

<sup>4</sup> See Humphrey (1990) for an overview of privatisation in Bangladesh in the 1970s and 1980s.

<sup>5</sup> the so called 'memoranda of understanding' or MOUs

among many other measures, have significantly improved the overall performance of SOEs in the last decade (see, S. K. Goyal, 2000).

Secondly, the main form of privatisation in Bangladesh has been block sales / wholesale divestment. Thirdly, majority of the divested SOEs were small scale and loss making industrial units (especially jute and textile mills). Finally, investors in Bangladesh have been free from conditions laid by the authorities unlike other countries like India where the purchase agreement would contain some key obligations for the investor (e.g. new investment, time restrictions on re-sale of shares and constraints on labour retrenchment).

### ***Privatisation and its impact on employment***

Privatisation is often accompanied by large-scale cuts in employment<sup>6</sup> which produce one of the most adverse outcomes that immediately affect the livelihoods of those who are made redundant. The influence of lay offs on poverty is likely to be more severe in low-income countries like Bangladesh where there are no provisions of social security (e.g. unemployment or income support). Among the affected households, those with limited other sources of income are most likely to fall below the poverty line after redundancies. Opportunities for and constraints on re-entering the labour market would be another factor that determines the scale of adversities and impact on poverty.

The scale of redundancies in the process of privatisation has been substantial in South Asia in general and in Bangladesh in particular, as given in Table 2. Note that it is not only the size of labour shedding but also the form of labour shedding that is important. Labour restructuring in Bangladesh was, mostly, in the form of retrenchments which pose more insecurity both in terms of income and other benefits (e.g. medical care). On the other hand, redundancies in India, though has been massive, mostly took the form of voluntary retirement, which has less severe implications. The cumulative retrenchments account for about 15 per cent of total manufacturing employment in Bangladesh. The older workers with long years of service are likely to be hit worst as loss of income is not the only adversity for them. The insecurity they may have to face as a result of losing the work related benefits such as medical coverage, which would make a crucial difference to the quality of their life, and the entitlement to a retirement income –assuming that they would be the most disadvantaged in finding a new employment

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<sup>6</sup> See, Kikeri (1998) for an overview of the redundancies in the developing world.

opportunity– poses a moral question that cannot be solved on the basis of pure economic reasoning.

**Table 2. Redundancies Resulting from Privatisation in South Asia**

	SOE employment	Redundancy (1) (per cent)	Retrenchment costs
Bangladesh	240 thousand	25	TK 7 billion
India	9.8 million	23 <sup>a</sup>	Rs. 48,092 billion
Pakistan	34.6 thousand	63 <sup>a</sup>	Rs. 3,559 million

Source: Joshi (2000)

(1) percentage of labour force in privatized enterprises

<sup>a</sup> voluntary retirement

The prevention of the welfare loss and/or poverty among the effected households depends heavily on measures taken by the government. The main dilemma here, however, is that once appropriate measures are put in place, the cost of privatization may outweigh its immediate benefits. This is point is made obvious by the data in Table 4 which illustrate that the cost of compensation of workers, is expected to be more than 10 times the sale revenues to be generated through privatisation.

Under the most current scheme known as ‘the golden handshake’, compensation offered to redundant workers varies with their service years. For instance, a worker with 10 years of service is entitled to a gratuity payment equivalent to 20 months salary plus an additional payment which again varies with the service years. Although the compensation offered to the laid off workers has improved over time in Bangladesh, it is still far from adequate, especially, when new employment opportunities are limited. The participatory review initiative of structural adjustment in Bangladesh revealed that:

‘a great many retrenched workers are yet to be paid the benefits of the much vaunted golden handshake ... those who received the money failed to put the amount in productive ventures... hundreds of them [retrenched workers] have died without medical attention.’ (Bhattacharya and Titumir, 2001, pp. 169 and 206)

What happens to the remaining workers? How is their welfare affected after privatisation? There is ample evidence from the developing world that increased flexibility after privatisation has increased the insecurity of workers. See, Van der Hoeven and Sziraczki (1997). The experience in Bangladesh has been similar as demonstrated by Bhaskar and Khan (1995) who found that among the mills privatised between 1983-1986 the reduction in the number of permanent workers was traded off by an increase in casual workforce with poorer terms and conditions of employment contracts.

