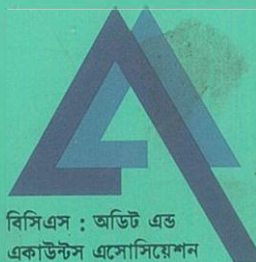


# **PUBLIC FINANCE AND DEVELOPMENT**

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একাউন্টস এসোসিয়েশন

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## DEMOCRACY, GOOD GOVERNANCE AND DEVELOPMENT IN THE POST- COLD WAR ERA

M Saifur Rahman\*

What Neville Chamberlain said about the outcome of armed conflicts is equally true about the Cold War: "In war, whichever side may call itself the victor, there are no winners, but all are losers". The euphoria on the victory of liberal democracy over the command economies is largely misplaced. There is as yet no peace dividend. The world is nowhere near the end of convulsion and turbulence which made this century one of the meanest, cruelest and bloodiest in human history. The same forces which shattered the dream for a Marxist never-never-land have also rendered capitalism obsolescent. Unwittingly, the world has already stumbled into the post-capitalist era. The end of the cold war is surely not the "*end of history*".

The quest for social justice and equitable order for the poor and deprived remains as elusive as ever. There are more poor people today than the total world population in the mid-nineteenth century when Marx and Engels wrote the Communist Manifesto. There are more hungry people now than ever. The world is witnessing a colossal wastage of human resources. Unacceptable levels of joblessness are undermining the social and political fabrics not only in developing countries but also in affluent societies. The rate of unemployment in developing countries like Bangladesh (about 37 percent) far exceeds the catastrophic heights of joblessness during the Great Depression (about 18.2 percent in the U.S.A.). In western Europe alone, more than 20 million workers are now idle; in the USA 8.9 million unemployed. The collapse of communism does not mean that there will be no new ideology to rally the deprived, the disadvantaged and the hungry. In the Cold War era, the threat of extremism came from mainly one ideology in the left. Liberal democracy today is likely to be besieged by a plethora of extremist ideologies from both the right and left of the mainstream. The disenchantment with representative institutions which gave birth to partitocrazia (the dictatorship of established parties) and the cartels of politicians and lobbyists against voters and taxpayers is widespread in both affluent and developing societies.

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\* Former Minister for Finance, Government of the People's Republic of Bangladesh. The article is a text of a speech delivered by him at Overseas Development Institute, London, on 20<sup>th</sup> April, 1995.

The pangs and trauma of poverty in the post capitalist society are much more poignant and agonising than ever. For the poor, it is excruciatingly painful to reconcile with the shame of stark deprivation in a world basking in glittering abundance and extraordinary potentialities. The problems of poverty, however, do not remain confined to the poor themselves or the societies in which they live. As the UN Human Development Report 1993 rightly stressed: "The real threat in the next few decades is that global poverty will begin to travel without passport, in many unpleasant forms: drugs, diseases, terrorism, migration. Poverty anywhere is a threat to prosperity everywhere".

Poverty is both a consequence as well as a cause of environmental degradation. In the context of struggle for survival, immediate requirements of the poor tend to overwhelm any concern for the environmental future. The pressures of poverty and the consequential environmental stresses have resulted in the rising incidence of natural disasters and multiplication of the number of victims. As the Brandt Commission rightly pointed out "... generally these pressures are local. Today the scale of our intervention in nature is increasing and the physical effects of our decision will spill across national frontiers". However, the loud emergencies of the environment such as global warming and ozone depletion should not detract our attention from the silent emergencies of poverty (such as water pollution, land degradation and environmental diseases).

On balance the recent shifts in the post-capitalist society are not wholly unfavourable to developing countries. Some of these changes have actually opened new windows of opportunities for economic transformation. Historically countries developed, if they possessed more natural resources, were initially rich and enjoyed the advantages of having higher capital per head as well as superior technology and skills. But with globalization and emergence of what Drucker describes as "Knowledge Society", the modernisation of a developing society is now feasible mainly on the basis of education and skills of the labour force. There are now real opportunities of leap-frogging the stages of development and telescoping the process of industrialisation. Most of the governments in the Third World have now recognized the futility of resisting the process of integration with the global economy. This realization has facilitated significant structural reforms which have dramatically enhanced the efficiency and competitiveness of their economies. Finally, the disintegration of command economies has exposed the perversities and hollowness of big governments compared with free market economic process. The costs of bureaucratic failures have been minimized and a new stage has been set for the flowering of the individual initiative and enterprise.



Despite these promising changes, the odds of economic development should not be underestimated. The forces that created the widening gap between the affluent and developing societies did not originate in the Third World. They are the products of industrial societies. Underdevelopment is not an original state, it was created by the developed countries themselves.

The process of interaction between developing and affluent societies has often been oversimplified. The widening gap between these societies was not produced by economic exploitation of imperial powers alone. The disequilibrium of underdevelopment arose mainly from the incomplete transfer of technology of the North to the south. While the North readily sold the know-how as well as the medicines for reducing mortality rate, it did not transfer the technology for raising the productivity of industry and agriculture which was essential for supporting the increased population during the demographic transition. Environmental problems originated from profligate use of natural resources by the developed countries. Because of the disequilibrium in the world economic order, the rich in the affluent societies are getting richer whereas the absolute number of the poor in the developing countries is swelling.

It is highly unlikely that most of the developing countries will be able to raise the resources for providing and maintaining minimum physical and social infrastructure required for sustainable development. To contain population growth and provide minimum health care facilities, expenditure on health alone in developing countries requires to be raised by four times of the current expenditure. Likewise, an enormous investment is needed to provide minimum standard of physical infrastructure. The reduction of concessional aid flow (ODA) from the affluent societies to developing countries will, therefore, be a serious blow to their hope for economic growth necessary to reduce poverty and improve living conditions.

Of late, there has been considerable debate on the role of foreign aid. Undeniably, there are many instances of inefficient utilization of external assistance. Aid fatigue in the affluent societies is, therefore, understandable. However, sub-optimal use of aid is not merely attributable to incapacity and rent-seeking in the recipient countries, the political and economic compulsions of the donors themselves have played their part as well. Aid is still viewed differently in many ways by the political realities of the cold war as well as the internal politics of the donors. First, political considerations divert aid to middle and high income countries. Low income countries generally receive relatively less aid than those which do not deserve aid on economic considerations alone. Secondly, the most generous per capita allocation of aid

does not necessarily go to the poorest countries. Thirdly, a substantial part of aid is used by donor countries for promoting their commercial and strategic interests. Tied aid, which constitutes approximately two thirds of all bilateral assistance, forces the recipients to buy goods and services from donor countries at a non-competitive price. Despite these limitations, aid has played a seminal role in various sectors. For example, economic assistance to Bangladesh has succeeded in promoting a highly successful population planning programme, in accelerating agricultural production, in construction of urgently needed rural infrastructure and somewhat in alleviation of poverty. What is needed to be done is to replicate the areas where success has been achieved rather than using aid as an instrument of political manipulation. The long-term political and social benefits are likely to outweigh short-term fiscal burden on donors.

Of course, aid by itself can never be a sufficient condition for development. The impetus for growth must come from within. Fascinated by the initial successes of command economies and alarmed by widespread market failures, the Governments in developing countries opted for big government with an overwhelming concentration of power in the hands of central government and an elaborate network of prohibitions, rules and regulations. The Governments forgot that they were supposed to manage the country's business and not the business of the country. The resultant massive government failure in developing countries vindicated the dire warning of the fourteenth century Muslim philosopher Ibn Khaldun: "Commercial activity on the part of the rulers is harmful to his subjects and ruinous to tax revenue". For example, in Bangladesh, direct losses of the parastatals are over one percent of the GDP per annum. The unsatisfactory performance of the monopolistic public utilities has stifled the potentialities of growth.

Because of ever-increasing bureaucratic failures and the appalling inefficiencies and losses of state-owned enterprises, the process of development inevitably involves the ordeal of undoing what has been laboriously done in the past: decrease regulation, privatize the public sector enterprises, and reduce the size of the government. A small government, however does not necessarily imply a weak government. The developing countries need more governance not less. The choice before them is between a big but ineffective government and a lean but strong government that can and does govern. Market economy cannot work in an institutional vacuum. It presupposes a strong government that can ensure rule of law, accountability, transparency and predictability in its day to day operations. Effective governance is a necessary condition for sustaining economic growth. The role of the state, however, cannot be curtailed overnight. It has to be done through the democratic process in stages.

Good governance, however, cannot be imposed from above. There is no single recipe for good governance. The erosion of public confidence in the governmental systems is not unique to developing countries, it is equally true about affluent societies which are also trying to reinvent the government. Good governance emerges through a process of trial and error. Given the immense diversity of cultures and political forms, each society must be allowed to find its own way to reconcile conflicting interest groups and weave them into a cohesive state organization.

Historical experience indicates that democratic governments tend to be more responsive to the needs of the people. Democracy is not, however, a one shot affair. It is not a matter of single decision or a hurriedly arranged election. It is a long and arduous process. Constant renewal of democratic values is needed to ensure that levers of power are not usurped by vested interest groups. Democracy allows maximum influence of the people on the decisions that affect their lives. However, even democratic institutions in nation-states have turned out to be too big for the small. There are always social groups who are excluded wholly or partially from the polity: the very young, the very old, the disabled and women with heavy domestic commitments. For millions of underdogs all over the world, political participation is a luxury. Affirmative actions are, therefore, needed to reduce the discriminations against the socially disadvantaged. Legal systems need to be modernised to fit with changing socio-economic circumstances, bureaucratic constraints need to be reduced and discriminatory social norms and practices must be discouraged. Even this is not sufficient. The disadvantaged groups will have to be empowered through both formal and informal education, and barriers to women's participation in the development process need to be removed. Bangladesh has, therefore, placed maximum emphasis on education for women and children. A programme for Food for Education at primary stage and stipend for female students at secondary stage has been introduced to discourage dropout rates. There is abundant empirical evidence to suggest that when the window of opportunity is opened to them the poor are indeed efficient users of resources.

Another precondition of good governance through democratic process is decentralization of power. First, more authority needs to be transferred from capital cities to local governments in regions, towns and villages. Secondly, people's organizations and non-government organisations (NGO) can play a significant role in empowering the poor. Innovative organisations in Bangladesh such as the Grameen Bank and the BRAC and a number of others have blazed the trail of new methods of self-help at the grass roots level. However, NGOs can at best supplement the government, they can never be substitutes of government. The real challenge of good governance is, therefore,

to blend an effective and compassionate national government with local governments, people's organizations, NGOs and other independent civic societies. This is not easy to achieve. It will have to be a long-drawn process of change led by people.

Ultimately, good governance will have to be nourished and sustained by the people themselves. At this crucial juncture of history, patriotism is not enough. Patriotism is the willingness to die for one's own country. What we need now is enlightened citizenship. It means the willingness to live for one's country. Without enlightened citizenship there cannot be that responsible commitment which in the last analysis holds together the body politic. Citizenship means an active commitment to one's community, to one's country as well as to the world at large. Such citizens will not be the passive recipient of change. They will shape their own future in the light of their vision and conviction.



# FINANCIAL ACCOUNTABILITY AND TRANSPARENCY: A SURVEY ON THE EXPERIENCE OF BANGLADESH

M. Hafizuddin Khan\*

## **Introduction:**

It is needless to say that the sustainability of democratic institutions as well as the pursuit of democratic values primarily rests on a system of governance which would ensure public good on the one hand and would remain truly accountable and transparent on the other. Against the background of widespread demand for good governance in meeting the challenges offered by the new realities in the social, political and economic arena throughout the world, the issue of establishing accountability and transparency in the management of public resources is being increasingly focused.

Although the perception of accountability and transparency varies from country to country depending on the peculiarities of environment and culture, their essence remains basically the same in all societies. Keeping this broader context in view, an attempt has been made in this paper to bring to focus the institutional arrangements available in Bangladesh to promote financial accountability and transparency in the management of public resources; their adequacies; and efforts being made to bring about changes in the systems and procedures for a more accountable and transparent public financial management.

## **Institutional arrangements: An overview**

The strength of a democratic system lies in a well-knit institutional arrangement which holds the public managers accountable for their action and brings to light the outcome of their action. This indeed is the aspiration of the citizenry of a democracy. The type and nature of such institutional arrangement would, however, depend on social awareness, political will and commitment, and the level of maturity of democratic practice. Like elsewhere in the world the sovereign Parliament of Bangladesh has the ultimate responsibility to ensure financial accountability and transparency in the management of public resources. The Supreme Audit Institution (SAI) headed by the Comptroller and Auditor General and created through constitutional provisions supports the Parliament in the discharge of this function.

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\* Comptroller and Auditor General of Bangladesh

The recent political transition to democracy has made the Parliament of Bangladesh sovereign and supreme in making laws, public policies and allocation of public resources. Turning to the question of financial accountability, we may analyze how the Parliament in Bangladesh plays its role in promoting the pursuit of financial accountability and transparency in public financial management and how it strives to attain success.

The process of financial accountability starts from the placement and presentation of annual budget before the Parliament. The Parliament authorises the public managers to make spending from the public purse within the ambit of the vote for each demand for grant. The public managers in turn are required to spend for the purpose for which the grant was made by the Parliament. In order to examine the dispensation of the authority delegated to the public managers the Parliament establishes a number of committees. The foremost among these committees is the Standing Committee on Public Accounts (PAC) which carries out its functions in the manner laid down in the Rules of Procedure of Parliament and ultimately holds the public managers accountable so far their actions relate to financial management. Besides the PAC, there are two other important Committees called the Committee on Public Undertakings (PUC) which evaluates the performance of State Owned Enterprises (SOEs) and the public authorities other than the Government departments, and the Committee on Estimates which scrutinizes the estimates of the demands for grants by the executive ministries.

The PAC which represents the oversight role of the Parliament on public expenditure while carrying out its functions has to depend on relevant, reliable and unbiased information. These are provided by the Supreme Audit Institution headed by the Comptroller and Auditor General (C&AG).

The C&AG of Bangladesh derives authority for exercising his functions from the Constitution of the People's Republic of Bangladesh [Article 128 (1)] and the Comptroller and Auditor General (Additional Functions) Act, 1974. The Constitution empowers the C&AG to audit and report on the Public Accounts of the Republic while the Additional Functions Act, enacted within the constitutional provision enables him to exercise some more functions which include *inter alia*, keeping of Government accounts, preparation of appropriation and finance accounts, audit of accounts of statutory public authorities, preparation of commercial accounts and general financial statement. The Additional Functions Act was followed by two amendments, the Comptroller and Auditor-General (Additional Functions) Amendment Act of 1975 and 1983, which in essence created provision whereby the

responsibility of keeping accounts may also be entrusted to persons or authorities other than the C&AG. Having carried out his functions as enshrined in the constitution the C&AG submits his findings in the form of **Audit Reports, Appropriation Accounts and Finance Accounts** to the President of the Republic who causes them to be laid before the Parliament. The Parliament in turn acts on these reports through its committees like standing Committee on Public Accounts and Committee on Public Undertakings, as mentioned earlier. In brief, this is how these two institutions play their role in establishing financial accountability and transparency in the management of public resources in Bangladesh.

### **Adequacies of the existing institutional arrangements: A Closer Look**

#### **Parliament:**

Since independence, over the years the Government of Bangladesh has grown in size with concomitant rise in the volume of public expenditure. The annual budget to run the ministries has been estimated to nearly Tk. 80 billion during the current fiscal year (1997-98) which accounts for more than 50% of the total revenue expenditure of the Government. The Government's development expenditure has also been growing in scope and volume. The strengths and logistics of the institutions which are entrusted with the responsibility of conducting scrutiny over the financial discipline are not adequate enough to face the emerging and growing demands thrust upon them.

The PAC which plays the key role in establishing financial accountability and transparency has difficulty to function properly since it is not supported by a full-fledged secretariat and necessary logistics. It has to depend on the Parliament Secretariat which is over-burdened with multifarious functions. Apart from this, because of the lack of continuity of parliamentary practice in the past, many of the reports of the Auditor General which stood referred to the PAC were not examined. At present, the PAC of the seventh Parliament is confronted with a gigantic task of examining about 300 reports. The PACs in the past attempted to update their examination but ultimately succeeded to examine only a few audit reports during their tenure.

The PAC of the first Parliament which was constituted in 1973 could hold only three meetings and could not submit any report to the Parliament. The first Parliament lasted only 30 months. The PAC of the second parliament which was constituted in 1979 met 27 times and attempted to bring its examination upto date but could discuss only a few audit reports and submitted a single

report to the Parliament. The second Parliament lasted only 36 months and could not complete its tenure because of the imposition of Martial law in March 1982. In March 1983, an ad-hoc PAC was constituted which existed till the formation of the 3rd parliament in March 1986. During this period the ad-hoc PAC met 106 times and prepared 3 reports. The third parliament which lasted only 15 months did not form a PAC. The PAC of the fourth Parliament could work for 32 months. During this period it held 65 meetings and submitted two reports to the Parliament. The PAC of the 5th Parliament was constituted in 1991 and could work till November, 1995. It held as many as 137 meetings and submitted 4 reports to the Parliament. The sixth Parliament which lasted only 12 days did not form a PAC. The PAC of the present seventh Parliament was constituted in 1996 and has been working for a little over a period of one year. It would be worth noting that over a period of a quarter century we have got only 11 (eleven) reports from the PACs. During this period, the PACs could discuss only 20 audit reports out of 394 reports so far placed at their disposal for scrutiny.

As the PAC Reports are not traditionally discussed in the Parliament, the outcome of the efforts put in by the PACs remained mostly confined in papers and the auditees treated them as mere recommendations. Since there is no effective mechanism in place to follow up implementation of PAC recommendations many of them remained unattended. Almost the same problems are faced by the other two committees mentioned above. Moreover, effectiveness of the Standing Committees of the Ministries (numbering 37 in the last parliament) which were chaired by the Ministers themselves instead of the MPs were open to question by various quarters. The new Parliament has, however, changed the system by way of amending the Rules of Procedures of Parliament.

### **Supreme Audit Institution (SAI):**

The SAI, as mentioned earlier, is the principal provider of information to the PAC on which it charts its course of action. It, therefore, follows that the effectiveness of a PAC, to a large extent, depends on the quality of information provided by the SAI through audit reports.

The SAI of Bangladesh brings out every year 10 (ten) audit reports covering all areas of Governmental operation, 5 (five) Appropriation Accounts covering civil, defence, railway, postal and tele-communication departments and 1 (one) Finance Accounts covering all government receipts and expenditure under each approved head of account.



It would be seen from the contents of the audit reports brought out by the SAI of Bangladesh that they essentially contain the results of conventional audit which basically point to the irregularities and lapses in the financial transactions without laying any emphasis on the results of the activities funded by the Government. As a result, they cannot create the desired impact on those for whom they are intended. Again, apart from the quality of contents of the reports, they utterly lack in timeliness as well. The reasons behind these obvious deficiencies can be broadly attributed to: (i) inadequacy of auditing skills and systems (ii) difficulties in eliciting proper response from the auditees. Having identified these reasons, we shall try to explain why they occur in our environment and how they contribute towards making the whole effort an exercise in futility.

The SAI of Bangladesh does not follow the auditing standards developed by the INTOSAI. The existing Audit Code and Audit Manual contain general description of audit mandate and audit procedures. These were framed for the purpose of defining audit areas and describing procedural check-list for conducting audit in different areas of financial transaction and accounting. Although these are still suitable for conducting compliance, regularity and certification audit, a set of modern auditing standards is needed for carrying out audit according to internationally accepted standard. **Secondly**, the personnel engaged in conducting audit are not adequately trained and qualified to shoulder the responsibility of auditing according to the modern concepts, techniques and methodologies. Consequently, the results of audit remain substandard and thus fail to create the desired impact. **Thirdly**, because of the enormous size of the Government and the creation of a large number of state-owned enterprises and public authorities, the audit coverage has become too wide. The SAI of Bangladesh at present has to provide audit coverage on as many as 22,250 auditable units. This, in a way, tends to create unfavorable impact on the quality of audit. **Fourthly**, although according to Article 128 (4) of the Constitution of the Republic, the C&AG is fully independent in exercising his functions, this independence is not clearly established by the Rules of Business of the Government. As a result, he has to depend on concerned executive ministries for budget, recruitment and training of personnel and other important administrative matters. **Fifthly**, because of the absence of strong internal control and internal audit system in the auditee organisations, the C&AG cannot conduct System Based Audit (SBA) which is indeed crucial to the utilization of scarce audit resources in a more meaningful way. In brief, these are the bottlenecks the C&AG has to face in conducting his audit operation.

About the difficulties confronted by the SAI of Bangladesh in eliciting proper response from the auditees to the audit reports, it may be mentioned that in the absence of democratic practice for a period of two decades, the grip of accountability has not been firmly established in public administration and as a result long overdue audit reports remain either unattended or perfunctorily attended resulting in further delays in resolving audit observations. There are instances of delay “of a period of more than 12 years by some Ministries in taking effective preliminary steps after Audit Objections were raised“. This situation has been reflected in the reports of the PAC of the present Parliament with a note of dissatisfaction of the committee. To further illustrate the situation, a few examples drawn from the reports of the committee are set out below:

<u>Ministries</u>	<u>Delay (Average Months)</u>
Food	148.15
Agriculture	135.67
Foreign Affairs	128.82
Land	116.50
Textiles	110.43
Environment & Forest	100.08
Water Resources	95.03
Civil Aviation & Tourism	90.72
Power, Energy & Mineral Resources	77.54

In the ministries /divisions and other audited bodies, there are no designated Cells to deal with the observations made in the audit reports. As a result, a huge number of audit observations has piled up over the years. Many of the audit observations could however be resolved had there been proper response from the auditee side. The present PAC along with its precursors, took serious note of it and made specific recommendations in their reports to set up designated Cells in all ministries/divisions to deal with the audit reports issued by the C & AG in order to ensure early response. One can, therefore, logically infer that only a mere attitudinal change could make a real difference in this regard.

### **Efforts made to bring in changes: A way forward**

During recent times, a number of studies have been conducted on public sector reforms in Bangladesh. The reports based on the results of these studies brought to focus the problems having various dimensions which exist in the

management of public sector and made recommendations for improvement. One common aspect of these recommendations is strengthening the institutions engaged in the task of promoting accountability and transparency in the management of public resources through organising suitable reform initiatives. To illustrate the point, I would like to quote here from "Report on Public Administration Sector Study in Bangladesh" prepared by UNDP in 1993, which reads as follows:

"The Comptroller/Auditor General plays a key role in public accountability. The office needs to have trained staff, logistics and information to ensure the timely release of reports on the use of financial resources by the Government. Although the main function at this time is financial audits, this office could, with additional training, perform selected performance audits, as requested by the Parliament."

In another report entitled "Government that works: Reforming the Public Sector" prepared by the World Bank in 1996, a set of institutional reforms relating to the department of the C&AG has been recommended which include, inter alia, the following:

- Improve the availability of capable human resources to the C&AG
- Introduce quick preliminary audits
- Strengthen the training programs
- Initiate comprehensive audits to move from procedural accountability to consequential or output oriented accountability.

The same report also recommended a concrete Action Plan for strengthening parliamentary oversight which would include the following:

- Providing MPs with adequate office and research facilities
- Establish the time tested parliamentary practice of questioning Ministers
- Strengthen the system of standing committees
- Subject the key appointments to parliamentary approval
- Establishing permanent Parliamentary support and oversight Agencies
- Establishing an Ombudsman's office, as called for in the constitution.

Following the recommendations of these studies, reform initiatives in some areas of the public sector have been initiated by the Government. In order to bring about reforms in the existing budgeting and accounting system which lack transparency and consistency, the Ministry of Finance, with technical assistance from the British Government, launched a project entitled "Reforms in Budgeting and Expenditure Control" (RIBEC) in 1994 which has already passed through two phases and is still going on. The achievements made by the project so far are indeed encouraging and the project showed its potential to meet the challenges and expectations, but the scope of the project itself is very limited. The project in its two initial phases has addressed a number of issues like new classification structure for budgeting and accounting, computerisation of core accounts, updating of financial rules and regulations and training of officers and staff, but they effectively encompass a small part of the whole gamut of public financial management in Bangladesh.

Some such reforms are indeed essential for strengthening the audit capability of the C&AG. Although a small project entitled 'Development of the System of Audit of Foreign Aided Projects' launched by the C&AG with the assistance of the development partners like IDA, UNDP and others has been implemented, no comprehensive programme on the basis of the needs and requirements of the Department as a whole has been taken up for implementation. It is encouraging to note that recently the UNDP has come forward and demonstrated interest to assist the C&AG in launching a comprehensive project for reforming Government Audit. Already a formulation study conducted by a mission has assessed the needs of the department. Besides this, at the department's own initiative performance audit on pilot basis has been introduced which has already covered sixty seven organisations. This initiative in its character and contents is indeed rudimentary but it has certainly set the tone for future reforms in this field. The British Department for International Development (DFID) has also expressed interest in providing assistance in improving Government audit.

Apart from the above initiatives, the SAI of Bangladesh is holding seminars and conferences at regional level to make the officers and staff aware and receptive of the changes they are going to confront as a result of the reform measures the department is going to adopt. The experience and results of these seminars and conferences are really encouraging.

Some other reform initiatives with the assistance of the UNDP have been taken by the Parliament and a project entitled 'Strengthening Parliamentary Democracy' is at work to steer these reform initiatives. The terms of reference



of the project include both institutional and operational reforms. Institutional reforms include revision of the Rules of Procedure of Parliament and reform of the Committee system, while operational reforms include orientation for MPs and training for staff to be provided by an independent Institute for Parliamentary studies, improved research, office, printing, library and staff support for MPs and Committees.

During recent times, the Government has also launched a number of Commissions such as Public Administration Reforms Commission, Law Reforms Commission and Local Government Reforms Commission to initiate reforms in other areas of public sector. The common goal of launching these Commissions is to make public sector in Bangladesh more accountable, transparent and responsive.

### **Conclusion:**

It is evident from the above analysis that it is difficult to ensure accountability and transparency in the management of public resources in true sense without carrying out some fundamental reforms aimed at strengthening and modernising the systems and procedures as well as the institutions entrusted with this task. These reform measures need to be carefully devised, should encompass all the relevant areas simultaneously, should be well balanced and implemented in a sequential order. Above all the issue of sustainability of the reforms should receive proper attention. The reform agenda already taken up by the Government and those at the conceptual and formulation stage should properly address the problems in order to firmly establish rule of law in public financial management. Along with gradual consolidation and strengthening of the democratic roots, two vital aspects of democracy i.e. accountability and transparency must also be given due opportunity and environment to bloom to their full potential.

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## THE MANAGEMENT OF PUBLIC RESOURCES<sup>1</sup>

Gholam Kibria\*

I am grateful to the BCS: Audit & Accounts Service Association for this opportunity to be the keynote speaker at their seminar on a subject that touches us all. As a former member of the Association I am also thankful to the Chairman of the Public Accounts Committee for his presence here as the Chief Guest.

Many years ago when I was a probationer in the Audit & Accounts Service, I used to consider the old and the retired as neither alive nor dead, but merely "un-dead". The un-dead, as some of you may recall, are beings suspended between life and death in their coffins, from where they periodically emerge to recharge themselves with other people's vitality. Their most illustrious representative was Count Dracula of Transylvania, the master hero of horror, immortalised in a famous novel and several highly successful movies. Now that I have been one of the un-dead for some years, I find that I am beginning to appreciate Count Dracula and to enjoy occasional forays into the world of the young and the active.

My intent this morning is to place before you a tentative framework for a discussion on the effective utilisation of resources in government and the public sector. "Resources", in this context, will include financial as well as real resources, both material and human, but exclude land and environmental resources in the public domain.

To keep the presentation concrete and to keep it within manageable limits, it will be structured around a few well-known and much-discussed problems in resource management in Bangladesh. These are:

- (i) The wide social and professional chasm between officers and staff in government departments and public sector corporations;
- (ii) The identification of staff and trade unions with political parties and vice-versa.
- (iii) Absence of effective arrangements for the appropriate custodianship of physical assets and their proper maintenance.

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<sup>1</sup> The paper was presented as a keynote paper in a seminar organised by BCS : Audit and Accounts Association at a local hotel on December 13, 1997

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- (iv) Large and chronic inter-enterprise and inter-agency debts, which have far-reaching consequences for the government and the economy.
- (v) Absence of a smoothly operating system for the timely adjustment of the prices of marketable goods and services provided by the public sector.
- (vi) The absence of modern and high quality internal audit organisations in government and the public sector.

Though the presentation of the keynote paper will be structured around the half-a-dozen issues just enumerated, the ensuing discussion, I presume, will not be limited to these topics.

### **Social and professional gap between officers and staff**

The personnel structure in government departments and the public sector corporations and enterprises is heavily hierarchical, with a wide social and professional chasm between officers and staff. This dichotomy in personnel structure partly reflects a dichotomy between work at the grass roots and work at the upper levels of an organisation, which is a fact of life everywhere. But the whole trend of modern management world wide has been towards simplifying the details of work at the grass roots, facilitating a better grasp of details by senior management inducing a better understanding of the rationale of decision-making at the higher levels among personnel at junior levels. This two-way movement of mutual comprehension and respect has been sharply accelerated by the rapid growth of word processing and computerisation, opening up new horizons for personnel at senior and junior levels alike, and improving the quality of decision making as well as grass-roots implementation. In our country, however, the management environment and outlook have remained rooted in the past. In fact, the adverse consequences of the dichotomy just described have perhaps been aggravated by the growing volume of details at the bottom with increasing demand for public services, unchanged procedures for dealing with them and the growing sophistication of work at the decision-making level under the impact of international interaction and globalisation. This growing gap between the upper levels of management and their grass roots deprives the decision making process of insight into details and many well-meaning policy or management decisions get bogged down in implementation. This is a recognised problem and in several areas of government, initiatives have been taken to deal with various aspects of the problem. The Reforms in Budgeting and Expenditure Control (RIBEC) Project

of the Ministry of Finance within the framework of the Public Sector Resource Management Adjustment programme is the most comprehensive of these initiatives. However, this is primarily a process-oriented rather than human resource oriented project. I believe what the government and public sector machinery as a whole now needs is a comprehensive strategy for modernisation which will include provision for upgrading the skills and attitudes of junior level staff so that they may be re-absorbed in the modernised set-up. Only a part of possible redundancies at the grass roots level caused by work simplification and data-and word-processing will be absorbed through attrition within a reasonable time span. The demand for higher skills created by the same process of modernisation should at least partly be met through the remedial education and retraining of existing relatively young grassroots personnel. If this is not done, we may be losing the use of some valuable existing experience and besides, any modernisation process initiated at the top may be held hostage to organised resistance within the system.

#### **The identification of staff- and trade-unions with political parties**

The adverse consequences of the politicisation of staff and trade unions are too well known to require detailed narration. It handicaps the government in dealing with government staff and trade union problems on a completely objective basis and it also affects the ability of staff associations and collective bargaining agents to represent the interests of their members unhampered by party political loyalties. The solution, of course, lies in all political parties arriving at a consensus on distancing themselves from involvement in staff associations and trade unions. In our present circumstances, such a consensus is difficult to visualise but the subject could, and should, be kept constantly on the public agenda.

#### **Oversight of the custodianship of government's physical assets**

The overwhelming emphasis in government financial management is on the control of money flows rather than the stock of physical assets. Public sector business organisations have reasonable inventories of their assets, but in hard core government, attention to physical assets and their maintenance is inadequate, to say the least. Awareness of the value and condition of physical assets among top management is often lacking. This makes for poor custody and maintenance of government assets, with incalculable costs. To remedy this undesirable situation, government could consider allocating to the Ministry of Finance the responsibility for the oversight of the assets custodial functions of the ministries and departments. The following tasks could be envisioned for a

new unit set up in the Ministry of Finance for this purpose:-

- i. To build up and maintain central records of the description and value of physical assets of the government above a certain value. (The responsibility for the day-to-day operation, maintenance and supervision of these assets will, of course, remain with the administrative authorities concerned and they will also maintain their own records of these assets.)
- ii. To ascertain, through periodic reports and physical inspection, whether the administrative authorities are using or operating their assets with due care and maintaining them properly. Preventive maintenance of equipment should be encouraged and enforced.
- iii. To help facilitate appropriate allocation at the time of the annual budget exercises, where resources allocated for operation and maintenance are seen to be inadequate.

The enormous database capacity of computers makes the central supervision of physical assets possible today. The new labour government in Britain undertook the preparation of a database of government assets soon after it took office last May and the task has just been completed. A couple of weeks back, I heard in a BBC broadcast that the bulk of the information gathered would be put on the Internet. This is a remarkable achievement, indeed, comparable to the Domesday Book compiled in 1086 A.D. under the orders of William the Conqueror, recording the properties of the King and his tenants-in-chief. (One minor but delightful discovery to come out of the new Labour Government's recent labours is the fact that the British Army has more horses than tanks.)

### **Chronic inter-enterprise and inter-agency debts**

Inter-enterprise and inter-agency debts arising from unpaid bills for goods and services supplied to each other are a major public sector problem in Bangladesh, as in many other countries with large public sectors. Typically, a state-owned enterprise (SOE) tries to finance the liquidity-gaps caused by arrears from its debtors by postponing the payments of its own obligations to other SOEs, the government, private sector claimants and, finally, the banking system. This leads to an extension of the web of mutual debts outside the closed circle of SOEs and the Government (which is a member of this circle because of arrears in its payments to the public utilities). This extension of the web of debts to the private sector and the banking system makes the problem

of inter-enterprise debts a general problem for the economy as a whole. It also casts a dark shadow over negotiations with development partners for new project loans.

Inter-enterprise debts are, then, a major problem with large resource implications and a resolute programme aimed at their early liquidation, therefore, needs to be undertaken. The following general approach is suggested here for such a programme:

- i. As the debts of each enterprise to the other enterprises are intimately connected with the debts of other entities (including the government) to it, the first step should be the construction of a matrix of mutual debts and claims (Please see Annex). A multi-lateral solution rather than a series of bilateral settlements should be attempted.
- ii. On the basis of this matrix, the enterprises should be divided into two groups - one of net debtors and the other of net creditors.
- iii. For each net debtor entity, a repayment schedule of its net debt is to be worked out on the basis of a realistic assessment of its liquidity projection over a short or medium term time frame. These payments should go into a central fund to be controlled by an Administrator of Enterprise Debts in the Ministry of Finance, who will distribute the amounts among its creditors on a suitable pro-rata basis after deducting from each instalment necessary amounts for the settlement of each creditor organisation's own debts.
- iv. All the transactions should, of course, be reflected in the respective accounts on a gross basis.
- v. An essential pre-condition for the success of this strategy is that a comprehensive long-term financial restructuring programme will be undertaken on a case-by-case basis.

### **Smooth adjustment of prices of public sector goods and services**

The disastrous economic distortions caused by any significant delays in price adjustments in the public sector are well known and well documented. They give wrong signals to the producers and consumers alike, they cause heavy losses to the manufacturing and trading organisations concerned, causing also liquidity gaps which have to be met by a combination of budgetary subsidy and

un-repaid bank loans of an expansionary nature. Finally they give rise to serious difficulties in negotiations with development partners or the IMF for new loans or credits. All these problems are well known. The disruptive effects of single-stroke large adjustments reflecting accumulated arrears of reasonable adjustments due in the past are not, however, explicitly recognised. These aggregate adjustments carried out by government or state-owned enterprises, to be socially tolerable and economically effective at all, must be matched by ever widening circles of innumerable mini-adjustments in the budgets of economic agents - households and business enterprises- scattered all over the country. These mini-adjustments involve large shifts in the consumption and income patterns of economic agents. Their ability to make these difficult changes and shifts is determined by their level of consumption and resources at the start of the adjustment process, which in our economy tends to be low in most cases. In such a situation many of the households and other economic agents respond with street protests for a start and then gradually settle down to a wide variety of malpractice that decrease their individual bills but increase the collective cost to the whole society and the economy. These bad habits, of course, once entrenched in difficult times, prove incurable even in more prosperous times. This is a major factor in so-called system losses.

Two conclusions seem to follow from the scenario sketched above:

- i. Let us obviate single-stroke massive price adjustment by establishing 'an arm's' length relationship between government and state-owned enterprises at least in the area of price setting, which should be entirely cost-and-market driven except in those rare cases where for reasons of declared public policy, government comes up with offers of explicit cash subsidies in the shape of lump-sum advance payments subject to quarterly adjustments. To make the public sector price setting process transparent and to provide safeguards against the reckless underwriting of poor management and uncontrolled costs in the public sector, an independent professional body may be set up to oversee the price setting process. Public utilities and other monopolies should be required to submit their price setting proposal with underlying data to that body which could then hold a public hearing of reasonable duration, say two weeks. For other state-owned enterprises, which compete in the market place, a statement published in the press explaining the underlying factors should be enough.
- ii. In cases of massive, really massive, external price shocks such as the second oil price shock of 1979, very large price adjustments may



become inevitable in such cases, which should be very, very infrequent, hopefully, the pace of adjustment may be determined in consultation with the government, keeping in view the shock-absorptive capacity of the economic agents.

### **Effective internal audit set-ups in the state enterprises and government departments**

In recent years, the Comptroller and Auditor General's independent external audit has made remarkable strides towards the induction of Comprehensive Audit, representing a combination of traditional Compliance Audit and the new concepts of Performance and Value For Money (VFM) Audit.

The first highly readable report of the present star-studded Public Accounts Committee led by its able and energetic Chairman and supported by professionally qualified staff shows that the first and most important user of the Auditor General's reports will be able to give him all necessary support. But both the Comptroller and Auditor General and the Public Accounts Committee will be handicapped in their modernisation and improvement programmes unless a strong network of internal audit organisations is built up across the Government and the public sector. The whole trend in Government and private sector audit in recent years has been towards strengthening internal audit. The growth and strengthening of the offices of the Inspectors General in the U.S. Federal agencies and the role of internal audit in commercial business organisations in the U.K. and elsewhere in stimulating the growth of "Control Self Assessment" (CSA) illustrate this development. In order to improve the management of resources in government and state owned organisations and to simplify and facilitate the work of external audit, both that of the Comptroller & Auditor General and the Chartered Accountants (in relation to the public sector) - a policy-directed initiative for the creation of a network of internal audit organisations in all the major Government Ministries and Departments and in the major public sector corporations and state owned enterprises with the following features could be undertaken:

These organisations should be manned with good professionally qualified staff, initially drawn from the Audit Department but later replaced by specialised personnel appropriately trained for the purpose.

The chiefs of the internal audit units regardless of their rank and pay scales, should be given direct access to the heads of the organisations concerned - ministries, departments, corporations and enterprises.

The internal audit units will not only carry out standard internal audit checks of financial operations, they must also work as pro-active advisors and consultants to management in constantly assessing and improving their internal control systems.

Before I close, allow me to address the relatively young members of the audience who now stand at the threshold of their careers in the management of public resources. As you must already know and may have felt while listening to my remarks this morning, the management of public resources is a messy business calling for many hard decisions for which there never will be a neat, ready-made model. Mao Tse Tung's remarks on revolutions are partly true about the management of public resources too. "A revolution," he said, "is not the same as inviting people to dinner, or writing an essay or painting a picture", or, I must add in all fairness, confessionally, "delivering the keynote address at a well arranged seminar"

Mao Tse Tung went on to say that "a revolution is an insurrection, an act of violence by which one class overthrows another". In our profession, we do not go for revolutions of this kind or any other, but we do often have to advise or take many hard decisions that sometimes have the effect of causing heads to roll, at least figuratively --our heads as well as others. But it is a noble profession nevertheless, because it lies at the very heart of the process of conducting the public's business. I have had the honour of spending a lifetime in this profession and, believe me, in retrospect I know that I enjoyed every moment of it. I would not have changed it for any other.

#### Annex

Matrix of Mutual Debts and Claims

Debts to Debts of	A	B	C	D	E	F	Net debt(+) or Net credit (-)
A	X	A <sub>B</sub>	A <sub>C</sub>	A <sub>D</sub>	A <sub>E</sub>	A <sub>F</sub>	
B	B <sub>A</sub>	X	B <sub>C</sub>	B <sub>D</sub>	B <sub>E</sub>	B <sub>F</sub>	
C	C <sub>A</sub>	C <sub>B</sub>	X	C <sub>D</sub>	C <sub>E</sub>	C <sub>F</sub>	
D	D <sub>A</sub>	D <sub>B</sub>	D <sub>C</sub>	X	D <sub>E</sub>	D <sub>F</sub>	
E	E <sub>A</sub>	E <sub>B</sub>	E <sub>C</sub>	E <sub>D</sub>	X	E <sub>F</sub>	
F	F <sub>A</sub>	F <sub>B</sub>	F <sub>C</sub>	F <sub>D</sub>	F <sub>E</sub>	X	

#### Notes:

1. The subscripts indicate the organisations to whom debt is owed. Thus A<sub>B</sub> stands for debt of A to B. If A has a claim on B rather than a debt to it, A<sub>B</sub> will be a negative figure. A negative figure in the last column, representing the sum of the figures in a particular row, will imply a net claim.
2. Only six organisations have been assumed for illustration. In actual practice, the number, though unknown to me, will, of course, be much larger.

# HEALTH CARE EXPENDITURES IN BANGLADESH

Dr. A.K.M. Ghulam Rabbani\*

## Introduction

The objective of this paper is to explore the level and pattern of household health care expenditures as obtained from Morbidity and Health Status Survey (MHSS) of Health and Demographic Survey System (HDS) of the Bangladesh Bureau of Statistics (BBS). In national accounting terms, households are considered to be financing units for all health care expenses made out of their income, except for transfers in kind received from the Government, and the NPISH (non-profit institutions serving households) sectors and the rest of the world. Household health care expenditures clearly comprise a significant source of financing of Bangladesh Health Care System. However, it is not easy to obtain global and accurate estimates of actual level of household health care spending in the country. Household Expenditure Survey (HES) conducted by BBS has so far been the only source of data on household health care expenditures. Although nationally representative, usefulness of HES data is vitiated due to its irregular execution and large degree of under coverage. To mitigate the data deficiency, the nation wide Health Status Survey has included a special module on household health care expenditures in its successive rounds and has by now developed fairly comprehensive data base on household health care expenditures covering both urban and rural domains of the country. In this paper, we shall examine the relevant data on household health care expenditures for the period February 1994 through January 1995 and compare them with the data from 1995-96 HES and other sources such as national accounts to assess the degree of coverage of the data from the various sources.

