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AGGREGATE FINANCIAL PLANNING, FLOW OF FUNDS, FINANCIAL PERFORMANCE AND FINANCING OF PUBLIC SECTOR BODIES IN BANGLADESH

Introduction

It is not possible to analyse the resource allocation situation in Bangladesh within the kind of flow of fund framework used to discuss the condition in the U. K. The analysis will be limited to financial performance of public sector enterprises since they comprised the manufacturing, energy and transport business almost in totality excepting a few multinational units—in pharmaceuticals, electrical appliances and tobacco. There are basically two other reasons for restricting the analysis on public sector enterprises and autonomous bodies. First, data on these entities are available at an aggregage level and second, although these units are in the public sector they like private sector enterprises budget and report their financial performance in terms of conventionally-measured profit and their reported figures are not only used for budgetary purposes by the government, taxes and payment of dividend to the government are also charged and realised by the government according to these reported figures. Payment of taxes and dividends by BSFIC and BTMC and three enterprises of BCIC have been demonstrated in Chapter 6 alongwith two private sector companies.

Financial Performance of Public Enterprises

As is well known government budgetary exercises are carried on with cash flows. When accounting flows of public enterprises are included within the non-tax revenues it actually amounts to mixing 'bananas' with 'mangos' and makes financial forecasting truly a hoax. In the following sections we will make an attempt to throw some light on the problems created by the uncritical use of accounting information for the purpose of government budgetary operations, illustrate the magnitude of the 'error' in measuring financial performance of a very large autonomous body—Bangladesh Power Development Board (BPDB) and report limited sectoral flow of fund analysis based on banking statistics and make certain observations and recommendations for improving performances.

The following Table 1 presents data on accounting profits and losses of public corporations and autonomous bodies for the year 1979, 1980 and 1981.

TABLE 1 : **FINANCIAL PERFORMANCE OF PUBLIC ENTERPRISES AND AUTONOMOUS BODIES*** (Taka in Million)**

Corporation***	FY79	FY80	FY81	% of Revenue in FY81
Manufacturing				
Jute Mills	(611)	1,167	401	6.3
Textile Mills	47	(187)	(110)	(3.3)
Steel & Engineering	110	158	126	3.7
Sugar and food	63	212	297	8.9
Chemicals	47	51	92	2.5
Energy				
Power	(393)	(304)	(333)	(18.6)
Petroleum	74	(1340)	520	4.5
Petrobangla	2	74	128	16.3
Transport				
Water Transport	(14)	(20)	(41)	(15.0)
Shipping	(2)	69	123	10.2
Biman	5	(64)	(144)	(9.4)
Total	(688)	(184)	1059	

*Source World Bank Report No. 3768-BD, March 1982.

**Losses are shown in brackets

***Does not include many other bodies such as BRTC, WASA, Water Development Board, BFIDC, BADC, BFDC & etc, In FY81, net profit margin of the manufacturing sector was estimated at 4% and excluding the jute mills the same was about 3% only. In the face of such low accounting profit in FY81 and losses in other previous years upto FY74 in the manufacturing sector, the government current revenue budget included a surplus figure for the nationalized sector (including banks) under the non-tax revenue category in each of those years. It was one thing to budget for a profit/surplus but a more serious thing was to actually transfer such budgeted surpluses out of the nationalized sector irrespective of the fact that such surpluses were not actually generated in cash in the sector. For example, in the FY78 an amount of Tk. 250 million representing about 9% of government non-tax revenue receipts was transferred mainly out of the chemical, steel and sugar corporations while the combined total accounting profit of these three corporations was Tk. 145 million only and the manufacturing sector as a whole reported a net loss of Tk. 65.0 million[1].