On the other hand, we cannot deny the possibility that labour force restructuring during privatisation may produce efficiency gains and increase profitability. It is well documented that many SOEs in many developing economies operate with substantial excess workforce. Yet, there is no guarantee that firm specific efficiency gains after divestment, if any, may be translated into economy wide gains. When laid off workers remain unemployed for prolonged periods because of lack of employment opportunities, the economy wide impact of labour shedding would be increased unemployment, reverse multiplier effect induced by the reduced wage bill,<sup>7</sup> and loss of welfare for the households affected with the possibility of increased poverty. What we suggest, therefore, is that a proper accounting of the distribution of gains and losses associated with sizeable labour cuts has to be made and policies should be chosen accordingly without allowing for outright inefficient use of resources.

### ***Revenue generation through divestment***

Revenue generation and its use for social purposes underlie almost all of the objectives of privatisation policy in Bangladesh.<sup>8</sup> The success of the implementation can be evaluated, therefore, by the level of net revenues generated through divestment and the extent to which they are used for poverty reduction. There are three dimensions to revenue generation through divestment. These are the sale income net of cost of privatisation (e.g. administrative cost, compensation of employees), profits foregone or losses unloaded of SOEs and change in the tax revenues after privatisation. Of these, sale income associated with each divestment have to be considered as a one-off gain/loss while the latter two are of long-term character as long as enterprises continue to exist after privatisation. As mentioned before, even if privatisation generates extra funds for the state both in the short and the long term, this does not imply an improvement on the poverty front unless they are invested in areas that are conducive to poverty reduction (e.g. investment generating employment, creating infrastructure and improving health and education for the poor).

*Gross revenue generation* in Bangladesh has been rather dismal in spite of the large number of units involved in privatisation as shown in Table 3 below. The primary reason for this is that the privatisation has been more or less confined to the relatively smaller, loss making labour intensive manufacturing units operating under more

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<sup>7</sup> assuming that marginal propensity to consume for workers is much higher

<sup>8</sup> See, Privatisation Policy of Government of Bangladesh (2001).

competitive market conditions with substantial debts such as textile and jute mills.<sup>9</sup> Under these conditions, there has been a serious lack of interest on investors' part. In addition, privatisation of quite a large number of mills took the form of denationalisation which involved returning these units to their previous owners.

**Table 3. Privatisation Revenues in South Asia** (up to 1999)

	Revenues (US\$ Millions)	Number of Companies Privatized	FDI from Privatisation (US\$ Millions)
Bangladesh	60	1083(*)	0
India	8983	78	1547
Nepal	13	10	1
Pakistan	1,993	106	939
Sri Lanka	807	75	408

Source: World Bank (2000) Development Economics Prospects Group<sup>10</sup>  
 (\*) Joshi (2000)

Gross privatisation revenues from 1982 to 1998, at most, constituted 1.5 per cent of total government expenditure in the best years like 1983 and 1993. For most other years it was no more than 0.3 per cent of total government expenditure.<sup>11</sup> What these estimates indicate is that even assuming the most unlikely case that these were net proceeds and they were utilized entirely for poverty reduction, the impact is likely to be insignificant especially if they are unsustainable. Besides, the Privatisation Act 2000 states that the priority in using the proceeds of privatisation will be given to meeting the outstanding loans and liabilities of the respective enterprise.