The paper is divided into five parts - the first part provides an introduction to the study, the second part deals with the household morbidity pattern in Bangladesh in the context of proximate determinant of household health care expenditures, the third part examines the level and pattern of household

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\* Former Secretary, Statistics Division and Director General, Bangladesh Bureau of Statistics. The author is indebted to M. Shahadat Hossain, Project Director and A.K.M. Tahidul Islam, Statistical Officer of the Health and Demographic Project of the Bangladesh Bureau of Statistics for the assistance received in data analysis and tabulation. The paper is a modified version of the text that was presented in the October, 1997 seminar on the Health and Demographic Survey organized by the BBS. The views expressed in the paper in no way reflect the policy or the official views of the BBS.

expenditures in depth on the basis of specially computed data from MHSS 1994-95, the fourth part attempts validation of MHSS expenditure data by comparing with HES 1995-96 and data from national accounts compilation and fifth part draws together the conclusions of the study.

**Household morbidity pattern in Bangladesh as the proximate determinant of household health care expenditures.**

After allowing for income, education, household sanitation, environment and other socio-economic factors, the proximate determinant of household health care expenditures in the country is the household disease burden or the level and pattern of morbidity at the household level. In fact, health care expenditure is the basic response of the household to the onset or prevalence of morbidity or diseases amongst household members. This hypothesis can be quantitatively explored through a cross sectional multivariate regression equation of the following form on the basis of data from the Morbidity and Health Status Survey 1994-95 for national, rural and urban locations:

$$Y = a + b_1x_1 + b_2x_2 + b_3x_3 + e$$

where

- Y = per capita household health care expenditure
- X1 = household morbidity prevalence index
- X2 = per capita household income or land (in case of rural areas)
- X3 = a measure of household sanitary index
- e = random error

To test the hypothesis, three regression equations - for the aggregate national, rural and urban residences were estimated from the MHSS data as follows:

National level :	$Y = 19.16 + 178.23x_1 + 0.064x_2 + 22.37x_3$
Rural :	$Y = 22.27 + 217.69x_1 + 0.38x_2 + 27.86x_3$
Urban :	$Y = 55.39 + 115.42x_1 + 0.04x_2 + 14.87x_3$

The explanatory powers of the estimated regressions were rather low as judged by the value of R<sup>2</sup> however beta coefficients of all the three explanatory variables were found to be significantly different from zero. The explanatory variables could thus be regarded as relevant for explaining the observed variability in the per capita health care expenditures as enumerated by the MHSS.

Crude morbidity rates estimated by MHSS show that on the average 15 to 20 percent of household members remain sick in course of a year. Sickness rate seems to worsen in the monsoon period (Mid-July to Mid-October) and improves somewhat during the cooler months (Mid-November to Mid-February). There is considerable variation between gender morbidity rates-females are found to be more sickness prone in Bangladesh; and between urban and rural areas - morbidity rate is relatively higher in rural areas compared to urban areas. Morbidity or disease prevalence also shows significant variations by age groups. In general, children below 5 years of age and elderly persons above 60 are more disease prone compared to teenagers or working age population; moreover, morbidity rates by age groups irrespective of gender are strongly responsive to seasonal variations i.e. worsening off in high monsoon and improving in dry and cooler months.

### Treatment status of morbid persons

More interesting from the health care expenditure point of view is the status of morbid persons with respect to treatments which can be interpreted as the response rates of morbid persons in seeking treatment with respect to variations in major seasonal patterns. More than 82% of morbid persons during the fair weather (cooler months) and nearly 90% during the high monsoon (Mid-July to Mid-October) had received treatments for their sickness according to 2nd and 3rd rounds of the MHSS. The following data from the 2nd and 3rd rounds of the MHSS on treatment status of the household based morbid persons provide the broad evidence in this respect:

**Table-1: Treatment status of the morbid persons (percent of morbid persons receiving treatment)**

Fair Weather: Third round: (Mid-November 1994 - Mid-February 1995)			
Residence	Both sex	Male	Female
National	82.1	78.6	85.2
Rural	81.1	77.8	84.1
Urban	85.1	81.2	88.7
High monsoon: Second round: (Mid-July 1994 to Mid-October 1995)			
National	89.9	91.2	88.5
Rural	88.7	90.3	87.2
Urban	93.5	94.7	92.5

Sources: Morbidity and Health Status Survey: Summary Reports, BBS.

After allowing for other factors, the level and pattern of health care expenditures are largely determined by the type of treatment and pattern of sickness (or morbidity pattern).

The data from MHSS show that allowing for the rather sharp seasonal variations, nearly 25% of the sickness episodes were self treated, 50-60% were treated by un-qualified physicians and the rest (around 20% on the average) were treated by qualified physicians of which majority of the cases were in private clinics or dispensaries, followed by government hospitals and dispensaries.

The following table provides the relevant data:

**Table-2: Sources of treatment of sick persons (percentages of treatments)**

Fair Weather: Third round: (Mid November 1994 to Mid-February 1995)			
Residence	Both sex	Male	Female
Self treatment	24.4	23.8	25.0
Unqualified physicians	53.1	53.4	52.8
Qualified physicians	22.5	22.8	22.2
In Govt. Hospitals	8.3	8.3	8.8
Private clinics	11.4	11.9	10.9
Others	2.8	2.6	2.15
High monsoon: Second round: (Mid-July 1994 to Mid-October 1995)			
Self treatment	15.8	15.1	16.4
Unqualified physicians	57.3	58.4	56.1
Qualified physicians	26.9	26.4	27.5
In Govt. Hospitals	10.8	10.6	10.9
Private clinics	13.4	13.4	13.5
Others	2.8	2.5	3.2

*Sources: Summary Reports: Morbidity and Health Status Survey*

The level and type of household health care expenditures is also correlated with types and duration of sickness episodes. One of the remarkable contributions of MHSS has been quantification of the nation-wide sickness episodes and their prevalence by gender disaggregation on a regular and systematic basis. Measuring sickness episodes by proportional morbidity and grouping them by the two categories - chronic and transient to take into account the episode duration, we observe from MHSS data that on the average around one-third of the episodes were accounted for by five chronic ailments - ulceration, asthma, heart diseases including rheumatic fever, diabetes and anemia. Nearly 40% of

the transient episodes were accounted for by three groups of sickness - diarrhea (including dysentery), common cold and fever of various types including typhoid and influenza. The data relating to episodes of chronic ailments show remarkable consistency from season to season (as measured by the round-wise data).

The dominance of transitory episodes in the overall morbidity pattern leads one to conclude that the remedial expenditures are also likely to be less expensive or in other words, per capita health care expenditures is still likely to be rather low and as disease burden shifts more towards chronic illness types, per capita health care expenditure is likely to rise in real terms.

### The Level and Pattern of Household Health Care Expenditure

Nation-wide household health care expenditures for the year 1995-96 (covering the period from mid-February 1994 through mid-January 1995) have been estimated from the health care expenditure module of MHSS. The estimates disaggregated by major categories of expenditures and by rural and urban areas are provided in the following table:

**Table-3: Household health care expenditures in Bangladesh-1994-95 by major expenditure categories**

(in million Taka)

Expenditure category	Total Country	Percent	Rural Areas	Percent	Urban areas	Percent
General expenditure of which:	33,158.7	87.5	25,006.9	90.4	8,151.8	79.8
Medicine	23,627.1	62.4	18,172.9	65.7	5,454.1	53.1
Physicians' fees	5,689.3	15.1	4,086.7	14.7	1,602.6	15.7
Travel expenses	3,842.3	10.1	2,747.2	9.9	1,095.0	10.7
Medical Tests of which:	3,515.6	9.3	2,088.1	7.5	1,427.4	14.0
X-ray	1,136.4	2.9	730.7	2.6	405.7	4.0
Urine	453.9	1.9	270.8	0.9	183.1	1.8
Stool	348.3	0.9	247.8	0.9	100.5	1.0
Blood	667.4	1.7	354.5	1.2	312.9	3.1
Other tests	905.9	2.4	484.5	1.8	421.5	4.1
Surgical operation related Expenditure of which:	1,219.4	3.2	577.8	2.1	641.6	6.3
Government hospitals	173.9	0.4	150.8	0.5	23.1	0.2
Private clinics	439.18	1.2	204.8	0.7	235.0	2.3
Surgeons' fees	276.4	0.7	87.6	0.4	188.8	1.8
Medicine	217.8	0.5	89.9	0.3	127.9	1.3
Other expenses	111.5	0.3	44.7	0.2	66.9	0.7
Total expenditures:	37,893.7	(100)	27,672.8	(100)	10,220.9	(100)

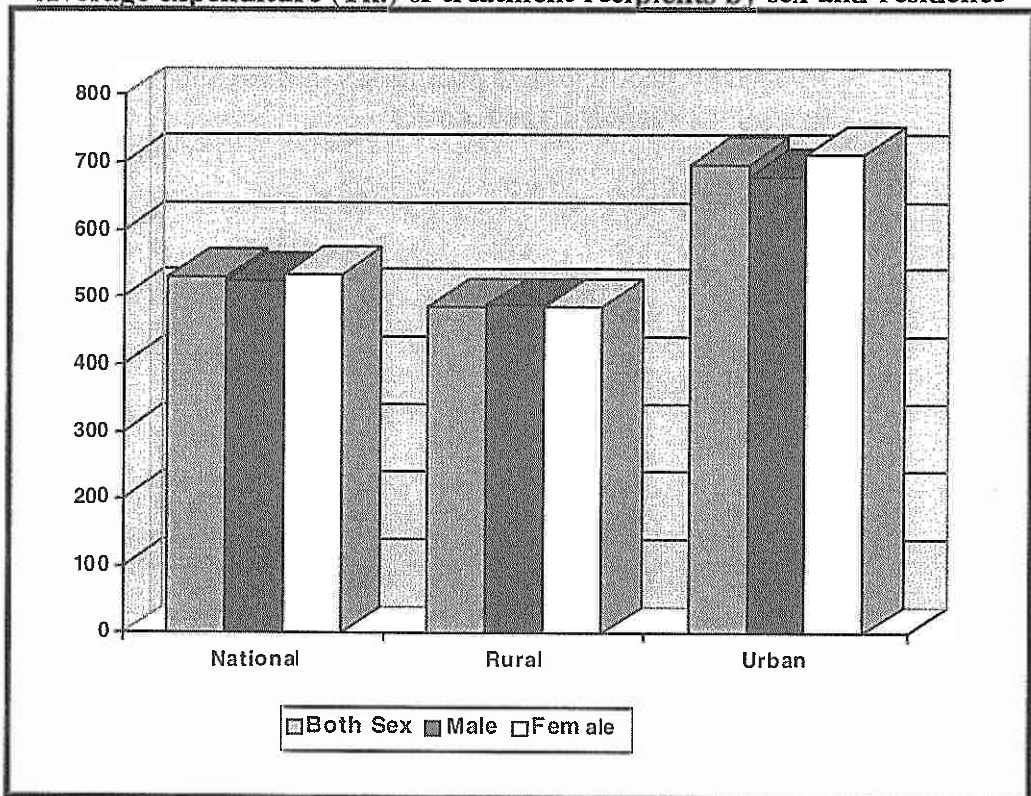
Source: Special tabulation from the Morbidity and Health Status Survey: Third and subsequent rounds.

## Health Care Expenditures in Bangladesh

Total household health care expenditure during 1995-96 as estimated by MHSS come to around Tk. 3789.4 crores or around 2.3% of GDP. Total expenditures of rural households were estimated at Tk. 2767.3 crore or around 73% of national total and total expenditures of urban households were estimated as Tk. 1022.1 crore or around 27% of national total.

The data also enable disaggregation of the expenditures by goods and services. Medicine constituted the single largest item of expenditures. Expenditures on medicine is estimated under two categories: general expenditure and surgical operation related medicine; combining the two, country wide total expenditures on medicine come to around Tk. 2580.5 crores or nearly 63% of the total household health care expenditures. Rural households seem to spend proportionately more on medicine (66% of total expenditure) compared to urban household (54.4%).

**Average expenditure (Tk.) of treatment recipients by sex and residence**



Nationwide, expenditures on services estimated to around 37% of the total expenditure or to Tk. 1208.8 crore of which health care related travel expenditures estimated around 10.1% of the total or to Tk. 384.2 crore. Urban



households were found to spend relatively more on services (45.6% of total expenditures) compared to rural household (34% of the total).

Excluding travel expenses, nationwide physician and surgeon's fees account for 15.8%, medical tests 9.3% while hospital and clinic charges account for 1.3% of the total expenditures. Two items of interest seem to be missing from the estimated expenditures: expenditures on prostheses (such as spectacles, hearing aid, dentures, artificial limbs etc.) and expenditures on medical treatment abroad. The latter is a growing phenomenon and the volume of health care expenditures abroad including expenditure on travel needs early monitoring. Similarly health expenditures need to include expenditures on family planning or family limiting or spacing expenditures.

Following analysis of the aggregate expenditure patterns, we now focus on the pattern of expenditures by recipients of treatments by locations, i.e. national and rural and urban areas. Our analysis would have been strengthened if the recipients could have been disaggregated first by gender, - females and males, and within each gender category, further disaggregated by broad age groups such as children below 5, 5 to 14 years of age, working age group, i.e. 15 to 64 and elderly 64+. For females, expenditures by special groups such as pregnant and lactating mothers, and women of the reproductive age groups are of interest. Again, along with average expenditures per recipient, it would have been useful if data on expenditures per episode were also available. Such data would provide information on the relative costs of treatments per episode of various disease categories, since expenditure per recipient include multi-episode expenditures (i.e. multiple response) including the same or different types of ailments suffered during the reference period.

Distribution of average expenditures by recipients of treatments during 1994-95 and by national, rural and urban locations are shown in the following table.

Health Care Expenditures in Bangladesh

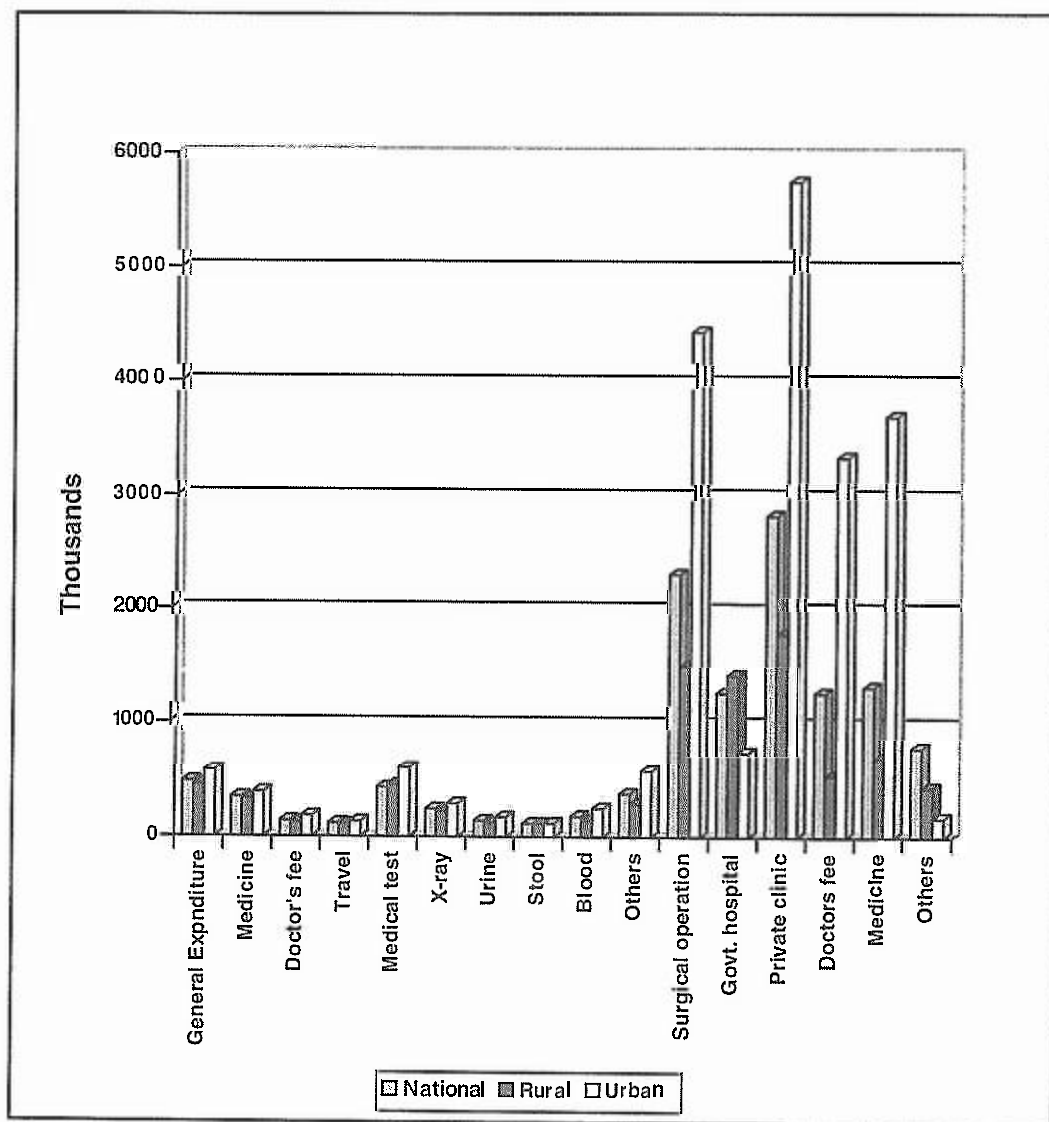
**Table-4: Distribution of average expenditures in Taka by recipient 1994-995**

Category of expenditure	National	Rural	Urban
General expenditure of which :	476.1	451.1	574.0
Medicine	355.1	329.4	449.0
Fees	137.7	126.0	180.4
Travel	118.6	113.8	132.9
Medical tests of which :	427.7	357.6	599.5
X-ray	240.9	220.7	288.6
Urine	138.1	122.7	169.7
stools	117.2	117.1	117.5
Blood	176.2	141.1	245.6
Others	371.2	285.8	565.4
Hospitalization and operation related expenditures	2302.0	1500.6	4434.4
Govt. hospital fee	1254.0	1407.4	733.9
Private clinic	2819.2	1778.8	5747.7
Surgeon's fee	1259.9	538.3	3334.3
Medicine	1315.2	686.5	3695.3
Others	774.0	432.7	1635.3
Total	530.2	487.3	696.1

*Source: Special tabulation, Morbidity and health status survey.*

Average expenditures per recipient was estimated around Tk. 530.2 for all households - for urban household the average was around Tk. 696.1 or nearly 43% higher than rural household average of Tk. 487.3. Average expenditures for all categories of expenditure are seen to be uniformly higher for urban households compared to rural households except for expenditures on Government hospital facilities. In fact average expenditure per recipient by rural households on Government hospital facilities (for operations and other treatments) was nearly twice the expenditure by urban households. On the other hand, average expenditures on private clinic by urban households was more than three times the average expenditure of treatment recipients in rural households.

Average expenditure (Tk.) of treatment recipients by type of treatment and residence



Earlier we have found that treatment recipients can be grouped by sources of treatment into three broad categories namely; self treated, treated by unqualified physicians and treated by qualified physicians. To study whether there is any significant variation in the level and expenditure pattern among the groups we disaggregated the various components of treatment expenditures of the three groups. For the sake of brevity, we disaggregated only the national level expenditures without venturing into urban or rural level disaggregations

as well. Broad results of the disaggregated analysis of treatment expenditures by the three groups and by gender are presented below.

**Table-5: Variations in health treatment expenditures among persons self treated, treated by unqualified and treated by qualified physicians at the national level.**

Indicators	Self treated			Treated by unqualified physicians			Treated by qualified physicians		
	M	F	Total	M	F	Total	M	F	Total
Percent of treatment by gender	49.0	51.0	100.0	49.8	50.2	100.0	47.9	52.1	100.0
Total expenditure per treatment recipient during the year (Tk.)	426.8	430.9	428.9	384.3	388.1	386.2	855.6	850.0	862.7
Expenditure ratio (F/M) x 100	-	101.0	-	-	101.0	-	-	99.3	-

*Source: Morbidity and Health Status Survey, 1994-95.*

The analysis reveals interesting variation in the rate of female expenditure patterns among the three groups; in all the three groups female treatment recipients seem to predominate even though slightly, 51% in case of self treated, 50.2% in unqualified physician treated and 52% in the qualified physician treated groups. Expenditure per treatment recipient shows significant variation across the groups - lowest per capita (i.e. both sex) expenditure was recorded in the unqualified physician group - at Tk. 386.2 per annum the highest per capita expenditure was in qualified physician group at Tk. 852.7 followed by Tk. 428.9 for self treated group. These compare with nationwide per capita expenditure of Tk. 530.2 given in table 4. Gender variation among all the three groups was rather subdued with female per capita expenditure slightly higher than male per capita in case of self treatment and treatment by unqualified physicians while lower in case of treatment by qualified physician (see M-F expenditure ratio in the table). Two conclusions can be drawn from the analysis: per capita expenditure in case of treatment by qualified physician seems to be nearly 2.2 times the expenditure in case of treatment by unqualified physician and around 1.99 times the expenditure in case of self treatment. Such wide variations in treatment expenditures by sources (of supply of treatment i.e. treatment by quacks and self treatment vis-à-vis treatment by qualified physicians including hospitalization charges) partly explain the overwhelming dominance of treatment by unqualified physicians seen earlier (Table-2). The other conclusion is that the choice of treatment source seems to be responsive to price of treatment (goods and services) so that price elasticity of household demand for health care needs to be systematically investigated. Collection of price paid by household for medical goods and

services will be a key step in demand analysis. Regressions were also run to identify the determinants of the differential health care expenditures of the three groups - self-treated, treated by unqualified physicians and treated by qualified physicians - into which two total number of treatment receivers were segmented. The determining or explanatory variables were the same morbidity prevalence index (group specific in contrast to household as in case of earlier regression), per capita household income (of the groups) and household (group specific) sanitary index. The regression coefficients turned out to be significant (as judged by the respective standard errors) and the power of the regression equations to explain the group availabilities was also significantly higher than found earlier.

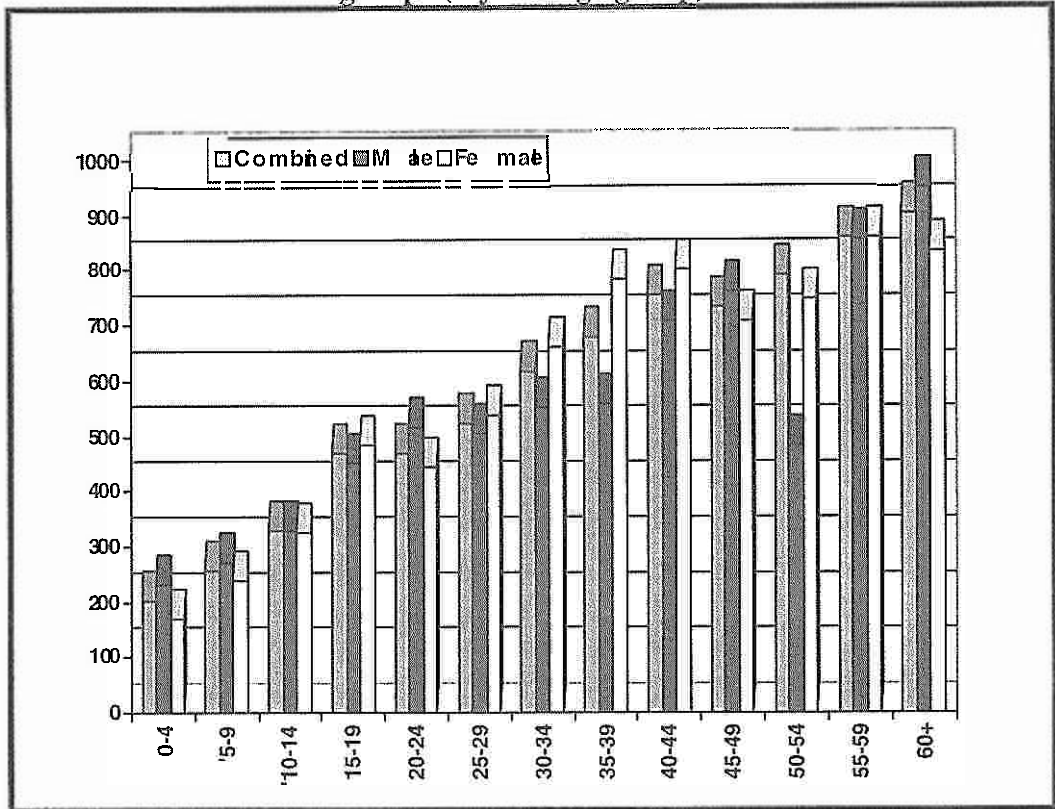
Variations in household health care expenditures among genders by broad age groups - five, ten or selected age groups children, teen-agers, adults or the aged were also analyzed on the basis of MHSS data. The findings are summarized in Table 6, which provides a comparison of the per capita annual health care expenditures of male and female treatment recipients by age groups. Only variations in the total expenditures are presented.

**Table-6: Variations in per capita health care expenditures (annual total) by gender and broad age groups at the aggregate national level (Taka per annum)**

Age group	Combined	Male	Female
0-4	202	232	169
5-9	256	272	237
10-14	327	329	325
15-19	468	453	484
20-24	471	515	443
25-29	525	504	537
30-34	617	551	662
35-39	679	559	783
40-44	754	708	800
45-49	734	762	708
50-54	790	843	748
55-59	859	856	861
60+	902	951	834
Age group	Selected age groups		
	Combined	Male	Female
0-4	202	232	169
10-19	386	379	395
15-49	608	581	629
60+	902	951	834
All age average	530	526	534

Source: Compiled from MHSS 1994-95.

Three bar-diagram (charts) showing per capita average health care expenditures by males, female and both sexes combined by broad age groups (5-years age group)



The general patterns of rise in per capita health care expenditures with rise in age is observed in both the genders. In case of males, per capita average expenditure rises steadily from Tk. 232 in age group 0-4 to Tk. 951 in the age group 60+. For females the rise is from Tk. 169 to Tk. 834. It is interesting to note that female per capita expenditures are lower than male expenditures for all age groups except for the age groups 15 to 44 which span in general, the reproductive age groups of the female. Higher per capita female expenditure in the age group 15-44 is primarily due to additional expenditures on account of maternity which is gender specific. Thus controlling maternity related expenses, female health care expenditures are lower than male expenditures for all age groups. However, the disparity is seen to reduce with rising age, for example, female expenditure is around 75% of the male expenditure in the age group 0-4 while in the elderly group (60+), it is around 87%.

To assess elasticity of the household health care expenditures, the average expenditures of treatment recipients were cross-classified by household monthly income classes. To allow for the variations in the number of treatment recipients in the different income classes, average expenditure instead of total expenditure per income class was used. The table below shows the variation of average expenditure of treatment recipients by household monthly income classes nationwide as well as by rural and urban locations. Average expenditure relates to the average or per treatment recipient outlay on all types of health care expenditures.

**Table-7: Variation of average health care expenditures of treatment recipients by household monthly income, 1994/95 (in Taka)**

Household monthly income size (in Tk)	National	Rural	Urban
< 1000	292	287	434
1000-1499	406	405	421
1500-1999	460	458	468
2000-2999	494	493	497
3000-3999	652	684	592
4000-4999	838	746	1017
5000+	1016	965	1061

*Source: Estimated from Morbidity and Household Health Status Survey.*

Income elasticity was estimated by using the following types of simple regression lines in double log form:

$$\text{Log } y = a + b \log x$$

$y$  = average health care expenditures per treatment recipient  
 $x$  = average household monthly income  
 $x$  for each income class is estimated from the primary data.

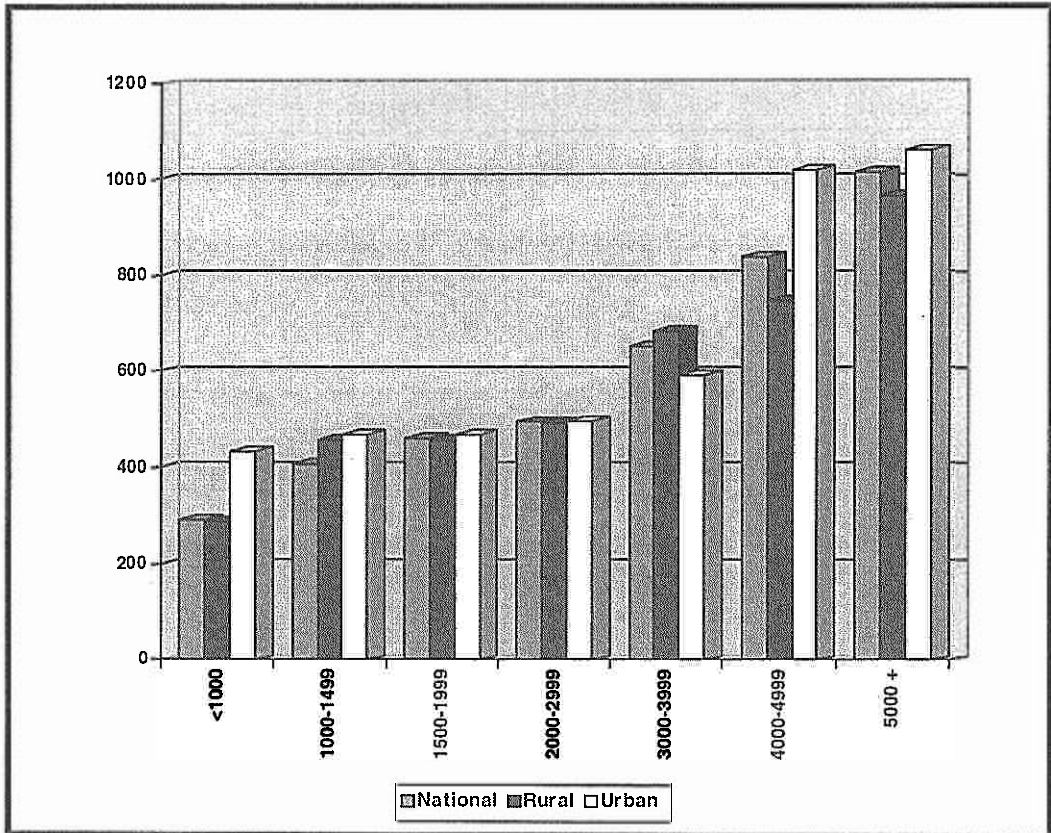
Double log form assumes constant expenditure elasticity given by the estimates of the parameter  $b$ . Estimates of elasticity were obtained for total expenditures, expenditure on medicine and travel for national, rural and urban locations. For rural areas, additional estimates were obtained by using household ownership of land in place of income, on the assumption that distribution of owned land is a good surrogate for income at least in rural areas. The estimated elasticity coefficients for the major expenditure categories for all Bangladesh along with their S.E and 95% confidence interval are shown in the table below.

**Table-8: Estimates of Income Elasticity of Health Care Expenditures: All Bangladesh, 1994/95**

Expenditure category	Elasticity coefficients	S.E	95% interval	Confidence
All expenditure	0.31	0.014	0.28	0.33
General Expenditure of:				
Medicine	0.31	0.014	0.28	0.33
Fees	0.32	0.014	0.29	0.34
Travel	0.22	0.017	0.19	0.26
Medical Tests of :				
X-ray	0.11	0.029	0.057	0.17
Urine	0.11	0.035	0.049	0.18
Stool	0.11	0.037	0.034	0.18
Blood	0.17	0.035	0.102	0.24
Surgical operation:				
Govt. hospital	0.33	0.25	-0.18	0.83
Private hospital	0.74	0.29	0.15	1.32
Surgeon's fees	0.22	0.23	-0.24	0.67
Medicine	0.54	0.21	0.11	0.97

Source: Computed from primary data of Morbidity and Health Status Survey

Average expenditure (Tk.) of treatment recipients by household income group



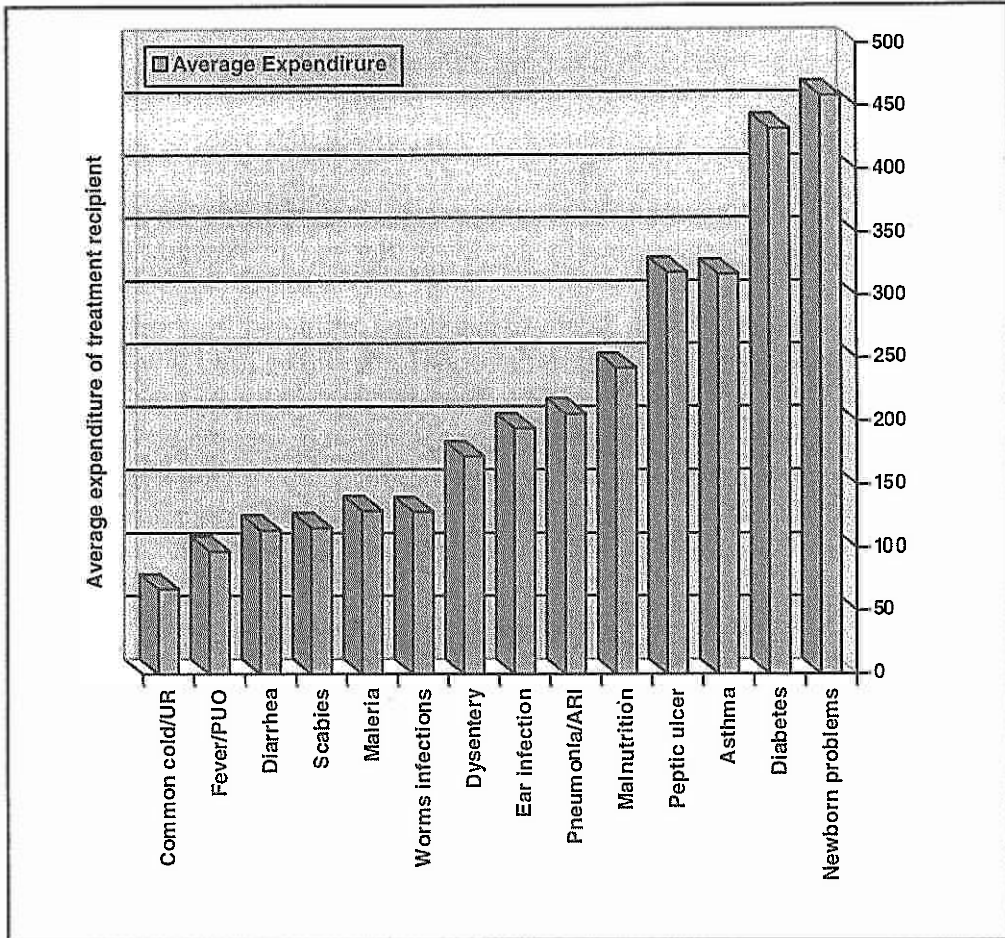


Income elasticity of household medical expenditures of all categories estimates at around 0.31 and is statistically significant. The estimated coefficient implies that with a 10% increase in household income overall health expenditure is likely to increase by 3.1% (keeping all other expenditures unchanged). Similarly, income elasticity of medicine estimates at 0.31 and is also statistically significant. The estimates of other elasticities range from 0.74 for private clinics to 0.11 for expenditure on x-ray tests. Estimates of expenditures on all categories of expenditures relating to surgical operation are in general not statistically significant, primarily due to smaller size of expenditure levels.

Compared to elasticity for Medicare expenditure estimated by the HES 1991-92, the observed income elasticity turned out to be rather low: 0.31 compared to 1.17 and 1.28 observed by HES 1991-92 for rural and urban areas. Exclusion of some of the key expenditures that are more income elastic such as health care expenditures abroad or expenditures on prostheses may be responsible for the observed low level. This point needs further investigation when data from future rounds become available.

The level of expenditure by disease pattern was also analyzed. The analysis was done only at the national level - no rural-urban disaggregation was attempted. The analysis reveals some interesting facts that are first discussed. MHSS estimated a total number of 71.47 million household dwellers who had received health care during the reference period 1994 (February) - 1995 (January) with a total expenditure of Tk. 3789.3 crore or Tk. 530 on the average per treatment recipient. On the other hand, the number of disease episode (both transitory or chronic or continuing form of disease incidence) was estimated around 168.44 million or 2.4 episode per treatment recipient during the reference period. Average expenditure (that includes medicine, physician fees, travel expenses etc.) per episode was estimated around Tk. 225 compared to Tk. 530 spent per treatment recipient.

Average expenditure (Tk.) of most common symptoms/diseases



Among the transitory type of illness, diarrhea episodes were estimated around 11.4 million with average expenditure per episode (that include all types of expenditures ranging from medicine to physicians fees and travel etc.) around Tk.114; by comparison dysentery episodes were estimated around 9 million with average expenditure per episode around Tk. 172; dysentery episode on the average was thus 50% more expensive to treat. Among transitory type, fever (of unknown origin) had the highest incidence with 15.4 million episodes with treatment expenditure of Tk. 98 per episode on the average. By comparison, an estimated 8.5 million episodes of malaria were reported with average expenditure of Tk. 129 per episode.

Among the chronic illness - the highest number of episodes was reported in case of peptic ulcer around 24.9 million with average expenditure of Tk. 319.

Applying the average ratio of 2.357 between episodes and recipients, we find the number of persons with peptic ulcer in the country to be around 10.57 million. Similarly, the number of persons reporting diabetes was found to be around 1.2 million. The number of diabetes related episodes was estimated around 2.96 million with average expenditure per episode around Tk 432.

The number of episodes relating to rheumatic fever was also very high 6.60 million with average expenditure per episode around Tk 319. The number of persons reporting rheumatic fever was estimated around 2.80 million. The table below summarizes the number of episodes during the survey year and average expenditure per episode for selected transient and chronic diseases. The table also indicates separately the episodes related to maternity problems.

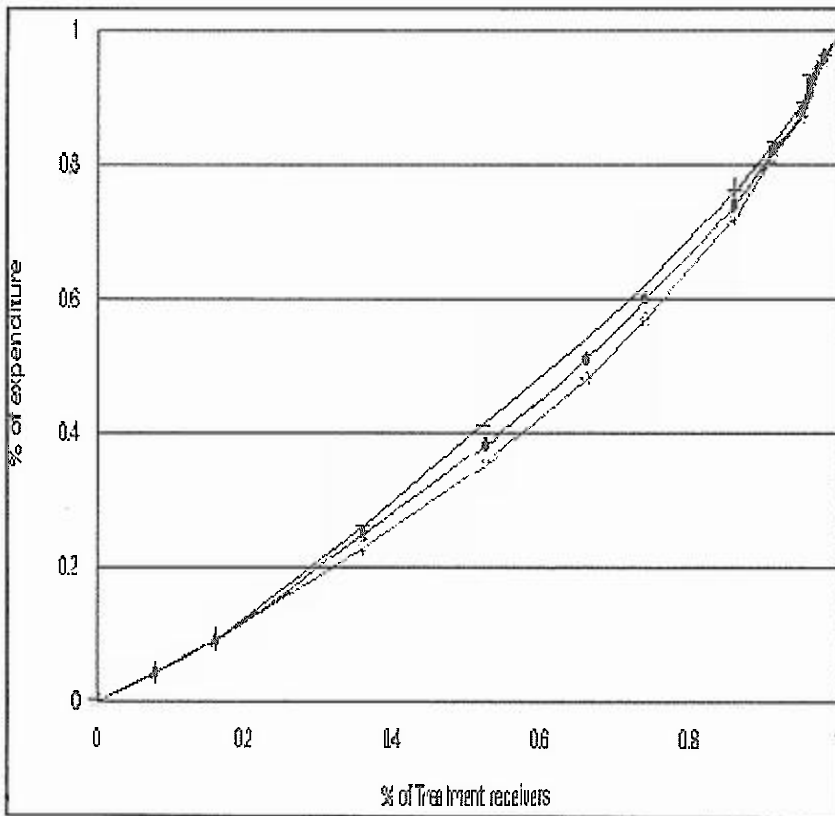
**Table-9: Number of episodes and average expenditure per episode during 1994-95 for selected transient and chronic illnesses in Bangladesh.**

Nature of disease/ Symptoms	No. of episodes (Million)	Average Expenditure (Tk.)
Transient:		
Fever ( of unknown origin)	15.4	98
Malaria	8.5	129
Typhoid	3.2	243
Measles	1.1	65
Diarrhea	11.4	114
Dysentery	9.0	172
Common cold	5.9	67
Influenza	3.5	58
Hepatitis	2.1	219
Chronic:		
Peptic ulcer	24.9	318
Asthma	8.1	317
Diabetes	2.9	432
High blood pressure	7.0	294
Heart disease	4.3	343
Rheumatic Fever	6.6	319
Tuberculosis	1.7	392
Maternity problems:	4.1	246
All types	168.4	225

Source: Special tabulation, Morbidity and Health Status Survey: Second and Third rounds.

The final analysis in this section relates to exploring the degree of inequality in household health care expenditure by gender disaggregation. This is done through segmenting the per capita male, female and total household health care expenditures (i.e. treatment expenditures for the year 1994-95 as obtained from the morbidity and health status survey) into deciles and drawing Lorenz curves of the health care (or treatment) expenditures. The three Lorenz curves - for male, female and total (i.e. both sex combined) are shown in the enclosed computer graphic. As measured by the concentration ratio female health care expenditure seems to be relatively more inequitably distributed compared to male expenditures (C.R for Lorenz curve for female expenditure is 0.23 compared to 0.17 for the male expenditure.) The decile distributions of male, female and total (both sex together) health care expenditures are given in Table 10 that follows the Lorenz curve.

**Lorenz Curve: Treatment expenditure**



**Table 10: Decile distribution of health care expenditures**

Decile	Both sex		Male		Female	
	% of total cost	Average cost	% of total cost	Average cost	% of total cost	Average cost
1	0.32	14.01	0.32	13.49	0.34	14.56
2	0.76	32.25	0.75	30.91	0.77	33.72
3	1.17	50.01	1.16	48.73	1.18	51.40
4	1.91	79.33	1.87	76.92	1.95	81.91
5	2.93	121.19	2.93	116.13	2.93	126.96
6	4.12	171.44	3.93	164.02	4.33	179.11
7	6.61	271.59	6.39	262.91	6.84	280.60
8	10.29	420.22	10.47	404.48	10.11	438.63
9	18.55	766.78	18.17	736.61	18.95	799.51
10	53.32	2202.69	54.01	2120.72	52.60	2297.69

*Source: Special tabulation for the Morbidity and health status Survey.*

The data show acute inequality in health care expenditures among deciles. More than 50% of the total health care expenditure is accounted for by the highest decile, while the first five deciles together account for a little more than 5% of the total expenditure. Both male and female expenditures reveal the same pattern of inequality, although female expenditures appear to be slightly less inequitable compared to male expenditures.

