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BANGLADESH: CORRUPTION RISKS IN THE PUBLIC FINANCIAL MANAGEMENT SYSTEM

QUERY

What are the corruption risks in the public financial management (PFM) system of Bangladesh?

PURPOSE

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SUMMARY

A country's public financial management (PFM) system is central for the achievement of a government's policy outcomes and goals. Like many government activities and processes, a PFM system can also be susceptible to corruption risks.

In Bangladesh, there are important corruption risks identified by different institutions, scholars and civil society organisations. These risks are present throughout the PFM system, including the tax administration, the budget preparation and allocation of funds, expenditure of public funds and the external oversight.

Some identified corruption risks include bribery and collusion in the tax administration; bribery in the allocation of development funds; embezzlement in the expenditure of public funds; collusion in public procurement tenders; and extortion in the performance of external audits.

This answer considers corruption risks in the PFM system of Bangladesh, focusing on Bangladesh's tax administration, budget process, public procurement process, and external audit and parliamentary oversight.

1 OVERVIEW

A country's public financial management (PFM) system is central for the achievement of a government's policy outcomes and goals. The PFM system is typically composed of a series of government activities relating to the collection, allocation, management, execution and oversight of public financial resources. This includes revenue collection and management, the planning, implementation and audit of public budgets, and public procurement.

Like many government activities and processes, a PFM system can also be susceptible to corruption risks. The PFM system is tasked with the role of ensuring the effective and efficient use of public resources and, when not done properly, it can be susceptible to different types of corruption and maladministration. Corruption can occur at different points within the PFM system.

The budget cycle is susceptible to corruption, from its planning stage – where decision makers can allocate resources to projects which will provide private gain – to the execution of resources – where politicians or public officials embezzle public funds. In procurement, corruption risks include nepotism or bribery in the award of contracts. This can occur at different stages of the procurement process, such as the needs assessment – identifying what needs to be purchased – preparation of tender documents, or in the award process.

In general, a PFM system is most vulnerable to corruption risk when:

- the regulatory framework is weak and allows for an inordinate amount of discretion by public officials
- processes are not rigorous and streamlined, which makes them difficult to monitor
- transparency is lacking, which prevents proper scrutiny of public actions and the use of funds
- internal and external controls are inadequate, allowing for low probability of detection and sanction

Given the importance of the PFM system in ensuring probity and effective use of resources, it is commonly assessed in order to identify weaknesses and areas

for improvement. These assessments are used to identify institutional reforms, but can also help to manage risks in overseas development assistance. It is important to note that many of these assessments do not look at corruption risks explicitly (Transparency International 2013) rather they do so indirectly by assessing good practices in the frameworks, processes and institutions embedded in the PFM system.

The PFM system in Bangladesh has been assessed by different institutions which look at different aspects of the system. The Asian Development Bank, in its 2013 Country Performance Assessment, provides an overall assessment of Bangladesh's public sector management and institutions with a 3.9 on a 1 (poor) to 6 (strong) scale (ADB 2001). This rating includes assessment of the country's property rights and rule based governance (4 points), quality of budgetary and financial management (4 points), efficiency of revenue mobilisation (4 points), quality of public administration (3.5 points), and transparency, accountability and corruption in the public sector (4 points) (ADB 2014). Notable is the score for transparency, accountability and corruption which is awarded a 4.0 on the same 1 to 6 point scale.

In 2012, Bangladesh approved a National Integrity Strategy, which sets out a series of goals, strategies and action plans to increase accountability, transparency and efficiency of state and non-state institutions (GoB 2013). There has been progress on the implementation of the strategy, such as the establishment of the National Integrity Advisory Committee (TI Bangladesh 2014).

2 CORRUPTION RISKS IN BANGLADESH'S TAX ADMINISTRATION

Corruption in tax administration can manifest itself in the various relevant processes, including registration of taxpayers, collection of tax dues, identification of tax liabilities and inspections (Transparency International 2010). In essence, tax related corruption occurs when tax administrators forego collecting taxes in exchange for personal gain. This can occur when: there is a weak legal framework which allows for discretion of the tax rates and provides for many exceptions, in which case citizens or companies can bribe or illegally negotiate to pay less taxes; where

the tax collection mechanism is weak and does not have proper controls to prevent bribery; or when public officers within the tax administration embezzle tax revenues.

The tax administration in Bangladesh is considered highly discretionary and informal (Hassan & Prichard 2013), which provides many opportunities for corruption. This is in part due to limited administrative modernisation. In Bangladesh, the system of control relies on the physical monitoring of taxpayers. This system of provides greater opportunities for collusion or extraction of rents from taxpayers (Ibid).