**Revenues net of administrative and restructuring costs is likely to be much meagre, perhaps even negative, than the gross figures. The compensation package for the retrenched employees is the largest cost in the case of Bangladesh for the divestments planned for the future. For instance, Table 4 below gives estimated sale revenues and the cost of compensation involving the companies that are planned to be divested during 2002-2003 fiscal year. What it shows is that the cost of compensation for redundancies alone is estimated to be more than ten times the net recoverable sale revenue.**

If one includes other costs such as cost of converting current debts into long-term debts and the administrative costs, privatisation seems to be levying a substantial

<sup>9</sup> In general, revenue generation through divestment of SOEs with natural monopoly characteristics (as in utilities) is known to be much larger; and this has been absent in Bangladesh.

<sup>10</sup> The database is accessible from ([www.ipanet.net/documents/WorldBank/databases/plink/](http://www.ipanet.net/documents/WorldBank/databases/plink/))

<sup>11</sup> Estimated by using Government Expenditure figures from the Yearbooks of Bangladesh Bureau of Statistics. Privatisation revenues for 1983 and 1984 are given in Humphrey (1991), those for 1989 to 1998 are from World Bank Privatisation Database.

burden on the government. For instance, although long-term liabilities are transferred to the buyer, they are deducted from the total sale price. The reduction in the expected sale price due to the indebtedness of these enterprises for the enterprises to be divested in 2002-2003 varies between 43 and 67 per cent. The average reduction is 38 per cent (see Table 4 above). Moreover, the investors purchasing the enterprise are provided with a long-term debt by the state to pay off the current debts. In addition, they are entitled to a maximum rebate of 40 per cent from the sale price provided that they pay all the dues within 30 days in foreign exchange. These concessions together with other costs suggest that privatisation has imposed substantial costs on the public sector, let alone generate revenue.

**Table 4. Enterprises to be divested during 2002-2003 Fiscal Year (Lac Taka)**

Estimated Sale Revenue (Gross)	Estimated Sale Revenue (net of Long-term Loans)	No. of Retrenchments	Estimated Severance Payment
12,205	4,678	21,771	49,359

Source: Monitoring Cell, Ministry of Finance

The next question is the size of funds that may be released after privatization as the public sector would no longer be liable for financing the deficits of SOEs. In Bangladesh, SOEs have been consistently loss making since the mid 1980s except for a few years. Although these losses can be considered marginal for some years, their size has been considerably large for many other years. According to Table 5, net SOE losses have been 2 per cent of total government expenditure on average during 1990-2000 and much higher for some individual years. The losses of the manufacturing SOEs are the primary source of these aggregate losses.

Several questions can be raised about this picture. The foremost is, of course, the implication of eliminating these losses through divestiture for the poor. Without appropriate policies in place, the released funds may be used to subsidize the rich in the name of promoting the private sector's participation etc.

**Table 5. The Ratio of Net SOE Profits (Losses) to Government Expenditure**

1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
(6.38)	(5.34)	8.24	(2.79)	0.18	(2.18)	(0.16)	(4.87)	(1.07)	(1.34)	(5.78)

Source: Monitoring Cell, Ministry of Finance and BBS Yearbooks

Second, are the causes of loss making in public enterprises. Addressing this question requires us to discuss the three possible sources of loss making:

- a) Are SOEs inherently inefficient which leads to them to incur losses?
- b) Are there economy-wide structural factors that contribute to their loss making?
- c) What is the role of the quasi-fiscal responsibilities of SOEs in their loss making?

Although the first two points are the subject of the next section, let us make a start on these here. One of the most popular arguments against public ownership is the theory of 'rent-seeking' (Krueger, 1974) and corruption. When the source of loss making is the corrupt practices of the public officials causing inefficiency, those outside the circle of corruption would lose including those living under poverty. The issue, however, is whether or not privatisation brings an end to rent-seeking and corruption. The experience in Eastern Europe and especially in Russia<sup>12</sup> as well as the incidents of corruption that hit the surface in the US in the recent years suggest otherwise. Neither privatization eliminates rent-seeking and corruption (and perhaps increases it under certain circumstances) nor countries with strong private sectors are free from them.