#### **Validation of MHSS estimates of household health care expenditures. Comparison with data from other sources.**

In order to validate the estimates of MHSS those should be compared with data from other independent and comparable sources. Nationwide estimates are available from two sources HES (Household Expenditure Survey) and National Accounts. Data from both sources were explored and compared with MHSS estimates.

BBS conducts HES rather irregularly on periodic basis. The latest data from HES are available from the HES 1995-96, that was conducted from August 1995 through July 1996. The time period covered by MHSS spans mid-February 1994 through mid-January 1995, the time span covered by the two surveys, therefore, does not match and HES enumeration started nearly six and half months after the completion of the MHSS. In comparison HES covered more recent period. The difference in the timing of the two surveys need to be kept in view while comparing the results of the two surveys.

Health Care Expenditures in Bangladesh

HES provides nationwide aggregated estimates of household health care expenditures in addition to disaggregation by rural and urban areas. Expenditures by males and females are also available. Nationwide aggregates will be concentrated upon only along with the male-female disaggregation, while comparing with the MHSS estimates. The table below provides nationwide estimates of health care with gender disaggregation by the expenditure categories used by HES:

**Table-11: Estimates of household health care estimates for all Bangladesh from HES 1995-96 (expenditures in million taka)**

<i>Expenditure category</i>	<i>Male</i>	<i>Female</i>	<i>All Bangladesh</i>
Physician's Fees	1209.8	1146.2	2356.0
Pathological tests	296.4	211.9	508.3
X-ray fees	234.3	179.6	413.9
Hospital expenses	1028.6	1107.9	2136.5
Medicine	9957.6	9277.9	19235.5
Immunization expenses	171.0	56.0	227.0
Dental care expenses	24.5	22.3	46.8
Kabiraji/Hakimi	160.5	166.7	277.2
medicine	157.1	158.1	315.2
Homeopathic medicine	133.5	475.2	608.7
Other expenditures	-	254.3	254.3
Maternity related expenses			
<b>Total</b>	<b>13373.3</b>	<b>13006.1</b>	<b>26379.4</b>

*Source: Computed from preliminary HES 1995-96 tabulation*

Classifications of expenditure categories of MHSS and HES are different except for a few common categories like medicine, medical test (including pathological test, X-ray fees etc.). However, under medicine HES distinguishes expenditures on indigenous medicine like Kabiraji/Hakimi and Homeopathic medicines separately, while MHSS does not. For the sake of comparison we reclassify the expenditures from the two sources by broad categories (somewhat arbitrarily in case of HES) as follows:

**Table-12: Comparison of Health Care Expenditures from MHSS 1994-95 and HES 1995-96**

Broad expenditure category	by broad expenditure categories					
	Male		Female		All Bangladesh	
	MHSS	HES	MHSS	HES	MHSS	HES
General expenditure including medicine	16179.2	11656.0	16979.5	10754.9	33158.7	22410.9
Medical tests	1852.4	530.7	1663.2	391.5	3515.6	922.2
Hospital related expenses except medicine	441.1	1186.6	778.2	1859.7	1219.4	3046.3
Total expenditures	18472.7	13373.3	19420.9	13006.1	37893.7	26379.4

*Source: Recomputed data from MHSS (Morbidity and Health Status Survey 1994-95) and HES (1995-96)*

Although HES estimates are relatively more current (by around one and half year), nonetheless overall HES estimate of total household expenditure is nearly 50% less than the estimates of MHSS.

By gender disaggregation also HES estimates are less (50% in case of both genders) than MHSS expenditures for all expenditure categories except for hospital related expenditures. It has been observed that HES as conducted by BBS is primarily food expenditure focused and in general under estimates the non-food expenditures particularly all service related expenditures like transport, health, education etc. due to general recall problems with respect to expenditures on services compared to expenditures on goods (particularly food). Even with respect to health related expenditures HES estimate of medicine (all categories) is closer to MHSS estimate (HES estimate is around Tk. 20354.9 million compared to MHSS estimate of Tk. 25805.0 million) compared to other expenditure categories that relate mostly to expenditures on services. In general, MHSS appears to be more efficient in capturing specialized expenditures of households like expenditures on health compared to HES, primarily due to difference in emphasis.

Comparison of MHSS data with data from national accounts of BBS poses some problem due to non-availability of relevant data. First, national account compilations of BBS do not provide disaggregated household expenditure data, so that estimates of household health care expenditures from national accounts side are not available. The only option left is to compare some selected flows from production accounts. Two major components; medicine and health services are selected. Again in absence of availability figure, i.e. domestic product adjusted for exports and imports and changes in inventories the production of medicine, i.e. drugs and pharmaceuticals is compared with

household expenditures on medicine (all kinds) from MHSS: the differences in the time coverage of the two should however, be noted (since national accounts estimates refer to July 1994 through June 1995 while MHSS data refer to mid-February 1994 through mid-January 1995).

National accounts reported output of medicine (by large scale manufacturing) during 1994-95 at Tk. 19852 million (page 142, National Accounts Statistics of Bangladesh, BES July 1997) while household expenditures on medicine as reported by MHSS amounted to Tk. 25805 million - the difference (nearly Tk. 600 crores) can be explained by net imports. (i.e. net of exports) and output of small scale industries, which however are not available.

Total output of health services are not available from national accounts; instead net output (i.e. gross output minus intermediate consumption) or value added estimates are available; total value added estimates of health care service for 1994-95 amount to around Tk. 15727 million of which Tk. 10816 was privately generated services and Tk. 4911 Govt. services. The services generated by NPISH are not reported by national accounts. Excluding the public or government generated health care services (which are regarded as social transfers in kind to households), the privately generated net output of health care services amount to around Tk. 10816 million compared to Tk. 8247 million estimated from MHSS. Adding approximately 20% for intermediate consumption, the gross output of privately generated health care services during 1994-95 comes to around Tk. 11032 million or about 35% higher than the service expenditures estimated by MHSS. National accounts estimates of privately provided health care services do not have firm basis i.e. unlike MHSS, they are not based on comprehensive nationwide field survey, but on limited case studies and expert consultations.

Comparison with the data from HES 1995-96 and national accounts of 1994-95 shows that MHSS estimates of household health care estimates are more robust, plausible and provide a more acceptable pattern and level of household health care expenditures compared to both HES 1995-96 and national accounts.



## Conclusions

Health care expenditures by all dwelling households (i.e. excluding institutional and floating populations) in Bangladesh during 1994-95 (mid-February through mid January) was estimated by MHSS at round Tk. 3789 crores or around 2.3% of GDP. Total expenditures by rural households estimate around Tk. 2767 crores or 73% of the national total and expenditures by urban households estimate at Tk. 1022 crores or around 27% of the national total. Of the total expenditures, 63% or Tk. 2581 crores was spent on medicine, 27% on services (around Tk. 825 crores) like physician's fees, pathological tests or X-ray charges, and 10% on health care related travel.

Urban households on the average were found to spend relatively more on services (46% of the total expenditures) while rural households spent proportionately more on medicine (66% of the total rural expenditure).

Average health care expenditure per treatment recipient estimated nationwide at Tk. 530 compared to Tk. 487 for rural residents and Tk. 696 for urban residents.

Disaggregation of treatment receivers (male and females) by sources of treatment i.e. self treated, by non qualified physicians and by qualified physicians, shows the overwhelming predominance of treatment by non-qualified physicians; more than 50% of the treatments (both males and females) are by non-qualified physicians compared to nearly the equal proportions (around 25%) by self treatment and treatment by qualified physicians. Per capita expenditure of treatment by non-qualified physician is found to be lowest around Tk. 386 compared to Tk. 429 in case of self treatment and Tk. 850 by qualified physicians. Wide variations in the perceived or real costs by the treatment sources may be a key factor behind the observed variation in the treatment pattern by sources.

Income elasticity of health care expenditure estimated nationwide at 0.31 and was statistically significant implying that on the average 10% increase in income led to 3.1% increase in health care expenditures, other factors remaining unchanged. Income elasticity (for the country as a whole) varied from 0.11 for medical tests like X-ray, urine or stool examination to 0.74 for use of private clinics and were in the expected range. Pathological tests in general tend to be income inelastic as they are becoming essential component of general health care system thereby reducing the user choice, while clinical services are relatively more income elastic reflecting wide user options.

The estimated income elasticity turned out to be rather low in comparison of income elasticity observed in developed countries, where it is usually more than one or in other words, health care or medical expenditures for health care in Bangladesh is observed to be income inelastic in contrast to its being income elastic in developed countries. This point needs further investigation. Exclusion of expenditures like health care expenditures abroad, expenditures on prostheses that are incurred more by higher income families compared to poorer families may be one of the reasons for the income elasticity to be rather low.

Analysis of the distribution of health care expenditures by deciles reveal highly inequitable pattern, more than 50% of the total expenditure is accounted for by the highest decile, while the first five deciles together account for only a little more than 5% of the total. Compared to male expenditures, female expenditures show slightly less inequitable pattern.

The proximate determinant of household health care expenditures in the country is the disease burden or the pattern and level of morbidity at the household level, after allowing for income, education, sanitation and other socio-economic factors.

On the average 15 to 20 percent of household members remain sick in course of the year, sickness rate worsens in the monsoon period and improves somewhat during non-monsoon cooler months. There is also considerable variation in sickness pattern between genders, areas and age groups (females are found to be more sickness prone) and morbidity rate is higher in rural areas compared to urban areas and children below 5 years of age and elderly persons above 60 are more disease prone. The health care expenditures also reflect these variations when disaggregated by gender, location and age groups.

The level and type of household health care expenditures is also correlated with the types and duration of sickness episodes. Overall, transitory sickness episodes dominate the overall morbidity pattern; as a result, average episode wide expenditures tend to be low. Or in other words, the per capita health care expenditures in the country tend to be rather low and as disease burden shifts more towards chronic illness type, health care expenditures are likely to rise in real terms.

Comparison with health care expenditure data from HES 1995-96 reveals the superiority of MHSS estimates both with respect to coverage and level of expenditures. Nationwide health care expenditures estimated by HES 1995-96 amounted to Tk. 2638 crore in nominal terms compared to Tk. 3789 crore by

MHSS, even though HES was enumerated nearly 1/2 years later. The pattern of expenditure categories of HES and MHSS was, however, broadly similar. In all, MHSS is seen to be more efficient in providing comprehensive and more reliable estimates of household health care expenditures compared to HES which is largely food expenditure focused.

Compared with national accounts, data was rather inconclusive, as no comparable household health care expenditure was available from the private expenditure component estimated in BBS national accounts. Comparison with output data particularly output of health services (both public and private) could not be made, as estimates of value added (output minus intermediate consumption) rather than gross output were available. Converting the value added into gross output showed that outputs of private health care services to be around 35% higher than the service expenditures estimated by MHSS. Since basis of VA estimates of production account was rather weak, being based on case studies rather than comprehensive surveys, no firm conclusion can be drawn, except that national accounts estimates of health services needs firming up. Domestic production of drugs and pharmaceuticals as estimated by the production account of NAB was 25% lower than MHSS estimate of household expenditure on medicines. In absence of net availability (production plus imports minus exports) figure, the comparison is rather tenuous.

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### Abbreviation

BBS	:	Bangladesh Bureau of Statistics.
HDS	:	Health and Demographic Survey.
HES	:	Household Expenditure Survey.
GDP	:	Gross Domestic Product.
GOB	:	Government of Bangladesh.
MHSS	:	Morbidity and Health Status Survey.
NPISH	:	Non-profit Institutions Serving Households.
NGO	:	Non Government Organization.
VA	:	Value Added.

# STRENGTHENING LEGISLATIVE AUDIT INSTITUTIONS: A CATALYST TO ENHANCE GOVERNANCE AND COMBAT CORRUPTION

Vinod Sahgal,\*

## Preface

This paper describes how strengthened Supreme Audit Institutions (SAIs) are potentially powerful instruments for promoting ethical behaviour, thereby combatting bureaucratic corruption and promoting good governance. A strengthened audit function is directly linked to greater accountability, transparency and improved public sector management. The SAI can be one of the key institutions charged with the responsibility to help combat corruption through preventative measures. There is need for strong and widespread support from civil society to accomplish this important task. The efficient and effective stewardship of the world's resources is fundamental to good governance. Governance has become a cornerstone of development co-operation policy. Governance, accountability, transparency and combatting corruption are inextricably linked.

Corruption is becoming a constraint to both international trade and development co-operation. The linkage between Ethics and Accountability is an area of emerging interest around the world. The role of legislative auditing is discussed here in such context.

The potential of SAIs as agents for combatting corruption by promoting ethics in public service and improving the quality of management is under-utilised. Corruption is bad for business as well as government. Business practices in several countries are under review. Cases of bribery and nepotism are being reported with increasing frequency. The full potential of the SAI to address such issues has not been exploited. This may be partly because of lack of visibility in the role played by SAIs in many countries. Or it may be partly because of insufficient understanding of the SAI's potential for combatting corruption: there is an opportunity to improve the situation. The emerging international consensus on the need to emphasise "good governance", reform certain institutions and combat corruption suggests that the need to cash in on this opportunity should be debated more widely.

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SAIs have an important role to play in preventing corruption. SAIs can be increasingly involved in examining major issues of ethics and promoting fraud awareness. They are uniquely suited to provide independent views on how ethical practices can be promoted including the quality of public sector management and the extent to which the individuals and corporations operate within stated authorities. When well equipped with the right tools, approaches and resources, SAIs can serve the public by examining and making transparent the business practices adopted in their countries as well as the performance of projects and programs that are funded by government. The overall objective is to improve both international trade and the sustainability of development projects and programs. Perhaps the International Financial Institutions (IFI) are ideally situated to take the lead in working with SAIs and Governments around the world in this area of Government-Citizen-Business Partnership.

### **Paper Overview**

In this paper, the author stresses the need to strengthen Supreme Audit Institutions in order that they act as a catalyst to enhance governance and combat corruption. It is suggested that they can do this by promoting ethics in public service in conjunction with support from the international financial institutions.

The author acknowledges that independence and objectivity of Supreme Audit Institutions are key success factors. The strong and widespread support of civil society, for an enhanced role for the SAI will also be needed.

### **Recommendations:**

1. The SAI should clarify its mandate and mission statement regarding its role as a catalyst for combatting corruption through the promotion of preventive measures.
2. The SAI should proactively pursue more policies and practices that promote good ethical behaviour in the public service.
3. SAIs should actively promote improvements in the quality of the public service.
4. SAIs should strengthen their reporting and communication strategies to benefit from the full impact of their audit work particularly in the area of ethics.

5. The SAI should play a role in raising the public's consciousness about ethics and corruption.
6. SAIs should get more directly involved in working with educators to enhance communications in schools and homes on the subject of corruption.
7. There is a need for the International Financial Institutions (IFI) to use their clout and financing to promote the efforts of developing countries and those of their institutions (such as the SAIs) to show some leadership in combatting corruption.

## 1. Introduction

The purpose of this paper is to explore the role of the SAIs for combatting corruption by promoting ethics in public service. Promoting ethical behaviour is well in line with the existing role of most SAIs. The link between governance, accountability, transparency and legislative auditing is discussed in this context.

The SAIs of all nations, rich or poor, have a moral and professional responsibility to be proactive in helping the efforts of their societies in combatting corruption. Recent polls in one rich country, indicate that many citizens do not trust their governments to always act in the public interest. This should be of direct concern to SAIs. The SAIs of developed nations also have to be cognisant of the fact that nationals of their countries may also play a role in contributing to unethical business practices at home and overseas. Thus, the issue of corruption has to be tackled on an international basis. It compromises open and transparent competition on the basis of quality and price and undermines governance. It promotes disparity. It leads to waste and can have several other harmful consequences for society.<sup>1</sup>

Developing countries have much at stake; they could be more active in the search for ways to combat corruption. Corruption increases poverty and can lead to economic stagnation because it diverts scarce resources that might have been used for a country's socio-economic development. The SAIs of developing countries could act as catalysts for promoting transparency and ethical behaviour in their jurisdictions. They could assist the effort of others working to minimise the waste of scarce resources for development with far-reaching effects throughout society.

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<sup>1</sup> Development Assistance Committee, Shaping the 21<sup>st</sup> Century: The Contribution of Development Co-operation, May 1996.

The paper outlines some specific steps that could be taken by those legislative auditors, governments and International Financial Institutions (IFI) that are willing to work together in this area and are able to take on the challenges ahead.

The Auditor General of Canada examined the question of Ethics and Fraud Awareness in Government in 1995. His Office believes that it is important to discuss ethics in government and to take action to maintain and promote ethics.

The paper suggests that SAIs are well situated to help meet the challenge of combatting certain aspects of corruption. They are widely viewed as the independent watchdogs of the public interest. They can build on this inherent advantage. They are mandated and staffed with highly motivated and experienced staff necessary for promoting the public interest. They could make a start by placing greater emphasis on accountability for "ethics in the public service" in the scoping of their ongoing audit work. There is need to modernise accountability.

What may be needed at this time for the SAIs, is a broadening of the scope of auditing activities from monitoring compliance with rules and regulations and promoting efficiency and effectiveness i.e. financial and management auditing to the proactive promotion of ethical behaviour through more awareness programs as well as openness and transparency with which the operations of government and business is conducted.

SAIs have a wide network of professionals with a common set of values located around the world. SAIs could point to best practices in governance. For example, they could assist governments design a variety of preventive measures for combatting corruption in the public service such as, a code of ethics for government and business, adoption of more modern principles of public life and accountability and appropriate standards of public scrutiny.

SAIs are also ideally situated to monitor the implementation of such measures. Monitoring the behaviour of public officials and the very threat of public reporting can have a salutary effect and be a strong deterrent to corruption.

The paper also suggests that combating corruption will require governing bodies to take a more proactive role in the search for solutions. There is, for instance, need for more "sunshine provisions" in legislation. The public and private sectors will need to forge a stronger partnership on this account if they wish to 'make a positive difference'.

Finally, the paper points out that the IFIs have the clout and the financing to promote the efforts of developing countries and those of their institutions willing to show some leadership in combatting corruption. The IFIs will however have to advocate not only the cause of strengthening legislative auditing and promoting greater transparency in the operations of government and commerce on a national basis, but also focus on related changes in the international banking sector. The Banks in some countries may inadvertently be contributing to corruption.

## 2 Governance, Accountability and Transparency

**Definition of governance:** Governance is generally defined as the exercise of power in the management of resources. It involves the nature and extent of authority, and the control and incentives used to deploy human and other economic resources for the well-being of the general public. The Institute on Governance (a non-profit, private organisation founded in Ottawa in 1990 to address governance-related issues) defines governance as "the responsible and responsive exercise of power on matters of public concern. In the public sector, governance comprises the institutions, processes and traditions which determine how power is exercised, how decisions are taken and how citizens have their say."<sup>2</sup> The World Bank defines governance at the country level as "the management of a country's economic and social resources for development".<sup>3</sup>

From an administrative standpoint, good governance demands sound and ethical public administration of bureaucracies and the policies they carry out. Governing well cannot be achieved without efficient, equitable and effective public administration; to be fully effective, public administration should support public policy. Thus, the two go hand in hand in making public service more transparent, accountable and service-oriented. The supreme audit institution is one important component of this process. An effective legislative process, an independent judiciary, and good public service agencies that promote and protect the principle of merit, also advance good governance. Donors of international aid and lenders place special emphasis on these aspects of governance.

From a political perspective, governance also encompasses respect for human rights and adherence to sound ethical principles. A free press and independent

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<sup>2</sup> Institute of Governance, working definition.

<sup>3</sup> Managing Development: The Governance Dimension, The World Bank, Washington D.C., 29 August 1991, p.i.



election commissions are other important components. Honesty, integrity, fairness and caring are important values. Accountability is at the heart of the issue.

**Principles of good governance:** The Canadian Comprehensive Auditing Foundation has been promoting discussion on good governance from an accountability perspective. Some principles have emerged:

Governing bodies acting as stewards of public resources must have:

- people with the necessary knowledge, ability and commitment to fulfil their responsibilities;
- an understanding of their purpose and of the best interests of their constituencies;
- an understanding of the objectives and strategies of the organisations they govern;
- knowledge of and access to the information required to exercise their responsibilities;
- a commitment, once informed, to ensure that the organisation's objectives are met and performance is satisfactory; and
- a responsibility to fulfil accountability obligations to those whose interests they represent, by reporting periodically on their organisation's performance.<sup>4</sup>

These principles of good governance are fundamental to public administration. They also guide SAIs in their efforts to serve the accountability relationship between those who govern and those who are governed.

Governance is becoming a cornerstone of international development assistance policy. Key governance issues that have been identified such as the need for combatting corruption, include developing institutions that militate against the arbitrary use of power and enhancing the reliability and consistency of public policy and administrative practices.

**Transparency and accountability:** Transparency is a key aspect of sound public administration. Governments have a moral and, often, a legal responsibility to report periodically on their performance: those from whom they receive their authority and those to whom they provide a service have a right to know. The essential principle that must be maintained is that the business of government must be transparent, no matter how governing bodies may use the information.

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<sup>4</sup> Canadian Comprehensive Auditing Foundation (CCAF), Update, The Search for More Effective Governance, Ottawa, Ontario, March 1994, p.5.

The Auditor General of Canada has argued that transparency allows the rays of light to enter the inner sancta of government in a way that can have a significant effect on "Sensitising" the management of the public interest. The practice of transparency can be a sound deterrent to corruption.<sup>5</sup>

Transparency focuses on public reporting and availability of information with the objective of making what governments do more visible, holding them accountable for the way they exercise authorities conferred on them and for meeting expectations they themselves have created. The cost of failing to be transparent, of ignoring the limits to authority and of underestimating the power of governing bodies can be high. A lack of transparency can lead to lack of credibility and trust and encourage corruption and poor governance which go against the public interest.

Accountability runs on information. Simply stated, accountability means holding public officials responsible for their actions, including the provision of appropriate information to the legislature.

In summary, transparency is a powerful tool to promote accountability for the effective stewardship of funds by those entrusted with the responsibility to use them properly and combat corruption. It is rightly recommended as a remedy for social and industrial disease. Sunlight is said to be the best of disinfectants where corruption has taken root.

### 2.1. The link between governance, accountability and SAIs

Political leaders are ultimately responsible to the people for their government's actions, and this means there must be full respect for accountability for stewardship within government. As indicated earlier, accountability basically means holding public officials responsible for their actions, including the provision of appropriate information to the legislature.

In Canada, a prerequisite for the proper funding of political democracy is that citizens have knowledge about the structure and contents of the public sector's activities.

Accountability and sound public sector management are important aspects of good governance.

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<sup>5</sup> "The Importance of Measuring Performance in the Public Service: The Official Development Assistance Context" - Notes for an Address by L. Dennis Desautels, FCA, Auditor General of Canada, 23 May 1996.

Supreme audit institutions or national audit offices, as they are often called, are institutions that promote transparency and accountability on behalf of the citizens of a country, which, in turn, support good governance.

In considering the promotion of good governance through transparency and accountability, some questions arise. For example, is a constitution with transparency and public participation in decision making a part of good governance or a condition preceding it? Can we divide good governance into reasonable components that have logic and consistency? Is there a role for an independent audit function to serve the accountability relationship between governments and legislatures?

The answers to the first two questions can be debated further. The answer to the last question is "yes". However, the SAI must be independent of the government. It must employ qualified professionals with the right mix of skills, possess the required tools for modern legislative auditing and carry out its audits appropriately to make a positive difference. These qualities are essential to carrying out its responsibility to report publicly on matters of a nature and significance that warrant the attention of the governing bodies they serve.

The argument put forward in the following section of this paper is that strong SAIs promote transparency and accountability. Transparency of government programs and operations enables the legislature to hold the government accountable. Government accountability will promote good governance and combat corruption.

## 2.2. The relationship between governance and development

Development requires leaving behind something of value that is sustainable after aid funding ends. In the context of development assistance, good governance has been defined as the provision of a favourable political, social and economic environment in which sustainable and equitable development can take place. A strong legal framework and strong institutions that promote a government's accountability to its citizens are now recognised as significant components of sustainable development.

**Key elements of the relationship:** In the context of development, good governance and ethical behaviour are synonymous with sound management. The key elements of governance - promoting transparency in the operations of government, and accountability to parliamentarians and other governing bodies- are also elements of sound development management.

The World Bank has pointed out that good governance is central to creating and sustaining an environment that fosters strong, equitable development. It is an essential complement to sound economic policies. Governments play a key role in the provision of public goods. They establish the rules that make markets work ethically and efficiently and, at times, they correct for market failure. To play that role, they need revenues, and agents to collect revenues and produce the goods and services demanded by the public. Doing these things effectively requires systems of accountability, adequate and reliable information, and efficient resource management, and delivery of public services.<sup>6</sup> The SAI is an important element of this overall system. (Later sections of this paper will elaborate on this point.)

It is now widely recognised that corruption undermines the credibility of, and public support for, development co-operation and devalues the reputation and efforts of all who work to support sustainable development.<sup>7</sup> The Auditor General of Canada recently conducted an audit of Canada's international development activities. He pointed out that accountability is central to their effectiveness, as is the quality of management employed to deliver development assistance.<sup>8</sup> Where the public sector capacity to manage the economy and deliver public services is weak and where corruption is rampant, the prospects for development are poor. Structural weaknesses in public sector institutions make self-reliant development very difficult. Unless ways are found to strengthen institutional capacity and combat corruption, there is a risk of diminishing returns on any other investment.

The public sector in many developing countries "has been characterised by uneven revenue collection, poor expenditure control and management, a civil service that is inflexible, top-heavy and underpaid, a large parastatal sector that provides poor returns on the scarce public funds invested in it, and weaknesses such as unethical practices in the core economic agencies. Those weaknesses hinder the very design and implementation of policies to correct them."<sup>9</sup> In countries where such problems persist, a catalyst is required to speed reform; there may be an urgent need to strengthen the role of the SAI.

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<sup>6</sup> Managing Development: The Governance Dimension, The World Bank, Washington, D.C., 29 August 1991, p. i and ii.

<sup>7</sup> Recommendation of the Development Assistance Committee (DAC) High Level Meeting, 6-7 May 1996

<sup>8</sup> Report of the Auditor General of Canada to the House of Commons, 1993, Canadian International Development Agency - Bilateral Economic and Social Development Programs, Chapter 12.

<sup>9</sup> Managing Development: The Governance Dimension, The World Bank, Washington DC., 29 August 1991, p.8.

**Need for strengthening institutional capacity.** Many development agencies have recognised that there is no certainty that institutional capacity conducive to growth and alleviation of poverty will evolve on its own. If frameworks that help create such capacity are to emerge, incentives and adequate funding are needed to develop and sustain them. Donors and lenders are increasingly involved in helping developing countries build those frameworks and develop the much-needed capacity. The SAI should be identified as an important element of the frameworks. This has not yet happened; the situation warrants attention.

In the area of public sector management, the IFIs such as the World Bank, have broadened their work from assisting with the management of project-related agencies to addressing systemic constraints to sound management. Those constraints include weaknesses in the civil service, in wage structures, and in the central economic agencies responsible for policy formulation and program delivery. A broader approach is also underway in other areas of governance, such as action to clarify accountability and to strengthen the legal framework where warranted. The role of legislative auditing is rightly being examined in this wider context. Other international financial institutions, such as the regional development banks, reportedly are moving in the same direction. Those institutions are beginning to realise how crucial the role of audit can be in promoting sustainable development. The need to examine the role of audit as a catalyst to combat corruption may be the next step to take.

### 3. Legislative Audit

#### 3.1. The role of legislative audit

The currency of accountability is information, but it is transparency that allows accountability to work effectively.

A popular government without popular information or the means of acquiring it, is but a prologue to a farce or a tragedy; or perhaps to both (James Madison). Auditing is, first and foremost, a function that serves accountability. It can be one of the most cost-effective means of promoting transparency and openness in the way governing bodies operate and improve their performance. The need for objective public reporting on ethics, effectiveness and efficiency is fundamental to good governance.

The concept and establishment of audit is inherent in public financial administration, as the management of public funds represents a trust. Audit is

not an end in itself, but an indispensable part of a management system that aims to identify violations of accepted standards of ethics, and deviations from the principles of legality, efficiency, effectiveness and economy in resource management. Audit strives to accomplish this aim early enough so that accountable parties will accept responsibility for their conduct and for their use of public funds, and will take corrective measures to prevent violations from recurring.

The objective of serving accountability is not to assign blame but to discover why something went wrong, what can be done to rectify it, and how its recurrence can be prevented. The behavioural impact of auditing starts well before the audit. Many managers begin to change their actions as much in anticipation of an audit as after its completion. In that sense, a well-performing independent audit function is central to good governance. It is a powerful voice that can speak truth to power.

Audit can also help to combat corruption and act as a potent deterrent to waste and abuse of public funds. For example, audit can help restrain any tendency to divert public resources for private gain. It can help establish a predictable framework of law and government behaviour conducive to development. It can reduce arbitrariness in the application of rules and laws, and simplify administrative procedures, particularly where they hinder the smooth functioning of markets. Audit can also expose to the public excessively narrow or non-transparent decision making that is clearly not in the public interest.<sup>10</sup>

In its efforts to curb corruption, the Development Assistance Committee (DAC) of the Organisation for Economic Co-operation and Development (OECD) has recognised that opportunities may exist for corrupt practices in aid funded procurement. Together with other efforts to deal with corruption, the DAC has expressed its firm intention to work to eliminate corruption in aid procurement. However, the extent to which SAIs can be expected to play a role in this area has not been defined.

There may be an opportunity here for members of the DAC to "walk the talk". They should proactively seek the assistance of the SAI community to promote measures that would minimise the risk and impact of corruption.

Thus, audit could serve as an essential instrument for development, promoting good governance by improving public sector management and combatting

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<sup>10</sup> Ibid. p. 14

corruption by promoting ethical behaviour. Any supreme audit institution that provides high-quality audit services clearly has the potential to assist its legislature and other governing bodies in holding the government accountable for its stewardship of public resources.

**Evolution of audit:** The aim of audit has evolved beyond an emphasis on minimising waste, abuse and fraud and ensuring compliance with authorities. It now aims to improve services to society by promoting value for money in government decision making and enhancing organisational performance. Audit's potential for proactively promoting good governance is now recognised as a significant factor in the evolution of public sector reform.

The earliest references to audit were found in Athens, and in the kingdoms of China and India in the pre-Christian era. Reporting and inspection systems were introduced to ascertain the status of the monarchy's finances, and to safeguard royal property from internal fraud.<sup>11</sup>

Later, the control of money became a contentious issue between royalty and the taxpaying public. Audit tasks were specified and developed over the years to become an integral part of efforts by democratic institutions to put their finances under the vigilant eye of an independent body. A shift took place: the primary client was no longer the Crown but the people's representatives.<sup>12</sup>

As economies grew and institutions strengthened, public expenditures also grew, reflecting the broader scope of public services. A parallel evolution took place in audit. Audit expanded and the traditional emphasis on ensuring legality and regularity was exercised through accountancy audit (detection of accounting errors and fraud), administrative audit (observance of laws and rules) and appropriation audit (ensuring that funds were spent for the purposes intended). New areas of audit have since emerged.<sup>13</sup>

More recently, despite considerable initial controversy and some misgivings, performance or value-for-money considerations have been audited; audit's potential for promoting value for money has been established.<sup>14</sup> Its importance is now undisputed; that aspect of audit is widely practised in several nations. The purpose is to ensure that funds have been spent well, performance is up to the mark and taxpayers receive value for money.

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<sup>11</sup> A. Premchand, *Role of Audit Institutions in the Restructuring of the Public Service*, IMF, Vienna, Austria, 25 April 1994, p. 1.

<sup>12</sup> *Ibid.* p. 1

<sup>13</sup> *Ibid.* p. 1

<sup>14</sup> *Ibid.* p. 1

The SAI is, in many ways, the linchpin of a country's integrity system. The responsibilities of the SAI include ensuring that the executive complies with the will of the Legislature, as expressed through parliamentary appropriations; promotes ethical behaviour, efficiency and cost effectiveness; and prevents corruption through the development of sound internal control and reporting procedures designed to effectively reduce the incidents of corruption and increase the likelihood of its detection.

**Role of the SAI in promoting public accountability:** Audit coverage has increased in recent years to cover the quasi-autonomous organisations attached to government and the whole range of public enterprises. Spending by governments in pursuit of economic and social development, expansion of public enterprises, greater autonomy in local authority and administration, and trends toward privatisation in some countries have all steadily increased, yet the character, scope and dimensions of public accountability have not expanded correspondingly.

In some countries, as a result of increased public awareness, the demand for public accountability of persons and bodies managing public resources has likewise increased. There is now a greater need to ensure that the accountability process is effective. Weaknesses in the process will require innovative reforms to strengthen them. The media too are pointing to this in several countries. Business practices are under attack in several countries.

SAIs believe there is a need to increase awareness about public accountability in all sectors of society. They have become increasingly concerned with the need for proper mandates, systems, controls, checks and balances in government planning, programming, implementing and delivering. These are required in addition to the traditional forms of audit to ensure ethical behaviour and value for money in the management of public resources.

At the same time, there is a heightened awareness of the potential impact of information technology on the audit and its environment. Governments are looking for ways to increase efficiency, promote ethical behaviours and to give better service to the public. They are often finding solutions in advanced technologies such as electronic data interchange (EDI). For auditors, using advanced technologies will require a careful re-evaluation and adjustment of the audit approach.

In summary, although different SAIs give different emphasis to the kinds of audits undertaken, they agree on the need for comprehensive audits linked closely to issues of governance and ethics.



The comprehensive audit approach has a variety of components. It is focused on the entity as a whole and, in some countries, the results of audits are reported publicly. In addition, due to increased public interest, issues of equity and environment are being added to the already broad scope of value-for-money audits. For instance, the 1990 Report of the Auditor General of Canada to the House of Commons dealt with the consistency of the level of service provided at Canadian missions abroad.<sup>15</sup> More recent Reports have dealt with questions such as integrity in government, need for public sector reforms and tax-equity. In many countries, the public is increasingly interested in such matters.

The investigative approach is emphasised in some countries. It mainly involves examination of special issues, while ensuring that accounting systems in government agencies and related internal control systems are adequate for their purposes.<sup>16</sup>

The various components of comprehensive auditing are equally important. Each nation must decide the relative prominence that should be given to each.

### 3.2. Characteristics of effective supreme audit institutions

Independence, objectivity and professionalism are fundamental to the effective functioning of supreme audit institutions. With duties often enshrined in the constitution or in legislation, SAIs are legally protected from outside influence since they report to the legislative body, not to the governments they audit.<sup>17</sup>

Independence must be real; it must exist both in law and in practice. This is not always easy to achieve.

SAIs are granted full access to information to carry out their functions. They have the right to make the public aware of any situation where access to information or personnel was denied.

The heads of these institutions generally have tenure; they are typically appointed for a fixed term. They can be removed only in exceptional circumstances.

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<sup>15</sup> Report of the Auditor General of Canada to the House of Commons, 1990, Immigration - Foreign Delivery, Chapter 13.

<sup>16</sup> A. Premchand, Role of Audit Institutions in the Restructuring of the Public Service, IMF, Vienna, Austria, 25-29 April 1994, p. 2 & 3.

<sup>17</sup> Lima Declaration of Guidelines on Auditing Precepts, The IX Congress of INTOSAI, Lima, Peru, 17-26 October 1977, p.8.

SAIs have the full right to use the funds provided by the legislature as they see fit, within their own framework of responsibility. They determine the scope and nature of their work. The standards they apply are generally based on those of professional associations, not set by law.

**Key relationships:** Effective supreme audit institutions work co-operatively with the government. Their audits of the activities, programs, functions and administrative authorities of government and any other subordinate institutions are carried out in a spirit of mutual respect.<sup>18</sup>

**Powers:** Effective SAIs have full power to investigate the use of money appropriated by the legislature, as well as the collection of revenue and receipts of the government.

In some countries, particularly in Latin America, the SAIs can enforce their recommendations. Where fraud is detected, the SAIs may have the power to prosecute. Similarly, in some countries, they provide expert opinions in specified areas dealing with public expenditure.<sup>19</sup>

**Audit staff:** Effective SAIs subscribe to the principle of continuous professional development of their staff. To ensure high-quality work, they employ qualified staff, remunerate them adequately, emphasise continuous improvement and encourage knowledge of the areas subject to audit.

For example, there is an increased need for auditors to improve their skills in fraud detection and information technology through a combination of training, education and experience. Dependence on information systems by all types of organisations continues to increase and will not decrease in the future. Thus, auditing information systems become important and auditors need training and planning for some form of continuing education. The auditing skills and knowledge of today will not be sufficient for auditing in five to eight years.

In certain instances where special professional knowledge is required, auditors may call on outside expertise.<sup>20</sup>

**Sharing of knowledge and experience:** International exchange of ideas, knowledge and experience is an effective means of raising the quality of audit, harmonising standards, sharing best practices and generally helping SAIs to

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<sup>18</sup> *ibid.* p.9

<sup>19</sup> *ibid.* p.10

<sup>20</sup> *ibid.* p.11

fulfil their mandates. To this end, international congresses, training seminars, regional and inter-regional conferences and the publication of international journals have promoted the development of the profession. However, those activities may not be enough. The increasing globalisation of issues such as economic and social development, the environment and migration, the power of technology to transform the way government services are provided, and reported increasing corruption in many parts of the world call for more innovative ways of enhancing SAIs capacity to deliver audit services.<sup>21</sup>

Increasingly, SAIs liaise closely with enforcement officials in other government agencies to ensure that skills and insights are shared and that the office becomes more adept at spotting corruption.

Meeting this challenge will require more active participation in the audit process by international development agencies, who have a primary interest in good governance. They may have to invest a large sum of money and assign a higher priority to strengthening legislative audit institutions in developing countries. The IFIs will have to proactively work with Governments around the world and seek their active support to the enhanced role of the SAI. This calls for a strategy and approach that demands careful deliberation and timely action on the part of all the stakeholders.

### 3.3. Some of the new dimensions of public sector audit

Legislative auditors are moving with the times. They are in the business of forming opinions and, more important, are potential opinion makers in the areas of public sector reform, productivity and innovative societies.

**Public sector reform:** Around the world, the international financial institutions are playing a key role in encouraging structural changes in the public sector to improve governance. In addition, the budgetary situation in many countries, both industrialised and developing, is forcing governments to re-examine the role of the public sector, improve its efficiency and explore ways to "reinvent" government. Governments are also looking for ways to crackdown on bribery and graft.

Many countries have already introduced measures to improve public sector management. The current emphasis is on reducing the size of the public sector, changing the composition and quality of expenditures, and making systemic

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<sup>21</sup> Ibid. p.12

improvements. Such improvements include a new management philosophy with emphasis on incentives, decentralisation and detection of fraud and corruption. For example, the United States is emphasising improved financial management in spending agencies. The performance of public enterprises is under increased scrutiny in India. Accounting and financial reporting have been upgraded in New Zealand. Canada is considering adding ethics routinely to its lines of enquiry.

The power, sophistication and ease of use of technology are changing at exponential rates. A priority for government is the effective use of information technology to deliver services tailored to the public's changing needs. Information technology offers government the opportunity to deliver more services faster at the same or lower costs. It also offers significant potential for delivering new services or delivering existing services, in ways that provide added value to the public.

Corruption is reportedly becoming increasingly globalised, particularly in the financial system. Due to the heightened use of more sophisticated technologies in the transfer of funds and information around the world, corruption is also increasingly difficult to combat and control.

Modern information systems and advanced technologies, such as electronic data interchange (EDI) and client servers, are gaining importance due to the many benefits they provide. These technologies have had, and will have, a major impact on the way business is conducted; their use will require a careful re-evaluation and adjustment of the audit approach. EDI, for example, represents a change in business practices, especially the lack of a paper-based audit trail.<sup>22</sup>

EDI significantly increases the dependence of organisations on computer systems and thus forces the auditor to put more reliance on computer system controls. It is vital that auditors obtain knowledge of the client's business. The auditor will need to perform system reviews to gain an understanding of how the client's system operates and to identify and assess the system processes, controls and risks. Computers can help detect fraud and unethical practices. In a non-EDI environment, much of the auditing is done around the computer. With EDI, one cannot audit around the computer because the paper stream into and out of the computer is replaced by electronic data streams that can be analysed only by automated means. EDI's strong reliance on computer controls

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<sup>22</sup> Strengthening Legislative Audit Institutions in Developing Countries, A Catalyst to Enhance Good Governance, IDI, July 1995, p.12.

and its lack of paper documentation will make the traditional paper-based audit approach difficult, if not impossible.<sup>23</sup>

The SAI has a potentially major role to play in the effective use of information technology as a tool for combatting corruption. This field is likely to grow rapidly in the years ahead.<sup>24</sup>

In many countries, SAIs enjoy high credibility in the eyes of the public. The public has already placed a good deal of faith in reform. SAIs are ideally positioned, then, to report periodically on their governments' progress in the area of reform. SAIs are placed favourably to monitor how changes are occurring, to develop recommendations to make reform more effective and, certainly, to make the management of change as transparent as possible.

Thus, SAIs could become recognised as a key instrument for maintaining and enhancing credibility of the "state" in the eyes of the public.

#### **4. The Challenges Ahead**

There are several challenges ahead. The body of legislative auditors, governments, the international financial institutions and civil society around the world will need to work together to combat corruption. There is a call for innovation. There are no blueprints for action. There is no easy solution. But there is need to experiment and move forward with courage and determination. There is a lot of groundwork still to do. Clear guidelines on how the role could be played have yet to evolve. It would be timely for the IFIs to give some thought to the next steps needed to make things happen around the world on this important front.

Corruption is essentially a social problem and the decision to combat it has to be ultimately taken by the citizens. In this regard, there is a political dimension. Institutions that can influence political decisions may have a role to play. The IFIs and the SAIs are clearly in this field. The challenge is how to marshal this resource. The strong and widespread support of civil society is given.