The Global Integrity Report (2010) identifies weaknesses in the uniform and predictable application of tax laws and notes that the government provides special treatment to different groups.

Tax liabilities by large and small businesses are defined by a negotiation process between the businesses and the tax administration, whereby both parties enter into implicit agreements which involve regular informal payments. This dynamic is more prevalent with small businesses due to the regular interaction between them and the tax collectors. Accounting and audit firms, who nominally verify tax declarations, are largely passive participants of this informal process. In sum, this process lends itself to a high degree of collusion and corruption (Ibid). The World Bank's Enterprise Survey for 2013 reports that, in Bangladesh, 41 per cent of firms expect to give gifts in meetings with tax officials.

The National Board of Revenue (NBR) – the central tax administration entity – operates in a weak policy framework, characterised by a wide range of exemptions, incentives and special regimes, providing significant scope for discretion in granting benefits to targeted groups of taxpayers in both tax policy and administration. This situation undermines both revenue collection and equity. The NBR faces major human resource and capacity challenges, and is also characterised by high administrative fragmentation and weak enforcement mechanisms (Ibid). This space for discretion combined with a low level of automation and inefficiency of data management continue to provide NBR officials with many opportunities for collusion with, or extraction from, taxpayers.

This discretion is exacerbated by significant fragmentation and low coordination and information sharing between the various NBR departments which operate autonomously, increasing the risk of collusion, arbitrariness and abuse (Ibid).

In addition, enforcement mechanisms relating to the tax administration is weak. On the one hand, large-scale taxpayers are able to use political influence to avoid enforcement efforts. On the other, the judicial system contributes to weak enforcement given that lower level appeals are characterised by widespread corruption while high court cases offer informal means to delay or avoid tax payments given the long process delays and suspension of tax collection while cases are pending (Ibid).

The informality of the tax system in Bangladesh has allowed politicians to use it in pursuit of their own interest, as it serves as a mechanism for distributing patronage and a source of funding the political leadership (Hassan & Prichard 2013).

3 CORRUPTION RISK IN BANGLADESH'S BUDGET PROCESSES

The budget process spans a series of activities which can be vulnerable to corruption. The process includes allocation of public resources, cash expenditures and management and financial reporting, and auditing.

Allocations of public resources/budget formulation

The allocation of public resources in the budget is a critical step to ensure funds are used in the most efficient and effective manner. Poor planning and allocation of resources during the first stage of the budget process can undermine its effectiveness and give space for corruption and maladministration. In addition, risks of corruption are higher in cases where transparency and participation are low. The major risks of corruption during the this phase of the budget cycle are 1) allocating resources in preparation of future embezzlement, 2) allocating resources to projects based on personal or political criteria, and 3) allocating resources in order to seek future rents (Transparency International 2014). In some cases, corruption risks in the allocation of public resources

may come in the form of bribes to politicians from special interest groups for development of infrastructure, for example (U4 2005).

Bangladesh is currently utilising a medium term budgetary framework (MTBF) which allows the government to set the strategic direction of expenditure in the medium term. This framework restricts the discrepancy of budget allocation through setting ceilings and priorities based on careful analysis of macroeconomic and fiscal conditions. Despite the establishment of the MTBF, the preparation of the development and non-development budget has not been integrated fully into this framework (PEFA 2010), which can increase the risk of non-strategic and/or discretionary budget allocations.

In terms of the level of transparency, Bangladesh scores relatively well on the Open Budget Index for 2012, with a score of 58 out of 100 (IBP 2012a). The information provided in the executive's budget proposal receives a score of 76 out of 100.

The lack of information on extra-budgetary funds which are not reported in full in the executive's budget proposal is noteworthy (IBP 2012b). In addition, there are statutory bodies that perform government functions; however, not all of their allocation is appropriately reflected in the budget (PEFA 2010). It is also important to note that unreported extra-budgetary expenditures constitute 1-5 per cent of total expenditure (Ibid). This lack of transparency of budget allocation increases the risk of corruption and maladministration of off-budget expenditures. Off-budget expenditures can often be used as a vehicle for embezzlement, patronage, or corruption as they do not form part of the traditional budget oversight process.

The Public Expenditure and Financial Accountability (PEFA) 2010 assessment for Bangladesh rates orderliness and participation in the annual budget process with a B (maximum score is A), and highlights that the budget estimates compiled by the ministries and divisions are approved by the National Cabinet at a very aggregate level (PEFA 2010), which can constrain the cabinet's oversight. In addition, the National Parliament has relatively little time to review budget estimates, which is insufficient for meaningful debate (Ibid) and oversight. This

raises the risk of corruption as there is no proper scrutiny of resource allocations.