Surprisingly, while it was emphasized that "Proper accounting practice should be applied before transfers are made out of the nationalized sector"[2], after about two years the same body observed that it was difficult to document the effects of poor financial performance of the nationalized sector on the government budget and that was after reporting a net profit of Tk. 1059 million in FY81[3]. It is not understood why it should be so difficult to see the interconnection between accounting profits and financial performances and hence their effect on government budgets when the volume of literature mentioned in Chapter 3 and subsequent publications originated mostly in the industrialised countries of the western world. Attempts to raise the related issues in Bangladesh, however, did not succeed in generating interest of policy makers for various reasons, important one could be that it was not being pressed or prescribed by such international bodies who are to a large extent responsible for providing guidance to our national planners. It is, however, heartening to note that the *Asian Development Bank* recently concluded that :

Since inflation have become a permanent feature of modern economies, governments should make inflation accounting part and parcel of the management of the public household[4]. The place where it should be startedi n Bangladesh is in measuring financial performances of public corporations because confusions seem to be compounded in this sector as discussed below.

It has been indicated that 'dis-saving' by public corporations financed outside the budget might have amounted to as much as 1% of GNP in certain years[5]. Since extra-budgetary investments in fixed assets by public corporations was negligible, this 'dis-savings' was actually operational cashflow deficits no matter what had been budgeted and subsequently reported as accounting profit by these autonomous bodies. The following Table 2 presents data on investments and savings in Bangladesh. It should be noted here that investments of public corporations financed from retained earnings andlosses financed outside the budget are included in estimates of "Private" investment and savings. Although a note of caution was given as to these estimates for any particular year, certain broad trends in the increase of investment both by public and private sector are discernible from Table 2. Estimates of Private investments and savings reported in

TABLE 2 : INVESTMENT & SAVINGS IN BANGLADESH
(% of GNP)

	FY75	FY78	FY79	FY80	FY81
Public Investment (Fixed)	2.8	6.3	7.8	8.3	8.4
Public Food Stocks	1.3	0.6	—1.1	1.8	1.5
Private Fixed Investment	4.0	5.7	6.1	6.5	6.8
Total Investment	8.0	12.6	12.8	16.6	16.7
National Savings	1.1	3.6	4.2	4.0	5.2
(Private)*	(2.7)	(6.0)	(6.6)	(6.5)	(5.9)
(Public)**	(—1.6)	(—2.4)	(—2.4)	(—2.5)	(0.7)
Foreign Savings	7.0	9.0	8.6	12.6	11.5
(External Assistance)	(6.2)	(9.1)	(10.1)	(10.3)	(8.9)
(other)***	(0.9)	(—0.1)	(—1.5)	(2.3)	(2.6)
	8.1	12.6	12.8	16.6	16.7

* Refers to private national saving which is derived as a residual ; of this monetised saving amounted to about 4.0% of GNP in FY81.

** Public Savings deffer from the surplus on revenue account. The latter does not include current expenditures within the development budget.

*** Includes net short-term external borrowing and draw-down of revenues.

the table are of particular interest here since they include (for curious reasons) extra budgetary investments, and savings rather dis-savings of Public Corporations. Estimates of private investments reportedly do not include 'stock changes' and both investment and savings are assumed to include non-monetised elements, roughly 2.5%-3% of GNP in rural house-building and land improvement[6]. "The behaviour of private savings over the same period was found to be unclear and since it was estimated as residual it was likely to be subject to some what larger margins of error"[7]. This observation is correct because both private investment and savings are in fact under estimated. But for the so called dis-savings by public corporations (included in private savings) private savings would have been higher with corresponding decrease in public savings and some increase in investments in both private and public corporations due to working capital increases. The apparent decline in private savings since FY79 have been caused by increasing dis-savings by public corporations (despite a large accounting profit shown for FY81 in Table 1) against significant increases in private sector savings (excluding public corporations). As already indicated the peculiar treatment of public corporations' actual financial performance (not accounting) within the private sector, tantamount to showing lower dis-savings by the public sector as a whole. In reality it has in a way produced a camouflage effect on the magnitude of public sector deficit financing from the banking system. This is revealed from a comparison of the government deficit financing from the banking system shown in Table 3 with total public sector bank borrowing shown in Table 4.

