

# **BUREAUCRATIC CORRUPTION AND BUSINESS ETHICS: THE CASE OF THE GARMENT EXPORTS FROM BANGLADESH**

Munir Quddus

## **ABSTRACT**

This paper is concerned with the history and theory of bureaucratic corruption. It uses the context of the garment export sector in Bangladesh to further analyze issues relating to corruption in both the private and the public sector. The paper concludes that corruption in the Third World countries is a complex issue. Further, it argues that blaming the bureaucrats or the private businesses alone would not do justice to the problem. Neither will it help in finding appropriate policies to solve this important problem in governance and development.

### **Introduction**

Bureaucratic corruption has been defined *as the sale of government property--goods or services--by public servants for personal gain.*<sup>1</sup> This definition--*the use of public office for private benefit*--includes extracting bribes for permits, non-payment of taxes, avoidance of custom duties, for speeding up ones work, or for currying other illegal special favors by the private agents. Such payments or rents allow private agents to pursue economic activity they would not pursue otherwise. Since the bureaucracy has monopoly or discretionary power over the issue of licenses, permits, passports, visas and other documents necessary for doing business, they can collect bribes from the private agents. Not only are such rent seeking activities considered immoral and illegal in most societies, economic theory and research finds them to be an impediment to commerce and economic development.<sup>2</sup> However, one should not blame the bureaucrats alone for the existence of corruption. The politicians who fail to implement the rule of law, members of the civil society who tolerate a high level of corruption and fail to condemn it, the business people who more often than not willingly pay the bribe, sometimes even initiating the transaction, all share the blame for the existence of bureaucratic corruption. Therefore, a broader definition, one that is more consistent with business ethic issues may be: *corruption occurs if a party to a (implicit) contract breaks it for private gain by side-contracting with a third person.*<sup>3</sup>

The success of the garment export industry in Bangladesh is an excellent case study of how recent trends in globalization have opened up tremendous opportunities for low-income developing nations to participate in the global economy for economic development. Indeed trade can be a highly effective

vehicle for economic growth for the poor nations of the world. Beginning from a zero base in the late 1970s, the apparel-export industry in Bangladesh is today the only multi-billion-dollar manufacturing and export industry in the country. The industry employs close to two million workers, mostly women, and exports apparels worth more than four billion dollars to a host of markets in the developed world. The overall impact of the readymade garment export industry is certainly one of the most significant social and economic developments in contemporary Bangladesh. With over one and half million women workers employed in semi-skilled and skilled jobs, it is easy to see why the development of the apparel export industry has had far-reaching impact on the social and economic conditions of Bangladesh.

However, according to many, the growth of the apparel export industry has also led to the proliferation of bribery and corruption in Bangladesh. The topic is widely debated in the media and among the educated. There seems to be a difference of opinion on the cause and consequence of corruption for the industry: Is the apparel export business a cause of this widespread bureaucratic and private sector corruption or merely a victim? The official view of the Bangladesh Garment Manufacturers and Exporters Association (BGMEA) is that the garment entrepreneurs are innocent victims of corrupt customs and tax bureaucrats. The author interviewed the senior customs officer at the airport custom house to find that an alternate hypothesis, also shared by some in the private sector, is that both the private sector and the bureaucrats share the blame for the marked increase in bribery and corruption. This paper seeks to address some of these issues. We present some figures on the dimension of the problem, and raise questions about the impact of corruption on foreign-direct investment and the economic development of

Bangladesh. We conclude that contrary to some opinions in the academic literature, bribery and corruption are a serious problem that have greatly undermined the workings of free markets and must be rooted out. The policy conclusion is that the bulk of the responsibility lies with the bureaucracy that must be cleaned up of corrupt officials. Other administrative reforms that must be part of any attack on this problem include: decreasing the paper work in the export business, lessening the dependence on the bureaucracy in general, making the administrative process more transparent, and forcefully implementing existing laws on penalizing the corrupt. Implementation of these reforms would go a long way in checking the growth of corruption that in the long-run has large negative consequences for the industry and for the nation.