The SAIs of developing countries in conjunction with the IFIs could take the lead to develop legislative auditing as the catalyst to enhance good governance and combat corruption. Developing countries have much at stake. Corruption

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<sup>23</sup> Ibid. p. 12, 13

<sup>24</sup> Ibid. p. 13

increases poverty and leads to economic stagnation because it diverts resources that otherwise might have been used for a country's social and economic development. The argument is that corruption makes the state less efficient, reducing the effectiveness of its social spending. Moreover, it reduces the faith and trust of the people in their government. This in turn, has disastrous consequences on the state's ability to raise revenue and borrow capital.

Several steps could be taken to move this file forward:

**First, the SAI should clarify its mandate and mission statement regarding its role as a catalyst for combatting corruption.** The role of the institution as a catalyst for good governance and combatting corruption will need to be clearly accepted, established and communicated, as well as endorsed by the legislatures where necessary. For example, in Canada, the SAI outlined its role very clearly as an instrument for promoting honest, answerable and productive government. This sets the stage for looking at accountability from a variety of dimensions.

Auditing serves accountability: Promoting accountability is surely more than mere compliance with financial rules and regulations. The rules themselves may need to be challenged. This kind of broadened vision of the role of the SAI has to be widely accepted by society. Only then, will the institution have the opportunity to build the appropriate capacity to perform this broader function effectively.

**Second, the SAI should proactively pursue more policies and practices that promote good ethical behaviour in the public service.** The SAIs primary contribution to combatting corruption may lie in promoting measures that try to prevent corruption. Some SAIs are already looking at modernising the accountability regime in their respective countries. The need to address questions of ethics is very much on the table for further discussion. If it is not, it should be very soon.

SAIs will need to routinely include questions on "ethics" in addition to "efficiency", and "compliance" in their audit programs and training activities. This will take time to implement. Government auditors could play a clear role in promoting ethical behaviour in public life. A clear set of criteria for auditing issues of ethics will be needed to implement this aspect of accountability.

There may be a need to move resources deployed on traditional auditing of financial statements to the more productive aspects of legislative auditing:

internal control, ethics, value for money and promotion of transparency in areas such as procurement, licensing regulations, customs duties and tax havens.

The Auditor General of Canada has stated that "Public service is a public trust"; it is the central principle in any discussion of ethics in government. This issue may need wider debate in international fora.<sup>25</sup>

Questions that auditors can raise on "ethics" could include:

- Are there appropriate standards of public life to govern the behaviour of politicians and public servants?
- Is the policy of openness endorsed by governing bodies and those charged with the responsibility to manage the government's affairs?
- Is transparency an accepted norm for government and business?

The Auditor General of Canada has also proposed a framework for ethics in government-ethics in decision making. Ethics in decision making means that decisions are made impartially and objectively, and in the public interest. The framework refers to: Statement of Principles; Leadership; Transparent Decision Making; Ethics-Related training; A mechanism for Discussing and Reporting Ethical Concerns; and A Continuous Process which makes ethics a conscious and visible part of day-to-day decision making.<sup>26</sup>

Seven principles of public life were enunciated by the Nolan Committee in the UK. They were: selflessness, integrity, objectivity, accountability, openness, honesty and leadership. It was suggested that all public bodies should draw up Codes and Conduct incorporating these principles. Also, internal systems for maintaining standards should be supported by independent scrutiny. The committee also pointed out that more needs to be done to promote and reinforce standards of conduct in public bodies, in particular through guidance and training, including induction training.<sup>27</sup>

A statement of principles is meaningless unless the people at the top are willing to support it and, more importantly, act in a manner clearly consistent with it. The SAI, as the independent watchdog of the public, can play a major role in the monitoring of the implementation of the principles adopted by the legislature.

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<sup>25</sup> Report of the Auditor General of Canada to the House of Commons, Chapter 1, Ethics and Fraud Awareness in Government, May 1995.

<sup>26</sup> *Ibid.* p.17.

<sup>27</sup> Nolan Committee, May 1995.

An ounce of prevention is better than a pound of cure. SAIs could lead the effort towards providing positive incentives for alternative behaviour in order to minimise human, financial and material resource losses. This task involves establishing clearly defined sanctions for those who break the law and imposing discipline within institutions by implementing sound internal control and reporting procedures. Other areas of interest could include: conflict of interest guidelines, training programs, ethics counsellors, to name but a few.

**Third, SAIs should actively promote improvements in the quality of the public service.** Public sector reform is on the list of priorities of many SAIs. The need is perhaps greatest in developing countries. It is reported that in one developing country, only a quarter of official development assistance (ODA) was spent in the country - of which about half goes to middlemen in a variety of forms. Improving the terms of employment of public servants and the quality of employees, while reducing their numbers will be the challenge. This work too would have to be guided by a well defined code of ethics. The guiding force here should be the concept of transparency. Perhaps it is time to introduce "sunshine provisions" in legislation. The public and private sectors will need to work in partnership to develop practical approaches in this area.

**Fourth, SAIs should strengthen their reporting and communication strategies to benefit the full impact of their audit work in the area of ethics.** SAIs work with legislators, bureaucrats and the media to communicate their findings. SAIs would need to focus their efforts towards giving publicity to cases of unethical practices uncovered by audits that are not dealt with swiftly by the appropriate authorities to the satisfaction of the SAI. This step would be particularly relevant in situations where leaders of organisations are found to be at fault. There is a general agreement that the single most important influence on the ethical behaviour of employees is the role model provided by an organisation's leaders.

**Fifth, the SAI can play a role in raising the public's consciousness about ethics and corruption.** There is an urgent need to improve the awareness of the costs associated with corrupt practices. One suggestion is the creation of "hot lines" that encourage citizens to denounce cases without having to reveal their identities. Such hotlines can be a valuable source of information on what is happening and why, when, and where. However there are many that advocate that there are other ways to deal with the problem. There is no consensus on this matter.



**Sixth, SAIs should get more directly involved in working with educators to enhance communications in schools and homes on the subject of corruption.** This type of action would be new ground for SAIs. This step could lead to very substantive and sustainable change particularly if all the stakeholders involved work together on this front.

**Finally, there is a need for the IFIs to use their clout and financing to promote the efforts of developing countries and those of their institutions (such as the SAIs) to show some leadership in combatting corruption.** Many SAIs may not have the independence and resources to expand their mandate. The IFIs will have to work with the community of SAIs to develop a strategy and approach for proceeding on this front. They will also have to advocate not only the cause of strengthening legislative auditing and promoting greater transparency in the operations of government and commerce on a national and international basis, but also focus on related changes in the international banking sector. The notion of transparency should apply equally to banks and like institutions where the fruits of corruption can often be hidden from the public eye.

## HEALTH AND POPULATION SECTOR EXPENDITURE AND FINANCING IN BANGLADESH

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### 1. Introduction

In pursuance of the objectives of Health for All (HFA) by the year 2000 and a net reproduction rate of 1 by the year 2005 health care system in Bangladesh has been reoriented to provide preventive and promotive services including facilities-based curative care. While health is recognised as a basic requirement to improve quality of life, the provision of Primary Health Care (PHC) has been chosen as the key strategy to improve the health status by reaching the essential minimum health care facilities to all by the year 2000.

The priority attached to health care and population control has been emphasised in the successive Five-Year Development Plans of the country since independence. The First Five-Year Plan emphasised the need to create a rural health infrastructure system to provide Maternal and Child Health (MCH) services at local levels. The Second Five-Year Plan aimed at expanding the coverage of the health care services and reducing the gap between rural-urban access to health care facilities. During the Third Five Year Plan a comprehensive national strategy for Maternal and Child Health was endorsed by the GOB where creation of a rural health infrastructure responsive to PHC was particularly stressed. Besides adoption of the HFA, the Fourth Five Year Plan re-emphasised successful implementation of the Third Plan objectives and targets. The Fourth Plan attached special emphasis on the consolidation of the existing health facilities and programmes and strengthening of management capabilities at the field levels to ensure efficient functioning and optimum utilisation of the services.

In order to implement the expanded health and population programmes GOB invested substantial resources in the health sector. For example, massive investments have been made in the rural health infrastructure through the construction of nearly 400 health complexes at the Thana levels for boosting PHC activities. Available evidence indicates that while Bangladesh achieved laudable success in some target areas (i.e. reduction in fertility and child mortality) much remains to be done in many other vital areas (i.e. basic health care facilities, maternal and child health care etc.). There may be many reasons for this; this deals with financial allocations and public expenditure patterns in

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the health and population sector. A review of the resource allocation and historical expenditure pattern will enable one to observe the links between the stated objectives and the progress achieved. Indeed, a comparison of the progress towards key objectives and targets with the trend of public expenditure will shed light on the strengths and weaknesses of the current investment decisions. It may also provide important clues to the cost-effectiveness and sustainability of the current initiatives in the health and population sectors and provide necessary guidelines for effective planning and design of the Fifth Health and Population Programme. With this end in view analyses of the financing and expenditure pattern of the health and population sector activities in Bangladesh have been done.

## **2. GoB financing of health and population sectors**

The level and prioritisation of public sector allocations for health and family planning activities during the successive Five-Year Development Plans are revealed by the data presented in Table 1. It will be observed from the Table that funding for both health and family planning has significantly increased in absolute terms especially since the Second Five-Year Plan period. Between 1980-85 and 1990-95, for example, the public sector allocations for both health and family planning have more than doubled in absolute terms over the successive plan periods. However, when compared in relative terms, the public sector allocations for health and family planning do not appear very attractive. While the relative shares of health and family planning together as proportion of total public sector allocations are found to vary between 5 to 7 percent, these allocations seem to be inadequate especially in the context of long term national goals and strategies of HFA 2000<sup>1</sup>. Another uncomfortable feature of the health and population sector-financing pattern, as discussed later, is that there has been a high degree of dependence on foreign aid.

It is difficult to provide any accurate estimate of the total financial outlay for the health care system. Information on the expanding private sector outlay for providing health care services is not available. In fact, expenditures incurred by private individuals on available health care services is not available. According to World Bank (July 31,1996) sources, the private sector outlays for health per households is 2.6 times higher than public outlays. The World Bank estimate puts the combined public and private per capita expenditure on health and family planning for Bangladesh to be a meagre US\$ 7 in 1990. This compares very poorly with that of other South Asian countries. For example, per capita

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<sup>1</sup> The health and population sector allocations (Tk.90856 million) in the Draft Fifth Five-Year plan (1997-2002) constituted 10.5 percent of the total public sector allocations (Tk. 858939 million) indicating firm commitment of GOB to improve health care facilities in Bangladesh.

expenditure for health is US\$ 21 in India, 18 in Sri Lanka, and 12 in Pakistan. Though proportion of GDP allocated to health and population sector has more than doubled in the last ten years, rising from 0.6 percent in 1985/86 to 1.3 percent in 1994/95, Bangladesh still lags behind many other low-income Asian countries in this respect as well (Griffin: 1995). Needless to reiterate, a stronger financial commitment to health and population sector is called for to implement the HPSS. In addition a reallocation of resources within the health and family planning sector to support the Essential Package, improvement of the efficiency of utilisation of the public sector inputs and services and mobilization of additional resources from the domestic sources, based on public's willingness and ability to pay, will be the other important determinant of the achievement of the goals and objectives of the HFA-2000.

### **3. Trend of public expenditure in health and family planning sectors**

The GOB funding of health and family planning in both revenue and development budgets has significantly increased since mid 1980s. The expenditure pattern in the 1990s has been analysed.

#### **3.1 Health and Family Planning Activities in the Revenue Budgets**

The government revenue expenditure for health and population sector is seen (Table 2) to have increased from Tk. 3869.30 million in 1990-91 to Tk. 7300.60 million in 1995-96, registering an average growth rate of 14.7 percent per annum during the six year period. In percentage terms, health and family planning allocations in the total budget increased from 5.32% in 1990-91 to 6.37% in 1995-96. The expansion in the funding of health and family planning activities remains impressive (over 9 percent) even when expressed in real terms (i.e. at constant 1984/85 prices). In per capita terms, per capita revenue expenditure on health and family planning was Tk. 34.76 in 1990-91 and Tk. 59.79 in 1995-96. The average percentage growth rate in per capita availability of revenue expenditures was 11.76% per annum during the period under consideration.

However, the growth in the expansion of funding in the health sector has been much more pronounced (i.e. 15.04% compared to 11.55% in current prices and 9.54% as opposed to 6.61% in constant prices) than that in the family planning sector in both current and real terms. Indeed, as shown by the data in Table 3, the relative share of the health sector in the combined budgetary allocations to the recurrent activities in the health and population sectors during 1990/91 and 1994/95 has been significantly higher than that of the population sector. The figures in the Table reveal that the allocations to the health sector are more than ten to twelve times larger than those to the population sector. However, as

will be observed later, a significant proportion of funding of ADP population projects is, in practice, going to the recurrent items. That the share of the total revenue as well as development budget allocated to health has always been higher than that for family planning is also supported by other cost and finance studies concerning the sector (Nazmul Kawnine, et.al. 1995 and M.R. Khan, 1990).

While the trend of revenue expenditures for the health and family planning activities clearly demonstrates GOB's continued commitment to these social sectors, the pertinent question is where the additional funds have gone? Which tiers/levels of the health sector have benefited most from the expanded funding during the recent years?

The results of an expenditure survey analysis (quoted in IRBD, 1995) revealed that 45 percent of the recurrent expenses in the health sector is used to operate the Thana Health Complexes (THCs) and another 28 percent of the revenue budget is used for other hospitals.

Thus only 27 percent of the recurrent budget is left to be used for running the union and village level operations. The implication of these findings is that the health system is heavily biased towards hospitals and curative care facilities.

A similar trend of utilisation of the revenue budgets of the health sector during 1991/92 and 1994/95 could be observed by a public expenditure review (Nazmul Kawnine et. al. 1995) of the health and population sectors in Bangladesh. The study divided health sector activities into four broad categories, such as, primary, secondary, tertiary, and others and then defined each category to consist of different types of services for analytical purposes. For example, the "primary" component was defined to consist of the basic package of curative services and preventive programmes; the "secondary" to be concerned with general curative hospital based services; the "tertiary" to comprise more specialised hospital services and the "others" to cover administrative and planning operations of the Ministry of Health and Family Welfare (MOHFW) headquarters. Based on these classifications of the levels of health sector activities, the primary health care (PHC) system emerged as the major beneficiary through raising its share in the expanding revenue budgets from 20 percent in 1985/86 to over 50% in 1994/95. Though there was slight decline in the PHC share from 53.4 % in 1992/93 to 48.7% in 1993/94, it recovered again in 1994/95 raising its share to 52% in the health sector revenue allocations. During the period under consideration, the increased funding of the health care system through revenue budgets was evenly spread among the other constituent components. In fact, PHC activities also gained substantially

in the ADP funding of the health sector by raising its share to over 50 percent in 1994/95. Thus not only has GOB reallocated development expenditures towards health care in the 1990s, but it has also reallocated funding within the health sector towards PHC.

### 3.2 Health and Family Planning Activities in the ADP and Revenue Budgets

The analysis of the GOB expenditure pattern on health and family planning activities in this section is carried for the last five years, with 1994/95 as the terminal year instead of 1995/1996 in the previous section. Because of an abrupt fall in the budgetary allocations for both health and family planning activities (perhaps linked to a decline in the donors' contribution especially the family planning activities) our analysis of the six year period extending between 1990/91 and 1995/96 will give an underestimation of the rising trend in the GOB expenditure pattern in the 1990s.

As seen from our analysis in Tables 4 through 6, both health and family planning sectors continued to receive expanding shares of GOB spending in both development and revenue budgets. The total development expenditure for the health sector increased from Tk. 1649 million to Tk. 3952 million in 1994/95. In percentage terms, the ADP allocations to the health sector rose from 2.53 percent of the total development outlay in 1990/91 to 3.54 percent of the total development outlay in 1994/95. As noted earlier, this share suddenly dropped to 3.01 percent in 1995/96, but is reported (World Bank 1996) to have increased again to 4.9 percent in 1997. The resources devoted to the health sector from the ADP allocations thus registered an increase of over 27 percent per annum during the last five years. In fact, the allocations to the sector recorded an annual growth of staggering 21 percent in real terms during the period under consideration.

In similar fashion to the health sector, there has been substantial expansion of GOB activities and GOB and donor funding in the population sector. However, in contrast with the revenue shares, the population sector's share in the development outlay has been consistently much higher than the health sector's share. The family planning's share in development budget is seen to have varied between 50 percent to 64 percent of the total allocations of the ADP for health and family planning together.

The annual development expenditure share of the family planning sector increased from Tk. 2593.90 million in 1990/91 to Tk. 5122.80 million in 1994/95 and registered a growth rate of 14.68 percent per annum. In constant

terms, the rate of growth was 10.2 percent per annum. As percentages of total Government development outlays, however, the family planning sector's share is seen to remain roughly around four and a half percent.

The health and population sector together shared between themselves 7 to 8 percent of the total Annual Development Budget of the GOB during 1990/91 and 1995/96. This indicates that compared to eighties, there has been a doubling of the GOB spending on the health and population activities in the 1990s.

True, budgetary allocations for both health and family planning activities have increased overtime, but their relative shares in both revenue and development budgets have tended to vary roughly between 4 to 6 percent of the revenue budgets and between 2 to 4 percent of the ADP allocations.

Unlike in the family planning sector where most expenditure is incurred under the development budget, a large portion of the health sector spending is covered by the revenue budget. As revealed by the data in Tables 5 and 6, between 1990/91 and 1995/96, the ratio of ADP funding to revenue budget in the health sector was on average roughly 34:66, whereas in the population sector it averaged 91:9. A plausible explanation put forward by Stephen Thomas et. al. (1995) is that many of the recurrent costs of population (estimated to be roughly around 47%) initiatives are included in the ADP and funded by the donors. This assertion is verified next through analysing the extent of donor participation in the funding of the population activities.

The relative shares of GOB and its development partners in the funding of the population sector are highlighted by the data in Table 7. It will be noted from the Table that assistance from the donors has been the major source of funds for the population programmes in Bangladesh. Donor funding accounted for over 60 percent of the total funds in the population sector throughout 1990s:<sup>2</sup> This clearly indicates greater reliance on external assistance in the population sector. Though family planning has traditionally been a top priority in the aid programmes of the donors in Bangladesh, continued reliance on external assistance may undermine future sustainability of the recurrent activities in the population sector.

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<sup>2</sup> The donor contribution to funding of ADP projects in the health sector declined from 54% in 1990/91 to 38.6% in 1994/95.

#### 4. Expenditure utilisation pattern in the health and population sector

While the foreign development partners of GOB may be willing to invest in the development activities relating to health and population, they may be reluctant to provide funding required to meet the operating costs of such investments. It is, therefore, important to examine current as well as future liabilities of the GOB in its health and population sector. In order to assess the recurrent cost implications of GOB in the health and population sector a study (Stephen et. al. 1995) was conducted under the initiative of the Health Economics Unit (HEU) of the MOHFW. Based on a sample survey of 60% of the ADP projects covering roughly 80% of the actual expenditures in the health and population sector in 1994/95, the study concluded that in terms of both ADP allocations and expenditures, supplies constituted the largest functional line item, accounting for 22 percent of allocations and 26 percent of expenditures.

On a desegregated basis, the largest category of allocations and expenditures in the health sector was construction (i.e. 45% of allocations and 47% of expenditures) directed to improving health infrastructure through construction of almost 400 health complexes at the Thana level. The next largest category of allocation and expenditure was purchase of equipment. Thus construction and purchase of equipment together constituted over two-thirds of ADP allocations and expenditures for the health projects in 1994/95.

In contrast to the health sector, the largest category of allocations and expenditures in the population sector are accounted for by the recurrent items such as, salaries, allowances and supplies. This is expected as the infrastructure for delivery of population control activities is already in place.

On a broad capital versus revenue expenditure break-down basis of the health and population sector activities in the ADP, it is seen from Table 8 that ADP projects in the health sector are primarily concentrated in the capital expenditure oriented activities; while the population projects are concerned predominantly with the recurrent activities. Between 1992/93-1994/95, recurrent activities in the population sector accounted for 80% of total expenditures in the population projects, although GOB funded only 33% of the total ADP expenses in the sector. Thus, a sizeable 47% of the recurrent expenses incurred in the population projects was borne by the donor community. The implication is that GOB has to increase (which is estimated to be US\$ 56 million) its funding of recurrent activities in the population sector through its Revenue Budget. While one option may be to move some of the donor funded recurrent items in the population sector to the Revenue Budget, GOB has to raise substantial amount of additional resources not only to sustain its present level of activities in the health and population sector but also to



meet the increased requirement for funds needed to implement the HFA envisaged in the Fourth Five-Year Plan especially in the light of the design of the upcoming Fifth Health and Population Project (HAPP-5). The preparations for a National Health Strategy and the design of the HAPP-5 will require a much larger resource envelope which will require GOB to carefully assess financial viability and sustainability of its current as well as future health and population sector policies and programmes. It is to these issues we turn next.

## **5. Financing of the future health care reform programme**

GOB wants to achieve the goal of Health for All by the year 2000 through bolstering the National Health System and Primary Health Care activities. While a National Health strategy and the Fifth PHP are still in the process of formulation, the GOB is trying to implement a Health and Population Sector Strategy (HPSS) (prepared jointly by MOHFW and the World Bank) where the primary objective is to introduce a client-centered reproductive health care system in Bangladesh by offering an "Essential Package of Services" (EPS). The EPS consisting of a basic set of preventive and curative services to address the most important health problems of the population is envisaged to (a) have the greatest health impact per Taka spent; (b) be cost-effective on several counts; (c) ensure effective management of the health care services; (d) improve the quality of services without incurring larger cost increases, and (e) improve equity of resource allocation in the health and population sector by funding programmes designed to serve the low- income groups.

### **5.1 Potential Savings in Costs**

The EPS is envisaged to be delivered from a single spot for providing the prospective clients with 'one-stop shopping' of reproductive and other basic health care services. The notion of "packaging" and a "single-point" delivery is designed to make EPS both efficient and cost-effective. While the basic objective of the EPS is to ensure equitable access to basic health care facilities, cost-effectiveness of the overall implementation mechanism is expected to play the crucial role.

The base-line per capita cost of the EPS has been estimated to vary between US \$ 3.5 to 4.5. The current allocation of public funds (including donor contributions) to primary care being estimated at US\$ 2.3 per capita indicates the existence of a sizeable gap between the EPS requirements and the budgetary allocations. Thus, with the available funds, the EPS has to be administered in the light of projected improved cost-effective delivery system.

In addition to overall efficient management of the system, the projected cost-effectiveness is expected to be ensured through potential cost-savings in the following manner:

- i) Maximum utilization of the shared inputs comprising the elements of the EPS;
- ii) Built-in synergism between treatment and prevention activities;
- iii) Improved use of specialized resources and fuller utilization of existing health care facilities;
- iv) Reduction in the overhead costs achievable through lower requirement for supplies and easier supervision and better coordination.

The basic tenet of the cost-saving argument is that integrated delivery of services is more cost-effective than a series of vertical programmes. However, it is difficult to quantify the actual magnitude of savings in costs that may be derived through efficient delivery of the EPS. This has to wait till implementation of the HPSS, perhaps on a pilot basis, in selected areas of the country. Nevertheless, removal of present inefficiencies and improvement in the projected delivery mechanism should make the potential savings in costs more real than apparent.

## 5.2 Recurrent Cost Implications and Resource Requirements

While sizeable efficiency gains may be obtained either from savings in input requirements or increase in outputs or both, there are concerns that EPS may involve higher expenses for GOB in the short-run. Preliminary estimates, (quoted in GOB, January 1997) based on the experiences in Sub-Saharan Africa, Latin America and the Caribbean countries, suggest that the delivery of EPS may require per capita expenditure of US\$ 12.0 which is about four times higher than the US\$ 3.2 spent per head through the GOB budgets in 1994/95. This leaves a shortfall of almost US\$ 8 per person. An alternative costing of a minimum health package by the World Bank for Bangladesh also returned a figure of US\$ 10.3 per capita (Nazmul Kawnine et. al. 1994) which also indicated the cost of a basic health package to be well out of reach under the existing resource distribution pattern for the health sector. The implication is that to make implementation of EPS financially viable and sustainable, GOB has to bridge a sizeable resource gap. According to the World Bank estimates of this indicative costing of the PEHS, Bangladesh would require a minimum of US\$ 850 million extra funds each year than its current level of spending through revenue and development budgets.

The need for far greater resource mobilization in the health and population sector by GOB for implementing the HPSS also becomes clear from a UNICEF study (1995) which attempted to calculate unit costs of the provision of essential health and nutrition services in a District. According to UNICEF estimates, the annual cost of providing the essential health and nutrition services through a Thana Health Complex is approximately US\$ 5.1 million or Tk. 200 million. This suggests that the recurrent costs needed for such services are far in excess of the current funding patterns. If UNICEF estimates are accurate, then GOB spending on recurrent costs would have to be doubled from its present level for running an efficient programme of basic health and nutrition services.

### 5.3 Financing Strategies of the Health Sector Reform Programme

By all stretches of imagination, public expenditures in health and population have to be substantially increased in order to achieve the GOB health goals. However, forecasting future revenue earnings from tax and non-tax sources including receipts from commodity and food aids and the earlier quoted health sector expenditure studies conclude that GOB will face substantial shortfall of resources required to sustain its future health and population programmes. The resource gap estimated by such forecasts in the year 1999/2000 is approximately US\$ 142 million for the health sector and US\$ 32 million for the population sector at 1992/93 prices. Estimating the likely GOB expenditures on the operating costs in the health and population sectors, based on the UNICEF cost estimates for the provision of essential health and population services to the entire population of Bangladesh by the year 2000, yet another study (Stephen Thomas, 1995) concludes that GOB revenue budget provisions for health and population activities have to be enhanced from the present 5-6 percent to 9-10 percent. However estimated, there is a clear need for mobilizing substantial additional funds for formulating and implementing a realistic health and population policy supportive of successful adoption of the HPSS and achievement of the HFA by the year 2000.

The pertinent issue is thus how to meet the sizeable resource gap of the future? Several strategies are suggested by researchers and experts to bridge the potential resource gap. These are:

- i) Mobilization of additional resources from GOB sources through reallocation from other economic sectors.
- ii) Improvement in the efficiency of public sector inputs and services.
- iii) Mobilization of resources from non-GOB sources.

Each of these resource mobilization strategies is discussed below to highlight the possibilities for meeting potential resource gaps.

#### 5.4 Mobilization of Additional GOB Resources

This strategy would require GOB to reallocate additional resources to the health and population sectors and also to EPS within the health sector. According to an HEU estimate (Nazmul Kawnine et. al.1996) of the funding gaps and additional resources requirements, GOB would have to raise its revenue budget expenditures by 6.9 percent in 1998/99 for the health sector and by 2.5 percent for the population sector. However, given the limited resource base, such large reallocations may be difficult for the GOB. It will also involve a significant opportunity cost in terms of GOB activities in other competing sectors i.e. increased food production and better sanitation. These issues may be resolved through efficient planning and rational decisions of the proposed inter-sectoral reallocations.

#### 5.5 Improvement in the Efficiency of Utilization of Public Sector Inputs and Services :

In order to ensure improved efficiency of recurrent public sector expenditure in the health and population sector a proper balance has to be struck between different heads of allocations, i. e. personnel salaries and allowances, drugs, equipment supplies and operation and maintenance costs. Since a large share of recurrent expenditures is currently financed out of GOB development budgets, the MOHFW has to initiate a thorough review of the structure and composition of expenditure patterns. Needless to mention, priority has to be attached to funding of maternal health and family planning and other reproductive health, child survival and communicable and endemic diseases as essential elements of the PEHS, while formulating expenditure plans for the HAPP-5.

#### 5.6 Mobilization of Resources from Non GOB Sources

This option involves the strategies of raising revenues from donor sources and from the domestic households through imposition of "User-Fees".

As far as the donors are concerned, it may be difficult proposition given the fiscal austerity facing the aid programmes in many western countries. Further, excessive reliance on external assistance may be temporary relief and not a permanent solution to financial constraints facing GOB. In addition, it would also undermine future sustainability of the health sector programmes and weaken GOB's desire of achieving increasing self-reliance.

Alternatively, GOB may turn to the domestic household sector as part of its efforts to mobilize additional resources for the health sector. Introduction of user-fees, in particular, is being considered by many governments in many developing countries as a possible option to mobilize resources. By 1993, almost all countries in Sub-Saharan Africa had some form of cost recovery schemes in place or were about to introduce one. Due to increase in the range and cost of health technology and rising expectations of people for access to quality care, Government is not in a position to shoulder the entire financial burden involved in funding all aspects of health care for all people. That is why, user-charges are becoming increasingly popular among Governments in many developing countries as an instrument for mobilizing additional resources domestically. China, for example, increased the share of its health expenditure financing through user-charges from 19 percent in 1980 to 43 percent in 1985. South Korea, Thailand, Malaysia, Singapore and Indonesia also have user-charge policies in health which co-exist as cost-sharing provisions or potential social insurance schemes. In Bangladesh, GOB, NGOs and private hospitals are also using various cost-recovery methods. In the private sector, the Social Marketing Company recovers a considerable proportion of the commodity cost through charging prices at subsidized rates for contraceptives and ORS. At public sector hospitals at the district and upper levels the providers are charging modest fees for drugs, radiology, ambulance services etc.

There is evidence that households might be willing to pay for services offered from GOB facilities if better quality can be ensured. From a reconnaissance survey of a sample of 723 respondents conducted by this study, it could be gathered that 581 (or 80 percent) of the patients interviewed are willing to pay for such services. Of those who are willing to pay 67% are ready to bear 5 to 10 percent of the total health care expenses. Evidence available from various countries of Africa suggests, however, that the potential for revenue generation through imposition of user-fees is limited, its acceptability is critically dependent upon tangible qualitative improvements in services, and it may adversely affect the poor households. While some studies are already in place (i.e. Nazmul Kawnine et. al. 1996) more research is needed to examine how user-fees and protection of the poor can be achieved simultaneously under the given socio-economic realities in Bangladesh.

A study (Nazmul Kawnine et. al. 1997) of the macro flow of funds to the health and population sectors in Bangladesh in 1994/95 found that the total funding of the health and population sector in 1994/95 was approximately US\$ 855 million which was equivalent to US\$ 7.1 per capita and 3.1 percent of GDP. The largest single source of these funds was household expenditures

worth US\$ 404 million (or 47.3%), followed by GOB worth US\$ 228 million (or 26.6%), donors worth US\$ 221 million (or 25.8%) and the NGOs worth US\$ 2.0 million (or 0.3%). While the average out of pocket expenditure by the private individuals on health and population services worked out to be US\$3.4 per capita, it was concentrated in the richest 25% of the population who were found to spend 95% of the resources in buying private curative care using very little funds to purchase public sector services.

While public and private spending was nearly of the same magnitude, there was little coordination between the two sectors. The up-shoot of all this is that private households in Bangladesh spend a sizeable amount of funds every year for purchasing health care services. However, a large proportion of this expenditure remains ineffective because of the poor quality of the services received and almost nothing is channeled into the public sector (i.e. district level and above) with all revenues reverting to the National Exchequer and thus having no impact on improving the quality of the services provided, especially below the district levels.

However, if the private households can be motivated to invest in the public sector health facilities, especially in the rural areas (i.e. Thana level and below) large amount of resources can be mobilized and effective community participation in government health care system through cost-sharing can be ensured. One study (Stephen Jarrett, 1994) estimated that if only 15% of the total amount spent (i.e. Tk. 133 now being spent per head in the rural areas) can be diverted to public sector health care facilities, it will make available Tk. 2.0 billion (roughly Tk. 20 per head) for the union health care system per year. While cost sharing possibilities at this scale may appear lucrative, community participation at this scale can be ensured only if the quality of services can be significantly improved.

In addition, availability of community resources and expenditure pattern for health care services needs to be accurately assessed through proper survey studies. To assess this effectively, "National Health Accounts System" should be developed. In the absence of such a system, it is difficult to accurately estimate the desegregated expenditure pattern. This also renders effective expenditure planning difficult.

The next step will be to design appropriate cost recovery mechanisms and pilot test them in selected areas. Such pilot studies will include the following elements: (i) fixation of various service charges to be realized from the users; (ii) revenue retention at the facility levels to be used for quality improvements; (iii) evolving mechanisms for exempting the poor and the disadvantaged

groups; (iv) rational pricing of the services reflecting economic costs and addressing referral anomalies. As the current household spending is primarily for curative care, especially drugs, GOB needs to encourage the private-for-profit sector service providers to make provisions for more comprehensive health care packages, including both preventive and promotive care. GOB should also play an important role in ensuring proper coordination between public and private sectors and should pursue regulatory measures to ensure minimum service standards and facilitate making of rational choices by the consumers in the market.

Finally, though Bangladesh may not be ready for use of health insurance system on a large scale, yet preparatory work may be undertaken to develop a basis for the future. In the long-run, health insurance schemes have to be used extensively for avoiding high costs of care for serious illnesses and disabling conditions. The design of future health insurance models should take into account the diverse needs of the urban and the rural masses and for the potential users in the formal as well as the informal sectors.

## 6. Concluding remarks

The expenditure and financing of health and family planning activities has to be judged from the perspective of the impact of health and family planning efforts on the overall socio-economic development process. Improvement of aggregate health status of the population of Bangladesh is one of key elements for raising productivity and thus achieving competitiveness in various sectors of the economy leading to higher income, poverty alleviation and upliftment of life of the greater section of the society. Similarly, the family planning activity has positively contributed to poverty reduction. Allocation of financial resources for HAPP-5 and consequent socio-economic gain can be seen from the viewpoint of ESP, its cost, services delivery and efficient utilization of available resources. The concept of ESP consisting of five important elements comprehensively covering the health care and family welfare need of the poor masses fits very well into the overall poverty alleviation strategy of the GOB.

As of today no study has been commissioned to quantify the economic gain and social return of the expenditure and financing of health and population sector. It is therefore necessary to explore as to what extent the existing resources could be efficiently programmed through inter-sectoral prioritization and adjustment for generation of maximum outcome and benefit.

**Table - 1**

Share of Health and Family Planning Sectors in the Total Public Development Outlays in Various Plans.

Plan Periods	Total Public Sector Outlay (in mn. Tk.)	Allocation for Health (mn. Tk.)	Allocation for Family Planning (mn. Tk.)	Allocation for Health and Family Planning (mn. Tk.)	Share of Health and Family Planning Sector in total Public Sector Outlay
First Five Year Plan (1973-1978)	39,520	2,000	700	2,700	6.83
Second Five Year Plan (1980-85)	1,11,000	2,880	3,100	5,980	5.39
Third Five Year Plan (1985-90)	2,50,000	5,500	8,700	14,200	5.68
Forth Five Year Plan (1990-95)	3,47,000	10,600 [MF1]	15,980	26,580	7.66

*Source: GOB - Planning Commission, Ministry of Planning, Various Plans.*

**Table - 2**

Revenue Expenditure in Health and Family Planning as Proportion of Total Government Revenue Expenditure 1990/91 - 1995/96 (Tk. in Million)

Year	Total Govt. Revenue Expenditure	Revenue Expenditure in Health	%of Total	Revenue Expenditure in Family Planning	%of Total	Revenue Expenditure in Health & Family Planning	%of Total
1990-91	72,651	3,578.48	4.92	290.82	0.40	3,869.30	5.32
1991-92	78,651	3,957.62	5.04	350.06	0.46	4,307.68	5.50
1992-93	86,430	4,765.33	5.51	399.21	0.47	5,164.54	5.98
1993-94	92,124	5,645.67	6.12	427.21	0.47	6,072.88	6.59
1994-95	99,982	6,393.60	6.39	459.00	0.46	6,852.60	6.85
1995-96	114,544	6,807.90	5.94	492.70	0.43	7,300.60	6.37

*Source: GOB - Ministry of Finance, Various Budget Documents*



**Table - 3**

Allocation to Health and Population Sector in the  
Revenue Budget, 1990/91 - 1995/96  
(Tk. in Million)

Sector	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96
Health	3578.48 (4.92)	3957.62 (5.04)	4765.33 (5.51)	5645.67 (6.12)	6393.60 (6.39)	6807.90 (5.94)
Population	290.82 (0.40)	350.06 (0.46)	399.21 (0.47)	427.21 (0.47)	459.00 (0.46)	492.70 (0.43)

*Source: Same as Table - 2*

*Note: Figures in brackets are percentages of Total Govt. Revenue Expenditure.*

**Table - 4**

Development Expenditure in Health and Family Planning as Proportion of  
Total Government Development Expenditure, 1990/91- 1995/96,  
(Tk. in Million)

Year	Total Govt. Development Expenditure	Development Expenditure in Health	% of Total	Development Expenditure in Family Planning	% of Total	Total Development Expenditure in Health and Family Planning	% of Total
1990/91	65,210	1,649.50	2.53	2953.90 (64.15)	4.53	4,603.40	7.06
1991/92	71,500	2,065.80	2.89	3387.30 (62.11)	4.74	5,453.10	7.63
1992/93	81,210	2,620.00	3.23	3456.70 (56.88)	4.26	6,076.70	7.49
1993/94	96,000	3,040.70	3.16	4463.90 (59.47)	4.65	7,504.60	7.81
1994/95	111,500	3,952.80	3.54	5122.80 (56.44)	4.59	9,075.60	8.13
1995/96	104,470	3,148.80	3.01	4497.10 (58.82)	4.30	7,645.90	7.31

*Source: Same as Table - 2*

*Note: Figures in the brackets are shares of Family Planning Development outlays as percentages of total Development outlays of health and family planning activities.*

**Table - 5**

Total Funding of the Health Sector in the ADP and Revenue Budgets,  
1990/91 - 1995/96  
(Tk. in Million)

Year	ADP Allocations	% of Total	Allocation in the Revenue Budget	% of Total	Total
1990/91	1,649.50	31.55	3,578.48	68.45	5,227.98
1991/92	2,065.80	34.31	3,957.62	65.69	6,023.42
1992/93	2,620.00	35.48	4,765.33	64.52	7,385.33
1993/94	3,040.70	35.02	5,645.67	64.98	8,686.37
1994/95	3,952.80	38.21	6,393.60	61.79	10,346.40
1995/96	3,148.80	31.63	6,807.90	68.37	9,956.70

*Source: Based on Table 3 and 4*

**Table - 6**

Total Funding of the Family Planning Activities in the ADP and Revenue Budgets, 1990/91 - 1995/96  
(Tk. in Million)

Year	Allocations in the ADP	% of Total	Allocation in the Revenue Budget	% of Total	Total Allocations
1990/91	2,953.90	91.03	290.82	8.97	3,244.72
1991/92	3,387.30	90.63	350.06	9.37	3,737.36
1992/93	3,456.70	89.62	399.21	10.38	3,855.91
1993/94	4,463.90	91.27	427.21	8.73	4,891.11
1994/95	5,122.80	91.78	459.00	8.22	5,581.80
1995/96	4,497.10	90.14	492.70	9.86	4,989.80

*Source: Based on Table 3 and 4*

**Table - 7**

Funding of Population Activities in the ADP by GOB and Donors,  
1990/91 - 1995/96  
(Tk. in Million)

Year	GOB	Donor	Total	Donor as % of Total
1990/91	877	2077	2954	70.3
1991/92	1068	2319	3387	68.5
1992/93	1100	2550	3650	69.9
1993/94	1360	2860	4220	67.8
1994/95	1740	3620	5360	67.5
1995/96	1590	2817	4407	63.9

*Source: IRBD, 1997*

**Table - 8**

Division of ADP Expenditure for Health and Population Sectors between  
Capital and Recurrent Activities, 1992/93 - 1994/95 (in %)

Year	Health				Population			
	Capital	Recurrent	Others	Total	Capital	Recurrent	Others	Total
1992/93	83	15	2	100	3	82	15	100
1993/94	72	21	7	100	7	81	12	100
1994/95	79	16	5	100	9	77	14	100

*Source: Stephen Thomas et. al. (1995)*

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## TAX ISSUES IN BANGLADESH

Mohammad Delwar Husain\*

Tax structure in Bangladesh is still heavily dependent on indirect taxes. Import duties constitute about 36% of our total revenue. Indirect taxes from the domestic economy collected in the form of VAT, excise and supplementary duty contribute nearly 49% of the tax revenue. The share of direct taxes is about 15% of the total revenue collected by the National Board of Revenue (NBR). NBR, an agency under Ministry of Finance is solely responsible for planning supportive tax laws, initiating reforms and devising strategies in keeping with the needs and objectives for mobilising and augmenting internal resources of the country. Our tax/GDP ratio is about 12% which is considered low compared to that of our neighbours. Introduction of VAT in 1991 is a major tax reform in indirect taxation. Agriculture, though is the largest economic sector, makes no notable contribution to tax revenue.

### **Income Taxation:**

Income Tax Ordinance, 1984 is the basic tax code that guides assessment, levy and collection of income tax in Bangladesh. Income tax contributes the lion's share of our direct tax revenue. Other major direct tax components are wealth tax and gift tax. Capital gain tax on assets and property is a component of income tax. We have about 700,000 taxpayers enrolled with tax department. Our tax economists and tax administrators concede that in a country of 120 million people this number is unrealistic and that potentials for netting more tax payers need to be harnessed. The latest legislative measures undertaken to broaden the tax base are expected to yield immediate results. Income tax measures in our fiscal dispensation have been designed primarily to achieve the twin objectives of augmenting revenue and promoting investment, although such goals are apparently hard to reconcile. I intend to give here a brief outline on our experience with the major direct tax reforms carried out in the recent years.

Recently we have made a switch over in personal income taxation from conventional exemption method to an income threshold method. At present our threshold limit is Taka 60,000. Income exceeding this limit is subjected to tax under a four stage progressive slab beginning with the initial 10% and ending with the highest marginal rate of 25%. During the last ten years, rate of

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personal income tax has been gradually reduced. In 1986-87 fiscal year, the highest marginal rate of personal income tax was 50%. Similar reduction was made in corporate income tax. In 1986-87 fiscal year, corporate tax rate was 60% for banks, insurance companies, financial institutions, local authorities and private companies, 50% for non publicly traded industrial companies and 45% for publicly traded industrial companies. The latest tax measure enacted in 1997 has stipulated corporate tax rate for publicly traded company at 35% and for others at a uniform rate of 40%. Inter-corporate dividend is taxed at 15%. There has been no change in the recent years in the rate of taxation of inter-corporate dividend.

In the recent past there was serious deficiency in our tax regime to use withholding mechanism for hassle-free tax collection. Prior to 1988-89 fiscal year, the traditional areas covered under withholding system were:

- (a) employment income;
- (b) contract income;
- (c) indenting commission;
- (d) payment to non-resident;
- (e) interest on securities;
- (f) dividend;
- (g) income from lotteries, betting etc;
- (h) a few listed categories of import.