Cash expenditure and management/budget execution

Proper cash expenditure and management and transparency of the execution of public funds are key to reduce corruption risks. In the Open Budget Survey (2012), Bangladesh scores 88 out of 100 for in-year reporting, this means that transparency in expenditure execution is adequate during the budget year.

Despite the timeliness and transparency level reported by the Open Budget Survey, the PEFA 2010 assessment considers that effective budgetary control is still an area needing improvement. The assessment finds that the budget and accounting information system is not integrated and automated and lacks a mechanism for monitoring expenditure commitments (PEFA 2010). This raises the risk of corruption and maladministration given that expenditure verification is performed manually. In addition, there is an integrity risk in the management of payroll given the lack of regular reconciliation of personnel and payroll records (Ibid). The PEFA 2010 assessment also notes the absence of an internal audit function and internal audit reports. Lastly, it is reported that compliance with financial rules is lax, as it is not common for officers to be held to account when found guilty of irregularities (Ibid).

Another possible risk associated with the implementation of budget allocations is the high rate of deviations of actual expenditure versus planned. It is found that in Bangladesh actual expenditures vary significantly from what is initially budgeted (PEFA 2010). This can pose a corruption risk given that it undermines the oversight role of the National Parliament in the budget process. It is noted that changes in the budget during the year (supplemental budgets) are approved by the legislature after funds are spent but before the end of the financial year (IBP 2012).

Another area of risk can be found in the inter-governmental transfers of funds. Although transfers from the national to local governments are a small share of total national budget, they represent a significant percentage of local government revenues

(PEFA 2010). It is noted that the transfer system is fragmented and, for the most part, allocated through ad hoc negotiations rather than formula driven (Ibid). In addition, it is reported that fiscal reporting from local governments is weak as there is no consolidated fiscal report consistent with the national fiscal reporting. In sum, inter-governmental transfers pose a corruption risk in that the level of transparency in allocation and reporting is weak in Bangladesh.

A report from Transparency International Bangladesh, which looked at the behaviour of members of parliament, found that 75.5 per cent of parliamentarians were involved in negative activities regarding development funds at the local level (TI Bangladesh 2012). This included taking bribes for distributing development funds, influencing the approval of development projects and allocating funds to fake projects or organisations. The study further identified that 78.7 per cent of members of parliaments who misappropriated development funds took “commissions” for approving projects (Ibid).

There are also leakages in the transfer of funds from the central government. A study on effectiveness of public expenditure in the education sector found that corruption in resource management, leakages of funds and political or bureaucratic capture affected the impact of public expenditure in education. The study finds that on average only 38 per cent of the total non-wage development funds allocated to primary schools reached their destination, while the rest was leaked (Hossain 2013).

4 CORRUPTION RISKS IN PUBLIC PROCUREMENT

In procurement, corruption risks include nepotism or bribery in the award of contracts. This can occur at different stages of the procurement process such as needs assessment, preparation of tender documents, and in the award process or the execution of a contract.

Public procurement in Bangladesh is regulated by the Public Procurement Act of 2006 and subsequent regulations (Public Procurement Rule 2008). However, the consistent application of the act and rules has been relatively inconsistent across government and individual agencies. This is

exacerbated by a lack of information and expertise within the procuring institutions (TI Bangladesh 2014). The lack of adequate procurement management capacity in implementing agencies is also noted in the PEFA (2010).

The World Enterprise Surveys (2013) for Bangladesh identifies that 49.6 per cent of the participating firms identified corruption as a major constraint. The percentage of firms experiencing at least one bribery payment request is 47.7 per cent, while the percentage of firms expected to give gifts to secure a government contract is 48.9 per cent. The value of the gift expected to secure a government contract is 2.9 per cent of the contract value (Ibid).

Common corruption risks in procurement include political patronage (Business Anti-Corruption Portal 2014) and bribery to gain contracts. According to the World Economic Forum Global Competitiveness Report for 2013-2014, it is quite common for companies in Bangladesh to make undocumented extra payments or bribes to win contracts or licences with a rating of 1.9 on a 1 (very common) to 7 (never occurs) scale. The report also states that favouritism of government officials to well-connected firms is high, with a rating of 2.2 on a 1 (always show favouritism) to 7 (never show favouritism) scale.

Local government procurement is also regulated by the aforementioned rules; however, TI Bangladesh asserts that there is limited awareness at the local level of these rules by elected officials (TI Bangladesh 2014) raising the risk of corruption in procurement at the local level.

At the sub-national level, bid rigging is a common risk of corruption. Procurement officials tend to manipulate the technical specifications or the qualification requirements in order to favour a specific bidder (Sirajul Islam 2012). Other forms of corruption are the release of insider information to a specific bidder to enable them to submit the best bid, or influencing the tender evaluation committees (TI Bangladesh 2013). In addition, collusion is also a common risk, whereby companies reach informal agreements between themselves to favour a specific bidder (Sirajul Islam 2012).