### **A Review of the Literature on Corruption and Rent Seeking**

Corruption is as old as governance in human societies. Modern and ancient civilizations have all suffered from this problem. After initial hesitation, economists have embraced the topic of corruption, and have addressed many dimensions of the problem. Gary Becker's path breaking work in the economics of crime established the topic as a respectable field of analysis.<sup>4</sup> Gunnar Myrdal, in his monumental work on development, *Asian Drama* (1968) devotes an entire chapter to the economics and sociology of corruption and its negative implications for economic development. Anne Krueger (1974) first used the word rent-seeking in her analysis of corruption in Turkey. There is a large literature in trade theory that deals with the consequences of rent-seeking activities for the welfare of the participants. These are called DUPE (directly unproductive activities). Gordon (1980) and other Public Choice theorists have also addressed the issue using the special tools of public choice analysis. Rose-Ackerman's (1975) classic study further advanced the field as a topic in political economy. Shleifer and Vishny (1993) use simple models of monopoly power to derive various results regarding the consequences of corruption for economic development. Bardhan (1997) provides the most current and comprehensive survey on the topic of corruption available in economic literature.

### **Bureaucratic Corruption and Private Rent Seeking in Garment Exports**

It is often claimed that one of the factors behind the increase in graft and bribery is the willingness of the garment exporters to readily pay bribes to send their

products abroad on time. Some exporters use the channels and opportunities made available in such an environment to cheat the taxpayer, the country, and even their own industry. The extension of this argument is that bribery may be somewhat efficiency enhancing under these business circumstances. However, those who suggest that limited bribery may increase efficiency as it facilitates trade and commerce (oil that lubricates the bureaucratic machinery) have a myopic and incomplete understanding of the corrosive nature of the problem. No one knows what is the "optimal" level of bribery! Further, the environment created by the prevalence of bribery and corruption is poisonous to the long-term working of free markets. Undoubtedly the best strategy is to stamp out corruption using the powers vested in the hands of the state.

In a survey of garment entrepreneurs that the author conducted in 1994, the primary hurdle identified by most entrepreneurs was dealing with the bureaucracy.<sup>5</sup> Forty four percent singled out dealing with bureaucracy as the most difficult problem during the initial years. Seventy percent of those in our sample believed that dealing with public officials was "either very difficult or difficult" for them at the start-up phase. At the time, there were three separate ministries with responsibility over the garment industry: the Finance Ministry, the Commerce Ministry, and the Textile Ministry. Further, the National Board of Revenue (NBR), the powerful tax bureaucracy under the Finance Ministry, without adequate coordination and consultation with other relevant ministries or with the private sector, has imposed new rules and regulations on the industry. The World Bank also concluded that bureaucratic corruption has become institutionalized in Bangladesh (World Bank, 1992) partly as a result of growth in garment exports. Based on 1996 data, Transparency International ranked Bangladesh as one of the most corrupt nations in their sample with a rank of 51 of the 54 nations covered. The mean score Bangladesh received was 2.3 (10 being least corrupt). This placed Bangladesh as being somewhat less corrupt than Kenya (52), Pakistan (53) and Nigeria (54), but more corrupt than India (46) and Russia (47).<sup>6</sup>

What is the impact of the booming garment industry on the extent and forms of corruption in Bangladesh? The garment export industry has both contributed to these trends and has also become the most significant victim of this ominous development. Because of the large profit margins, huge foreign exchange earnings, tight schedules, and tedious paper trails, the apparel

**TABLE 1: An Evaluation of the Initial Constraints**

ITEM	VERY DIFFI- CULT (%)	DIFFI- CULT (%)	NOT DIFFI- CULT (%)	N.A. (%)	NO REPLY (%)
GETTING INITIAL EQUITY	30.6	25.0	25.0	5.6	13.9
GETTING INITIAL CAPITAL	33.3	30.6	25.0	2.8	8.3
DEALING WITH BUREAUCRACY	44.4	27.8	19.4	2.8	5.6
GETTING FACTORY SPACE	5.6	30.6	50.0	5.6	8.3
HIRING MANAGERS	30.6	22.2	41.7	0.0	5.6
HIRING WORKERS	13.9	19.4	58.3	0.0	8.3
GETTING ORDERS	33.3	25.0	33.3	0.0	8.0
CONVINCING A BANK	36.1	22.2	30.6	2.8	8.3
LEARNING GARMENT BUSINESS	22.2	33.3	30.6	5.6	8.3