Loss making due to economy wide factors (e.g. lack of infrastructure, skills etc.) is likely to remain under private ownership. More importantly, if a component of SOE losses emerges because of the quasi-fiscal role of the SOEs, certain sectors and social groups including the poor may be losing the subsidies provided through SOEs as a result of divestiture.

To make this final point more concrete, let us take the example of Bangladesh Chemical Industries Corporations (BCIC) which is a public sector company and has the monopoly over urea (a type of fertilizer) production. Urea prices by BCIC were about 45 per cent below import parity price on average during 1990-2002 according to a World Bank study. As shown in Table 6, total annual subsidy varied from a minimum of around 3 billion to a maximum of 14 billion taka between 1991 and 2000.

**Table 6. Total Subsidy on Urea and the Performance of BCIC (billion taka)**

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Total Subsidy on Urea	5	6.1	4.8	5	12.8	13.9	11.7	4.9	2.7	3.7
Net profit/loss of BCIC	-0.34	-0.55	0.21	0.25	-0.75	-1.21	-2.38	-0.67	-1.42	-1.50
Profits without subsidy <sup>13</sup>	4.66	5.55	5.01	5.25	12.05	12.69	9.32	4.23	1.28	2.20

Source: World Bank (2002)

Once these subsidies are taken into account, the net losses of BCIC are converted into substantial amounts of net profits. The subsidized sales of SOEs to various sectors do

<sup>12</sup> See, for instance, Stiglitz (2002)

not only affect their financial performance but they also have implications for the overall economic growth and distribution since they effectively represent a transfer from public to private sector.

How might these subsidies be affecting the poor? Bangladesh is a country where about 63 per cent of the active labour force was involved in agricultural production and about 75 per cent of the population lived in the rural sector in the year 2000. According to the Household Income and Expenditure Survey (2000), the headcount ratio for rural poverty was 52.5 per cent in 2000. If we associate land holding with farming and use of urea, the subsidy on urea is likely to be benefiting a large proportion of small and marginal landholders. This is because the concentration of land holding is not very high in Bangladesh. Only about 20 per cent of households at national level own land greater than 1.5 acres (HES, 1995-96). About 10 percent of households are landless. The remaining are small and marginal landowners who are likely to be benefiting from the subsidy in varying degrees.

Bangladesh is fortunate to have large natural gas reserves which allows the SOEs to provide fertiliser to farmers at significantly subsidized prices. Divestment of enterprises involved in urea production under BCIC may imply that subsidies are eliminated or they are reduced significantly, leading to a redistribution of income towards the new owners in the form of increased profits. What would be the impact of such changes on poverty? One possibility is the increase in land concentration rate if the rise in the price of fertilizer is such that the small and marginal landholders are driven out of farming. The implication is that if those affected households are already among the non-poor they may fall into poverty or extreme poverty. A second possibility is that the general decline in the use of fertiliser associated with price increases may not only push some households below poverty line or extreme poverty conditions but it may also threaten the national food security. The welfare of the non-farming communities and urban population may also be negatively affected by the higher cost of agricultural production and higher prices for basic food-stuff.

Overall, the impact of privatisation on poverty with respect to the role of subsidies is likely to depend on the line production and service being privatised. While there may be a direct link between poverty and privatisation of firms producing, say, fertiliser, in other areas the adverse outcomes may not be felt by the poor if they were not the users of the goods and services produced by SOEs prior to privatization. Even in this case, there may be a rationale for subsidies to exist if they play a vital role in the growth and development of some industries.

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<sup>13</sup> Note that this estimate does not include the subsidy to BCIC provided by BOGMC through under priced

Another line of argument would be that provision of subsidies can be maintained even after privatization through budgetary allocation. The dilemma, here is posed by the fact that the low income economies are already seriously constrained by the lack of capacity in revenue generation and by the tight fiscal stance they are required to follow. Given that poverty is a widespread phenomenon in many of the low-income economies and support for industrial development is required much more, the amount of subsidies/support necessary for the survival of the poor and the industries through budgetary allocations is a major challenge for these economies to meet.