Flow of Funds

Consistent overstatement of public sector net borrowing from the banking system could be observed in all years FY77-FY81 (FY77 and FY78 are not shown in Table 3) excepting the year 1980[8]. Since the private sector in Table 3 does *not* include public coporations, it may be observed that the public sector as a whole borrowed an additional amount of Tk. 12.84 billion during the period FY77-FY81 of which Tk. 8.54 billion was provided from the increased financial surplus of the private sector and the rest Tk. 4.31 billion was obtained from the foreign sector. Notwithstanding measurement errors in private sector investment and savings, the apparent excess of private

TABLE 3 : GOVERNMENT BUDGETARY OPERATIONS

(Taka in billions)

(Actual)	FY 79	FY 80	FY 81
A. Total Revenue	14.19	17.40	21.88
(Tax Revenue)	(11.82)	(14.15)	(17.99)
(Non-tax Revenue)	(2.37)	(3.25)	(3.89)
B, Surplus available to finance development expenditure	3.82	0.49	3.83
C. Deficit after ADP & exchange adjustment	12.65	21.23	21.13
Financed By :			
Domestic Resources :			
Banking system	0.06	2.92	5.00*
Other	0.72	0.86	0.90
Foreign Resources (Net)	11.87	17.45	15.23**

* In the revised budget the deficit was shown at Tk.2.09 billion.

** In the revised budget availability was estimated at Tk. 17.10 billion.

Source : *World Bank Report*, March 1982.

TABLE 4 : CHANGES IN SECTORAL FINANCIAL ASSETS AND LIABILITIES/SECTORAL FLOW OF FUNDS

(Tk. billion, current prices)

Change in	1977	1978	1979	1980	1981	Total
A. Private Sector						
1. Asssts : Currency	0.26	1.48	1.09	0.80	2.21	
Deposits	2.22	2.44	3.87	1.77	5.88	
Total	2.48	3.92	4.96	2.57	8.09	
2. Liabilities : Credit	1.25	2.00	1.77	4.87	3.59	
3. Net Asset Position (1-2)	1.23	1.92	3.19	—2.30	4.50	8.54
B. Foreign sector	—0.85	1.16	—1.74	2.48	3.26	4.31
C. Public sector (-A-B)	—0.37	—3.08	—1.45	—0.18	—7.76	—12.84
Change in Gross Assets of Private Sector/GDP (%)	2.3	3.0	3.4	1.5	4.0	

Note : It was assumad that currency was only held by the Private sector.

Source : *World Bank, op cit.*

investment over saving in Table 2 may be illusory. Between FY77 and FY80 average real interest rates were negative which was pushed up roughly to 1% positive in FY81. Massive increase in private sector borrowings in FY80 which resulted in a deficit of Tk. 2.30 billion (Table 4) for the sector might have been caused to a large extent by speculative trading in foreign exchange market. That is, given the relatively low interest rates in Bangladesh upto FY80, it might have been profitable to engage in *arbitrage* operations in the foreign exchange market specially in the face of depreciating taka vis-a-vis other currencies. The gap between official exchange rate and open market rate was widening fast in FY80 and FY81 and the availability of wage earners remittance facilities and scope for other black market transactions might explain the changes in financial assets and liabilities of the private sector in these two years. It may also be pointed out that during FY77—FY81 money supply (currency+demand deposit) increased by about Tk. 1.34 billion and given the fact that about 80-90% of bank deposits and advances were centred in urban areas (60-70% in and around Dhaka and Chittagong) the private sector which accumulated the massive financial surplus in Bangladesh could be quite sensitive to financial factors (rather than real activities).