In 1988-89 fiscal year, new enactments were made to cover extensive areas under tax withholding. The new areas brought under the system are:

- (a) bank interest;
- (b) house property income;
- (c) manpower export commission;
- (d) general export;
- (e) sale price of goods publicly auctioned;
- (f) payment by film producers to actors and actresses;
- (g) commission paid by manufacturers to Wholesalers;
- (h) insurance commission paid to policy agents; and
- (i) sale price of urban land and property at the time of its transfer.

Although withholding tax is admittedly the least painful method of tax realisation, its success depends largely on responsible withholding agents and rapid settlement of tax claims with delivery of refund, where due, in the quickest possible time. Due to procedural complications and need for formal

treasury verification, claims of refund cannot be settled as expeditiously as the taxpayers expect. Taxpayers' complaints for delayed refund are almost endemic, frequently undermining relation between them and the tax administration. This development has activated new thoughts and perception to reform the procedure for quick settlement of the claims. We collect nearly 70% of our income tax revenue through withholding mechanism.

There is a general consensus in our country that a large number of taxpayers have remained outside the tax net. This year a package of new laws has been enacted requiring house owners, car owners and persons owning business enterprises in the municipal area for mandatory enrolment with the taxes department. Our presumption is; due to these measures at least three hundred thousand new taxpayers would come within our net. Results so far achieved in widening the tax base by netting new taxpayers indicate that the target may be achievable within the current fiscal year.

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I am giving here a quick rundown of only a few important incentive measures mainly related to investment promotion, employment generation and economic growth. Most of these measures have recently been either renewed or legislated afresh in the interest of the economy despite their immediate unfavourable impact on the resource mobilisation.

(i) Tax holiday is a major incentive in our tax regime. The scheme recently extended up to 2000 is available for any newly set up industry including tourist industry and physical infrastructure facility for a period ranging from five to seven years depending on the location of the facility. Increasingly large number of entrepreneurs are coming forward to avail the scheme. The scheme is expected to help build a viable industrial base by 2000 with enhanced capability to meet our increased resource needs. From revenue point, our experience with tax holiday is however a mixed one. There is a noticeable tendency among many entrepreneurs to report lesser income or even loss in the post tax holiday period in cases where hefty income was reported during the tax holiday period.

(ii) Our incentive package includes 100% ADA (Accelerated Depreciation Allowance) facility as a competing alternative of tax holiday- 100% ADA being spread over a period of three years. Our experience with ADA is not a happy one. The entrepreneurs have not shown any notable interest to this scheme possibly due to the provision of a more advantageous tax holiday.

(iii) A blanket 10-year tax exemption has recently been designed for fishery, poultry, cattle breeding, dairy farming, horticulture, floriculture, sericulture and mushroom cultivation. This facility is available up to year 2000. This fiscal measure has generated enthusiastic response from the investors most of whom find it a "safe heaven" for investing "untaxed income" with legal amnesty.

(iv) A new law enacted this year has distinguished between overseas Bangladeshi non-residents and foreign non-resident individuals. Non-resident individuals, regardless of their political nationality, were taxed at 30% but the new law provides for taxing overseas non-resident Bangladeshis under a progressive tax regime available for resident individuals in the home country. There is no special tax break for a non-resident foreign company on the criterion of its fiscal domicile. A foreign association or body incorporated by or under the law of a country outside Bangladesh is deemed to be a company according to a recent amendment and it is taxed in the same manner as a domestic company.

(v) Investment tax credit is available to all assesseees other than companies. Maximum investment ceiling is 20% of the total income not exceeding Taka 1,00,000. Tax credit is allowed at 15% of the amount invested. Major areas of investment for tax credit are stocks and shares of publicly traded companies and selected saving instruments issued by the Government.

(vi) Dividend income in the hand of an individual enjoys exemption upto Taka 30,000 if the distributing company is publicly traded. Dividend distributed by a private company to its shareholders does not enjoy such exemption. Recently with a view to boosting our fledgling capital market, capital gains on transaction of shares and stocks, both primary and secondary have been totally exempted from tax with opportunity for foreign fund making portfolio investment in the stock market.

(vii) In a recent tax measure, income of leasing companies has been made tax-free for a period of 5 years from the date they operate commercial service. In another measure, industries located in the export processing zones have been made tax-free for 10 years from the date they commence commercial production.

(viii) With a view to achieving the objective of technology transfer and skill development, salaries of foreign technicians engaged in an enterprise under a contract of service approved by NBR is exempted from tax for 3 years from the date of their arrival in Bangladesh. In a recent measure, income of



commercial investment venture between the Government of Bangladesh and a foreign Government has been made tax-exempt for such period as the contracting parties mutually agree between them.

(ix) Self-assessment is an important hallmark of a developed tax system. The system has gradually been made accessible to almost all categories of assesseees. Originally it was limited to individuals, firms and AOPs. Over the last five years the scheme has been extended to private and public limited companies including foreign companies. Though the areas of self-assessment have been widely extended, the level of voluntary compliance is still very low. According to the latest available statistics, about only 15% of the total enrolled taxpayers report their income under this scheme. About another 10% submit their annual tax returns within due date voluntarily. This clearly shows the magnitude of default and delinquency in respect of voluntary compliance. New initiatives are being taken to improve the situation.

(x) Non-resident shipping business and non-resident air-transport business are covered under special tax assessment system. The former category of assessee is required to pay tax @ 8% on the gross-freight income treating such tax as final discharge of liability. The latter is required to pay tax @ 3% on the gross freight income treating such tax as final discharge of liability. Bilateral tax treaties concluded so far provide for reciprocal reduction or total exemption of tax.

(xi) Our self-assessment scheme contains a durable element of tax amnesty for initial capital of new business enterprises reporting their income for the first time. This fiscal indemnity in the latest amendment has been raised in monetary terms to Taka 25,00,000 from the previous limit of Taka 2,00,000, the only major condition being disclosure of at least 25% of such capital as income.

### **Net Wealth Taxation:**

Wealth tax does not give us much revenue yield. Its objective has not been to raise additional revenue but to supplement income tax. During the last fiscal year, wealth tax yield was more than double mainly due to improved administrative management. Wealth tax returns have been simplified and self-assessment in wealth tax has been introduced in a recent amendment. These steps are likely to improve voluntary compliance of wealth tax, though its revenue potential compared to income tax is limited. In our country, the same authority enforces law relating to income tax and wealth tax, the latter being

governed under a separate wealth tax code. Net wealth is taxed after an initial threshold limit of Taka 25,00,000 with a three tier rate varying from 0.5% to 1%, total tax liability comprising income tax and wealth tax not exceeding 30% of total income determined under income tax code.

### **Indirect Taxation:**

Bangladesh had a relatively complicated indirect tax system. It failed to provide domestic resources needed for achieving the macro economic goals. The system relied too heavily on the taxation of imports, which essentially taxed the raw materials and intermediate goods. The import-based taxation performed two related functions. It was both to raise revenue for the Government and also to play a protective role for the domestic industries. The structure of protection again afforded unintended protection to industries, not justified on economic grounds. It thus led to inefficiencies in production and created an overwhelming anti-export bias. Since around 60% of the total tax revenue is collected from import based taxation, revenue collection in Bangladesh effectively became a hostage to the balance of payments situation. The system of excise taxation used for collecting revenue from domestic production and services was also badly flawed. The base was very narrow. There were too many rates and exemptions. In the absence of a credit mechanism, substantial cascading was prevalent. There was also a lack of harmony in regard to the tax treatments of the imports and the domestically produced goods. The resultant effects of all these were a low tax/GDP ratio. Moreover the system of taxation was inefficient, distortionary and inelastic. In the background of this scenario, VAT was introduced in 1991 as a substitute of excise duty and sales tax to combat the above features and to create a stable tax environment with better tax administration and increased efficiency in resource allocation. VAT in Bangladesh has the following features:

- A single stage VAT for import-cum-manufacturing.
- A uniform rate of 15% is applicable for both goods and services.
- VAT on wholesalers and retailers is compulsory for selected items.
- VAT is applicable for all items except some of the unprocessed agricultural products and 35 listed services.
- Exports are zero-rated.
- VAT is leviable at the time of supply of goods and services.
- Turnover tax @ 4% is leviable where turnover is less than 1.5 million Taka.
- Cottage industries are exempted from VAT.
- Tax paid on inputs is creditable against output tax.

- Tax returns are to be submitted on monthly or quarterly basis.
- Luxurious and socially undesirable goods are subject to supplementary duties at different rates ranging from 5% to 350%.

### **Conclusion :**

In this paper an attempt has been made to briefly highlight the structure of our taxation system as well as its evolution as Bangladesh moves ahead on the path of economic development and self reliance. In this process both direct and indirect taxation system will continue to change on the basis of experience and expectation. The ultimate objectives of all efforts in this field should continue to be achievement of self reliance, accelerated economic development and equitable income distribution through increasing the tax/GDP ratio on the basis of a suitable taxation policy. This policy should be viewed in a dynamic context within the framework of a well developed organisational structure and environment.

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# DEVELOPMENT ISSUES AND CONTROL PROBLEMS OF PUBLIC ENTERPRISES OF BANGLADESH - A CRITICAL EXAMINATION

Dr. Shahzad Nasir Uddin\*

## Abstract

This paper examines three development models in order to address the problematical control issues of Bangladeshi state enterprises. The researcher believes that it is inevitable to incorporate economics and accounting for the wider understanding of control issues. This paper analyses three development models, namely, Classical, Structuralist and Neo-Classical Models indicating the implications for control systems of Bangladeshi Public Enterprises. It is concluded here that no single development model would be appropriate to grasp the control problems of Bangladeshi state enterprises. However, these episodes suggest that a political economy approach to development planning could be suitable for the Bangladeshi context.

## 1. Introduction

It was recognised in recent studies that the control issues of the public sector of Bangladesh (e.g. bureaucratic control and politicisation over management) are problematic (Alam, 1982; Uddin, 1987; Hoque, 1993; Hossain and Uddin, 1996a; Hossain and Uddin, 1996b; Uddin and Siddique, 1995; Uddin, 1997). It was also identified that these problems have a strong affiliation with the country's socio-economic and socio-political factors (Uddin, 1995; Hoque, 1993; Uddin, 1987). The Bangladesh Government has initiated the privatisation programme in the context of the public sector inefficiencies, taking a neo-classical prescription from western society vis-à-vis aid agencies. This privatisation programme has been implemented placing emphasis on ownership structure, without paying justified attention to the control problems of the public sector. As a result, the privatisation programme did not give the expected result (Uddin, 1997; Uddin and Hopper, 1996, 1997). So there is tension for determining appropriate organisation structure and proper organisational objectives, where social, political and economic factors affect the whole organisation. To address those issues it is inevitable to refer to social sciences such as economics and accounting. Similarly, the role of control systems in a privatisation programme should be attempted by social scientists incorporating economics and accounting. However, being consistent with this objective, this paper is going to address control issues with respect to different development models elaborated by economists. The following issues are deemed to be necessary for discussion in this regard:

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1. Definition of development.
2. Review of literature regarding different development models and implications of development models in management control system.

## 2. Definition of Development

The term "development" is the most-often repeated word in economic literature. But it appears that development is at once the most fundamental and elusive of concepts (Hulme and Turner, 1990). It is, as Welch (1984, p-4) suggests, "the lazy thinker's catch-all term". But it is a crucial lesson that one should follow Seers' (1977, p-2) suggestion "brush away the web of fantasy we have woven around development and decide more precisely what we mean by it".

Precisely, development means economic development, since economic development indicates a high rate of GNP etc. In this case economic development is more familiar as economic growth which avoids a total view of development. But it became evident that the above definition was not appropriate for developing countries. So, social scientists redefined development in terms of progress towards a complex of welfare goals (Hulme and Turner, 1990). Seers (1977, p-2) defined development as the realisation of the potential of human personality allied to three goals-guaranteeing the provision of basic needs, the creation of full employment and the reduction of inequality. Related definitions of development in terms of the pursuit of a variety of basic needs have dominated the academic and government literature into the 1980's (Streeten et.al., 1981). These definitions included also access to employment opportunities, personal security and civil rights with the minimum needs for physiological well being (food, shelter, clothing) and basic services (health, education, clean water). The literature of basic needs in development is very extensive (see Sirinivasan, 1977; Dell, 1978). Development economists no longer consider only the improvement of GNP; rather they emphasise the quality of the development process. Variations between specifications of basic needs indicate that development definition or development objectives are grounded in the personal values of those involved in the activity (Hulme and Turner, 1990). So recently one argument is more debatable, that is: Who defines the development? Is it politicians, experts or those whose lives are to be improved? Here one forceful argument (Hulme and Turner, 1990, p-5) is that development must be defined by those whose lives are to be improved, rather than by technical experts or politicians, and must incorporate an explicit recognition of the need for the empowerment of the poor.

However, the above definitions frequently bear little resemblance to the perceptions of those in power and to the practice of development. So development explanations are subject to judgmental disagreements when they are

applied to individual objectives for the operational purpose of policy formulation and measurement of development (Colman and Nixson, 1986). Individual objectives collectively constitute society objectives which are supposed to be reflected in the development plans of particular country. Those desirable objectives drive economic development, which varies from country to country. In the case of developing countries, the development process should be linked with policy issues with a view to alleviate their poverty, reduce inequalities, accelerate growth rate and so on. Otherwise, problems like unequal income distribution, unemployment problems, low income can not be solved only by relying on past strategies of development planning, capital accumulation and foreign aid (Meier, 1984). Those problem solving policies are inevitably related with social, political, cultural and economic factors. But the problem is there is no complete understanding of these socio-cultural and socio-political factors which constitute desired objectives and how socio-cultural and political development contributes to economic development and is in turn determined by it. In this respect more interdisciplinary studies are important for understanding different development models with reference to developing countries.

From the above discussion it is apparent that the concept of development is viewed differently because development depends on social values, life styles and preferences which have no scientific specification. The precise meaning of economic development is problematical for specifying and prioritising the conditions to be ameliorated, and for indicating the means of attainment. For most writers authentic development is perceived as being broadly concerned with the improvement of the conditions of existence of the majority of the population and particularly of the poorest (Hulme and Turner, 1990, p-6). It is supposed to be a beneficial process which carries with it not only the idea of economic betterment, but also of greater human dignity, security, justice and equity (Brandt Commission, 1980, p-48) (cited from Hulme and Turner, 1990, p-6). However, different schools of economics postulated different development models and in those models development meanings did change. The next sub-sections will discuss those views.

### **3. Economic Development Model and Implication for Control**

#### **3.1 Classical Growth Theory**

Adam Smith, Thomas Malthus, David Ricardo and John Stuart Mill, who are called classical economists, attempted to define economic growth with variables like capital, population and labour. The economic growth process described by Smith is that the economy grows by re-employing its primary factor, labour,

under conditions which enable that labour force to produce a surplus. This requires firstly that productivity of labour should exceed the real wage rate. Secondly, as the re-employment of labour is constrained by the supply of consumer goods that labour requires, what matters for growth of output is the productivity of labour in wage goods production on the one hand and the proportion of a labour force employed in that line of production on the other. There is no endogenous mechanism to determine the latter (Chaudhuri, 1989). Smith assigned a major role to capital accumulation or investment in the growth process. For him, capital is the main determinant of the number of useful and productive labourers that can be set to work (Meier, 1984). Smith did not assign any government role to development. He argued that government intervention would handicap the positive forces of growth. Individuals should be free to act on their prosperity, to trade, barter and exchange one thing for another and to pursue self-interest. Competition and market forces would act as an invisible hand to bring self-interest into harmony with public interest. Public spending should be kept to a minimum and production in the public sector should be limited to that small share that could not be supplied by private enterprise. The sovereign duties were limited to defence, administration of justice and the maintenance of some public works, the profit from which could never repay the expense to any individual (Meier, 1984). Smith argued, "little else is required to carry a state to the highest degree of opulence from the lowest barbarism, but peace, easy taxes, and a tolerable administration of justice" (cited from Chaudhuri, 1989, p19-30).

### 3.1.1 Implications for Control Issues

Classical growth theory finds economic development emphasising the private sector and keeping the public sector away from development. The theory argued that state intervention distort markets, labour productivity and so on. The private sector is driven by the profit motive of the entrepreneur. By exploring technical innovation and labour productivity, a firm will earn profit. Markets will act as the deciding factor for combining factors of production. Thus, it is assumed that the management control system will be designed in order to grasp market signals. Managers have only one objective i.e. profit maximisation. Having this one function, they want to survive in market competition by making appropriate strategic decisions. In a classical economy, competitive advantage depends on labour productivity and technological innovation (which are complementary in a firm) and market competition is determined by these two factors. It is also assumed in a classical economy that managers behave rationally. As rational managers, they formulate a control system to gain the objectives of the enterprise. Top management, divisional managers, supervisors and workers in every respect act rationally, being motivated by reward for their performance. Appropriate

performance measurement can be established to control divisional managers, who can control lower level managers and workers. It seems from classical arguments that in business enterprises the principal-agent relationship is clear. In a sense, agents, i.e. top management, act according to owner expectations, i.e. profit maximisation, since the strength of profit affects the wealth of managers through their fringe benefits from the organisation. So, top management have their own motivation to make the organisation more efficient and in turn a reward structure can be rationally designed for an appropriate control system. The owner can also gain information or perceive the organisation through market reaction because there is a profit market, as assumed in classical growth theory.

Apparently, the management control system under classical growth theory is based on the ideal world. Firstly, the classical growth theory assumes that organisations have only one goal; in turn, the system can work rationally to implement that goal, i.e. profit maximisation. But organisations are collectively constituted and may have multiple organisational goals simultaneously, and the goals may fundamentally contradict one another (March and Olsen, 1976; Seers, 1977; Perrow, 1986). For example, workers may seek to increase wages, which, in turn, reduce the profit of the organisation, or government guidelines to the organisation may not be attainable by it. Social class differences may also become a barrier to attaining single objectives. So, organisational goals are difficult to define theoretically and measure practically. Therefore, it seems that the management control system under classical theory is unable to face those irrational (?) difficulties.

Secondly, classical growth theory assumes that a perfect market exists and a management control system could exploit this situation. But the fundamental question is whether perfect market mechanisms exist in a real situation. It has been identified that perfect market mechanism does not prevail in the developing world and it is very common in those countries that government plays an active role in market mechanism. Government distorts market signals through taxation and other public finance adjustments. In a third world country, monopolistic and oligopolistic markets do exist. So a competitive market is far away in those countries. Given this situation, the classical growth theory argument to profit oriented and market driven organisations has little relevance to the reality and it is hard to design an appropriate control system under classical philosophy.

Thirdly, the basis of classical theory is profit maximisation. This concept leads to economic development and growth through capital accumulation, improving labour productivity and technological innovation. But it seems unsuitable for the developing world because they have a lack of capital, incomplete markets and so



on. In other words, this mechanism is not sufficient to reawaken the underprivileged but essential sectors of the economy. So, governments have to intervene there by running the underprivileged and unprofitable sectors. Rational management control system under classical philosophy does not consider this situation since it believes that an organisation should lead by one objective i.e. profit maximisation. Welfare objectives of an organisation are quite absent in a classical world. So the vital question is how management control would react to those welfare objectives? The classical theory fails to answer this question.

In Bangladesh, the market mechanism is very poor. Product and factor markets cannot be driven by market forces such as demand. This situation gives rise to the government's intervention and the monopolistic environment. Political instability and infrastructural problems also reduce the smooth functioning of the market. Management control does not work properly because markets do not give signal properly. Given these circumstances, there is no role for classical theory to play. The public sector of Bangladesh has suffered by excessive bureaucratic controls. Classical growth theory finds market control as the guiding factor but in Bangladesh bureaucratic rigid rules fixes the price and production plan. Bureaucratic control also spreads over the private sector. Bureaucrats take decisions following certain rigid rules and regulations in the public sector without paying much attention to markets and competition. But classical theory does not believe that such bureaucratic control has any role to play in entrepreneurial activities.

The first section acknowledged that politicisation over management is one of the control problems of public sector enterprises in Bangladesh, which has been identified as a chronic disease of our society. Here, first of all, classical growth theory does not consider the role of the public sector in the development process and naturally it is silent on this issue. But, not surprisingly, the public sector has been playing a vital role in the Bangladeshi economy since independence (see Alam, 1982; Uddin, 1987). Given this situation, the classical growth theory is not simply able to explain the control problems and development processes of Bangladesh.

### 3.2 Structuralist Views

Classical economic assumptions do not hold in the developing countries and this realisation of economists led to the new definition of economic development, namely structuralism. It takes a broader view of economic growth as one aspect of the transformation of the structure of production that is required to meet changing demand and to make more productive use of technology. Structuralists

do not believe that equilibrium will be established without any intervention and disequilibrium in a society is such a condition where structural change should occur. Chenery (1986) argued in this regard "... given imperfect foresight and limits to factor mobility, structural changes are most likely to occur under conditions of disequilibrium; this is particularly true in factor markets, thus a shift of labour and capital from less productive to more productive sectors can accelerate growth. Structuralist economists find disequilibrium a barrier to growth and argue that reallocation of resources to productive sectors would be removal of this barrier" (p-97). On the other hand, in classical and neo-classical theory, it is assumed that efficient allocation of resources (Pareto optimality) would be possible. The structural approach focuses on differences among sectors of the economy that may inhibit equilibrating adjustments in resource allocation so that it does not assume optimal allocation (Chenery, 1986). In this regard Lal (1980) asserted that any real world market is not likely to be Pareto-efficient, first because of technological indivisibilities which lead to increasing returns in production over a range that is large relative to the economy and secondly, because of the transaction costs attached to markets (including the cost of exclusion as well as those of acquiring and transmitting information). Consequently, many markets will not exist or else will be imperfect. Disequilibrium is more often manifested by the differences in returns to labour and capital in different uses than by the shortages and surpluses that indicate the complete failure of markets to clear (Chenery, 1986).

For structuralists, structural analysis is an important tool for policy making in developing countries which hold all economic problems like distorted factor markets on which structural analysis is based. "Structural transformation of the developing countries is the set of changes in the composition of the demand, trade, production and factor use that take place as per capita income increases..... More specifically, changes in demand and trade may affect the sources of growth as much as the changes in factor supply that have been stressed so far" (Chenery, 1986 p. 31-32). Structuralists believe that state intervention could accelerate the rate of development. Eventually, this approach emphasises central planning for new physical capital, utilising reserves of surplus labour and adopting import substitution and industrialisation policies. Therefore, active state participation is urgently needed to formulate development policies which will ultimately bring growth of GNP and industrialisation based on import substitution (Bhagwati, 1984).

### 3.2.1 Implications for Control Issues

This programme expands the public sector role in an economy. Public sector enterprises emerge as an effective way of resource allocation to transform the structure of the economy. The public sector as an institutional form appears as an alternative control model in place of market control since structuralists view market control as a poor device. It has been seen that the market structure of developing countries is imperfect. So, especially in developing countries, public sector enterprises have emerged as structuralist weapon for development. However, in order to fulfil structural objectives, public sector enterprises have to play a beneficial role. A very effective control system needs to be employed in those enterprises to accelerate economic growth. So top management or policy-makers of those enterprises should devote themselves to define organisational goals, structures, preferences and incentive systems to establish an effective control system. However, the crucial problem of the public sector is to define organisational goals. As a device of structural transformation the public sector should be concerned with welfare activities, but as an enterprise it has to set objectives for profit maximisation. So trade-off between two vital objectives is hard to decide. Apart from this, other interests also affect organisational goals. Nevertheless, structural transformation needs careful planning for the development process of the country. In practice, these processes are subject to political decisions and bureaucratic mechanisms. Political decisions come from different political parties. It is very common in developing countries that newly elected governments deliberately change the policies of the previous government to gain political advantages. So it certainly hampers the role of the public sector. Frequent changes in policy in the public sector restrict the smooth functioning of public enterprises. For example, in Bangladesh, the Awami league government (1971-1975), according to their socialistic philosophy, used public sector enterprise as a vehicle to accelerate the development process of the country, whereas the next government changed these processes immediately after they came into power. This situation indicates that politicisation in state enterprises is very likely. On the other hand, bureaucratic control is also prominent in the day-to-day operation of the public sector in developing countries. For example, the administrative structure of the public sector in Bangladesh is dominated by three-tier control systems rather than delegated management systems (See Alam, 1982; Uddin, 1987; Hoque, 1993). Bureaucratic processes cause delay in purchasing, production and other necessary functions of the public enterprises. Consequently, the public sector fails to take timely decisions and hardly achieves the objectives of the enterprise. Thus, MCS (Management Control Systems) of public sector of Bangladesh is really burdened by bureaucratic rigid rules and regulations and

politicisation. How can this problem be removed? This question remains unanswered under this model.

Structuralists view development as the transformation of factors of production from less productive to more productive sectors using public sector mechanisms. But the control problems in the public sector provide restrictions to the transformation of the economy. Structuralists assume that the public sector will run smoothly without any politicisation or excessive bureaucratic control, enterprise can be operated as hybrid organisations, e.g. with both welfare and profit maximisation as objectives. But in Bangladesh, it has been seen that public enterprises are suffering from problems like politicisation and excessive bureaucratic control. So it seems that the structuralist view of development in the formulation of proper control system for those enterprises is problematical and not very compatible with those situations.

### 3.3 Neo-classical Theory

Structural theory's shortcomings for economic development motivated economists to think about new approaches to it. During the 1970's and 1980's economists tried to see world development in a new shape. Neo-classical economics can be described as "... a paradigm that tells one to investigate markets and prices, perhaps expecting them often to work well, but also to be on the watch for aberrations and ways of correcting them. Perhaps the single best touchstone is a concern for prices and their role" (Little, 1982, p- 25-26). The main thrust of neo-classical theory is towards demonstrating that a growing economy is not inherently unstable as suggested by Harrod (1948). That is, with a given technology, an economy would tend to grow with full employment, constrained only by the rate at which that ceiling is rising i.e. by the rate of growth of the labour force. If the full employment equilibrium is disturbed, the economy tends to revert to an equilibrium position (Chaudhuri, 1989). Neo-classical economists find growth - GNP rises as the result of long-term effects of capital formation, labour force expansion and technological change, which are assumed to take place under conditions of competitive equilibrium. Shifts in demand and the movement of resources from one sector to another are considered relatively unimportant because labour and capital produce equal marginal returns in all uses (Chenery, 1986). So, the sources of growth according to neo-classical economists are capital accumulation, increase in labour quantity and quality and total factor productivity within each sector. Neo-classical theory also argued that inequalities would be removed by Pareto optimality (efficient allocation of resources) and that the economic system had sufficient flexibility to maintain equilibrium prices.

For neo-classical theorists, it removes the problems of price distortion and market imperfections within an economy. Here applied research was placed on neo-classical models with specific context, and policy makers under neo-classical philosophy obtained some insights from those researches (Meier, 1984). However, some recommendations from development plans and policies of neo-classical prescriptions are as follows:

1. Liberalisation: Policy makers have advocated an increased role for markets and price mechanisms. They emphasise liberalisation of the foreign trade regime and export promotion (Balassa, 1982).
2. Removal of interventions: Policy makers find state interventions as the main root of distortion of market mechanism which leads them to advocate removal of various forms of government interventions in product and factor markets (Cook and Kirkpatrick, 1988).

The above policies are represented in the privatisation programmes undertaken by both the developing and developed worlds and it is treated as the main weapon of development.

3. Professionalism: Policy makers also advocated increased professionalism in project appraisal (Meier, 1984). This policy also led to privatisation of public enterprise.

### 3.3.1 Implications for Control Issues

As stated earlier, the role of public enterprise is discouraged by neo-classical economists in the belief that this would distort market and price mechanism. The private sector would be a panacea for economic growth and efficient allocation of resources. Neo-classical prescriptions gave birth to the privatisation programme as the remedy for the inefficiency of public sector enterprises.

Neo-classical economists rely on price and market control as contributory factors to run an enterprise. This puts price and market control in place of political and bureaucratic control. They believe that the removal of state control or ownership changes will automatically remove bureaucratic and political control over the enterprises. It is also assumed that price and market mechanism can be perfectly established even in developing countries. But, in many developing countries, as stated earlier, the price and market mechanism is completely unorganised and imperfect. These mechanisms are also politicised and bureaucratised in developing countries (Sobhan and Ahmad, 1980). Political affiliation or bureaucratic control from any sort of institutional arrangement is hard to remove.

The need is to change the whole society. Therefore, simply ownership change might not make any difference.

The neo-classical prescription indicates that market competition is the main requirement for the achievement of development objectives. But in Bangladesh, as a typical third world country, it has been seen that monopolistic and oligopolistic competition, price distortion and unorganised capital markets are natural problems. So market and price mechanisms are seen to be ineffective in Bangladesh. Consequently, Management Control Systems under the neo-classical economy approach is unable to formulate an appropriate control system.

Politicisation over management is also separate from ownership criteria. For example, in Bangladesh, private sector management is also constrained by politics and guidelines of government. Apart from this, political turbulence is natural and taking unfair political advantage is not considered malpractice in Bangladeshi society. So, given these circumstances, how would MCS under neo-classical theory treat this situation? Bangladeshi control problems cannot be addressed by the neo-classical economy approach because of their extreme assumptions about society and the economy. This approach is too normative in explaining the situation in such countries.

#### 4. Conclusion

This paper has attempted to highlight three development models and tried to relate these to control systems specially in the Bangladeshi context. Different models have different underpinnings of control systems and in turn they produce different consequences. In Bangladesh it is clear that no single model would be appropriate to explain and address the control problems. A new approach to development should be put forward which would be based on social, political and cultural factors. In other words, a political economy approach to development plans may be favourable in Bangladesh, as it emphasises contextual factors.

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## FISCAL MANAGEMENT

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### Introduction

Fiscal policy is a very important instrument for a country's overall economic management. Any government has to incur expenditure for undertaking different activities of administrative, developmental and welfare nature. The resources needed for this are derived from tax and non-tax revenues. Generally, revenue falls short of expenditure. The gap or the fiscal deficit is financed by feasible mixes of bank, non-bank and foreign borrowing. The size, composition and nature of revenue and expenditure have powerful influences on the economy. On the positive side, a well designed policy for generation of revenue can make the resources available for implementing the government's development programs. Similarly, a suitably designed expenditure program with appropriate quality and composition of different items of expenditure, can lay the foundations of rapid economic development through providing the required social and physical infrastructure side by side with addressing the problem of poverty alleviation. On the negative side however, even the most carefully designed revenue and expenditure programs can have undesirable effects on savings, investment, distribution and growth as well as the general level of welfare.

### Main Objective of Fiscal Management

Investment is a major requirement for ensuring economic growth. The ultimate objective of fiscal management is thus to be able to maintain investment as a proportion of GDP at a reasonably high level and make the required resources available for growth. It should be possible to bring about a net increase in different productive assets every year. In order to ensure this, annual investment has to exceed annual capital replacement requirements. Through appropriate fiscal management, it should be possible to increase investment by ensuring –

1. domestic resource mobilization at high and rising levels, basically through designing more elastic and less distortionary tax policies;
2. stronger tax administration designed to minimize evasion;
3. tighter control of current expenditure; and
4. proper design and implementation of public investment programs.

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In addition to the above, fiscal deficit, referred to earlier, in itself has important implications for both external and internal stability, as it can adversely affect domestic prices, interest rate and domestic debt on the one hand and exchange rate, current account balance and external debt burden on the other. Fiscal management then broadly refers to the management of revenue and expenditure programs of the government, both separately as well as in conjunction with each other, while keeping careful watch on the level, modes of financing and dynamics of fiscal deficit. In more simple terms, fiscal management deals with the issues relating to how efficiently each Taka of revenue is mobilized and how productively and judiciously it is spent.

## **Revenue Generation or Resource Mobilization**

### **Tax Revenue**

The main endeavor of any government with regard to financing its expenditure should be concentrated on providing increasing amounts of resources from domestic sources. This is unavoidable for increasing expenditure on infrastructure and reducing fiscal deficit, in view of reduction in recent times in external resource inflows. At present, over 80 percent of the domestic resource in Bangladesh comes from tax revenues and the remainder from non-tax sources. Out of the total tax revenues, direct taxes account for only around 21 percent and indirect taxes account for the remaining 79 percent.

An ideal tax system, whether direct or indirect, should have low rates and broad base. There should be as little exemptions, exclusions and items subject to special systems or incentives as possible. The tax system should be simple and the taxes should be easy to pay, administer and monitor. The tax system should be elastic, non-distortional and neutral with respect to resource allocation. Individually, it may not be possible for each tax to be equitable. However, all the different tax systems in place could together better deal with equity issues. In fact, it is not advisable to too much tamper with tax system for the sake of equity. Experience has shown that a well designed expenditure program is better equipped to address equity or distributional concerns. Ideally, a particular tax should target a particular objective. Thus, customs duty should play a protective role, VAT and income tax should have a predominantly revenue role while an excise or supplementary duty, could, by taxing luxury goods impart some progressivity to the system.

Once an ideal tax system is in place, the more important task is one of administration, monitoring and management. There should be transparency in

operations and flow of information and full accountability. Designing a sound tax system is only half the work done. The other half is tight implementation for tax compliance, to a great measure voluntarily but at least to some measure, compulsorily.

The table below shows tax and non-tax revenue as well as total revenue as percent of GDP in Bangladesh in recent years.

**Table 1 : Revenue as Percent of GDP in Bangladesh**

	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
Tax Revenue	7.7	8.5	9.5	9.6	9.5	9.4	9.8
Non-tax Revenue	1.7	2.0	2.2	2.3	2.6	2.5	2.2
Total Revenue	9.4	10.5	11.7	11.9	12.1	11.9	12.0

*Sources : Budget Documents and BBS.*

The resources mobilized domestically in Bangladesh as percent of GDP is low even by South Asian standard. The comparison is usually made with reference to the Tax-GDP ratio or the tax effort which continues to remain fearfully low in the face of major tax reforms undertaken in the current decade, which actually resulted in some measure of systemic, structural and administrative improvements in case of different taxes.

Although, the tax effort has increased following the introduction of VAT in 1991, the increasing trend has more or less leveled off thereafter. VAT is an efficient, broad based and revenue productive system of indirect taxation but problems of weak management and a lack of appreciation of its systemic features have resulted in substantial non-compliance as indicated by the low ratio of actual base to potential base of VAT. With regard to the other main indirect tax --- import duties, substantial progress has been made in reforming rate structures: high rates have been significantly lowered, number of duty slabs drastically cut down, dispersion among rates reduced and user specific rates eliminated to a great extent. In spite of these reforms, customs duty still remains a source of economic distortions.

With regard to income tax, which accounts for most of the direct taxes, in the last few years the rates have been significantly lowered for personal income taxes. Some rationalization of rates has also taken place in the meanwhile in case of the corporate taxes. Certain special incentives of generous yet unproductive nature have also been eliminated although one of the most significant of them, the tax

holiday still continues. The tax base as represented by the number of tax payers is still small. This has in fact constrained further needed reforms of the distortionary import duties – as in the face of revenue constraints, it would be unwise to reduce import duties which at present perform an overwhelming revenue role, although they should ideally play only a protective role.

From a design point of view, the effects of income taxes on savings, investment, labor supply and distribution are important concerns. Emphasis on revenues is bound to have some adverse effects on them. Care has to be taken to minimize them wherever practicable. With regard to the indirect taxes, the important concerns relate to distortions in case of resource allocation, regressivity, rise in prices and reduction in consumer welfare. Again, due care has to be taken to keep them at the minimum. As indirect taxes are more regressive and distortional, there should ideally be more dependence on direct taxes for revenues rather than on indirect taxes. But this seems to be a function of the stage of development.

### **Non-Tax Revenue**

Management of the non-tax revenues, which currently account for around 20 percent of total revenues and over 2 percent of GDP, is a difficult and challenging task. These revenues are generated from sources that are diverse as well as large in number. The administration of these sources is not within control of the Finance Ministry. Although, each source is under one or the other line ministry or department, revenue possibilities seem to arise more as a by-product of operations rather than as a defined objective. As a result, ensuring collection, transparency in operation and monitoring have proved difficult. The important management issues here are: ascertaining the correct legal bases; identifying areas of leakages, evasion and non-compliance; raising collection to levels as close as possible to the legal or potential bases by streamlining administration and enhancing transparency of operations; modernizing rate structure; identifying new sources and modernizing collection procedure, supervision, monitoring and flow of information.

Although substantial reforms have been implemented in case of taxes in Bangladesh during the current decade, no notable reform or improvement could be done in case of the non-tax revenues. Any increase of non-tax revenue has been almost by default rather than by design. Even no study or analysis seems to have been conducted to assess the potential and flag important issues.

## Public Expenditure

There seems to be nothing wrong in public expenditure as percent of GDP being high provided (i) it contributes to building social and physical infrastructure, human resource development and poverty alleviation and encourages private investment; (ii) it restricts unproductive current expenditure to the minimum and (iii) it is mostly financed from domestic resources. Thus, in designing a public expenditure program, both resource availability and quality (capability of enhancing the productivity of private investment as well as that of human capital) of both current and development expenditure have to be kept in view. Table-2 below gives the amount of total public expenditure and its constituents as percent of GDP.

**Table 2: Public Expenditure as Percent of GDP**

	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
Total Public Expenditure	15.0	15.2	15.9	17.5	17.6	16.8	17.0
Current Expenditure	8.7	8.6	9.0	8.8	8.8	9.1	8.6
Development Expenditure	6.3	6.6	6.9	8.7	8.8	7.7	8.4

Source: IMED, Planning Commission.

It is observed that (i) the ratio of total public expenditure to GDP has been significantly higher than that of revenue to GDP over the years (by comparing with Table-1) implying that there is substantial deficit and (ii) the ratio of current expenditure to GDP has been higher than that of development expenditure to GDP. Although current expenditure has certain items of development nature and vice versa, current expenditure indeed has quite a large share in total public expenditure. However, the growth of development expenditure has been somewhat faster than that of current expenditure in recent years.

## Design of Current Expenditure

A key target of current expenditure should be to make more funds available to higher priority social services like health, education, family planning, youth and cultural development, women and child welfare as well as for operation and maintenance in relation to road, flood control, irrigation etc. Another key target would be to keep the growth of current expenditure under check by reducing subsidies, losses of public enterprises and reducing expenditure in low priority purposes and rationalizing manpower. Current expenditure could also be kept under check by limiting large cost overruns by departmental enterprises which

have more financial independence. As a measure of limiting current expenditure, its growth rate could be kept below that of nominal GDP. The rationale is that if revenue rises with GDP more than proportionately i.e., is elastic, then current expenditure could be kept within financeable limits without generating inflationary tendencies. However, ways to limit individual items of expenditure need to be evolved for imparting required fiscal discipline. Limiting current expenditure by way of fiscal prudence may often require actions which are politically difficult. If such actions are not however feasible, then the inevitable outcome would be to drastically cut down on the financing of high priority development expenditure.

### **Design of Development Expenditure**

First of all, development expenditure should not have a size that cannot be supported by the available resources, both financial and physical. High priority should be given to improvement of physical infrastructure in flood control and irrigation, transportation, communication, power and gas, development of water supply, sanitation and rural roads as well as improvement of social infrastructure through primary education, primary health and family planning and bringing distressed women and children into the mainstream of development. The main objective here is to lay down the social and physical foundations so that the private entrepreneurs can enhance productive activities in both agriculture and industry. Public resources should be allocated in such a way so as to address the key objectives of rapid growth, poverty alleviation and employment generation through human resources development. Resources generated from taxes and raised from external sources should be devoted only to high priority projects and essential services as efficiently and as cost effectively as possible.

### **Supervision of Resource Use**

For accelerating timely use of foreign resources, items of development program have to be prioritized in such a way that sufficient local funds are available for implementing aided projects. Periodic review of implementation of on going projects may lead to cost savings and dropping of low priority projects. Intensive monitoring of high priority projects is also essential. Efficient project administration is necessary for avoiding both time and cost overruns. The trend as well as pattern of public expenditure, both current and development, has to be continuously monitored and controlled by employing modern planning, budgeting and accounting techniques.

## Fiscal Deficits

In between the public expenditure and public revenue lie the fiscal deficits, which are the biggest cause for concern to the policy makers. The fiscal deficits during the current decade are shown in Table-3 below:

**Table 3: Fiscal Deficits**

(Percent of GDP)

	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
Fiscal Deficits	7.2	5.9	5.9	6.0	6.8	5.7	5.1
Net foreign Financing	6.2	4.9	5.6	4.9	4.9	3.6	3.6
Net Domestic Financing	1.0	1.0	0.3	1.1	1.9	2.1	1.5

*Source: Ministry of Finance.*

As indicated above, fiscal deficits can have various adverse implications for the economy of a country. Their impacts on the economy depend on the modes of financing the deficits. In fact, balancing these impacts on different sensitive macroeconomic variables causes big anxiety as well as challenge in fiscal management.

Broadly, there are three modes of financing the fiscal deficits:

- (a) **Domestic bank borrowing:** This includes borrowing from both the central and commercial banks. If the borrowing is directly from the central bank, this leads to money creation which may consequently lead to rapid inflation. Increase in money supply may increase imports, put pressure on the foreign exchange reserves and worsen the current account deficit. On the other hand, if the borrowing is from commercial banks, this may leave less resources available for the private sector borrowers and thereby dampen economic activity.
- (b) **Domestic non-bank borrowing:** This mainly includes borrowing through the sale of national savings instruments. Increased borrowing through these schemes generally diverts resources away from bank deposits and thus adversely affects both the borrowing and the lending rates of interest. This again discourages private investment. Higher interest rates to attract savings through these schemes also divert resources away from the stock market. As fiscal deficits add on to the outstanding stock of debt, excessive domestic borrowing to fill up the deficits may precipitate a domestic debt crisis.



- (c) **Foreign Financing:** This is in fact the biggest source of financing the deficits. Part of this is grants and part loan. The disbursement of foreign aid in recent years is shown in Table-4.

**Table 4: Disbursement of Foreign Aid**

(In million US\$)

Fiscal Year	Grants	Loan	Total
1991-92	817	794	1611
1992-93	818	857	1675
1993-94	710	849	1559
1994-95	890	849	1739
1995-96	678	766	1444

Source: Ministry of Finance

Financing the fiscal deficit through external borrowing has the risk of exposing the economy to a debt crisis through widening the current account deficit and leading to appreciation of the domestic currency, discouraging exports.