Source: Sample Survey Conducted by the Author

entrepreneurs are vulnerable to a corrupt bureaucrat's attempts to extract rents. Critics point out that unethical entrepreneurs in the apparel export sector are also part of the problem. These businessmen have contributed to the rise in corruption by resorting to the evasion of income and other forms of taxes, by offering bribes to speed up things (speed money) or to circumvent legitimate laws that govern commerce and trade. From our interviews with the entrepreneurs, we found that while most garment exporters find the system of bribery disturbing, they have adjusted to it as a nuisance and have learned to deal with it as another bureaucratic hurdle. Since many of them previously worked in the government (army and bureaucracy), they are comfortable dealing with government agencies. For others, the costs of bribe are included as part of doing business and is included as a miscellaneous expense.

### **Corruption and the Private Sector in Bangladesh**

In academic circles and generally in the society, there is a strong sentiment that most of the money made in the early days of the RMG industry was made illegally by deceiving the tax authorities and leaking fabrics, imported duty-free under the bonded warehouse scheme, into the local markets. This must have happened, perhaps on a large scale, as some of the duties on imported fabrics were as high as 300%. To the extent this fabric displaced local fabric or fabrics imported legally, there was a loss to the

public exchequer. However, cross border smuggling of fabrics on a large scale is a well-known fact for Bangladesh. Consumers in the local markets also must have received part of the windfall.

According to various reports in the newspaper, an official of the Bangladesh Garment Manufacturers and Exporters Association (BGMEA) claimed that the sum of monies paid as bribe to the bureaucrats at all levels by this sector alone exceeded \$40 million (Tk. 2000 million) each year. This is a large sum of money, and if true, would indicate the massive costs of corruption to the industry and the economy. On the contrary, since there is little sign of the industry losing its competitive edge or slowing down as a result of these illegal rent seeking activities, some have argued that these higher "transaction costs" are not prohibitive given the profit margins in this business. Perhaps this is true, but as we have argued before, there are many hidden and long term costs of corruption that are not easily quantifiable. Additionally, the high moral costs of the existence of massive bribe and graft must not be underestimated.

The official position of the garment industry Association is that corruption is a serious impediment to further progress and development of the private sector. The industry leaders have called the attention of the government to the lawlessness prevailing in the country. This takes the form of rent-collection (toll collectors are local goons backed and protected by

politicians), bribes extracted by the customs bureaucrats and bank officers, frequent nationwide strikes (*hartals*) called by the political parties, or strikes called by the port workers. These factors have greatly increased the transaction costs and reduced the competitive edge of the private sector in general and apparel exporters in particular from Bangladesh. The President of the Federation of Bangladesh Chamber of Commerce (FBCCI) said,

Corruption is the major hurdle to growth. Because of corruption, money is going to people who are not entrepreneurs and this huge amount of money is being spent in the unproductive sector. The people possessing such illegal money are spending the amount either for buying land or apartments or taking the money out of the country. Because of such consortium of illegal wealth, prices of land are going up making more people land-less and sending savings rate down.<sup>7</sup>

Corruption is hindering economic growth; it's undermining our competitiveness in the local as well as international markets, destroying the allocation of resources, eroding the confidence in the political system and undermining the climate for investment. Moreover, the government is losing a huge amount in revenue every year.

Abdul Awal Minto went on to suggest that corruption becomes a hurdle to growth and development of an underdeveloped economy such as Bangladesh. He added that corruption was also destroying our culture, tradition and values of society. He reiterated that arresting corruption is the most imperative task now to make us competitive, to increase savings, and to increase investment.

What about the view that the private businesses are themselves corrupt? What forms of corruption are alleged on the part of private agents?

### **Corruption in the Garment Export Business**

There are several forms of corruption in the fast-paced garment export business in Bangladesh. This section describes some of these corrupt practices in this industry.