As is well known money, like water, once it is placed in the stream will flow out first in the domestic market pushing up price levels and then overflow to international markets, thus depreciating the domestic currency relative to foreign currencies. The sectoral flow of fund analysis presented in Table 4 tends to indicate that something like what has been discussed above has helped to increase the financial surplus of the so called private sector in Bangladesh with correspondingly increasing deficits of the public sector including public corporations. The upshot of the above discussion is that due to pursuance of inappropriate accounting, financial, pricing and taxation policies overall public sector deficits have been exacerbated by the deficits of public corporations. Meeting a greater portion of this deficits through a process of chain borrowing from the banking system not only increased inflationary pressure within the economy but also resulted in the accumulation of financial surplus. It may not be an exaggeration to state that the public sector bodies including banks and financial institutions have in fact accelerated the transfer of public money into private hands. One can only hope that the private sector will be able to perform 'efficiently' so that some degree of economic stability is attained in the country and no further flight of capital takes place in the future.

Having traced the process of resource transfer from the public sector to the private sector and retransfer from the private to the public sector in a manner which might be considered as harmful for the economy as a whole it becomes important to raise certain related issues. Firstly, how can such a process be controlled so as to minimise the magnitude of the transfer and secondly what are some of the alternatives for more direct participation of the private sector in *real* economic activities in the private as well as public sector. In view of the recent change in government policy to disinvest some of the nationalized industries to the private sector (which happened as a logical consequence of the accumulation of massive financial assets in the private sector), it is expected that certain other conventional measures such as lowering interest and tax rates, would follow which might affect the two related issues mentioned above. However there would still remain scope for further actions, at least with respect to autonomous bodies like BPDB.

Financial Performance Measured in Cashflows

Before we present our discussion on the relevant issues mentioned above it would be worthwhile once again, to measure the financial performance of BPDB in cashflow terms in the following Table 5.

The financial analysis presented in Table 5 is based on the Balance Sheet and Income Statements of BPDB contained in the Annual Report of 1980-81. The important indicator of financial performance are the figures derived in row (3) and (6). Instead of accounting loss of Tk. 331 million shown in Table 1 operating deficit was only Tk. 31.86 million and after adding net transfer payments of Tk. 40.62 as financial charges in row (4) the deficits amounts to Tk. 72.43 million only. The argument for netting out subsidy received from the government against financial charges is that for a public utility like BPDB such large financial charge is to a large extent the result of inappropriate capital structure representing debt-equity in the ratio of 65:35 in FY 81. And 35% equity was attained in FY 81 by the inclusion of Tk, 600 million arising out of *revaluation* of development stores of ongoing projects. Such financial charges are also caused by the practice of deducting Debt Service Liabilities at the time of releasing quarterly ADP local currency amounts and also of charging relatively higher rates of interest on long-term local as well as foreign currency loans. As indicated,

TABLE 5 : BANGLADESH POWER DEVELOPMENT BOARD*
FINANCIAL PERFORMANCE MEASURED IN CASHFLOWS

Tk. in millions

1. Operating losses before charging financial charges interest earned and subsidy received		..	(224.87)
2. Add back non-cash charges such as depreciation and Provision for bad debts		..	193.01
3. Operating deficits		..	(31.86)
4. (a) Financial charges	(145.47)		
Interest earned	4.85		
Subsidy received	100.00		(40.62)
5. Charges in working capital			
(a) Stock of stores (increase)	28.79		
(b) Bills receivables („)	242.82		
(c) Bills payable for goods	+367.48		
Bills Payable for expenses	+63.03		
			158.90
6. Net operating cashflow surplus			54.56
7. Addition to Fixed Assets		..	(1,478.54
8. Long term loan (Local & Foreign-net)		..	1,267.47
9. Other cashflows (net) : Advances, Payables for other finances, deposit work fund/investment etc.		..	(80.39)
10. Cashflows from bank & cash :			
(a) borrowing from banks		..	90.36
(b) Reduction in cash & bank balance		..	146.54

these policy measures are based on the recommendations from international financial institutions and agencies with a view to creating pressure on public sector enterprises to become more efficient.

There is nothing wrong with such objectives. But the trouble is that indiscriminate use of those recommendations for all public sector and autonomous bodies can hardly be justified. What is right for Chemical and Engineering corporation can not necessarily be right for a public utility and infrastructural development institution like the BPDB.