In addition, borrowing at commercial rates may be costly for the economy for the present as well as for the future when the debts become due for payment. Any default would reduce the country's credit rating and make it more vulnerable to external economic shocks. On the other hand, scope for borrowing from concessionary sources is limited and is becoming more scarce day by day. As of June 1996, Bangladesh's outstanding external debt at US\$ 15.16 billion is equivalent to about 48 percent of the country's GDP for 1995-96. The debt-service ratio measured by ratio of principal and interest to export earnings at 11.4 percent, as of December 1996, is however still at a manageable level. On the other hand, total domestic outstanding debt as of June 1996 was Tk 16643 crore, equivalent to 13.0 percent of GDP. Thus, the total outstanding debt at the end of 1995-96, stood at 61 percent of GDP – which is quite high by any standard. Hence there is the need to contain the fiscal deficits by keeping them within sustainable limits, so that they do not further add to the existing stock of debt.

It should however be mentioned here that the impact of fiscal deficit on the economy also depends on the composition of public expenditure. While in certain cases, public expenditure substitutes private expenditure, in other cases public expenditure may complement them. However, given the fact that fiscal deficits have highly undesirable implications for the economy, in all fairness they should be kept under check. It is necessary not only to keep the levels of individual items of borrowing separately under control, because of their interactive nature there has to be appropriate coordination of the different sources of borrowing as well.

## **Fiscal Management as Part of Overall Macroeconomic Management**

The task of fiscal management has to be closely coordinated with that of overall economic management of the country. For example, if fiscal deficits are up leading to an increase in interest rate, private investment may be discouraged, leading to lower growth. The decline in investment will dampen stock market activity. Imposition of more taxes to raise revenues may also discourage stock market investment. On the other hand, expenditure on non-traded items that accompanies the fiscal deficits will lead to currency over valuation and reduce exports as well as increase imports. This will again cause a deterioration of the current account in the balance of payments. On the side of exchange rate policy, if there is a devaluation, imports may decrease because these are now more expensive, leading to a reduction in import duties and thus widening of fiscal deficits. The devaluation will also worsen the burden of debt in Taka terms and thus affect the fiscal deficits. Similarly, from the side of trade policy, a reduction in tariffs will reduce revenue and widen fiscal deficits. Finally, from the side of monetary policy, an increase in money supply, by raising the price levels, may increase the nominal value of public expenditure (if the government wants to keep real expenditure at planned levels) and widen fiscal deficits. There are other channels of interactions between fiscal policy and other macroeconomic policies as well but these are only some instances underscoring the need for coordination between fiscal management and general macroeconomic management. Appropriate fiscal management has to keep all these interrelationships in constant review.

### **Other Fiscal Issues Needing Careful Attention**

- a. **Management of Internal Debt:** In Bangladesh, the government lends considerable amounts of money to the state owned enterprises and also to the departmental undertakings like Railways and T&T Board. It is necessary to keep the register of these debts continuously updated through timely monitoring in order to ensure repayment and keep the debt from growing explosively, for the sake of fiscal discipline.
- b. **Public Enterprise Pricing:** This is another area which needs careful attention. It is necessary to ensure appropriate pricing of public sector goods and publicly provided services so that these reflect market conditions. This also has clear implications for revenue and budget as well as for reducing inefficiency and economic distortions.

## Conclusion

Fiscal Management occupies a central position in overall macroeconomic management. It lies at the heart of the very concept of state itself and the functioning of the government. The collective provision of services, which the private sector cannot deliver satisfactorily, is the responsibility of the state. The rendering of these services requires marshalling of resources. Since these services are meant for the people, they pay taxes as token of their participation in defraying the required expenditure. But the taxes have to be collected while ensuring minimum side effects. Since the money that people part with as taxes actually belongs to them, this has to be spent judiciously enough to bring the biggest common good to people. Money that is taken out of the economic stream has to be returned to the same stream in more productive pursuits for maintaining and accelerating the pace of economic activities. Also when expenditure exceeds revenue, the difference has to be met in such a way that it brings the minimum possible difficulty to the economy and hardship to the people. Fiscal management is thus a serious responsibility, not a casual one. Living up to this challenging responsibility is a goal worth striving for.

# THE MANAGEMENT ACCOUNTING FUNCTION - AN ESSENTIAL TOOL FOR EFFECTIVE FINANCIAL CONTROL IN GOVERNMENT

John McMurrin \*

Dr. Mohammad Hassanul Abedin Khan \*\*

## Introduction - Existing Accounting Environment

Widespread financial reforms have taken place throughout the Bangladesh Government during the 1990s, changing inter alia financial rules and regulations, the speed of collection of financial information and the level of detail in which it has been produced. The emphasis of financial reporting has to date been on the production of financial accounts, which focus on publishing, in high level detail, income and expenditure for the reporting period.

There are two major sets of financial accounts published on an annual basis:

**Appropriation Accounts** are the most detailed annual financial accounts prepared by the Office of the Controller General of Accounts and by some other departmental accounts offices. They are produced for each individual Vote and are subject to audit by the Office of the Comptroller and Auditor General; the Principal Accounting Officer who supervises the allocation and expenditure of the voted monies is responsible for the related accounts.

The accounts are prepared largely on a cash basis with adjustments for inter-Agency transactions, and there is a limited economic analysis detailing both expenditure and monies voted, with a comparison of expenditure against Vote.

The **Finance Account** is an overall receipts and payments account for the Republic, stating receipts and payments in total and making no distinction between Votes. Again, the account is produced at the Office of the Controller General of Accounts and audited by the Office of the Comptroller and Auditor General.

Both these sets of accounts are presented to Parliament approximately one year after the financial year end, and they are also published for the use of interested parties.

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## The Need for Management Accounting

The financial accounts described above form a major part of the means by which the expenditure of Government is regulated. Parliament, development partners and other interested parties use the published accounts to assess the propriety and efficiency of the use of funds.

However, since the published accounts are produced approximately one year in arrears, expenditure incurred early in a financial year is only reported upon almost 2 years after the expenditure was incurred. With the financial reports covering a full year, it is impossible to assess trends during financial years, and there is insufficient economic detail in the Appropriation Account for the user to make low-level analyses.

Due to the standardised reporting requirements inherent in all such public accounts, there is little opportunity to tailor the financial reports for practical use in the performance of the finance function in Government.

Managers within Government require the production of financial information which will enable them to more effectively monitor and explain performance against targets and to subsequently take corrective action on a timely basis. In addition, development partners, especially those who do not get directly involved in the management of their development inputs, will require assurances as to the propriety and efficiency of the use of funds; mere scrutiny of annual financial accounts will not achieve this.

It is therefore obvious that the financial accounts currently produced are insufficient for the purposes of the government and for the use of the development partners. **The development of a strong management accounting function, i.e. the production of financial information as an aid to decision making, is essential to achieve genuine financial control.**

## Financial Information Required

A wide range of information is required for the monitoring and control of operations.

Typically, the detailed reporting of expenditure against budget is a vital part of the control function. Financial analyses produced may support comparisons

between different reporting periods, for example month by month, and between responsibility centres within the organisation.

A suite of performance indicators may be developed in conjunction with these analyses, possibly linked to a performance-related reward mechanism.

### **The Planning Process**

Prior to the implementation of a management accounting function, a detailed planning process must be undertaken. Both the current and future needs of the users of management information, as well as the mechanisms whereby these needs will be met, should be assessed during this process.

It must be ensured that financial information is obtained on a timely basis, otherwise immediate action cannot be taken as a result of findings and the value of the information is reduced as a result. Also, reporting must be on a frequent basis to facilitate the determination of trends between different periods during the financial year and to contribute to the timeliness of information.

Reports should be designed with the objective of providing users with information which is sufficiently detailed to meet their needs; however, care should be taken not to over elaborate since this will merely serve to supply the user with an overload of information.

Performance should be measured against targets/budgets and significant variances investigated for control purposes. Care should be taken in the explanation of variances, for example, an adverse variance may be due to an unreasonable target or uncontrollable outside influences rather than due to poor performance. Performance measures used in conjunction with financial information produced may be used to assess the performance of responsibility centres within the organisation, possibly with an input into rewards schemes. In such instances, it is crucial that responsibility centres are held responsible only for results over which they have control.

The system planning process should take account of the possibility of change, whether they are in the nature of operations, user needs or volumes of information processed. Particularly in the case of computerised management accounting systems, system design should incorporate the capacity for change.

Personnel factors should also be considered. As is the case in most change programmes, there is the possibility that efforts to introduce a management accounting system will encounter a degree of opposition or suspicion. Care must be taken, therefore, to fully involve personnel in the change process and to ensure that all performance measures produced by the system are seen to be fair in order to receive the co-operation of personnel.

### **Introduction of Management Accounting - Ministry of Health and Family Welfare**

#### *Changes Resulting in the Formation of Management Accounting Unit*

A report commissioned by the Government of Bangladesh in 1989 on the way forward for financial reforms specifically recommended the development of a greater degree of financial control at Line Ministry level, with Ministries having their own Budget Committees to allocate an overall "resource envelope" for the Ministry. This has been adopted as a major objective of the financial reforms process in Bangladesh ever since.

Some time after the release of the report, Budget Committees were formed in Pilot Line Ministries, but, in the absence of sufficiently sophisticated financial information, their use has been severely restricted. As a result, Line Ministries have been unable to play a major part in the financial planning and control process.

The proposed changes have been accelerated in the Ministry of Health and Family Welfare due to the advent of the Fifth Health and Population Programme (HAPP-5), which has necessitated radical changes to the financial framework of the Ministry.

Previously, donors have conducted their activities in a comparatively uncoordinated manner and exercised a degree of control over the projects in which they have a particular interest. Under HAPP-5, however, there is now the prospect of a willingness of Development Partners to act as a consortium and give the Ministry an overall resource envelope, thus affording the Ministry a degree of autonomy not previously enjoyed in the allocation of its funds to its individual activities.

It is obvious that this greater freedom necessitates the establishment of improved systems for financial reporting and control; not only will the Ministry

need to effectively plan and monitor expenditure in the light of the increased responsibility which it will enjoy, but donors will require assurances that their funds are being properly and efficiently utilised. Under HAPP-5, the introduction of the Annual Programme Performance and Expenditure Reviews (APPERS) by which Development Partners will monitor the progress of HAPP-5, will require the production of financial information in prescribed formats.

It is therefore fortunate that the Chief Accounts Office (CAO) of MoHFW was one of the first offices of its kind to be established and that, when the plans for HAPP-5 came to light, there were already good contacts made between this office and Ministry officials.

A Management Accounting Unit (MAU) was set up as an office of CAO Health in July 1997, with staff appointed (in part- and full-time capacities) from both CAO Health and the Reforms in Budgeting and Expenditure Control (RIBEC) Project, a financial reform project of Finance Division.

### *Preliminary Findings*

The first step in the introduction of management accounting was the familiarisation process; a full understanding of the organisation had first to be obtained in order to ascertain the information needs within the organisation and the sources of financial information.

An organisation chart was produced, and the MAU team investigated the relationships between the different sections within the Ministry and the exact role of each section. A list was also prepared of the Development Projects under the auspices of the Ministry, along with contact names, addresses, budget allocations, etc. in order to facilitate consultation. A Management Accounting database was established which would eventually also hold financial information for MAU, having the advantage of being sufficiently flexible to cope with change during its development.

A number of site visits was undertaken to various officers within the Ministry, Project Directors and accounts staff to gain an understanding of the various financing arrangements and accounting methods adopted in the operations of the Ministry, and officials were asked about their information needs.

After the initial examination of the Ministry and its financial environment, the MAU team examined the nature of the financial information available within



the Ministry. The reporting systems for Revenue (recurring) expenditure were found to be in place in the Controller General of Accounts (CGA) system in a degree of economic detail, but whilst there were expenditure figures relating to Development Projects on the system, these only incorporated Government of Bangladesh-funded expenditure and around 25% of Direct Project Aid. In addition, expenditure for each Development Project was stated as a total, with no economic analysis given.

This situation resulted in a large information gap; not only did MAU lack any information regarding Reimbursable Project Aid or most Direct Project Aid, but there was also no indication of the nature of the expenditure recorded, for example the split of expenditure between pay and allowances and supplies and services, which significantly detracted from the value of the information produced.

After discussion with Ministry officials, the MAU team found that there was a source of more detailed financial information relating to the activities of Development Projects under the auspices of the Ministry which could be used as a starting point for establishing detailed financial reports.

Projects reported on a monthly basis to two users of the information, namely the Implementation, Monitoring and Evaluation Division (IMED) and DG Health / DG Family Planning. In addition to reporting on the physical progress of the Projects to these bodies, the Development Projects also produced expenditure reports, detailing all Project expenditure using economic classes identical to those used in the Project Proforma, distinguishing between Government of Bangladesh – funded expenditure, Reimbursable Project Aid and Direct Project Aid.

This appeared to be the solution to the dilemma of incompleteness of information, but a number of difficulties still existed.

There was no written guidance on the submission of these financial reports. Whilst generally both IMED and DG Health/Family Planning should have received financial reports, it was not uncommon for, for example, IMED to receive two copies of the same report and DG Health / Family Planning to receive none; as a result, there was no comprehensive suite of expenditure information regarding the Projects. Also, there were no formal deadlines in the submission of reports, with the result that information was not collated on a timely basis.

With Projects reporting upon their expenditure using economic analyses identical to those used in their Project Proformas, there was very little uniformity among the formats used and therefore little scope for the performance of meaningful comparisons between Projects; for example, one Project would report along 40 economic lines, whilst another would report on only ten economic categories.

In addition, a number of Projects used economic classes which were not specific in their descriptions of the expenditure incurred. Contingency was a common heading, whilst Allowances for Unseen Costs appeared in the budget details in a number of reports. The use of accounts such as these significantly reduced the usefulness and meaningfulness of financial reports and could be open to use as "catch-all" accounts.

#### *Initial Changes in the Reporting Environment*

It was essential that this situation be remedied. A new economic analysis based on the New Classification had been developed for the production of Call Notices throughout the Government; it was decided that the possibility of developing a standard report for the Ministry's Development Projects using economic analyses similar to those in relation to Call Notices should be investigated.

MAU realised that if Projects were required to adopt a similar format to that developed for the Call Notice process, the reporting environment would not be unduly complicated. In addition, the New Classification had been accepted by the Ministry of Finance and various development partners; adoption of the New Classification by Development Projects would facilitate dealings between MoHFW and these bodies.

The similarity between the production of budgets and expenditure reports would facilitate the comparison of actual performance with budget, and meaningful analyses could be made on the same bases for all Projects, thereby enabling users of financial information to make comparisons between Projects and functional groups.

In using reporting formats based on the New Classification, Projects would be seen to adopt the most sophisticated accounting methods in the Government,

and the practice of using analyses which did not describe the nature of items of expenditure would be eliminated.

By directing financial reports to MAU as an office of CAO Health, a full and comprehensive suite of financial reports for the Ministry would be developed at CAO Health. The use of standard reports would form the basis for CAO Health to be able to act as a genuine financial adviser to the Ministry, and the introduction of a specific reporting timetable would enhance the efficiency of the flow of financial information.

Discussions ensued with a number of Project Directors to assess the feasibility of introducing such a standard report to the Development Projects. Some changes were made to the economic detail on the recommendation of the Project Directors interviewed, but it was ensured that the revised analyses could be reconciled to the Call Notice proformas to facilitate comparison between actual performance and budget.

All Project Directors and Accounts personnel along with various Ministry officials and other interested parties were invited to a series of workshops in which the work of MAU was explained and the revised reporting forms were introduced for comment. A question and answer session concluded each workshop in which the participants were invited to raise queries regarding the proposed reporting regime or suggest amendments to the new format. After completion of the workshops, the standard reports were finalised and circulated to the offices of the Development Projects for subsequent completion.

### *Future Action*

The issues of completeness and uniformity of financial information have thus been solved; the immediate tasks now facing the MAU team involve the creation of meaningful and useful analyses from the information compiled.

A monthly suite of financial reports will be developed using data collected on the Management Accounting database after discussions with the future users of financial information regarding their information needs, and a costing logic is to be developed as the basis for the apportionment of establishment costs within the Ministry to the various medical bodies concerned.

The MAU team aims also to consolidate all the financial information held by CAO Health onto the MAU database system and to put budget data onto the system to enable the system to produce reports of full costs against budget.

The management accounting function will be constantly under review; there will be consultation with Project Directors, Ministry officials and other interested parties in order to assess the need to revise the reporting systems and formats on an ongoing basis.

### **Conclusion**

This paper has outlined the current financial reporting environment in Government and highlighted some of the disadvantages inherent therein. It is essential that changes be made to increase the detail and frequency of the financial information produced in the interests of both greater accountability and tighter financial control.

The introduction of Management Accounting within Government will result in the production of more meaningful and useful financial information than that currently produced and will greatly improve the quality of information enjoyed by both management and other interested parties.

## REGIONALISM IN ASIAN TRADE REGIME: COOPERATION AND COMPETITION

Muhammad Abdul Mazid\*

At the backdrop of recent currency turmoil in some major South East Asian economies and the prognostic pessimism created out of crashes in the Asian stock markets, which is likely to engulf the confidence of Asian tigers, the present paper aims at analysing the current conditions of regional co-operation in Asian trade regime and explores the possibilities for its reinforcement. The recent rigorous movements of exchange rates of some Asian currencies reflecting bleak economic fundamentals of those economies suggest that excess volatility is not desirable and concerted efforts are required for its proper control.

### Regional Economic Unions and Global Trade

The development of regional economic unions is a striking feature in the world economic scenario in the 1990s. The underlying reason<sup>1</sup> for formation of so many regional economic unions was the general movement to recognise the implications of the international economic order: (a) the increased interdependency of the global economy; (b) the collapse of the state planning in command economies in the (former) communist countries and (c) the conscious efforts made in all developing countries to link up with highly developed market economies in order to achieve greater economic prosperity of their own. It was generally recognised that achievement of a country's own economic prosperity required building closer ties with central countries in the market economic system. This movement toward regional economic unions subsequently swept entire world, including the European Union (EU), the establishment of the North American Free Trade Agreement (NAFTA), the birth of the Asia Pacific Economic Cooperation (APEC) and the concepts of Free Trade Area of the Americas (FTAA), European Free Trade Association (EFTA), ASEAN Free Trade Arrangement (AFTA), SAARC Preferential Trade Arrangement (SAPTA) etc.

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Japan External Trade Organisation (JETRO), 'WTO and Regional Economic Unions', *JETRO White Papers on International Trade*, Tokyo, 1997, Page 16.

As of July 1996, there were 101 regional economic unions based on formal agreements. (Table 1). Sixty nine of these, corresponding to 60 percent were established since 1990. Classifying the regional economic unions by location the most numerous are to be found in North America and Latin America, 40 in all, followed by Europe with 39. As opposed to this, there are only three in Asia.

A comparison of the destinations of exports of key regional economies between 1990 and 1996 (Table 2) turns up the following three points: first, there has been a remarkable rise in the share of intra-regional exports in overall global exports in all regional economies with the exception of the EU and EFTA; second, in the EU and EFTA, where the share of intra-regional trade has fallen, that drop in share tends to be compensated by an increase in exports to Asia and third, the ANIEs, AFTA etc. which seem to have become the growth centre of the global economy, have had a tremendous spill over effect in increasing the trade of neighbouring economies.<sup>2</sup> This mechanism is leading to greater economic activity in Asia as a whole.

### **The Asian Trade Region**

The ancient Asian Civilisations (particularly from the Islamic world) were absorbed by the pre-modern Europe during the Renaissance period. During the transition from the middle ages to the early modern era civilisation shifted from the Mediterranean to the Atlantic and during the transition between the early modern and modern periods it shifted from the Atlantic to the Pacific. Now it is moving towards Asia. Three global trends are directly related to the present developments in Asian countries: firstly, world production has tended to increase more rapidly than world trade; secondly, world trade as a whole increased more than world trade in primary commodities; and finally, it is significant and ominous that the increase in international trade in primary commodities for the world as a whole has exceeded that for the Asian region itself.

The economic structures of most Asian nations, as they exist and function today, are, to a large extent, the result of international economic and political relationships developed over the past decades and the expansion in external demand remain mainly responsible for whatever degree of development occurred in the region.<sup>3</sup> One important and striking aspect of Asian external

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<sup>2</sup> *ibid.*, Page 17.

<sup>3</sup> Gunnar Myrdal, *ASIAN DRAMA, Volume 1*, Pantheon, New York, 1968. Page 581

trade is its orientation toward far distant countries. Between 50 to 60 percent of the export from Japan, ASEAN and SAARC countries are directed to Western Europe and North America. This pattern of marketing is, though somehow attributable to former colonial connections, mostly due to the excessive dependence by most of these countries on external conditions and economic support.

From 1965 to 1990 the twenty three economies of East Asia grew faster than all other regions of the world. Since 1960, eight high performing Asian economies (HPAEs) have grown more than twice as fast as the rest of Asia, roughly three times as fast as Latin America and South Asia and five times faster than sub-Saharan Africa.<sup>4</sup> Though fundamentally sound development policy was a major ingredient in achieving rapid growth, private domestic investment and rapidly growing human capital were the principal engines of growth. It was also due to many successful policy interventions, *inter alia*, establishing firm-and industry-specific export targets, developing export marketing institutions, and sharing information widely between public and private sectors, reductions in import protections accompanied by export credit and setting up of supporting institutions. The export development in these successful economies relied less on highly selective interventions and more on broad based market incentives and direct investment.

The economic growth rates of the Asian economies in last two decades (1976-1995) were significantly high, but their variation coefficients were varied.<sup>5</sup> Their variation coefficients (Table-3) for the second decade (1986-95) were smaller than those for the first decade (1976-85), suggesting that the growth pattern of Asian economies was relatively stable in the past ten years. At the moment though some developed economies in Asia are in recession, strong optimism prevails in the developing economies for impressive export performance (Table 4) on the basis of the following factors: (a) A rapid growth of inter-regional trade and investment; (b) Attractiveness of the regions as a destination for FDI; (c) Positive linkage between FDI and export expansion as well as technology transfer; (d) Import promotion initiative of some developed economies like Japan through JETRO; and emerging preferential trading arrangements such as AFTA and SAPTA. In their eagerness to improve competitiveness, developing economies (particularly the least developed ones) of the Asian region have adopted open market economic policies to liberalize their economies through *inter alia*, adoption of liberal investment and trade

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<sup>4</sup> The World Bank, *The East Asian Miracle*, New York, Oxford University Press, 1993, Page 2.

<sup>5</sup> Shunsuke Bando, 'Economic Growth Rates of Asian Economies and the Ranking of their Economic Development', *Pacific Business Industries RIM*, Vol. 1. Tokyo, 1997, Page 27.

policies, reduction of tariff, removal of tariff barriers and pursuing aggressive marketing strategies.

### Regional Trade Blocks in Asia

Asia has always been a region of extreme diversity, which has blocked the achievement of a clear consensus, even with regard to the extent of the region. For that reason Asia has made least progress toward regional cooperation. Though we talk of Asia as a single region, in fact the countries of Asia vary widely in terms of religious, ethnic and linguistic structures, political systems and other characteristics. The Asian nations are at variance in terms of their levels of industrialisation, internationalisation, and economic development. This diversity prevents the spread of regionalism in Asia. At one time, therefore, economists spoke of "Asian Stagnation".<sup>6</sup>

In the Asia region, growing and deepening economic interdependence has led to the formation of regional and sub regional economic cooperation on various levels in the 1990s. APEC, which covers the entire Asia-Pacific region with the exception of Southwest Asia, made its "Osaka Declaration" in November 1995 and entered its action phase. APEC members agreed to coordinate with each other in the Manila Action Plan (MAP) adopted at the fourth summit held in the Philippines in November 1996. APEC is now at the stage of implementation of trade liberalization. Since APEC leaders met in Seattle in 1993 for their first informal summit, the forum's focal theme has clearly shifted from economic cooperation to trade and investment liberalization not because external pressure worked but because Asia has changed. Foreign and Trade Ministers at the annual meetings of the APEC vowed on November 22, 1997 in Vancouver, Canada to pursue trade liberalization despite turmoil in Asia's financial markets and agreed to put nine industries on a fast track to liberalization and it has been hoped that this would calm jittery investors. Identified nine priority sectors for early voluntary trade liberalization are: environmental goods and services, fish and fish products, forest products, medical equipment and instruments, toys, energy, chemicals, gems and jewellery and telecommunications.<sup>7</sup>

In ASEAN a deeper and broader regional economic integration is being pursued through the early realization of ASEAN 10 and the speeding up the

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<sup>6</sup> Kenichi Kamiya, 'Regionalism in Asia- From Economic Perspectives', *Pacific Business Industries RIM*, Vol. II, 1995, Tokyo, Page 3.

<sup>7</sup> *The Japan Times*, November 24, 1997.



establishment of AFTA as announced in the "Bangkok Declaration" of December 1995. The AFTA has decided upon the implementation of its programme over a 15 year timespan. ASEAN can emerge as an integral regional market of over 320 million people with a combined purchasing power of \$340 billion in 1991, that is growing at 6-8 percent a year. The expansion in 1992 of the Economic Cooperation Organisation (ECO), involving most ESCAP countries in North and Central Asia is also another arrangement with potential for enhancing trade and investment cooperation in the region.

In Southwest Asia, SAPTA was launched on December 7, 1993. The SAARC Foreign Ministers Conference held on 19th of the same month agreed on the establishment of a South Asian Free Trade Area around the year 2005. SAPTA was concluded under the "GATT Enabling Clause" by the SAARC member states: Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. The SAPTA agreement affirms the belief of the Contracting States that "the expansion of trade could act as a powerful stimulus to the development of their national economies, by expanding investment and production, thus providing greater opportunities of employment and help securing higher living standards for their population." The agreement provides "to promote and sustain mutual trade and economic co-operation" through exchanging concessions in the area of tariffs, para-tariffs, non-tariff and direct trade measures."<sup>8</sup>

More recently we have witnessed the formation of Bangladesh, India, Sri Lanka and Thailand Economic Cooperation (BISTEC), and the birth of the Summit Conference of the Developing Countries (D8) participated by the heads of eight Islamic countries (Turkey, Iran, Egypt, Nigeria, Pakistan, Bangladesh, Indonesia and Malaysia). Broader regional networks are in the offing through the creation of these new economic cooperation frameworks.

The formation of Growth Triangles in several parts of the Asian region has also substantial trade and investment promotional aspects and strengthened interregional economic cooperation. These growth triangles are: Northern Growth Triangle (Indonesia, Malaysia and Thailand), the Northern Quadrangle (Myanmar, Southern China, Lao PDR, and Thailand), Indochina Hexagon (Myanmar, Southern China, Vietnam, Lao PDR, Cambodia and Thailand), Tumen river Triangle (China, Democratic Republic of Korea and Russian Federation), the Yellow Sea Triangle (Taiwan Province of China, Republic of Korea and north east China) and Bengal Bay Industrial Triangle (Calcutta,

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\* Ghulam Rahman, 'Prospects of Export Promotion Under SAARC Preferential Trading Arrangement (SAPTA)', *Dhaka International Trade Fair '97 Souvenir*, Ministry of Commerce and Export Promotion Bureau, Dhaka, 1997, Page 43.

Chittagong, Bangkok and Singapore). The Japan International Cooperation Agency (JICA) in a Study<sup>9</sup> Report suggested the formation of Bengal Bay Industrial Triangles. Located between East Asia and the Indian Subcontinent, the region surrounded by the Bay of Bengal is conceived as a new trade and industrial triangle where potential development centres are accumulated including Calcutta, Madras, Chittagong, Colombo, and Yangon of Myanmar in the future. Also the landlocked regions and countries such as the North Eastern India, Bhutan, and Nepal which are the important hinterland of Chittagong would be benefited.

### Challenges for Asian Economies

The Asian region is experiencing more dynamic economic growth and this dynamism is expected to be sustained over the medium term inspite of the currency crisis in East Asia. This rapid growth has also brought to the fore long term global issues related to food, energy, the environment and other matters. The APEC members are actively considering the coordinated response to FEEEP issues (Food, Energy, Environment, Economic growth and Population), as these are long-term matters crucial to the ability to achieve sustainable growth in the region. Various APEC fora engaged in substantive work, submitted reports to the Ministerial Meeting within the FEEEP symposium held on 2-4 September, 1997 in Saskatoon, Canada. The FEEEP symposium emphasised the need for (1) activities and breakthroughs connected with economic and technical cooperation to be applied as broadly as possible; (2) effective measures for liberalisation and facilitation of trade and investment, and (3) the constructive involvement of not only governments, but also a wide spectrum of society, including local governments, companies, rural villages, local communities, etc.<sup>10</sup>

A study (Emerging Asia: Problems and Prospects) conducted by the Asian Development Bank in conjunction with Harvard Institute for International Development and published prior to ADB's 30th anniversary meeting in Fukuoka, Japan in April, 1997, predicted that the number of impoverished people in Asia will be drastically reduced in the not-so-distant future if the region's potential is fulfilled. The Report also pointed out that "Asia still has more poor people than any other part of the world. By many measures- health, education, nutrition, as well as income-the quality of life within Asia has been

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<sup>9</sup> Pacific Consultants International and Nippon Koei Co. Ltd, *The Study on Industrial Development of Chittagong Region in Bangladesh*, Japan International Co-operation Agency and Board of Investment, People's Republic of Bangladesh, September 1995. Final Report, Vol. 1, Page 2-71.

<sup>10</sup> Minoru Sthiyya, 'FEEEP-APECs Long Term Agenda', *The Japan Economic Review*, Oct 15, 1997.

diverging. As Asia's vast markets grow and open up, they will provide enormous trading, investment and employment opportunities for the rest of the world. Growth in Asian income is likely to lift the growth of world income". To help liberate Asia from poverty, the ADB proposed improving the region's infrastructure, fostering the financial sector and revamping political systems.

The financial sectors of several Southeast Asian nations are now facing the ill effects of over investment in real estate which has led to speculative attacks on their currencies, growth rates in the more developed Asian economies continue to be slow and they are struggling to implement the reforms that could revitalize their flagging performance. Since 1965 per capita income in Asia has grown by an annual average of 3.5%, by far the fastest rate of increase of any developing country/ region in the world. The success has been possible mainly by the contribution of the fastest growing east Asia sub-region, which has recorded an average rate of increase of 4.5% per year during 1965-94 when South Asian growth was considerably slower. The four fastest growing economies- Singapore, Hong Kong, Taiwan and Korea have been rapidly catching up with the world's economic leaders, with an average income climbing from just one sixth of the U.S. level in the early 1960s to over two-thirds today (Table 5). Three other rising economies - Malaysia, Indonesia and Thailand are also coming up despite some recent backlash of currency and environmental disaster. The prospects for continued rapid growth in Asia over the next 30 years are bright. The tigers are likely to follow Japan by completing the process of catching up with the world leaders within the next generation. East Asia's successful growth in recent decades can continue in the future and even spread to south Asia, but continued success will depend on further market reforms and better governance in the years ahead.<sup>11</sup>

In recent years most economies in Asia have been making rapid progress in economic liberalization, deregulation and other changes in its internal institutions relating to the trade system. At the same time, the backlash from the industries affected has created pressures against liberalization. Asian countries are faced with the difficult task of balancing liberalization with protection of their domestic industries. The Malaysian Prime Minister warned other developing countries against indiscriminately lowering trade barriers and opening economies to the west.<sup>12</sup>

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<sup>11</sup> Jeffrey D. Sachs and Steven C. Radelet, 'Emerging Asia : Bright Prospects', *The Asian Wall Street Journal*, May 19, 1997.

<sup>12</sup> *The Japan Times*, November 1, 1997

The challenge for the countries of the Asian regions will be how to take full advantage of the new opportunities in a fiercely competitive global environment. To cope up with this new environment, national strategies will need to be developed for building national competitiveness and for export expansion. The conclusion of the Uruguay Round is: on balance a welcome development of the countries of the region will follow. The Multi Fibre Arrangement (MFA) will be phased out in four stages over ten years. All quantitative limits on agricultural goods will be replaced by tariffs. Moreover, Asian developing countries agreed to bind 70% of their imports- a measure which "should ensure the security of market access and should promote intra-Asian trade".

Competition among Asian countries to attract FDI has also grown in intensity in recent years. The change in basic approach to economic development and policy persuasion by some countries has led to a competitive environment in the region. Within the environment Governments can attract FDI by improving investors' perceptions by ensuring, *inter-alia*:

- a sound macroeconomic climate ;
- political stability ;
- clear and efficiently implemented economic and investment policies;
- relatively few policy biases which favour one group of firms over another
- the existence of a transparent, predictable and preferably automatic regulatory regime;
- an efficient institutional frame work; and
- priority accorded by the government to the removal of infrastructure bottleneck and to human resource development.

The nature of the competition for FDI has changed and is now largely focused on deregulation of the business environment and on facilitation of the private sector rather than control. The governments which can convince potential foreign investors with the determination and ability to implement such programmes will be the beneficiaries of the FDI flows in the next decade.<sup>13</sup>

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<sup>13</sup> Andrew Proctor, 'Global Competition For FDI: Overview and policy implications for Asia and the Pacific', *Expansion of Trading Opportunities to the year 2000 for Asia Pacific Developing Countries : National Strategies and Institutional Frameworks for Export Expansion*, UNCTAD, UN, New York 1995 Page. 123.

## Balanced Development

*Trade and Development Report, 1993* of the United Nations Conference on Trade and Development (UNCTAD) posed a question for the economies of Asia as to "whether the factors which have led to the generation of greater demand from within the region in recent years will continue to operate." The answer to this question is straightway no, as the prospect for further development of many of Asian economies lies in the factors, not internal but external to them. Eventually the need for mutual co-operation among themselves for promotion of trade by sharing the information network and exchanging capital and technology comes up. To this end in view Asian Trade Promotion Forum (ATPF) was established a decade ago with the Trade Promotion Organisation (TPO)s of the Asian economies. As of now 19 TPOs of the Asian economies including Australia and New Zealand are the members of the ATPF. As the member economies of the Asian region are at various levels of trade development and export performance (Table 6), the ATPF is now actively considering to focus on the concept of Balanced Development.<sup>14</sup> According to it, making full use of the merits of diversity, it is in the fitness of circumstances that Asian countries should develop an integrated, but interdependent economic force for mutual benefit and understanding. If this could be done, there is every likelihood that the region could maintain steady economic growth and eventually emerge as the world's largest market with pragmatic purchasing power.

The first meeting of the ATPF (Tokyo, May, 1987) agreed that "the promotion and invigoration of Asian trade is of the greatest importance to the development of Asia and to the revitalization of the world economy". The second meeting (Seoul, October, 1988) recognized "the importance of developing inter-regional trade, and encouraged closer and informal contacts among the overseas offices of the TPOs by exchanging information and visits by business delegation." The third meeting (Singapore, July, 1989) agreed to "promote the removal of trade barriers, restraints and disincentives". The fourth meeting (Beijing, October, 1990) reiterated the basic policy for cooperation among TPOs on "mutual respect, equality and mutual benefit, further exchanges and progress", and emphasised on making "active and effective contribution to a sustained economic prosperity in Asia". The eighth meeting (Bali, September, 1994) suggested to "develop programmes and foster inter regional trade and investment within the Asia region, under the spirit of mutual growth and prosperity". The ninth meeting (Ulaanbaatar, August, 1995) agreed

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<sup>14</sup> Muhammad Abdul Mazid, 'Balanced Development between ATPF Members', *Asian Trade Promotion Bulletin*, No. 8, September, 1997, Asian Trade Promotion Forum, JETRO, Tokyo. Pages 13-20.

that "Asian economies should cooperate more closely and workout joint strategies to cope with the changes in newly emerging environment in view of ongoing integrational tendencies in the world market". The tenth meeting (Kyoto, September, 1996) endorsed that "activities to realize equitable development of ATPF members should be reinforced". The eleventh meeting (Goa, India, October, 1997) recognized the increasing importance of the "linkage between trade and investment" and resolved that "the information available with the TPOs relating to investment and trade would be made available to other members of ATPF".

The prospect for recovery of the global economy, coupled with a consolidation of the open international trading system through the conclusion of the Uruguay Round of multilateral trade negotiations, augurs well for close coordination and mutual cooperation among the Asian economies for enhancing the trade promotion opportunities. The possible loss of competitiveness due to escalation in production costs as a consequence of new environmental and labour standards, as well as the application of the intellectual property rights provisions of the Uruguay Round Agreement, could further erode the competitiveness of the least developing economies of Asia. High expectations for growth of export and investment by the year 2000 and beyond, may lead to market saturation and protectionist reactions in traditional markets due to cumulative effect. Such a possibility calls for urgent attention to the development of balanced market and product diversification. There is also a need to pay attention to new and emerging issues which are not tackled by the Uruguay Round. As tariff and non tariff barriers have come down, the major trading nations of the world may resort to new protectionist measures such as labour and social standards to restrict the flow of exports from the least developing countries.

The suggested strategies to assure Balanced Development includes the extension of technical assistance to the TPOs of the least developed member economies by the developed ones and the international organizations. While looking into ramification of the result of the Uruguay Round, initiation of joint efforts for development of trade and commerce of the respective economies could help better understanding of the implications for the policy options of the least developed countries. To build up the export capability, encourage product diversification, and improve product quality; assistance would be necessary for the developing member economies of the region with regard to investment finance, technology acquisition and human resource development. Developed member economies should participate actively in project lending and joint venture investment in the region. Export expansion in the least developed

countries of the region would lead to higher economic growth, which in turn would stimulate a higher level of consumption and increased import from the more developed economies in the region. A major concern for the developing countries of Asia in the post Uruguay Round situation is increased global competition. To deal with this, there is need for right type of information, especially by SMEs, on market opportunities and trends around the world. Potential benefit of such information, however, depends greatly on their quality and timing. TPOs may share the results of their market research for undertaking effective measures for capturing the market opportunities. For instance, developing countries of Asia have wide ranging scope for inter regional cooperation in the sectors and area like textiles and clothing which constitute substantial segments of exports for Bangladesh, China, India, Republic of Korea, Macao, Pakistan, the Philippines, Sri Lanka, Tonga and Tuvalu. GATT economists predict a 60 percent rise in textiles in Asia.<sup>15</sup>

### **Regional Integration: Future Direction**

The authors of the *East Asian Miracle* expressed reservations about the effect of the regional trading blocks: "Developing economies will be affected differently by the emergence of regional blocks. Economies that currently enjoy preferential access to the U.S and EC markets under schemes such as generalised system of preferences are likely to see the value of the privileges erode. If, however, regional arrangements further multilateral liberalization, they will open new opportunities for trade, and if blocks succeed in stimulating the growth of their members, those outside the regions will find increased export opportunities."<sup>16</sup> The World Bank economists were suggestive that exports can be promoted by a variety of means that are consistent with developing economies' emerging obligations for market access and limited subsidies.

The recent financial crisis faced by Indonesia which has been described mostly as "confidence crisis" prompted Malaysia and Singapore to offer financial assistance to help Jakarta weather the economic turbulence. Australia and Japan also followed the wisdom and goodwill of Malaysia and Singapore. The involvement of the World Bank and IMF also helped bring back credibility. This commitment and demonstration of active support extended to Indonesia to combat the currency crisis "could serve as the beginning of the process of realisation of the Asian Fund, a mechanism suggested by ASEAN members a

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<sup>15</sup> *Far Eastern Economic Review*, April 28, 1994

<sup>16</sup> The World Bank, *The East Asian Miracle*, op.cit, Page 364

month ago.”<sup>17</sup> Reports from Washington on November 8, 1997 said that a senior U.S. official reiterated that United States will oppose the proposal for establishing an “Asian Monetary Fund” saying that Washington wants the International Monetary Fund to maintain its central role in any kind of regional arrangement for economic stability.<sup>18</sup> These events and developments are indicative of the future opportunities and challenges for the regional integration efforts in this part of the globe.

**Table 1: Regional Economic Unions**

	Before 1950	1950-59	1960-69	1970-79	1980-89	After 1990	Total
Africa	0	0	2	2	0	4	8
Asia/Oceania	0	0	0	0	1	2	3
Europe	0	0	1	2	0	36	39
Middle East	0	0	0	0	3	1	4
North America and Latin America	0	0	2	1	15	22	40
others	0	0	1	1	1	4	7
Total of Region	0	0	6	6	20	69	101

Source: *Japan External Trade Organisation.*

**Table 2: Regional share in world trade (based on export) 1990/1996  
(Unit:%)**

Imports Exports		World	EU	APEC	East Asia	Asian NIEs	AFTA	ASEAN4	China	NAFTA	US	Japan
World	90	100.0	43.7	38.3	11.4	7.4	4.2	2.6	1.4	19.1	14.5	6.1
	96	100.0	36.1	44.6	16.9	9.6	6.3	4.2	3.2	19.9	15.2	6.1
EU	90	44.1	29.1	6.6	1.6	1.0	0.6	0.4	0.2	3.6	3.1	0.9
	96	38.4	23.3	6.8	2.4	1.4	0.9	0.6	0.4	3.2	2.8	0.9
APEC	90	38.8	7.5	26.6	8.7	5.7	3.2	2.0	1.1	12.9	9.1	3.9
	96	44.4	6.6	32.6	12.9	7.3	4.9	3.2	2.4	14.4	10.3	4.1
East Asia	90	12.3	1.9	9.0	3.9	2.4	1.4	0.9	0.7	3.0	2.3	1.8
	96	17.3	2.4	12.9	6.6	3.4	2.4	1.6	1.6	3.6	3.4	2.3
Asian NIE	90	7.9	1.3	5.7	2.2	0.9	0.9	0.7	0.6	2.3	2.1	0.9
	96	10.5	1.4	7.8	4.3	1.6	1.5	1.2	1.5	2.3	2.1	1.0
AFTA	90	4.1	0.7	3.0	1.3	0.8	0.8	0.5	0.1	0.9	0.8	0.8
	96	6.3	0.9	4.8	2.4	1.3	1.4	0.9	0.2	1.3	1.2	0.9
ASEAN4	90	2.6	0.4	1.9	0.7	0.6	0.4	0.1	0.1	0.5	0.5	0.6
	96	3.9	0.6	3.0	1.4	1.0	0.8	0.3	0.1	0.8	0.8	0.7
China	90	1.9	0.2	1.4	0.9	0.9	0.1	0.1	-	0.2	0.2	0.3
	96	2.9	0.4	2.2	1.0	0.9	0.2	0.1	-	0.5	0.5	0.6
NAFTA	90	16.2	3.5	10.6	1.9	1.3	0.6	0.4	0.2	6.7	3.4	1.7

<sup>17</sup> Paridah Abd. Samad, ASEAN solidarity combats currency crisis, *The Japan Times*, November 9, 1997

<sup>18</sup> *The Japan Times*, November 8, 1997.