### **Evidence on the Efficiency of the public vs private enterprises and the implications for poverty**

The link between growth and efficiency is obvious. How the latter may come about is less than obvious. Although the advocates of privatization would argue that the form of ownership makes a difference, the empirical evaluation of the relationship between enterprise efficiency and ownership is fraught with enormous difficulties. This is partly due to the differences in the objectives of enterprises under private and public ownership.

Millward (1988) indicated, for instance, that the empirical evidence is in no way uniformly support the view that private enterprises are more efficient than public enterprises. Indeed, both the cross-country and single country studies on privatisation and performance reveal mixed results. For instance, Megginson, Nash and van Randenborgh (1994) find that the financial performance of the 61 companies from 18 countries improved after privatisation though the improvement was found to be insignificant and far less smaller for non-competitive companies. Another cross-country study by Cook and Uchida (2001), on the other hand, has shown that privatisation had a negative impact on economic growth. The econometric evidence presented by Bhaskar and Khan (1995) for the case of Bangladesh also disclose a negative association between the output level and privatisation in the 1980s. Mixed evidence on the impact of privatisation on efficiency and economic growth did not slow down the process of privatisation in many countries. In fact, in some countries, privatisation was carried out in spite of the evidence in the opposite direction as indicated by Millward (1988).

How does the experience of Bangladesh fit into the overall picture of privatisation in developing economies? Financial weaknesses of SOEs have been well documented

in Bangladesh. They have been shown to be heavily reliant on state equity injections and credits (See, for instance, Akram 1999, World Bank 1995). This is especially true for corporations operating in manufacturing industry. Financial troubles of non-financial SOEs seem to have become more pronounced after the mid 1980s. Since then, not a single year has seen profits in their overall balance sheets. Their losses were around 2.5 per cent of total gross industrial output between 1986-1996.

However, three surveys that were carried out in the past reveal some crucial firm level evidence with respect to the impact of privatisation on efficiency. The first was a survey conducted by Board of Investment in 1991. It revealed that 53 per cent of the privatized companies were either shut down or dysfunctional. Those that were still operational were not performing in a superior way in any sense.<sup>14</sup> The second study was carried out by Sobhan & Mahmood (1991) which compared the performance of denationalised Jute and textile mills during 1981-85 (in terms of output growth, volume and quantity based factor productivities, wastage etc.) with those that were publicly owned. The findings of this study indicated that production in the privatised jute mills had declined since denationalisation. Machine productivity and wastage has been notably poorer in the denationalised mills. The overall evidence in this study leads authors to rule out the argument for increased efficiency and profitability after privatisation. Finally, the findings of Sen's (1997) survey covering 205 firms privatized during 1980s and 1990s depicted a similar picture. The closure rate is found to be 40 per cent, with 55 per cent of the divested firms being reported as operational.<sup>15</sup> On the other hand, he finds that the profitability of the enterprises in operation increased after privatisation. These, when considered in addition to Akram's (1999) findings on high levels of indebtedness and loan defaults among privatized firms, raise serious questions about the degree to which privatisation can be regarded as a panacea for efficiency.

To sum up the discussion, when efficiency is measured by a financial indicator (e.g. profitability), the incidence of poor performance in the public sector is, generally, higher. If efficiency is measured by a more technical criteria (e.g. quantity per machine, industrial sickness, survival in the market), then the existing indicators and research suggest, in no way, an unambiguous improvement in efficiency after privatisation. The experience in Bangladesh is unique in the sense that despite sizeable labour redundancies, the performance of the privatised enterprises did not seem to have

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<sup>14</sup> Reported in Rahman (1991, p. 206)

<sup>15</sup> Akram (2000) suggested Sen's survey would indicate a 28 per cent closure/exit rate if 'the term closure' is modified to take into account different forms of closure (e.g. liquidation, inactivity). In any case, the closure rate is much more than marginal.