Regarding the effects of financial performance of BPDB on the government budget item (6) in Table 5 indicates that there was a cashflow surplus of Tk. 54.56 million which was achieved by a net inflow of working capital of Tk. 158.90 million (item 5). From the point of view of efficiency in financial management BPDB appears to have done well by being able to obtain more credits from suppliers of goods and services than what it had given to its customers and invested in inventory. The year-end position however shows that it was forced to bank-borrowing to the tune of Tk. 90.36 million [item 10(a)] and the surplus of (6) along with cash from (10b-9) were used for financing the shortfall between capital expenditure (7)[9] and net long-term loans (8) received for this purpose. It may, therefore, be concluded that BPDB's operations in FY 81 did not in fact, create any adverse impact on government finances directly. Rather it had to use funds from bank loan and its cash balance to finance shortage in capital expenditure. Certainly, this must have had created problems in development project implementation in the one hand and financial deficits for its suppliers of goods and services on the other. Both have undesirable consequences on the government finances[10]. Project implementation bottlenecks are well recognised for contributing to higher project cost requiring more budgetary allocations in next years' (besides increasing cost of electricity); and unpaid bills of Petroleum Corporation and Petrobangla and other public sector enterprises forced them to borrow inturn from banks to meet their deficits whatever might have been their reported accounting profits for these entities. The point is that a vicious circle of chain borrowing has been operating adding financial charges to cost of production/services at each stage. Simply pressing the autonomous bodies to become more efficient and meet their obligation cannot produce any result under the circumstances. It has been rightly pointed out that. "where unpaid balances have become too large and where the financial position of the body is such that the corporation will clearly not be able to meet its debt service obligations allowance should be made for these in revising budgetary resource estimates ; it may also reschedule such loans in consultation with the relevant corporation"[11]. The truth of the matter is that these corporations need injection of long term low cost fund in their capital structure, just to finance the increasing shortages in working capital requirements. The need for increasing permanent working capital, however, seems to be less clearly understood by both the managers of industrial enterprises and policy makers in Bangladesh. There is however no doubt that efficient management of PEs could contribute to generate part of it from their operations. Recognition of certain important inter-connection between operating, accounting and financial variables by policy makers can make definite contribution towards realisation of such objectives rather than ignoring them. We now turn our discussion in that direction taking BPDB as a case.

Improving Financial Performance of BPDB

1. *Revenue collection*: Sales during FY 81 showed an incrase of 75.24% over FY 80; this was contributed by a 57% increase in Tariff effective from lst Oct. 1980 and 24% increase in sales volume (GWH). Although some improvement in organizational efficiency such as meter reading and billing[12] had been claimed, in fact BPDB collected exactly 89% of its sales of energy in both FY80 and FY81. As a result its bills receivables in FY 81 increased by 105% over FY 80= (Tk.242.82 million). In FY 80 & 81 bills receivables as a %of sales were 24 and 29 percentages respectively. This clearly shows slowing down of billing and collection efforts rather than an improvement. Meter reading, billing and collection took about 2—3 months within DES in FY 82 and the system of service disconnection to defaulting customers was observed to be unsatisfactory. Of course, it is the bulk consumers in public sector which mostly failed to pay bills in time. Maintaining bills receivable at 24% of sales would have generated additional cash of Tk. 81.0 million in FY 81. On the other hand reducing delay in collection by one month would have generated Tk. 136.32 million in additional cash during the same year.

2. *Fund Management:* It may be possible to reduce the float of cash on transit and also transaction cost of cash movement. Bank charges for distribution alone amounted to about Tk. 0.5 million in FY 81. There does exist some inconsistencies in maintaining huge cash and bank balances simultaneously with large bank loans. In the audited reports for FY81, cash and bank balance was shown as Tk.566.49 million and Tk. 387.44 million at 30.6.80 and 30.6.81 respectively. Simultaneously bank loan was reported at Tk. 235.19 million and Tk. 358.05 million on those two corresponding dates. Through better management of fund it might have been possible to reduce the need for bank borrowing at high bank interest and charges.