**Regionalism in Asian Trade Regime: Cooperation and Competition**

	96	17.5	2.7	12.5	2.4	1.6	0.9	0.5	0.3	8.3	4.6	1.5
US	90	11.6	3.1	6.8	1.7	1.2	0.6	0.3	0.1	3.3	-	1.4
	96	11.9	2.4	7.5	2.2	1.5	0.8	0.5	0.2	3.6	-	1.3
Japan	90	8.5	1.7	5.8	2.5	1.7	1.0	0.7	0.2	3.0	2.7	-
	96	7.9	1.2	5.9	3.4	2.0	1.4	1.0	0.4	2.3	2.2	-

*Source: Ministry of International Trade and Industry, Government of Japan, 1997*

**Table 3: Correlation coefficients among real economic growth rates of Asian economies (1976-95)**

	South Korea	Taiwan	Hong Kong	Singapore	Thailand	Malaysia	Indonesia	Philippines	India	Japan	United States
South Korea	1.00										
Taiwan	0.51	1.00									
Hong Kong	0.29	0.79	1.00								
Singapore	-0.03	0.06	0.23	1.00							
Thailand	0.35	0.22	0.02	0.48	1.00						
Malaysia	0.05	0.05	0.21	0.80	0.51	1.00					
Indonesia	-0.27	0.24	0.37	0.51	0.30	0.55	1.00				
Philippines	0.09	0.26	0.38	0.55	0.47	0.51	0.38	1.00			
India	-0.02	-0.11	-0.16	0.09	0.35	-0.14	0.12	0.05	1.00		
Japan	0.27	0.32	0.15	-0.01	0.33	-0.02	-0.07	0.12	-0.13	1.00	
United States	0.48	0.62	0.42	-0.03	0.20	0.03	0.13	-0.10	0.13	0.19	1.00

*Source: Compiled from IFS; and statistics of each country.*

Table 4: Trade between major Asian economies (1985/1995)

Units in US\$ Million			Bangladesh	Brunei	China	Hong Kong	India	Indonesia	Japan	Korea	Malaysia	Mongolia	Nepal	Pakistan	Philippines	Singapore	Sri Lanka	Chinese Taipei	Thailand
	Imports	Exports																	
1985	0.1	13	10	0.7	72	2	3	...	...	5	42	...	...	...	...	...	...	...	0.8
1995	1.0	18	116	5.0	103	7	7	...	...	10	26	...	...	...	...	...	...	...	5.0
1985	...	0.03	0.7	0.2	1733	184	1	...	...	...	0.1	...	...	...	14	223	...	...	301
1995	...	0.15	1.0	1.0	1220	...	4	...	...	...	...	...	...	...	14	203	...	...	263
1985	76	3	7148	124	6091	...	186	...	...	17	185	...	...	...	314	2063	61	...	116
1995	633	34	36003	1438	28466	6688	1281	63	53	789	1030	3500	239	3086	1752	...	...	...	1752
1985	63	11	7858	122	1279	544	223	...	...	5	30	311	850	320	210	850	76	320	210
1995	500	24	5786	803	10596	2804	1547	10	74	76	2009	4944	364	1843	1615	4944	364	1843	1615
1985	56	2	35	7	1089	191	90	...	...	78	14	5	201	24	32	201	68	24	32
1995	960	5	283	501	2130	394	355	1	107	70	122	807	383	414	461	807	383	414	461
1985	24	1.9	143	18	9007	602	94	...	...	...	57	166	1095	7	73	1095	97	414	73
1995	64	4.9	1866	349	12908	3020	1110	...	...	...	106	560	...	...	611	...	...	2150	611
1985	314	91	6564	2191	...	7159	2184	...	...	62	793	946	3893	273	2047	3893	273	5549	2047
1995	348	131	27780	9969	...	3129	16802	42	60	1240	7100	23006	429	30266	1971	23006	429	30266	1971
1985	1228	581	174	207	4468	...	245	...	...	218	93	185	487	80	146	487	80	187	146
1995	570	9.8	10646	2962	17088	...	2957	...	...	...	361	1494	6700	332	2428	6700	332	4327	2428
1985	43	31	161	66	3784	906	...	...	...	1	121	368	2991	24	527	2991	24	481	527
1995	55	296	3964	976	9416	2074	...	1	4	715	676	15013	186	2954	2901	15013	186	2954	2901
1985	...	...	...	...	82	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1995	...	92	1	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
1985	...	2	0.1	39.3	...	1	...	...	...	...	2	...	...	...	...	2.2	4	...	...
1995	4	...	1.0	25.0	...	2	...	...	...	...	...	...	...	...	...	1.0	...	...	...
1985	2.3	0.5	136	57	828	87	68	...	...	0.7	11.4	26	78	60	20	78	60	7.5	20
1995	15.0	11.0	347	199	2225	707	287	...	...	34.0	13.0	137	192	85	184	192	85	446	184
1985	65	0.4	58	38	309	46	16	...	...	0.1	...	...	32	45	24	32	45	65	24
1995	153	3.0	119	105	542	271	46	...	...	3.0	...	...	88	55	60	88	55	268	60
1985	8	0.5	81	19	875	75	174	...	...	0.5	1.3	...	250	7	83	250	7	104	83
1995	5	3.0	216	123	2760	443	358	...	...	...	7.0	...	896	10	770	896	10	623	770
1985	302	291	333	486	2148	281	3539	...	...	12	241	2187	192	276	949	2187	192	276	949
1995	589	1486	2759	1877	9219	3243	22665	15	85	306	1928	377	2958	6824	...	...	...	...	6824
1985	15	0.05	17	6	64	0.5	12	...	...	0.1	27	0.4	46	6	1.3	46	...	6	1.3
1995	10	0.06	2	35	211	...	22	...	...	...	45	8.0	49	15	21.0	49	...	15	21.0
1985	36	0.4	...	281	3461	254	195	...	...	...	50	239	885	56	236	885	56	...	236
1995	285	21.0	379	1869	13157	2572	2899	...	...	12	181	1653	4405	275	3072	4405	275	...	3072
1985	69	14	271	43	951	133	354	...	...	4	24	53	572	21	147	572	21	...	147
1995	192	64	1642	811	9477	801	1554	3	129	205	414	7917	216	1485	...	...	...	...	1485

Source: (1) International Monetary Fund, 'Direction of Trade Statistics Yearbook' 1986 and 1996; (2) Taipei World Trade Center, based on customs Statistics of the Republic of China; (3) Brunei Darussalam, Ministry of Finance.

Table 5: Key indicators of key Asian economies

	Bangladesh	China	Hong Kong	India	Indonesia	Japan	Korea Rep.	Malaysia	Mongolia	Nepal	Pakistan	Philippines	Singapore	Sri Lanka	Chinese Taipei	Thailand
Population (Million)	101 1200	1040 1200	5 6	765 929	162 193	121 125	41 45	16 20	2 2	16 21	96 130	55 69	3 3	16 18	19.3 21.3	52 58
GNP per capita (US Dollars)	150 240	16374 16502	6230 22990	270 340	530 980	11300 39640	2150 9700	2000 3890	...	160 200	380 460	580 1050	7420 26730	380 700	3297 12439	800 2740
Average Annual GDP Growth (%)	3.6 4.1	9.8 1.4	5.9 5.6	5.2 4.6	3.5 7.6	3.8 1.0	7.9 7.2	5.5 8.7	...	3.4 5.1	6.0 4.6	-0.5 2.3	6.5 8.7	5.1 4.8	6.8 6.5	5.1 8.4
Exports (Billion US\$)	1 3	4666 149	30 174	10 31	18.6 45.0	176 443	30 125	15 74	...	0.1 0.3	2.7 8.0	4.6 18.0	22.8 118.0	1.3 4.0	3.1 11.2	7.1 56.0
Imports (Billion US\$)	2.8 6.0	963 2179	29.7 193.0	14.6 35.0	12 41	130 336	31 135	12.3 78.0	...	0.5 1.3	5.9 11.0	5.5 28.0	26.2 125.0	1.8 5.0	2.0 10.4	9.2 71.0
Average Annual Export Growth (%)	7.1 14.2	8.8 19.0	9.4 15.9	4.6 11.5	1.1 11.7	7.3 8.7	13.0 12.8	10.7 20.0	...	8.4 10.6	2.4 6.1	-2.1 16.9	5.9 17.6	7.3 14.6	9.1 11.0	8.4 18.6
Average Annual Import Growth (%)	3.1 12.0	17.6 20.7	7.7 18.1	2.2 8.0	4.9 11.5	2.4 6.7	9.8 12.1	6.4 20.3	...	7.8 15.0	3.9 7.0	5.9 18.0	4.2 15.5	1.5 14.6	0.3 14.9	7.8 15.3
Average Annual Growth of gross Domestic Investment	0.5 8.2	16.5 15.5	-1.7 11.7	4.6 5.3	5.6 16.3	2.4 -0.8	9.6 7.2	5.3 16.0	...	...	6.1 4.0	-14.4 3.2	7.4 6.0	-4.4 6.8	-0.1 10.8	1.7 10.2
Current Account Balance (Billion US\$)	-0.5 -1.0	-11.0 1.6	...	-2.5 -6.0	-1.8 -7.0	49 111	-0.8 -8.0	-0.7 -4.0	...	-0.1 -0.3	-1.0 -2.0	0.08 0.2	-0.3 15.0	-0.6 -0.5	n.a. 5.4	-1.5 -13.0

Source: (1) The World Bank, "World Development Report", 1987 and "World Development Indicators", 1997; (2) Taipei World Trade Center, based on statistics of Council for Economic Planning/Central Bank of the Republic of China; (3) Brunei Darussalam, Ministry of Finance.

**Table 6: Classification of Asian economies by major export category**

Group	High income	Middle income	Low income
Exporters of Manufacture	Hong Kong, Japan, Macao, Singapore	Korea, Malaysia, Thailand	China, India, Pakistan
Exporters of non-fuel primary products			Mongolia, Myanmar, Vietnam
Exporters of fuels	Brunei, Qatar, United Arab Emirates	Bahrain, Iran, Iraq, Oman, Saudi Arabia	
Exporters of services	Kuwait	Maldives	Bhutan, Cambodia, Nepal
Diversified Exporters		Indonesia, Philippines	Bangladesh, Lao PDR, Sri Lanka

*Source: The World Bank, World Development Report, 1996*

## FRAMEWORK OF FINANCIAL REPORTING SYSTEM OF THE GOVERNMENT OF BANGLADESH - AN ANALYSIS

Mohammad Muslim Chowdhury\*

The objective of this paper is to build a conceptual framework of Government financial reporting system as introduced in this part of the world in the early part of this century. Then an elaboration is made about different changes that have been made from time to time and their effect on the system. The later part of this paper identifies some of the problems presently encountered and need to be looked into as part of ongoing reform process.

Like many countries Bangladesh Government's total financial activities revolve around constitutionally created two major parts viz. Consolidated Fund and Public Account. Barring a few government departments whose accounts are departmentalised (such as Railway, Defence, Postal, T&T etc.) all other departments performing particular function of Government or a group of functions as per allocation of business under Rules of Business of the Government, operate on these two parts under centralised arrangement. Controller General of Accounts (CGA) acts as pay master as well as accountant of those departments taken as a whole.

Controller General of Accounts (the then Accountant General, Civil) is responsible for maintaining Government Cash Book showing at any time Government's Cash Balance in Bangladesh Bank. Moreover, he prepares the Annual Receipts and Disbursement Account as well as Balance Sheet of the Government every year incorporating Assets and Liabilities of all the departments including Postal, Defence, and Railways adjusted on a cash basis. The Balance Sheet does not include accrued receipts and charges as Government accounts are kept on "cash basis". For the same reason, the assets include only the financial assets; physical assets are not included because these assets are not valued as such in Government Main Account. But accounts of physical assets of government commercial undertakings such as Postal, T&T, Railway etc. are maintained outside the regular account on a *Proforma Basis*.

Prior to the introduction of the Constitution of the then Islamic Republic of Pakistan in 1962 there were four main divisions of Government Accounts as per Government of India Act, 1935:-

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\* Finance Controller (Army), Log Area.

- I. Revenue.
- II. Capital.
- III. Debt.
- IV. Remittance.

From the accounts of 1962, in conformity with the constitutional provision then prevailing the above division of Government accounts have been kept in the following two parts:-

### **Part-I: Consolidated Fund**

The Consolidated Fund consists of all revenues received by the Government, all loans raised by issue of treasury bills, loans or ways and means advances and all money received in repayment of loans.

No money out of the "Consolidated Fund" can be appropriated except in accordance with law and for the purposes and in the manner provided in the Constitution.

All issues of public money on account of cost of collection of revenue, expenses of civil administration, expenses of Public Works Department, Defence service, administration of debt services, capital outlay on public works, repayment of permanent and floating debt (which includes treasury bills, ways and means advance etc.) and loans and advances made by Government are treated as disbursements out of the Consolidated Fund which come within the jurisdiction of the Legislature.

### **Part-II: Other Money**

For payment out of the "other money", no demand is required to be presented to the legislature and requirements are met by executive authority from time to time as they arise. These payments are largely of the nature of banking transactions. State Provident Funds, Depreciation and other Reserve Funds of Government commercial departments, Postal Savings Certificates, Miscellaneous Deposits, Remittances are included in the *Other Money*.

Worth noting here is that Bangladesh Constitution also recognises these two parts with the difference that Part-II is termed as "Public Account" instead of "Other Money". Government's Annual Account (Finance Account) still uses the heading "Other Money" in Part-II.

Within these two parts, depending on the activity to which a transaction relates, the following main divisions are created.

#### **Under Consolidated Fund:**

- Revenue

This division consists of all revenue raised and all grants received by the government on the receipt side and all current expenditure to run the government on payment side as revenue expenditure, the net result of which represents "revenue surplus" or "revenue deficit" for the year. In Government Account no head exists for this, albeit "surplus" or "deficit" is shown in the Annual Account (an account depicting total receipt and disbursement of the Republic, known as Finance Account) as a balancing figure.

- Capital

This division deals with the expenditure met usually from borrowed funds, such expenditure being incurred with the objective either of increasing concrete assets of a material character, or reducing future recurring liabilities, such as those for future pensions, by payment of the capitalised value. It also includes receipt of capital nature which can properly be applied as a set-off to capital expenditure. Most of the development expenditure is included under this division.

- Debt

This division comprises loans raised by Government-- Loans of a purely temporary nature classed as "Floating Debt" (such as Treasury Bills, Ways and Means Advances) as well as other loans classed as "Permanent Debt" and "Loans and Advances made by Government" together with repayment of the former and recoveries of the latter.

*Permanent debt* includes all debts, which at the time it is floated, has a currency of more than 12 months.

*Floating Debt* includes borrowing of a purely temporary nature with a currency of less than 12 months and comprises of:-

- i) *Treasury Bills*:- These are issued to finance a short term (3 to 12 months) excess of expenditure over revenue, and have to be repaid on maturity.
- ii) *Ways and Means Advances*:- These are the advances taken from the Bangladesh Bank to tide over the temporary difficulties. Both principal and interest of such advances are repaid as soon as revenue comes in and in any case by the end of the year. Presently, agreed limit of Ways and Means Advance on a day to day basis is Taka 640 million.

Government is required to incur Permanent or Floating Debt liability in public interest, hence the nomenclature *Public Debt* is used for this type of Debt.

#### **Under Public account:**

- Debt

This division comprises receipts and payments, other than those falling under Debt heads pertaining to Consolidated Fund, in respect of which Government incurs a liability to repay the money received or has a claim to recover the amount paid, together with repayments of the former and recoveries of the latter. State Provident Fund, National Savings Certificates, Postal Savings Certificates etc. are recorded in this division. Though the net amount (receipts minus repayment) received in a particular fiscal year under this division is used by the government to finance its expenditure, the debt under this division is not included in the Consolidated Fund because the Parliament by promulgating specific act has given the government the authority to incur the liability without yearly intervention of the Parliament as a matter of public policy. For example, The Provident Funds Act, 1925 authorises the government to incur debt under the head "State Provident Fund" and the prime purpose of creating such fund is to encourage employees' savings. Sometimes debt like provident fund, included under this division is termed as *unfunded debt*, a British term to indicate "not funded by cash".

- Deposit and Reserves

This division comprises receipts and payments in respect of which government acts as a banker. Examples are civil deposit, personal deposit, renewal reserve fund etc. This sort of function is non-existent in the countries of the developed world. But in Bangladesh Government still performs many of these functions



which elsewhere are undertaken by private enterprises. Government acts largely as banker and holds and pays immense sum which are not government revenue or expenditure. Why the government, then, bother to deal in the money which is not its own and should better be left to other institution to deal in? The obvious reason is to improve the ways and means position by using others' money at least cost or no cost at all in financing its activities.

- Remittances

This division embraces all adjusting heads, e.g., remittance to and from Bangladesh Bank and PWD, T&T, Defence, Forest, Postal etc. and also includes remittances to Bangladesh Missions abroad. The initial debits or credits to the heads in this division is cleared eventually by corresponding receipts or payments either within the same circle of account or in another account circle.

Within each of the divisions mentioned above, the transactions are grouped into sections which are sub-divided into major heads of accounts. The Major heads are sub-divided into Minor heads, sub-heads and detailed heads. Under each of the Major and Minor heads the expenditure is shown distributed between "Charged" and "other than Charged". The Major and Minor heads and the sub-heads prescribed for the classification of expenditure in the general accounts are not necessarily identical with the grants, sub-heads and other units of allotments which are selected by the Ministry of Finance for the Demands for Grants and Appropriation Accounts; but in general, a certain degree of correlation is maintained between the Demand for Grants and Appropriation Accounts on the one hand and the Finance Account on the other.

### **Finance Account Vs Appropriation Account**

The phrase "Government Account " means only the Finance Account of the Government which shows the annual receipts and disbursements for the purposes of the Government, distinguished under the respective heads thereof, all other accounts including the Appropriation Account is complementary to it. To quote from the Account Code Volume-1-"the object of these accounts is to relate expenditure brought into account during a financial year to the several items specified in the schedule of authorised expenditure (Appropriation Act). As no special process of accounting is involved in the preparation of Appropriation Accounts they should be regarded as complementary to the accounts of annual receipts and disbursements....." (Art 5).

Any reform initiatives in the Government Accounting sector, if mainly focused on Appropriation Accounts without establishing linkage with the Government Finance Account, transparency and reliability of Government Account may seriously suffer.

### **Account Closes to "Government" and Account Closes to "Balances"**

Two terms frequently used in Government Accounts are: Accounts closes to "Government" and Accounts closes to "Balances". Understanding of these two terms is essential to interpret the Government Financial Statements effectively. Government Revenue Expenditure is set off against Revenue receipts (please refer to Revenue Division above), net result of which is Surplus or Deficit. This is akin to profit or loss of a commercial company adjusted on cash basis. At this point, we can say that Revenue Division closes to "Surplus" by balancing. But what happened to this "Surplus" in government account. What a commercial company does with its profit? Obviously they use it for betterment of the company. From the same analogy, this surplus is also used by the Government to finance its Capital Expenditure. So, this surplus is again closed to Capital Expenditure. The Capital Expenditure of the Government consumes not only the surplus on revenue account but also the Debt (under Consolidated Fund and Public Account both). But at this point, treatment of Capital Expenditure in Government account differs from the treatment of the same in commercial company. Commercial company carries over this expenditure to the next year as balance and also shows it as assets in the Balance Sheet. But in the Government Account, Capital Expenditure is closed to an omnibus account named "Government Account". This may be expressed by the following equation:-

**Government Account** = Opening balance of the year plus (Capital Expenditure minus Revenue Surplus).

This balance is carried forward from year to year (Please see the Balance Sheet 2nd year below). New list of Major head and Minor head issued in the Year 1988, did not provide any major head for "Government Account". Consequently, preparation of the Annual Finance Account of the Government remained defective.

Debt division (under Consolidated Fund and Public Account), Deposit Division and Remittance Division Closes to "Balances". As every item under these divisions individually indicates either Liability or Asset of the Government (as a banker or remitter, borrower or lender), these are carried forward as balances in the next year, hence closes to "Balances" (Please see the

Balance Sheet below). No head is required for this because every item itself shows balance. For example, the difference between credit and debit in the "State Provident Fund" during a year denotes the balance at the end of the year to be carried forward to next year.

### Role of Bangladesh Bank in the Accounting Flow

Though in the Government Account, a distinction is made between Consolidated Fund and Public Account, cash balance of the Government is one and is the net effect of transactions encompassing both the parts. Bangladesh Bank, in acting as cashier and banker of the Government records all money on behalf of the Government in one account and shows as one balance of the Government. But by inspecting Government Account, one can easily derive figures of cash balance attributed to Consolidated Fund and Public Account (please see the cash balance analyses below).

A clear understanding of the division of responsibility between the accounting organisation and the Bangladesh Bank is crucial. Changes were made in the eighties by involving Bangladesh Bank in some of the accounting work without visualising this division of responsibility. This is one of the main reasons for creation of chaotic situation in the sphere of reconciliation of figures between the Bank's book and the CGA's book.

We can now prepare Finance Account (in abstract form) of a country taking imaginary figures (assuming the country started its first year neither having any bank balance nor any debt, whatsoever).

## FINANCE ACCOUNT

For the year ended 30<sup>th</sup> June, 19XX

### CONSOLIDATED FUND

Receipts	Tk.	Disbursement	Tk.
<b>Revenue Division</b>			
Revenue Receipts	50,000	Revenue Expenditure	20,000
<b>Capital Division</b>			
Revenue Surplus (transferred from Revenue Division)	30,000	Capital Expenditure	1,00,000
<b>Debt Division</b>			
Debt Received:		Debt Repaid (amortised):	
Permanent	70,000	Permanent	9000
Floating	15,000	Floating	3,000
<b>Total Under Consolidated Fund(A)</b>	<b>1,15,000</b>	<b>Total under Consolidated Fund(A)</b>	<b>1,12,000</b>

## PUBLIC ACCOUNT

Debt Division			
State Provident Fund	15,000	State Provident Fund	4,000
Deposit Division			
Contractors' Deposit	13,000	Contractors' Deposit	2,000
Remittance Division			
Cash Remittance to Bangladesh High Commission, London	8,000	Cash Remittance to Bangladesh High Commission, London	12,000
<b>Total Under Public A/c (B)</b>	<b>36,000</b>	<b>Total under Public A/c (B)</b>	<b>18,000</b>
<b>Total Receipts (A+B)</b>	<b>1,51,000</b>	<b>Total Disbursement (A+B)</b>	<b>1,30,000</b>
Opening Cash in Bangladesh Bank (Assumption, being first year)	Nil	Closing Cash in Bangladesh Bank	21,000
<b>Grand Total</b>	<b>1,51,000</b>	<b>Grand Total</b>	<b>1,51,000</b>

The Cash Balance of Tk. 21,000 can be analysed in the following way :

Consolidated Fund:	Tk	Tk
Receipts	1,15,000	
Disbursement	1,12,000	
Net balance		3,000
Public Account :		
Receipts	36,000	
Disbursement	18,000	
Net Balance		18,000
<b>Therefore, Cash Balance, Analysed</b>		<b>21,000</b>

Shown below is the first year's performance of the Government in terms of fiscal operations rearranging the figures of Finance Account above :

**FISCAL ACCOUNT**  
For the year ended on 30<sup>th</sup> June, 19XX

	<b>Tk.</b>
Revenue Receipts	50,000
Less Revenue Expenditure	20,000
<b>Revenue Surplus</b>	<u>30,000</u>
Less Capital Expenditure	(1,00,000)
<b>Overall Deficit</b>	<u><u>70,000</u></u>

<b>Financing of Deficit:</b>		<b>TK</b>
Permanent Debt (Gross)	70,000	
Less Repayment	9,000	
Net	<u>61,000</u>	61,000
 Floating Debt(Gross)	 15,000	
Less Repayment	3,000	
Net	<u>12,000</u>	12,000
 Public Account (net)		
Provident Fund	11,000	
Deposit	11,000	
Remittance (indicates money lying with London High Commission)	(4,000)	
	<u>18,000</u>	18,000
Cash Balance		(21,000)
		<u><u>70,000</u></u>

**BALANCE SHEET**  
As at 30<sup>th</sup> June, 19XX

<b>ASSETS</b>	<b>Tk.</b>	<b>TK.</b>
Government Account :		
Opening Balance	Nil	
Capital Expenditure	1,00,000	
Less Revenue Surplus	<u>30,000</u>	
		70,000
Cash Balance		21,000
Remittance (lying with London High Commission )		4,000
		<u><u>95,000</u></u>

<b>LIABILITIES</b>	<b>Tk.</b>
Permanent Debt (By Source , say IDA Credit)	61,000
Floating Debt (By type of instrument, say Treasury Bill )	12,000
State Provident Fund Balance	11,000
Contractors' Deposit Balance	11,000
	<u><b>95,000</b></u>

Building of conceptual framework of government financial reporting system will not be complete, if at least one more year's accounts are not shown. The following accounts relate to year 2.

**FINANCE ACCOUNT**  
For the year ended 30<sup>th</sup> June, 19XX

**CONSOLIDATED FUND**

Receipts	Tk.	Disbursement	Tk.
		<b>Revenue Division</b>	
Revenue Receipts	80,000	Revenue Expenditure	85,000
		<b>Capital Division</b>	
		Revenue Deficit (transferred from above)	5,000
		Capital Expenditure	50,000
		<b>Debt Division</b>	
Debt Received:		Debt Repaid (amortised):	
Permanent	50,000	Permanent	69,000
Floating	25,000	Floating	8,000
<b>Total Under Consolidated Fund (A)</b>	<u><b>75,000</b></u>	<b>Total under Consolidated Fund (A)</b>	<u><b>1,32,000</b></u>

**PUBLIC ACCOUNT**

		<b>Debt Division</b>	
State Provident Fund	18,000	State Provident Fund	8,000
		<b>Deposit Division</b>	
Contractors Deposit	20,000	Contractors Deposit	12,000

**Framework of financial reporting system of the government of Bangladesh-an analysis**

<b>Remittance Division</b>			
Cash Remittance to Bangladesh High Commission, London	7,000	Cash Remittance to Bangladesh High Commission, London	4,000
<b>Total Under Public A/c (B)</b>	<u>45,000</u>	<b>Total under Public A/c (B)</b>	<u>24,000</u>
<b>Total Receipts (A+B)</b>	<b>1,20,000</b>	<b>Total Disbursement (A+B)</b>	<b>1,56,000</b>
Opening Cash in Bangladesh Bank	21,000	*Closing Cash in Bangladesh Bank	(15,000)
<b>Grand Total</b>	<u>1,41,000</u>	<b>Grand Total</b>	<u>1,41,000</u>

\*Negative cash balance indicates Government borrowed from Bangladesh Bank Tk. 15000 to finance its expenditure

**The Cash Balance of Tk. (15,000) can be analysed in the following way :**

<b>Consolidated Fund :</b>	<b>Tk.</b>	<b>Tk.</b>
Receipts	75,000	
Disbursement	1,32,000	
Net balance		(57,000)
 <b>Public Account :</b>		
Receipts	45,000	
Disbursement	<u>24,000</u>	
Net Balance		21,000
Cash Balance of last year utilised		<u>21,000</u>
<b>Therefore, Cash Balance, Analysed</b>		<u><b>** (15,000)</b></u>

\*\*From the above analysis it can be concluded that, as far as the cash resource is concerned, Government fared well in respect of public account, but in respect of consolidated fund it incurred cash deficit due to less mobilization of internal resource and also because of more repayment of debt than receipt of debt.

Shown below the Government's 2<sup>nd</sup> year's performance in terms of fiscal operation rearranging the figures of finance account above:

**FISCAL ACCOUNT**

For the year ended on 30<sup>th</sup> June, 19XX

	<b>Tk.</b>
Revenue Receipts	80,000
Less Revenue Expenditure	<u>85,000</u>
<b>Revenue Deficit</b>	<b>(5,000)</b>
Less Capital Expenditure	<u>(50,000)</u>
<b>Overall Deficit</b>	<u><b>55,000</b></u>

<b>Financing of Deficit:</b>		<b>Tk.</b>
Permanent Debt (Gross)	50,000	
Less Repayment	<u>69,000</u>	
Net		(19,000)
Floating Debt(Gross)	25,000	
Less Repayment	<u>8,000</u>	
Net		17,000
Public Account (net)		
Provident Fund	10,000	
Deposit	8,000	
Remittance	<u>*3,000</u>	
		21,000
Cash Balance		<u>**36,000</u>
		<u><b>55,000</b></u>

\*Cash remittance sent to London High Commission this year is only Tk. 4,000, but the mission spent Tk. 7,000. How could this happen? If we remember that last year London High Commission did not spend Tk. 4,000 from last year's remittance. This year the mission spent Tk. 3,000 from that amount. In other words, released the fund for financing of expenditure.

\*\* Over and above the last year's balance of Tk. 21,000, an additional amount of Tk. 15,000 was used from banking sources.

**BALANCE SHEET**  
As at 30<sup>th</sup> June, 19XX

<b>ASSETS</b>	<b>Tk.</b>	<b>Current year Tk.</b>	<b>Last year Tk.</b>
Government Account :			
Opening Balance	*70,000		Nil
Capital Expenditure	50,000		
Add Revenue Deficit	<u>5,000</u>		
		1,25,000	70,000
Cash Balance		(15,000)	21,000
Remittance (lying with London High Commission)		1,000	4,000
		<u><b>1,11,000</b></u>	<u><b>95,000</b></u>



<b>LIABILITIES</b>	<b>Tk</b>	<b>Tk.</b>
Permanent Debt (By Source , say IDA Credit)	42,000	61,000
Floating Debt (By type of instrument , say Treasury Bill)	29,000	12,000
State Provident Fund Balance	21,000	11,000
Contractors Deposit Balance	19,000	11,000
	<b><u>1,11,000</u></b>	<b><u>95,000</u></b>

\*The head 'Government account' will show always debit balance, because it can be expected that government will always spend more in capital expenditure than the revenue surplus. Why is 'government account' balance shown as asset in the balance sheet? The same reason for which a business shows its accumulated loss on the asset side of its balance sheet as fictitious asset.

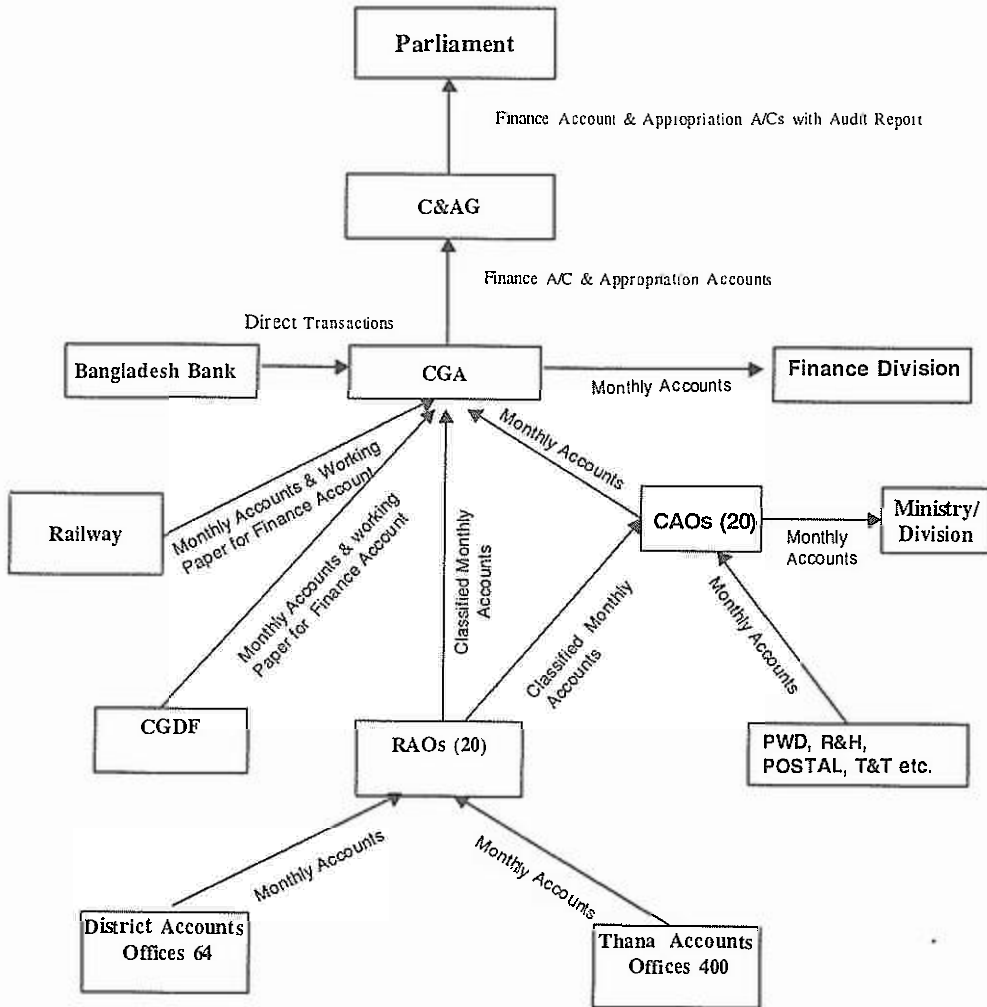
### **Government Accounts Balance to Balance**

One important feature of the Government accounts is that the accounts work from balance to balance, these balances work upto the cash balances the bulk of which is deposited with the Bangladesh Bank. If we observe the Balance Sheet of 2nd year, it can be noticed that beginning of the year started with balances in different accounts such as Government account Debit Balance of Tk. 70,000, Permanent Debt of Tk. 61,000 and also Cash balance of Tk. 21,000. The accounts under the head Government Account and Permanent debt ended with different balances at the year end. Consequently, these balances work upto the negative cash balance of Tk. 15,000.

### **Flow Process Stated**

Different elements of financial reporting system as explained in the preceding paragraphs hopefully created a demand of further explanation about the organisations involved in the financial information gathering and collation process and also about the flow of information itself. The flow chart below depicts the organisations involved and the flow of financial information among those organisations with indication of the final destination of output. It can be seen from the chart that financial information in the form of monthly accounts and other management reports serve as a strong tool for effective management of scarce resources by the executives and ensure accountability of the executives to the Parliament through submission of Finance Account and Appropriation Accounts along with a certificate from the state auditor i.e., the C&AG as to the reliability or otherwise of such information.

**Government of Bangladesh : Flow of Accounting Data Output**



**System introduced in eighties**

Before creation of 20 Chief Accounts Offices (CAO) Government accounting functions were highly centralised at the offices of Accountants General though the payment and receipts functions were mostly decentralised and used to be conducted by either treasuries or departmental officers. Only the presidency payments (an expression used for claims paid in respect of Capital City, Dhaka) used to be settled by Accountants General offices. In the year 1985, Government tried to departmentalise and decentralise the payment and accounting functions. Though every government department is linked to a particular CAO but as far as Republic's Account is concerned, still these offices remain part of the CGA system because no CAO operates on both side

(Receipts and Payments) of Consolidated fund and Public account, hence, cannot show individual balance in Consolidated Fund and Public Account. On the other hand, outside Dhaka, District Accounts offices (DAOs)/Thana Accounts offices (TAOs) perform the functions of Pay and Accounts Offices on behalf of most of the departments of the Government and operate on both side of the Accounts. They are thus in a position to reflect the transactions and the consequent balances on a particular date in the Consolidated Fund as well as in the Public Account for transactions occurring within their jurisdictions, though presently no system is in place to maintain such balance at every level.

From the above discussion, it can be concluded that unlike DAOs and TAOs, from accounting sense, the CAOs, in fact, remain as sections of Controller General of Accounts office linked to different departments, perhaps, for better and coordinated performance (not as a departmentalised office), each one feeding financial information to CGA, only in respect of the payments made by them along with the receipts deducted from those payments classified under functional and object head. Net amount paid by cheques are being reported as CURRENT LIABILITY under the head "Cheques Payable" until the cheques are paid by the Bangladesh Bank. Paid cheques are being sent back to the CAO concerned. No entry is passed in the CAO office for this. Cheques are used by the CAO only for reconciliation (a misnomer of the term bank reconciliation as used in commercial accounting) purpose. Natural question follows; how does the liability under the head "Cheques Payable" created by CAO then cleared? This is explained in the paragraph that follows next.

Receipt of revenue under the Consolidated Fund or deposit/remittances under the Public Account are deposited direct to the Bangladesh Bank by the tax/rate payer or through the departmental officers by Treasury Receipts. Bangladesh Bank at the day end prepares receipt scrolls showing the transactions occurred on the day without functional or object classification of the transactions. These scrolls are then sent to DAO, Dhaka with the supporting treasury receipts and other documents substantiating the transactions. The DAO, on receipt of the account, classifies the transactions under different functional and object heads of receipts by analysing the vouchers sent by the Bank.

In respect of payments, liability head "Cheques Payable" is debited in the books of DAO, Dhaka to clear the liability created by CAOs and "Government's deposit with Bangladesh Bank" is credited which signifies that the money has gone out of the Government Account. These procedures indicate that classification of receipts and expenditure and booking them under correct

head of accounts are the functions of the accounts office, not of Bangladesh Bank, which virtually does not perform any accounting responsibility.

Same system prevails outside Dhaka with the exception that each DAO himself records the expenditures as and when cheques are issued thereby creating the liability on the government for cheque issued and clears the liability when cheques are paid by the bank, both the side in one hand, because, as stated earlier, it operates on both side of the account.

### **Departmentalised Accounting System**

The accounting system is a bit different for the departments which run under the departmentalised concept such as Railway, Defence, Postal, T&T, Works, Forest etc. Interestingly, except Railway (Railway has separate bank account with the Bangladesh Bank, consequently shows separate bank balance in its books of accounts) all other departments do not have separate bank account. How do these departments operate, then, on the bank? These departments take money from the bank through the head "Remittance" an adjusting head in the government account and deposit their income through this head to the bank. This head is used by those departments for balancing their account.

From the above, it is clear that accounts prepared under the ambit of the CGA should reflect proper and reliable accounting information not only for statutory reporting but also showing fiscal information for various macro economic management purposes including preparation of Government Finance Statistics. Information from any other source may, of course, be useful for decision making but only as statistical information and certainly not as accounting information.

### **Systemic problems and their solutions**

Within the existing broad framework of accounting, changes occurred in the field of payment and accounting function through creation of CAOs and conversion of District and Sub-treasuries to DAOs and TAOs respectively. That created some round about procedures making system slow and unwieldy.

The prevailing system has evolved through changes made from time to time over the past few decades particularly the last one, which experienced major reform initiatives not only in the flow of accounting information but also in accounting organisation. The basis of accounting and the scope of the accounting domain have also changed following growing development inputs

from different development partners whose accounting requirement and funding practices are not uniform. Half-hearted measures in respect of departmentalisation and decentralisation of receipt and payment functions and concomitant need for accounting, have not been accompanied by necessary changes in accounting practices as well as accounting administration. As a result, although the system as evolved should have been able to generate necessary accounting data for managerial and statutory purposes, it has failed to do so due to following procedural and practical problems.

- The system as such has built-in loopholes which not only create delay in correct booking and compilation of information but also in reconciliation of data with other parallel sources of information.
- The system of internal control is inadequate. The loss of integrity of accounting information is frequent due to non-existence of structure where data is gathered, recorded and reported in an environment governed by strict controls.
- There is widespread misuse of Control accounts such as REMITTANCE A/C, DEPARTMENTAL A/C, SUSPENSE A/C etc. with unexplained balances remaining uncleared or being removed by 'fudged' accounting entries.
- The accounting data flows in too many directions, with a resultant loss of the steps in the double entry process and a confusion of audit trail.
- The CGA, in his capacity as the Government's chief accountant prepares the main Finance account of the Government which is expected to present the full picture of all Government transactions for the year. Under the current system of data collection and flow, the CGA is placed in a very difficult position. The main reason for this is that, although he should be expected to maintain 'ownership' of all the accounting data in order to prepare meaningful accounts, there are currently a number of major anomalies in this process and many transactions are processed and recorded by personnel and by procedure which are outside the CGA's control.
- The current procedural process for collecting, classifying, posting, recording, reconciling and balancing data is extremely fragmented. This, to a large degree, is a reflection of how current structure has evolved in a 'piecemeal' fashion over time, without any serious effort having been made at any one time to review the effectiveness of the system as a whole.

- A particular area of concern is the detailed role played by the banks in the crucial area of the actual coding of Government receipts and payments. The bank's involvement is currently at a level which is totally inappropriate in any well-controlled system. The Government accounting function should not be dependent on the banks for this aspect of financial processing.
- There are upto 5000 individuals in the system who have access to cheque books for the Government account, and the main Government account is sub-divided into 30 different user codes, which effectively operate like sub-accounts. It would seem unlikely that all payments generated in this way are being properly accounted for and in the absence of an effective system of internal control it is a dangerous situation to maintain so many sub-accounts and to permit so many people to have direct access to these accounts.
- The collection of data by the RAO offices from a widespread network of TAO and DAO offices and the subsequent classification of the transactions into CAO 'Head of Account' not only invites the prospects of delay but also tend to corrupt the data by splitting the double entry maintained at TAO and DAO offices and sending two aspects of double entry to two different destinations before this double entry is expected to be reunited again at the CGA office.
- The abolition of 'Exchange Accounts' between different accounting circles before any attempt was made to determine its effect on the collation and transfer of accounting data from one accounting office to another, created some problems in the area of preparation of financial statements. For example, the Postal department receives License fees for Radios on behalf of the CAO(Information). As the Postal Account is departmentalised, both sides of its account need to be balanced, and to ensure that its balancing structure remains intact, some accounting mechanism for money transfers needs to be in place.
- The decentralisation of Ledgers maintaining balances (such as Provident fund a/c, loan register etc.) from one place in the CGA office to at least 500 places, via the creation of DAO and TAO offices, was not accompanied by corresponding changes in the accounting procedure. Some accounting mechanism needs to be established to transfer balances from one accounting unit to another.