improved in a significant way as indicated by the results of the three surveys discussed above.<sup>16</sup>

There is another issue which require further attention. How should we re-interpret the high closure rates among privatised enterprises and unimpressive productivity performance within the context of poverty reduction? May this evidence suggest that there are certain structural features of the Bangladesh economy that inhibit the viability of privatised enterprises with certain characteristics as much as the public enterprises in the same sectors (e.g. drawbacks in the institutional structure, old technology, indebtedness, persistent decline in the world demand as for jute products, high power failure rates, lack of infrastructure, competition from abroad, lack of skills). In fact, the divestment outcomes in low-income countries like Bangladesh can be fundamentally different from those in the middle income economies. This question has critical importance which is beyond the scope of this paper as it requires further research and analysis. In fact, there is only one cross-country study, as far as I am aware of, by Boukbari and Cosset (1998) which examines the performance of enterprises in the middle and low-income economies together with a number of other issues. The study finds that there is a considerable disparity between middle income and low-income economies with respect to the efficiency of the firms after privatisation. According to their estimations, efficiency in divested firms in the middle-income economies has been quite favourable while the same did not apply to the firms in the low-income economies.

The direct impact of these closures on poverty would be related to the loss of employment income for households affected by closures and loss of income for the input suppliers of the respective firms. Although one can safely argue that these developments have had negative impact on households and were very likely to have increased the poverty level, even if marginally, it is impossible to make a precise judgement about the scale of the impact on poverty due to lack of information about the characteristics of households affected. Reduced wage bill and contraction of economic activities as a result of closures may have influenced poverty levels further in a negative manner.

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<sup>16</sup> Employment cuts have often been found as the main explanatory factor for rising profitability after divestment. See, for instance La Porta and Lopez-de-Silanes (1999) and Kikeri (1998) on this.

## CONCLUSIONS

The experience of Bangladesh with respect to privatization and its implications for social welfare is full of lessons for developing countries, especially for those of low-income status. This study highlights a number of dimensions of privatisation because of their implications for poverty reduction. First of all, the employment cost associated with labour force restructuring in the process of privatization can be larger than the immediate benefits, if any, of privatization. Retrenchment is the worst form of labour restructuring in countries like Bangladesh where social security and health services are mostly work-related entitlements and not provided universally. The implied cost to workers with limited prospects to re-enter labour market for various reasons (e.g. old age, constraints on mobility, lack of employment opportunities) can be enormous and no gratuity package can be sufficient in compensating their (and their dependants') losses.

Secondly, the primary objective of privatization policy of Bangladesh (e.g. use of divestment revenues for social/human development) has not been realised. Despite the high expectations expressed in official documents with respect to revenue generation through divestment, the likelihood of its imposing substantial burden to the society is very strong once all the relevant costs of divestment are taken into account.

Finally, the mildest interpretation of the evidence with respect to efficiency in the case of Bangladesh would be that the divestments did not fulfil the expectations. Two issues are important to mention. The losses incurred, because of the semi-fiscal role that SOEs were expected to play (as in the case of subsidies), must be separated from losses arising due to technical or economic inefficiencies of SOEs. To the extent that losses of SOEs contribute more to the sectoral development (both public and private) and well being of the poor, they may be tolerated. However, if there is no such justification then the rationalisation of the pricing or employment strategies adopted is the first option to consider for improving the financial performance of SOEs in Bangladesh. The other issue is the extent to which inefficiency is associated with structural factors prevailing in the low-income countries. The evidence of high number of closures among divested enterprises in Bangladesh is a strong indication of the effect of such factors. However, this is a matter that requires further research and analysis.

The evaluation of effects of privatisation, in this paper, has been limited with efficiency, employment and revenue generation. An important aspect, which is not tackled here, is the change in the prices and quality of as well as the access to goods and services produced by enterprises after their divestment. An analysis of privatisation in this respect may yield crucial results relevant for policy making in Bangladesh.

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