Fund management, specially cash forecasting, should be given serious consideration so that inflows and outflows of cash may be monitored on a more accurate basis throughout the PDB system.

3. *Reducing System Loss:* "The present system loss of PDB is rather high and almost double than normally expected from a system like PDB" [13]. Given that the demand for electricity exceeded the quantity supplied, a 10% reduction in system loss would have generated gross sales of Tk. 163.6 million in FY 81. To attain the aim of system loss reduction major distribution centres like Dhaka, Chittagong and Khulna should be turned into separate entities as soon as possible. This should be followed by an effective system of budgetary control so that not only are expenses controlled with reference to budgets but also to revenue generated. So long operations and maintenance function within DES (for example) have been performed in complete isolation of sales. The recent organisational changes within DES merging all of those functions under four circles appear to be well designed. A complete integration of the various functions in a manner to help introduce responsibility accounting will be desirable at the level of each circle.

4. *Alternative Sources of Long Term Financing*: There is no point in saying that the government should provide more long term low cost finance to rationalise the capital structure of BPDB. Instead of government borrowing directly from the public or from the banking system, it may be advisable to allow major distribution centres to accept subscription to their loan-stock from the public in general at comparable rates of interest [14] or at low interest bearing withdrawable or non-withdrawable deposits from the consumers of electricity. At

least progressively higher amounts of deposits may be charged on domestic and other customers depending on the value of their properties where connections are wanted. Public in general may be more willing to invest (put up) their savings for financing activities benefits of which are more directly related to their living and economic conditions rather usual government bonds and securities. From Table 4, it may be estimated that over the five years (FY77-81) approximately Tk. 1.70 billion of private sector savings have been transferred on an average per year to finance public sector deficits through the banking system. Such financing has helped to build up inflationary pressures within the economy and may not be available in the same scale in the future. In the case of public sector enterprises, like (BPDB), private sector savings may be solicitated directly for investment rather than through higher prices and/or intermediaries. For that purpose seperation of major distribution centres from the BPDB organization may be a pre-requisite. The regional accounting offices of BPDB may be given the responsibility to mobilise such savings in appropriate manners. After all, the concept of 'users financing' is not totally unknown in Bangladesh.

Recent changes in government policy of disinvestment of industries, setting up of banks in the private sector and stopping subsidisation of public sector enterprises directly as well as indirectly from the banking system make it all the more important for such units to initiate steps to streamline their financial position. For that purpose some of the suggestions made in the above paragraphs may merit serious consideration by autonomous bodies such as BPDB, WASA and other major units of public corporations. Not only that the private sector will not be interested in taking over such public enterprises, it is for the long-run advantage of private sector enterprises the over all performance of public enterprises and autonomous bodies should be improved through concerted efforts.

Footnotes

1. World Bank Report, *op cit.*
2. World Bank Report. March 1979.
3. Table 1.
4. Asian Development Bank, Economic Staff Paper No. 6 "Inflation in Developing Member Countries : An Analysis of Recent Trends"

5. World Bank, *op cit*
6. World Bank. *op cit.*
7. *Op cit*
8. In 1980 Govt. deficit financing from the banking systems was reported as Tk. 2. 92 billion whereas the net change in public sector's financial position with the banking system was Tk. 0.18. billion only. The difference was possibly contributed by the financial surplus of public sector enterprises although an accounting loss is shown in Table 1.
9. This item was derived as the residual ; the balance sheet figure includes adjustments due to revaluation of development stores and disposal of fixed assets.
10. Tk. 90.36 million bank borrowing, however, represent deficit financing from the banking system which is not included in government deficit.
11. World Bank, *op. cit.*
12. Annual Report, 1980-81.
13. Annual Report, 1980-81.
14. Such practices are prevalent in many States of Electricity Supplies in India.