- Some garment firms order excess fabric by giving false estimates. If two yards are necessary for each piece of apparel, 2.5 yards would be claimed on the L/C, the customs clerk is easily convinced (bribed), and much more fabric than necessary is imported tax-free. Since this is a one hundred percent export sector, special laws allow

the fabrics and other accessories to be imported duty free. Import of some excess fabric (15 percent) is legally allowed, given the uncertainties of the manufacturing process and the business. However, it becomes a drain on the public exchequer when large amount of excess fabric is imported. The excess fabric is then sold in the open markets in the underground economy. The same sort of leakage takes place with garment accessories, although on a smaller scale. The extent of this corrupt practice depends on the premiums involved. In the past, customs duties (tariffs) on some category of fabrics were as high as 150 percent. As a result, the quota premiums were high (fabric imported for \$100 was worth \$250 in the black market). Certainly very few legitimate businesses can compete with such high rate of returns. Presently the tariffs are lower, reducing this form of leakage of imported fabrics in the domestic market.

- A second method to earn illegal profits by factory owners in the garment business is through the selling of excess stocks in the local black markets. Apparel in excess of the order received from foreign buyers is not uncommon for several reasons. First, buyers often are willing to accept more goods than they had ordered. Second, factory managers anticipating some defective products choose to produce in excess of the order. This allows them to satisfy the order even after the expected rejections from the quality control inspectors. Third, excess production provides some protection against theft by workers. Fourth, the excess apparels are used as samples for future orders, or as bribes for customs and bank officials. They may also be used as gifts for friends and families. Some of these products are eventually sold in a market called "Bangla Bazaar," a sprawling "informal" market near downtown. These shops are tiny but crammed with apparels of varying qualities originally manufactured for export. The customers in this retail market include many foreigners, and much business is evident. However, according to the insiders, the retail activities reflect only the tip of the iceberg. The bulk of the product is kept in godowns for large-scale trading mostly in the form of smuggling. These market activities, although illegal, thrive mainly by the force of bribery.<sup>8</sup>

- Garment exporters claim that they are victims of a vast and corrupt bureaucracy entrenched in the customs department of the government. The myriad rules and regulations that govern import and export trade have created a haven for corrupt

officials, both low and high-level, to illegally extract large rents from the hapless private agents. This considerably increases the cost of manufacturing export-quality garments for the global markets in Bangladesh. The dimensions of the problem cannot be accurately determined. What is certain is that bribery has become institutionalized in the export business in Bangladesh. One garment exporter, also an experienced jute exporter, told the author that the contrast in rent-seeking activities between these two export businesses is remarkable. Jute exporting does not suffer from nearly the same level of bureaucratic corruption that has become the hallmark of garment exports. This raises a legitimate question of responsibility. Which party is more responsible for the extensive prevalence of bribery in garment exports? An opposite view is that the adverse impact of bribery on these exporters is minimal. Perhaps some of them even benefit from a system of graft, where they have the assurance of speeding up the process and even making illegal profits by not paying the taxes, avoiding payment of duties, or their ability to sell duty-free imported cloth in the markets. The truth lies somewhere in the middle. The pervasiveness of bribery and its unprecedented institutionalization in the garment business in Bangladesh is partly due to policies which create rents, encouraging rent-seeking activities by corrupt civil servants and bank officials, and partly due to the lack of business ethics on the part of apparel exporters. The culture of acceptance of bribery and corruption that generally prevails in the country must also share the blame.

One can logically argue that bribery, by adding to the cost of doing business, depletes the stock of viable entrepreneurs in this industry and is, therefore, growth-retarding and harmful to the economy. However, this view understates the broader economic argument against corruption. The more important argument is that corruption undermines the integrity of free markets and destroys their efficiency. For capitalism and free markets to function efficiently, there should be transparency and a sense of fairness, so that all parties have confidence in the process and the outcome. Corruption introduces uncertainty, gives extraordinary power to a few, and reduces confidence in the fairness of the outcome. This leads to lower participation by the ethical entrepreneurs and may result not only in markets that are highly inefficient, but eventually in the demise of the industry.