In terms of transparency, there is no specific regulation that provides guidance on management of

procurement documents (TI Bangladesh 2014). In addition, there is room for improvement in terms of providing procurement information to the public (PEFA 2010). The general provisions under the current regulation for publishing contract awards above a threshold is generally complied with, but not always. In addition, notifications of contract awards below the threshold have found to be rarely published (Ibid). This increases the risk of corruption given that a smaller procurement may not be opened to tender or the tender notice is not disseminated widely, pointing to potential patronage.

The Global Integrity Report (2010) notes that there are no mechanisms in place to monitor assets, income and spending habits of public officials. In addition, it notes that there is a risk of political influence in public procurement, for example, through a conflict of interests.

Most recently, corruption allegations have surfaced relating to the tendering of a public bridge and an attempt by businessmen to bribe public officials (McArthur 2013). The Padma Bridge is a US\$2.9 billion¹ project which was halted due to allegations of a high-level corruption conspiracy among government officials, potential bidder, SNC-Lavalin executives, and private individuals (World Bank 2012). The World Bank, who had extended a loan to the government for the construction of the bridge provided evidence and urged the government to take immediate action. As a result, the World Bank loan has been withdrawn and the executives of the accused company are facing trial in Canada.

The World Bank is supporting improvements in Bangladesh's public procurement system through the Public Procurement Reform Project II. This project, which began in 2007, seeks to improve the public procurement system through capacity building, performance monitoring, introducing e-procurement and social accountability mechanisms. According to the World Bank there have been some advances in terms of efficiency and effectiveness of procurement and enhanced transparency among others (World Bank 2013b)

5 EXTERNAL AUDIT AND PARLIAMENTARY OVERSIGHT

External audits

Proper external oversight of the PFM system is key to minimising corruption risks. In Bangladesh, the Office of the Comptroller and Auditor General (OCAG) is the supreme audit institution with the mandate to scrutinise public spending on behalf of the National Parliament. There are several corruption risks within the oversight of public resources. Firstly, the supreme audit institution lacks the capacity to perform timely audits. Secondly, the OCAG suffers itself from corruption. Lastly, the parliamentary committee responsible for safeguarding public resources lacks has not been effective in punishing and following up on the implementation of recommendations.

Although the OCAG is constitutionally independent, it is constrained by its financial dependence to the Ministry of Finance. This has not posed a problem to date as the budget requested has been largely met throughout the years (PEFA 2010). According to the National Integrity System Assessment of Bangladesh (TI Bangladesh 2014), the OCAG has some limitations in skilled manpower. It is reported that the OCAG operates with only 40 per cent of the staff required to perform its duties properly. It does not have the ability to recruit directly as this task is assigned to the Ministry of Establishments, which receives only informal input from the OCAG (PEFA 2010). In addition, there are possible cases of conflict of interest as auditors and accountants are part of the same force (Ibid).

Allegations exist regarding the purchasing of positions within the OCAG, whereby candidates would pay bribes to be recruited to a position (TI Bangladesh 2015). Similarly, nepotism is also a corruption risk as it has been reported that trainers and selection for foreign mission audits are not based on merit (Ibid). Lastly, request for bribery payments by auditors is common during field visits and after, when findings are discussed and negotiated (TI Bangladesh 2015 & 2013). While the OCAG has ample authority and access to investigate public funds, it lacks the authority to issue sanctions (PEFA 2010).

¹ Note: Transparency International takes "billion" to refer to one thousand million (1,000,000,000).

Parliamentary oversight

Until recently, there was a backlog of audits of public expenditure. The OCAG submits audit reports to the Public Accounts Committee (PAC) – the parliamentary committee in charge of the examination of public accounts – more than 12 months after the end of the fiscal year. Some stated reasons for the significant backlog include the lack of rules that compel administrative units to respond to audit findings (TI Bangladesh 2014). The PAC had a significant backlog of audit reports to review and table before the parliament. In 2009, the PAC had received 490 audit reports which were pending scrutiny (PEFA 2010). According to the OCAG's 2013 Annual Report, the PAC undertook unprecedented efforts to resolve existing un-discussed reports (OCAG 2013). To date the backlog of unaddressed audit reports has been cleared (Sánchez 2014).

The PAC produces recommendations in light of the audit reports; however, these are not enacted promptly and forcefully. Lastly, there is no institutional mechanism to follow up on the implementation of recommendations stemming from the audit (PEFA 2010). In sum, the sanctioning system is weak, to the extent that it has been alleged that the government has failed to take punitive action despite reiterated recommendations by the OCAG (TI Bangladesh 2014).

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