- In order to make the Government Finance Account more reliable and realistic, any figures incorporated therein should be from a source which is valid under established accounting procedures which form part of the main accounting flow. Various special accounts (DOSA, CONTASA , imprest etc.) created for aid disbursement at the instance of the development partners are not streamlined and brought to the accounting domain with clear flow both into and out of the Consolidated Fund.
- Debt is an important division within the Finance Account. A detailed schedule is needed to be attached with the Finance Account analysing debts by source as well as by instruments. The current practice of maintaining accounting details of foreign debt by Economic Relations Division does not form part of the main accounting flow. The system of Debt Management and Accounting thereof needs rationalisation.
- Theoretically, bank balances per the CGA's books and those of the Bangladesh Bank should agree because, unlike commercial accounting practice, the recognition time for cash transactions in both sets of books is the same. However, in practice this does not happen. This is partly due to the time lag in settling claims for government transactions conducted by Sonali Bank branches acting as the agent of the Bangladesh Bank and partly due to what we can term as *creative accounting*. The problem of Sonali Bank transactions, perhaps, could be tackled by opening an adjusting head under the Public Account namely 'Sonali Bank Suspense Account' to enroute all Government transactions conducted by the Sonali Bank branches throughout the country.
- Under RIBEC reform measures, computerisation of accounts consolidation at the CGA and CAO levels have been completed. What is needed now is to put in systems, procedures and appropriate internal control to improve the quality of accounting data in terms of transparency, reliability and accuracy. Computerisation at the transaction level will also have to be done gradually.

#### List of Abbreviations used

C&AG	Comptroller & Auditor General
CGA	Controller General of Accounts
CGDF	Controller General Defence Finance
CAO	Chief Accounts Office(r)
RAO	Regional Accounts Office(r)
DAO	District Accounts Office(r)
TAO	Thana Accounts Office(r)

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# FISCAL REGIME AND ITS MANAGEMENT IN BANGLADESH

Chayan Kumar Das\*

## Introduction

Bangladesh with the hope to become one of the emerging Asian tigers has passed its Fourth Five Year Plan (1990-95) and has embarked on the formulation of Fifth Five Year Plan (FFYP). Two critical objectives identified by the Twenty Year Perspective Plan for the country as well as FFYP are achieving sustainable economic growth and increased self-reliance. Domestic resource generation plays a critical role in realisation of the above objectives.

Although the non-monetarists advocate the use of both fiscal and monetary policies to stabilize output at the full employment level, the real emphasis still remains on fiscal policy. The appeal of fiscal policy is that changes in government spending or taxation directly and indirectly change output demand which leads the economy towards higher growth and full employment level of real GNP. Yet there are changes in Government spending and taxes that occur without any active decision on the part of the Government. For instance, an increase in income automatically raises taxes since income tax increases as income rises. Also an increase in income automatically reduces government transfer payments such as unemployment compensation and welfare payments.

Tax and non-tax revenues constitute the major sources of internal resources of a country. The resources available domestically in Bangladesh have historically been insufficient in enabling the government to play its assigned roles. As a result, heavy reliance on foreign resource inflows became necessary for supporting the development efforts of the country. In the absence of complementary domestic resources the available external resources could not also be properly utilized. Moreover, in the present scenario, the availability of external resources has decreased substantially owing to the recent disintegration of the former Soviet Union and the consequent fall of command economies in the eastern Europe. It is thus necessary to mobilize domestic resources substantially. On the other hand, Government should also be economical as well as judicious in spending its scarce resources.

Governments of developing countries such as Bangladesh play a very key role in the development effort either directly by carrying out a large part of the

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investment programmes of the country or indirectly by promoting and supporting the private sector.

Bangladesh has enormous potentials to increase its domestic resources by taxation and thereby pursue self-reliant economic growth. Historically, narrow tax base, higher exemption limits, various concessions and inefficient tax administration have been the major reasons for low tax yield. We have inherited an exemption-ridden tax system. A large part of our economy is outside the purview of our tax network. A vast part of our economy is also enjoying enormous exemptions. All exemptions are not well deserved. Tax holiday in many forms in the case of direct taxes, zero rates of customs duty and different exemptions from VAT have mostly contributed to the erosion of our tax base. There will always be scope for rationalisation of government expenditure programme which may improve the overall fiscal position of Bangladesh. An appropriate and dynamic fiscal policy as well as its proper management can have a wider impact on the economic development of the country.

The Ministry of Finance is the principal Government Ministry responsible for the preparation and implementation of fiscal, monetary and external sector policies. In addition to deciding on recurrent budget allocation and setting financial policies, the Finance Division is currently considering a number of fundamental structural reforms in financial, fiscal and external sectors. The Ministry feels the need to approach those and other policy issues associated with the structural reforms in a more comprehensive and analytical manner. The Ministry wants to ensure that the decisions related to economic and financial policies are based on a clear understanding of the macro as well as micro economic implications in terms of resource allocation, income distribution and other socio-economic considerations which are consistent with and supportive of the national development objectives. This would require a significant strengthening of the existing policy making operation of the Finance Division. Strengthening the analytical capabilities of the Finance Division will allow the Government to highlight the economic benefits and costs of various reform measures dealing with tariffs, taxes and credit policies which have wide-ranging impact on employment generation, resource allocation and utilization, domestic resource mobilization and income distribution.

The size and composition of both revenue and expenditure play a vital role in the process of economic development. On the revenue side, a suitably designed policy can have important contribution to the economy through making larger resources available for development. On the public expenditure side, a well-structured

policy to ensure high quality and appropriate mix of expenditure decisions can enhance productivity through increased infrastructural investment in the physical and social sectors leading to higher economic growth and poverty alleviation in the country. The two components of fiscal policy can however have certain side-effects. More importantly, fiscal deficit which is inevitable in our country has significant implications for both internal and external stability of the economy because of its adverse effect on prices, interest rate and the size of domestic public debt on the one hand and on the exchange rate, current account deficits and the external debt burden of the country on the other.

The main objective of the fiscal policy should be to facilitate faster economic growth by maintaining both internal and external stability. To achieve this, appropriate fiscal and monetary policy mix need to be adopted for maintaining fiscal and current account deficits as well as inflation rate at a lower level and raising both Revenue-GDP and Savings-GDP ratios.

The well-coordinated fiscal and monetary policies pursued recently contributed to sound macro economic management, exemplified by-

- A reduction in the inflation rate from 9 percent in 1990-91 to as low as 1.83 percent in 1993-94 although it has increased to 3.61 percent in September, 1997.
- A reduction in fiscal deficit from 7.2 percent in 1990-91 to 5.1 percent in 1996-97.
- An increase in the Revenue-GDP ratio from 9.6 percent in 1990-91 to 13 percent in 1994-95 which has slightly declined to around 12 percent in 1996-97.

### **The size of the Fiscal Deficit**

The level and the modes of financing the fiscal deficit can have important consequences for growth and macro-economic stability of the country. A fiscal deficit arising from increased expenditure on social and physical infrastructures contributes to economic growth by creating an enabling environment and by facilitating larger private sector investment. But the fiscal deficit financed by money creation may lead to higher inflation and if financed by domestic or foreign borrowing, to a rise in the interest rate and the external debt burden respectively. In Bangladesh, with undeveloped capital markets, the opportunity to mobilize the excess of savings over investment in the private sector for financing public

expenditure is limited. Consequently, any increase in the fiscal deficit in our country quite often manifests itself in the widening of the external current account deficits. It is thus necessary not only to keep the fiscal deficit under control but also to achieve a suitable balance in the mix of its modes of financing. A reduction in fiscal deficit releases resources towards the private sector and slows down the rate of monetary expansion thus stimulating private investment.

From 1991-92 to 1994-95 the net claim of the banking system on the government has been negative. This increased a little during July-December 1995 but the increase was well below the programme target set for 1995-96. Thus the fiscal deficit has not created any necessity for large monetary expansion in the country. Although in the coordination scheme between the fiscal and monetary policies in operation in Bangladesh, the former seems to dominate the latter because of the fact that the real interest rate has remained consistently below the rate of growth of real GDP, this did not exert any pressure on the Government in its effort to control either the growth of the monetary base or inflation.

The share of external resources in financing the fiscal deficit has also declined in the recent years. It was 86 percent in 1990-91 but came down to 70 percent in 1996-97. This has led to an improvement in the debt repayment capacity of the country.

The debt service liabilities increased 48 percent during 1991-96 while an appreciable improvement has also taken place in the debt repayment capacity (Table-1). The actual share of domestic resources in financing the ADP was around 49 percent in 1996-97 while it was only 24.99 percent in 1991-92.

### **Mobilization of Domestic Resources**

The prime economic reform efforts of the Government should be directed to overhauling the country's tax structure and system with the main objective of providing increasing amount of resources for development from domestic sources. Wide ranging systemic, structural and administrative improvements have led to a significant increase in tax revenues during the last half of the decade. The reforms have also led to an appreciable increase in tax revenue as a percentage of GDP (Table-2).

The centerpiece of the tax reform efforts has been the introduction of the value added tax (VAT) in the country (in 1991) which is a modern, non distorting and revenue predictive system of taxation. The VAT in Bangladesh has a broader coverage than that of the taxes it has replaced implying higher elasticity. Further, with improved supervision and monitoring it has also been possible to strengthen

tax compliance under the VAT. As a result, the revenue performance of the VAT has been quite satisfactory. Efforts have also been made to rationalize the structure of customs duty which include the lowering of high rates, reduction in the number of rates and the compression of tariff bands.

In order to accelerate economic development and poverty alleviation, it has become urgent to increase the amount of resources mobilized domestically both for promoting self-reliance and also in view of the bleaker aid climate. An undesirable feature of taxes in Bangladesh is the overwhelming dependence on indirect taxes as the direct taxes currently account for only about 21 percent of the total tax revenue. Also like other developing countries no potential exists in Bangladesh for any significant increase in direct taxes in the medium term. Hence much of the required revenue will have to be generated by VAT and customs duty. At the same time due emphasis should be given on base expansion and administrative improvements to increase the contribution of direct taxes.

#### **Tax Reform Measures:-1997-98**

Tax reform measures as pursued in Bangladesh are guided by the following basic principles:

- A progressive tax policy that ensures social justice and equity.
- A broad-based tax system, in which existing tax exemptions will be gradually eliminated and every well-to-do person in the country will be brought under the tax-net.
- Moderate tax rates and simple collection procedure.
- A tariff policy in line with the international and regional trends.

The tax proposals for FY 1997-98 have been formulated on the basis of the above principles.

**Direct Taxes:** Income tax is the principal source of our revenue among direct taxes. This year some changes have been brought in regarding income tax with a view to reducing the tax rate, widen the tax base, check tax evasion, encourage investment, reduce the complexities of tax law in order to make the income tax system realistic and progressive. The process of ongoing reforms of direct taxes came into effect since 1995-96. Several important changes in respect of income tax law and procedures were introduced in this year. Although the highest rate of

personal tax which is already one of the lowest in Asia was not reduced further the corporate tax rates for all types of corporate assessee were reduced in 1995-96. The tax holiday facility which was due to be terminated in June 1995 had been extended for another five years especially in view of the growth of investment in tax holiday companies in the last four years. Further, these facilities had been extended to commercially-run physical infrastructure facilities and to extraction of mineral resources. In the current fiscal year five-tier tax rates for individual tax payers have been introduced with the lowest tax rate of 10 percent in place of 15 percent. The amount of minimum tax has also been reduced to Tk. 1000 from Tk. 1200 with an expectation that the tax payers will voluntarily submit their tax returns showing taxable income. Discrimination to the non-resident tax payers has been removed. To rationalize the tax structure as well as to make the corporate tax system more equitable a uniform tax rate of 40 percent for non-publicly traded companies, banks, insurance companies, financial institutions and non-resident companies has been applied. Untaxed income will be exempted from tax if it is invested in setting up new industries within the period from 1st January 1997 to 31st December 1999. At the time of appeal to the Appellate Tribunal the required amount of tax payable by an assessee has been reduced from 40 percent to 30 percent.

**Indirect Taxes:** For the early settlement of customs, excise and VAT disputes a Customs, Excise and VAT Appellate Tribunal has been set up. The existing provisions for imposing anti-dumping and countervailing duties have been amended in compliance with the changes reflected in the 'Uruguay Round Agreement'. Extensive changes in the first schedule to the Customs Act have been introduced in line with the decision of the World Customs Organization (WCO). Provisions for allowing goods manufactured in export-oriented bonded warehouse to be sold in the local market have been introduced. The highest rate of duty has been lowered from 45 percent to 42.5 percent and the duty rates on a large number of raw materials, intermediate goods and capital machinery have been reduced. In the last fiscal year (1996-97) the VAT network was extended upto retail level only on ten items. To reap the benefits of VAT a phased expansion of VAT network upto retail and wholesale level has been undertaken. To remove the prevailing inconsistency and to enforce identical tax treatment both for the locally manufactured and imported goods, assessed supplementary duty on the sum of assessable value and customs duty for imported goods have been introduced. This measure will provide legitimate protection for local industries. Turnover tax has been increased from 2 percent to 4 percent.

## **Net Domestic Capital**

The net amount of domestic loans and advances and capital investment is expected to be in deficit mainly because of large repayment of foreign debt and increase in investment in areas such as rural social service credit programme, capital restructuring of corporations and the infusion of capital to different banks. This deficit however declined from 1.5 percent of GDP in 1993-94 to 1 percent of GDP in 1994-95. The net domestic capital has increased from Tk. 4.02 billion in 1994-95 to Tk. 13.09 billion in 1996-97 because of the increase in the net amount of the public account of the republic and some other reasons.

## **Public Expenditure**

Since the beginning of the current decade much careful thought has been given in designing public expenditure programme with the objective of enhancing the quality of both revenue and development expenditure. With this end in view, conscious efforts have been made to direct expenditure to the sectors possessing capabilities for increasing the productivity of human capital and the alleviation of poverty. The total of revenue and development expenditure was nearly 15 percent of GDP in 1990-91 (taking the constant GDP of 1994-95) and it is estimated to rise to 17 percent in 1996-97 (Table-3). In real terms, the volume of ADP expenditure during this period has been much higher than that of revenue expenditure. Although currently, revenue expenditure has been growing at roughly the same rate as nominal GDP, the ratio of development expenditure to GDP is expected to be higher than that of revenue expenditure to GDP.

## **Composition of Revenue Expenditure**

The economic classification of revenue expenditures during recent times indicates that the share of expenditure on goods and services in total revenue expenditure was 56 percent in 1990-91. This has increased to 59 percent in 1996-97. Pay and allowances, which is a subset of the expenditure on goods and services, would account for 35 percent in 1996-97 compared with 30 percent in 1990-91. The share of subsidies and other current transfers in revenue expenditure was 31 percent in 1990-91 and has declined to 26 percent in 1996-97. The share of interest payment has remained unchanged at around 11 to 12 percent. Revenue expenditure on the social sector was Tk. 16 billion in 1990-91. The same has increased to Tk. 31 billion in 1996-97. The education sector accounted for around 72 percent of expenditure on social sectors in 1996-97. The share of social sectors in total revenue expenditure was 23 percent in 1990-91 which has increased to 26 percent in 1996-97.

### **Composition of ADP Expenditure**

ADP utilization has increased from 86 percent in 1990-91 to 96 percent in 1995-96 and in 1996-97 it is not less than that of the previous year (Table-4). The increasing trends in ADP utilization is expected to continue in the years to come as a result of regular monitoring and improvement in project management.

The thrust of the ADP allocation continues to be on the development of socio-economic and physical infrastructure. The share of social sectors in total ADP was 17 percent in 1990-91, 31 percent in 1994-95 and the same has increased to 35 percent in 1996-97 (Table-5). Similarly, the share of physical infrastructure sectors like power, transport and communication was 21 percent in 1990-91 and the same has increased to 34 percent in 1996-97.

### **Resources for ADP**

The vastly improved mobilization of domestic resources following the implementation of the comprehensive tax reform program of the government has made it possible to finance larger part of the ADP from the country's own resources in the recent years. The share of domestic resources towards financing the ADP in 1994-95 was 43 percent and the same has increased to 49 percent in 1996-97 (Table-6).

### **Conclusion and Recommendations**

This paper broadly highlighted some of the key macro-economic indicators, which point to the fact that the economy, despite numerous structural constraints, has been growing recently at a reasonably satisfactory pace. The fiscal regime will, however, have to play a very important role to speed up the process of economic growth. In the medium to long-term there will be scope to further rationalise and improve the fiscal regime in order to achieve sustainable and equitable economic growth.

The primary objective of fiscal reform is to generate revenue at a sustainable level within the shortest possible time. And the secondary objective is to remove distortion in economic incentives and inefficiencies in the allocation of resources. A country like ours where indirect taxes are the major source of revenue and where there is hardly any potential for the direct taxes to become an important



instrument of revenue generation in the foreseeable future, it is all the more necessary to bring about well thought-out and coordinated reforms of the indirect taxes.

To ensure more revenue it is essential to gradually reduce the dependence on import based taxation, as these are typically inelastic in nature. It is necessary to expand the tax base of domestic goods and services by covering new areas of taxation and by reducing exclusions and exemptions. Further, the simplifications of tax-structure and the consequent transparency could make taxation a less exacting task.

Still there is some room for improvements in customs tariff structure by making it simple and transparent. The remaining user specific rates and the multiple rates can be abolished. There is hardly any justification for keeping positive duty rates below 15 percent. If not dictated by health, education or religious grounds the present zero customs rate can be raised to at least 15 percent. Unjustifiable zero tax rate narrows the tax base, loosens administrative control and creates opportunity for rent-seeking. For the sake of efficiency all types of imports should be subject to a minimum rate of customs duty which should not be less than 15 percent. Further, the duty rate could be brought down with appropriate downward adjustments of the duty rates on principal inputs.

In the case of VAT, no further base expansion seems to be possible in the short-run but there is a lot of scope for increasing collection by improving compliance performance.

Education of the taxpayers and tax collectors through continuous training can improve revenue collection. VAT collection on presumptive basis could also be tried for a larger number of hard-to-tax group of taxpayers. Whatever be the sales one has to pay a certain amount of tax on the fulfillment of some criteria. Valuation of imported goods still remains the most contentious part of customs assessment, some means need to be evolved to minimize disputes. The adoption of transaction value in the light of the Uruguay Round Agreement, while adversely affecting revenue to a certain extent would reduce valuation disputes significantly.

On the expenditure side, the Government's efforts to contain the growth of current expenditure and to divert more and more resources for development will have to be strengthened. This is easier to say but difficult to do because of the numerous constraints, some of which are apparently insurmountable. It is going to be a slow and difficult process, but given the commitment and initiative, reforms in phases will come by.

Appendices

**Table 1: Fiscal Deficit and External Debt**

Debt Patterns	1990-91	1995-96	Increase/Decrease (%) 1991-96
Fiscal Deficit/GDP (%)	7.2	5.7	-21
Total Debt Service (in million US\$)	317	468	48
Debt Outstanding (in million US\$)	11934	15166	27.1
Total Debt Service Export Earning (%)	19.4	11.4	-41.24
Debt /GDP (%)	51	49	-4

Source: Economic Relation Resources Division, Ministry of Finance.

**Table 2: Revenue Receipts**

(In million Taka)

Forms of Revenue	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
Tax Revenue	63830	77410	90300	98800	111100	122330	130400
Non-Tax Revenue	14390	17760	20300	24000	31000	32790	30950
Total Revenue	78220	95170	110600	122800	142100	155120	161350
Tax Revenue	7.7	8.5	9.5	9.6	9.5	9.4	9.1
Non-Tax Revenue	1.7	2.0	2.2	2.3	2.6	2.5	2.2
Total Revenue	9.4	10.5	11.7	11.9	12.1	11.9	11.3

Source: Budget Wing, Ministry of Finance and BBS.

**Table 3: Public Expenditure**

(in million Taka)

Types of Expenditure	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
Total Public Expenditure of which	25800	139240	150600	181330	206030	218300	238030
Actual Revenue expenditure	73100	79000	85100	91500	103000	118140	121030
Actual Development Expenditure (ADP)	52700	60240	65500	89830	103030	100160	117000
Total Public Expenditure of which	15.00	15.20	15.90	17.50	17.60	16.80	17.00
Actual Revenue expenditure	8.70	8.60	9.00	8.80	8.80	9.10	8.60
Actual Development Expenditure (ADP)	6.30	6.60	6.90	8.70	8.80	7.70	8.40

Sources: Implementation, Monitoring & Evaluation Division and Finance Division, Ministry of Finance.

**Table 4: ADP Utilization**

(in million Taka)

Years	Original Target	Revised Target	Actual Expenditure	Actual Expenditure as percent of Revised Target
1990-91	56680	61260	52700	86.00
1991-92	75000	71500	60240	84.30
1992-93	86500	81210	65500	80.70
1993-94	97500	96000	89830	93.60
1994-95	110000	111500	103030	92.40
1995-96	121000	104470	100160	96.00
1996-97	125000	11700	n.a.	n.a.

Sources: Implementation, Monitoring & Evaluation Division and Finance Division, Ministry of Finance.

**Table 5: Sectoral Composition of ADP, Key Sectors(%)**

Selected Sectors	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
Agriculture	5.8	7.0	5.7	5.8	5.2	4.5	5.5
Rural Development	4.2	5.3	5.6	5.3	6.6	6.8	8.8
Water Resources	12.8	8.9	9.4	6.3	6.3	5.6	9.0
Industry	1.8	2.0	1.1	1.7	1.3	1.5	1.6
Power	6.9	12.3	15.4	13.5	14.8	13.7	12.0
Oil, Gas & Natural Resources	7.2	5.4	7.3	3.6	2.3	4.1	4.2
Transport	12.0	13.9	14.8	17.2	18.9	20.1	19.9
Communications	2.2	2.7	2.2	6.0	4.4	2.9	2.0
Physical Plan, Housing & Water	4.4	5.2	3.6	3.5	4.7	4.3	5.8
Education	3.3	5.0	8.1	10.2	14.2	13.0	13.5
Population	5.9	4.5	4.3	4.5	4.6	4.1	4.2
Health	2.8	2.3	3.1	3.1	3.6	2.7	5.0
<b>Total ADP</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

Sources: Implementation, Monitoring & Evaluation Division and Finance Division, Ministry of Finance.

**Table 6: Domestic Resources Financing of ADP**

(in million Taka)

Sources of Financing	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
ADP	71500	81210	96000	111500	104470	117000
Domestic Resources (estimated)	17870	21300	34400	47980	44140	57250
Revenue Surplus (%)	20.47	29.96	34.20	37.96	31.30	33.31
Domestic Resources as percent of ADP	24.99	26.23	35.83	43.03	42.25	48.93

- Sources: 1. General Economic Division, Planning Commission.  
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# FINANCIAL SYSTEMS AND ECONOMIC DEVELOPMENT

Dr. Mohammad Hassanul Abedin Khan\*

## Abstract

Economic activities performed by multivariate economic agents in an economy cannot be undertaken without the existence of the Financial Systems (FS). Since economic performances are preconditions for economic development and the financial systems are manned for producing such economic activities economic development cannot be attained unless the FS actively support economic activities. In this article a brief discussion on financial systems and financial intermediaries has been made. The inter-dependence between the financial systems and economic development has also been outlined, while in the conclusion attempts have been made to put such strong indication that FS is not 'neutral' to economic development rather its existence is indispensable.

## Introduction

A financial system may be defined as the 'settlers' of needs of various economic enterprises and agents by locating, securing, and channeling funds for their uses and investment (Carter and Partington, 1981). In a very simple manner Kohn (1993) defines the financial system as a 'facilitator' to borrowing and lending; where presence of borrowers and lenders is in existence, and constitutes an essential part of the functioning of the financial system. A financial system consists of a set of markets, individuals and organisations who trade in those markets (Howells and Bain, 1990).

So, there are two distinct types of components in a financial system i.e. financial markets, and non-financial organisation or borrowers and related agencies. The non-financial component is composed of individual borrower, investor or business bodies. These may, in general, be termed as the borrower or deficit units (Tobin, 1989). The financial market, mentioned above is composed of two markets i.e. the direct financial market, and the intermediary market (Meyer, 1986). The participants of direct financial market are investment bankers, dealers and brokers; and the stock exchanges are used by these participants for their businesses in addition to their own premises.

The intermediary market, which is usually termed as financial intermediaries, is composed of commercial banks, development financial institutions (DFI), insurance companies, specialised banks and central bank (Kohn, 1993).

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There are various types of products that are produced by the financial markets, and traded in it among the interested parties. These products or instruments may be: bank deposits, finance or investment companies' deposits, savings certificate, treasury bills, bonds (government/private), shares/equities and life insurance policies etc. Based on the maturity, instruments may be classified under capital markets (markets for long-term claims) i.e. markets for bonds and equities, and money markets (markets for short-term claims) i.e. the discount market, the certificate of deposit market and the inter-bank market. However, the financial intermediaries (indirect financial market) use their deposits as instruments to deal with the deficit units, as this is one of their important functions to do under the financial system. The information and liquidity supplied and channeling savings to investors by financial intermediaries are central to the efficient operations of financial markets (Lewis, 1995).

### **Role of Financial System in Economic Development**

Economic development policy formulation and its achievement ultimately depend upon decisions taken by individuals or groups in a political and social context which result in the mobilisation of human activity for the task of transforming traditional modes of production, development policies and strategies and the social relations associated with them. However, without the presence and active participation of an efficient financial system the financing of economic development will be constrained and may even be stopped (Newlyn, 1977).

The development of a financial system leads to general economic development (Patrick, 1966) through making funds (created out of savings) available for financing deficit expenditure by ultimate users i.e. investors. However, financial institutions and markets influence economic welfare and development, in other ways than through the flow of aggregate spending. Financing institutions, for example commercial banks, provide an efficient medium for payments and thereby help the market system itself to function more efficiently. Access to credit from financial institutions allows entrepreneurs to undertake productive investment by providing opportunities for the establishment of new small and medium scale firms. Allocation of productive resources in a planned or orderly way rather than in disorganised ways may be possible through the existence and operation of financial institutions. In particular, financial institutions facilitate the orderly allocation of resources between consumption and investment; and it is the investment which adds to the nation's real wealth and contributes to economic welfare (Trescott, 1965). Financial markets and their operation have much to do with the processes by which productive capital, in the narrow sense, and real wealth, in the broad sense, are increased.

Historically, the process of development involves interactions among four broad categories or classes of factors, or variables: population, resources, technology, and social institutions. But for the purposes of precise analysis, these bundles of variables are neither single-valued nor, except for population, can they be easily quantified. However, for a clear understanding of the process of development it is necessary to take them into account. When a society has unchanging technology and stable social institutions, the situation in most societies for much of human history, the resources available to that society set the effective upper limits to its economic achievements in terms of the number and wellbeing of its members. But essence of economic development is change in both technology and social institutions, change that permits those upper limits to be expanded. Technology has been a powerful driving force in respect of rapid industrialisation, which is necessary for economic development, together with its concomitants, urbanisation and modernisation of agriculture. Social institutions may either hinder or facilitate technological innovation. In general, institutions tend to be stable and to resist change; but the possibility of institutional innovation does exist. One such innovation of considerable importance in the history of industrialisation was the invention of modern banking systems (Cameron, 1972).

### **Theoretical Aspects**

As an economic institution, the financial system might be expected to be more directly and more positively related to the performance of an economy than most non-economic institutions. According to Gurley and Shaw (1967), a financial system operates with two principal types of techniques. Distributive techniques (information collection and dissemination, including broker services) increase the efficiency of markets on which ultimate borrowers sell and ultimate lenders buy primary securities. Intermediary techniques bring financial institutions into the bidding for primary securities in the portfolios of ultimate lenders. Both techniques play a major role in determining the structure of primary securities (Fry, 1995).

Economists have expressed a wide variety of opinions on the effectiveness of financial systems in promoting or facilitating economic development. Schumpeter, the first modern economist to study the relationship between financial system and growth regarded the banking system as one of the two key agents (the other being entrepreneurship) in the whole process of development (Schumpeter, 1933). Other economists have argued more strongly that the banking system may bear the axiom of 'indispensability' (Fogel, 1964) and it is one of many institutions that impinge on an economy and affects its performance for better or worse (Cameron, 1972).

The way the financial system functions for economic development, as described by Cameron (1970), may be explained as follows:

- (1) The first and essential function of any financial system is to act as an intermediary between savers (or holders of idle money balances) and persons able and willing to borrow. As intermediaries, they may vigorously seek out and attract reservoirs of idle funds which will be allocated to entrepreneurs for investment in projects with a high rate of social return; or they may listlessly exploit their quasi-monopolistic position and fritter away investment possibilities with unproductive loans.
- (2) The second function, which makes financial institutions of special importance in market economies is that they furnish part or all of the means of payments, or money supply (Sayers, 1960). They may do this either by issuing their own promises to pay (i.e. bank notes); or by holding or transferring the monetary deposits of the public. In either case they are in a position not merely to serve as the custodians of the stock of money, but also to increase or decrease that stock. As creators and providers of the means of payment, they may redirect real resources into more productive activities.
- (3) A third possible function (although it is not inherent in the definition of a financial system many economists are advocates of this function) is the provision of entrepreneurial talent and guidance for the economy as a whole. That is, instead of restricting themselves to a purely intermediary function, banks and other financial institutions may actively seek out and exploit profitable undertakings in manufacturing, commerce, or any other productive activity and thus may set their country on the road to continuing growth, or they may waste its resources in uneconomical or fraudulent activities.

The financial system influences the size, composition and utilisation of a country's stock of capital, and so may promote growth of real national income (Drake, 1980). Patrick (1966) believes that the financial system can exert a growth influence on the capital stock by improving the composition of the existing stock of capital, efficiently allocating new investment among alternative uses, and raising the rate of capital formation by providing incentives for increased saving and investment. This underlies his advocacy of what he terms the *supply leading* policy of financial development in poor countries. *Supply leading* denotes the conscious creation of financial institutions, instruments, and services in advance of the demand for them. Supply leading is contrasted with



*demand following* finance, in which the financial system and its services develop in response to demand for financial services by investors and savers.

*Supply leading* has two functions: to transfer resources from traditional (non-growth) sectors to modern sectors, and to promote and stimulate an entrepreneurial response in these modern sectors. Financial intermediation which transfer resources from traditional sectors, whether by collecting wealth and saving from those sectors in exchange for its deposits and other financial liabilities, or by credit creation and forced saving, is akin to the Schumpeterian concept of innovation financing (Patrick, 1966; pp. 175-6).

Patrick's supply-leading policy may not be a permanent policy for a developing country, since as a country's economy develops there may be increased demand for money supply and other financial instruments and services on the part of entrepreneurs (which may be a result of a supply-leading policy) and a demand-following policy may emerge in due course.

Financial improvements may also facilitate international movements of capital, although it is doubtful if they have hitherto motivated capital inflows to any territories that were not already so destined for other reasons (Howells and Bain, 1990). In the contemporary world, however, it is very likely and important that local financial development will deter capital outflow by providing attractive financial assets in the home economy. The brevity with which this point is made should not cause us to underestimate its great importance. There is considerable evidence showing diversion of savings from foreign to local financial assets, as the opportunities to acquire the local assets were created by the development of a local financial system (Bank Negara Malaysia, 1979).

There is a beneficial division of labour in the process of financial intermediation by institutions. The argument for this type of financing rests chiefly on the grounds of improved allocation of resources. Just as direct finance breaks open the restraints imposed by an investor's dependence on his own saving, so indirect finance circumvents the direct link between any individual saver and an individual investor. In other words, financing conducted through financial institutions removes the 'marrying' difficulty that the direct form of finance imposes (Drake, 1980). The essence of the allocational argument for intermediation is that different financial institutions cultivate particular finance specialisations at which each institution becomes very adept. Given this specialisation, a network of such intermediaries should lower the real cost of financing and, by efficiently sorting out and ranking the various investment

proposals, improve the allocation of investible resources in total (Patrick, 1966; Drake, 1980).

### Historical Evidence

Historically, in developing economies, the function of the financial system has been of great importance. And over the last 15 years, a growing number of economists - Adams, Chandavarkar, Fry, Shaw and McKinnon, among others have agreed that a well-developed financial system does matter in economic development (Germidis et. al. 1991), ranking *pari passu* with other necessary 'inputs' such as natural resources, labour markets, management, technology, entrepreneurial ability, and this at a time when the need to relay foreign financing with domestic resources is becoming increasingly urgent and hence must be met through the reform and development of domestic monetary and financial systems (Germidis et. al. 1991).

The industrial countries of the present time are in part the results of their efficient financial systems (Gerschenkron 1962, 1968; Cameron 1970; UNDIIO 1990). Industrial countries have exhibited two distinct patterns of financial system development. The Anglo-Saxon countries developed commercial banks that supplied short-term finance for trade. Two important principles were self-liquidating paper and arm-length relations with business enterprises. In contrast, the universal and multipurpose banks that developed in eighteenth-century Germany supplied both short and long term finance and had close associations with their borrowers (Fry, 1995). Gerschenkron (1968) believes that the banking system played a key role at certain stages in the European industrialisation process. In Germany, the banking system was the primary source of both capital and entrepreneurship. He argues that the inadequacy in the number of available entrepreneurs could have been remedied or substituted for by increasing the size of plant and enterprise above what otherwise would have been an optimal size. In Germany, the various inadequacies of the individual entrepreneurs were also offset by the device of splitting the entrepreneurial function: the German investment banks, comparable in economic effect to that of the steam engine were in fact a substitute for entrepreneurial deficiencies. From their central vantage points of control, the banks participated actively in shaping the major and sometimes even not so major decisions of individual enterprises. It was they who very often mapped out a firm's paths of growth, conceived far-sighted plans, decided on major technological and locational innovations, and arranged for mergers and capital increases (Fry, 1995).

Modern developed countries came out of backwardness and attained their development through the process of industrialisation and the financial system

contributed tremendously in this regard (Gerschenkron, 1968). The approach analysed by Gerschenkron has also proved a useful starting point for the discussion of non-European late comers in the world economy, including Japan and the newly industrialised countries-NICs e.g., Korea and Singapore (Fishlow, 1989). Gerschenkron views industrialisation as a process that spread from its birthplace in England to 'more backward' countries. In general, 'backwardness' in this sense and viewed in the context of the Industrial Revolution varied directly with the distance from England, as do the dates for the inception of industrialisation. The 'degree of backwardness' thus became an organising principle according to which Gerschenkron classified a number of features of the development process. Depending on a given country's degree of economic backwardness on the eve of its industrialisation, the course and character of the latter tended to vary in a number of important respects (Gerschenkron, 1968, p. 353). Gerschenkron stated that the more backward the economy is:

"the greater ... (is) the part played by special institutional factors designed to increase supply of capital to the nascent industries and, in addition, to provide them with less decentralised and better informed entrepreneurial guidance; and it (industrialisation) leaves a smaller role for agriculture".

There have been numerous pieces of research which have sought to test the Gerschenkron hypothesis. The main idea behind these is to analyse the role of financial systems in economic development, within a strategy of industrialisation. According to a case study (Cameron, 1972), in the cases of four European countries (Austria, Italy, Spain and Serbia) it was seen that two of these countries i.e., Serbia (Lampe, 1972), Spain (Tortella, 1972) had failed to achieve significant industrialisation and the rest two's i.e., Austria (Rudolph, 1972), Italy (Cohen, 1972) industrialisation was tardy and incomplete before 1914. On the other hand, Japan (Yamamura, 1970) and the United States (Sylla, 1972) were extraordinarily successful- both achieved high rates of industrial growth. In studying the European countries, researchers have found that there are various possible answers to the question: what went wrong? Perhaps the countries were so poorly endowed with resources, natural and/or human, that industrialisation was simply out of question. On the other hand, although not every country has a Ruhr Valley, there are other possibilities for industrialisation, as the case of Japan shows. In the countries that failed to industrialise was the banking system at fault? Or did their governments' economic policies stifle the natural possibilities for growth? In each of the cases investigated in the research considered above it was detected that it was likely that many factors were at work in hampering economic growth that even a drastic restructuring of the banking system would have resulted in only a slightly better over-all performance (Cameron, 1972).

The Gerschenkron hypothesis received considerable academic attention in the late 1960s and early 1970s. It was taken up again by Khatkhate and Riechel (1980) and Patrick (1984). They advocate, in line with the Gerschenkron hypothesis, universal or multipurpose banking in developing countries. The World Bank also recommended the adoption of universal or multipurpose banking systems, wherein there will be banks and financial institutions to cater to the needs of various types for example-banks with programmes for poverty alleviation/industrial development in developing countries. It also advised on the strengthening of the financial system for the sake of economic development.

### **Financial Intermediaries in the Financial System**

Financial institutions first emerge in an economy to reduce liquidity and productivity risks for savers. They allow individuals to reduce the number of their transactions, so economising on transaction costs, by holding their savings in a bank or other financial institutions rather than in a diversified portfolio of direct financial instruments. At the same time, savers may achieve a preferred trade-off between liquidity and return. Financial intermediaries exploit economies of scale in evaluating and monitoring borrowers. Financial intermediaries are the only source of external funds for many small and medium-sized businesses because information costs are prohibitively high for them to issue equity or bonds (Fry, 1995).

Goldsmith (1969, pp. 395-7) argued that financial institutions can raise the totals of savings and investment above the levels that would have occurred in the absence of institutional borrowing and lending, when savers and investors would be limited to direct financing. The main support for this argument lies in the observation that most savers and lenders prefer to hold claims against financial institutions rather than the primary securities issued by actual investors (Drake, 1930).

Empirical support for the view that the existence of financial institutions raises the savings ratio can be obtained from the work of Hooley (1967), which shows that savings in the Philippines responded positively to development of the financial system in that country over the decade 1951-60. Similarly, many prefer to borrow from financial institutions than from individual lenders. Institutional finance may be more tailored to particular investment projects, may be in more continuous supply, may be more flexible (in amount and in terms) should circumstances change and may well be cheaper (Drake, 1980).

The existence of financial institutions does not of itself resolve the problems of uncertainty, costly information, transaction costs, and economies of scale in

information collection but it may help to augment the process of economic development by reducing these problems and by making financial transactions more effective. For example, the financial intermediaries can encourage individuals to release their savings for productive investment by reducing their holdings of unproductive tangible assets and can also improve the allocation of investible funds in various ways: pooling funds and acquiring information that enable them to allocate capital to its highest valued uses, so raising the average return to capital; providing maturity intermediation by offering liquidity to savers and, side by side, long term funds to investors, so stimulating productive investment; enabling individuals to diversify idiosyncratic risk of individual projects, so encouraging capital ownership and productive investment; evaluating investment projects and valuing the expected profits from specific innovative activities.

Improved financial intermediation is likely to increase the rate of economic development and growth through increased quality or quantity of investment in firms in the economy. There is a close interconnection among financial intermediation, savings, investment, income and economic development and growth (World Bank, 1989; Fry, 1995). Financial intermediaries operate to raise the level of savings which leads to higher level of investment which in turn increases the level of income and income then raises the level of savings. In a modern economy, investment is carried out by one group of individuals and institutions, while much of the savings is done by other groups.

### **Conclusion**

From the above discussion it can be inferred that financial systems are not 'neutral' with respect to economic development. Where they exist, they do so because there is a demand for their services, and such a demand is usually evidence of a growing, developing economy. It cannot be argued that financial systems invariably make a positive, unambiguous growth inducing contribution. They are not separate from the multivariate characteristics of the economy of which they are a part and thus may not be an independent variable in the growth process. As Tortella (1972) points out, the financial system can be 'tilted' by unwise legislation and policy. A financial system can distort and even thwart the growth of the economy. Although the fundamental dynamics of development lie outside the financial system, the way the system is structured can either significantly hasten or retard development. It is thus a matter of great importance for policy makers to know what structural characteristics are especially favourable or unfavourable. For better performance of financing development there should be a competition in the financial system i.e., among financial institutions, which may be possible, at the initial stage of development financing

by following the supply-leading policy and then demand-following policy afterwards. This competition in the financial system can act as a spur to the mobilisation of idle financial resources and to their efficient utilisation in trade, commerce, and industry. These inferences do not arise from any doctrinaire attitude, but solely from examination of and reflection on historical experience (Cameron, 1972).

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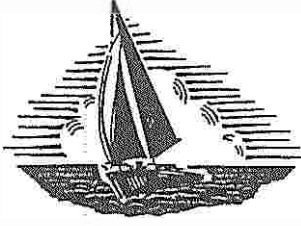
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  - ◆ বহুস্থায়ী স্ক্লেরোসিস (Sclerosis)
- পরিশি গ্রহণের জন্য কোন মেডিকেল সার্টিফিকেট প্রয়োজন হয় না

### (২) বৈদেশিক চিকিৎসা সংক্রান্ত বীমা :

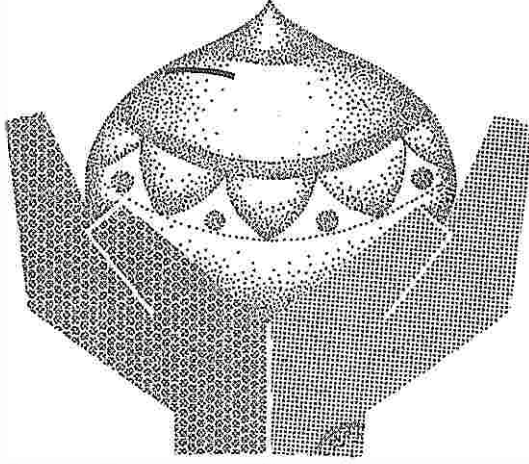
- যে সমস্ত বাংলাদেশী নাগরিক বাবশাঙ্কিত কাজে, অবকাশ যাপন, ঠাকুরী এবং শিক্ষার জন্য বিদেশে যাবেন, তাগাই এই পরিশি গ্রহণ করতে পারবেন
- বৈদেশিক মুদ্রা চিকিৎসকের মিসিং চিকিৎসা ব্যয়, হাসপাতাল ব্যয়, কলেজী চিকিৎসার জন্য স্থানান্তর ব্যয়, ট্রান্স যোগা ফুডজটির লান অন্যান্য ব্যয় ইত্যাদি পরিশোধযোগ্য

বিস্তারিত তথ্যের জন্য প্রধান কার্যালয়ের দায়গ্রহণ বিভাগে (ফোন : ৯৫৬১২৪৯)  
যোগাযোগ করুন :



রাষ্ট্রীয় খাতে সাধারণ বীমার একমাত্র প্রতিষ্ঠান  
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(অর্থনৈতিক নিরাপত্তার প্রতীক)

রূপালী ব্যাংক আপনার অগ্রযাত্রার সহযাত্রী



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আপনার বিশ্বাস এবং আস্থা ই আমাদের মূলধন



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