A 1992 World Bank study provides anecdotal evidence of the rents that must be paid to conduct garment business in Bangladesh. It is clear from the study that every agency and bureaucracy that is involved in this business—customs, central bank, export promotion bureau—becomes a hurdle that can only be overcome by the entrepreneur by paying a bribe, often the amount being higher than the fee itself. The average factory owner in the garment sector had to pay bribes five times the cost of setting up the business in the first year (see appendix). The bribe to initial set-up costs ratio exceeded four hundred percent. Similarly, in each year the factory operates, the bribes that have to be paid to various bureaucracies equal an amount thirty times the cost of renewal of licenses that is paid to the state exchequer. These figures, even when appropriately discounted to allow for non-scientific data collection methodology, reveal the startling costs of corruption for the industry and the country.

### **Concluding Remarks and Some Policy Implications**

There are many different ways corruption imposes costs on the society and the industries. A fundamental axiom of capitalism is that for markets to allocate resources efficiently full information should be available to all participants. Markets that are not transparent tend to exacerbate problems of moral hazard and information asymmetry and create volatility and inefficiency. In addition to efficiency loss, there is the bigger issue of many capable and honest entrepreneurs staying out of such markets. This would reduce national welfare. The international businesses are often at a disadvantage in a setting of nontransparent markets. Because of their commitment to business ethics and laws from their home countries, these companies may be at a disadvantage in bribing the officials or the tax collectors. There are ways foreign firms doing business in Bangladesh get around this disadvantage. One strategy for foreign firms is to work with local partners. In many factories that the author visited, the manager is a local recruit. Secondly, the foreign factories are often located in a special zone called the Export Promotion Zone, which allows them some leverage with the bureaucrats and the labor unions. Lastly, the author was told by at least one local manager of a foreign firm that at Christmas and other occasions, they send flowers, bottles of wine, and other gifts to important officials in the bureaucracy and the banking sector with whom they have dealings. Since such gifts are not exactly quid-pro-quo they are technically not considered bribe. However, the effect is to provide these foreign firms

a more level playing field in the rent-seeking business than otherwise.

Anecdotal evidence from the literature makes it clear that foreign direct investment declines as corruption destroys the goodwill for the nation in the international business community. Who would want to invest in a country where property rights are unprotected? When the courts are also corrupt and bribery can tilt the scales of justice, the foreign investor is justifiably discouraged in investing in that nation.

Whether bureaucracy is corrupted by influence pedaling of private businesses, or whether the bureaucrats use their monopoly power to exploit the hapless businesses, represents a vicious circle. A determined political leadership can break this cycle of corruption. Similarly, if bureaucratic managers are honest, demand honesty from their subordinates, and if they have political backing to reward the honest and punish the dishonest, the salutary influence of honest management will quickly spread throughout the bureaucracy. This applies to the private sector also. It is not that Bangladeshis are more or less corrupt than people in the developed West. The prevalence of corruption is simply a reflection on the behavior of private agents and civil servants to the laws and their enforcement. When the laws are full of loopholes, the courts are not responsive, the existing anti-corruption laws not enforced, bribery and corruption flourish. An important strategy is to strengthen the judiciary so that existing laws are enforced. The leadership should also appoint honest managers in positions of authority and make honest administration a top priority. If the administration is reformed (loopholes in the laws are closed and honest managers are appointed) experience from other nations shows that corruption can be controlled within a reasonable timeframe. However, simply by attempting to reform the laws without the right people or changing the people without reforming the incentives will be ineffective. The incentives should be such that honesty will once again become the best policy for the individuals both in the private and in the public sector.

#### Endnotes

<sup>1</sup> Shleifer and Vishny (1993) page 599.

<sup>2</sup> Bardhan (1997) page 1,322. Some writers have claimed that forms of corruption may be efficiency enhancing in a narrow sense. However, the general consensus is that corruption is corrosive to free markets and to economic progress.

<sup>3</sup> Eskeland and Thiele (1999).

<sup>4</sup> See Becker and Stigler (1974).

<sup>5</sup> There were forty participants in our original sample. We found thirty-six questionnaires complete enough to be usable. The initial sample size was one hundred, randomly chosen from the list provided by the Bangladesh Bureau of Statistics. However, many firms on the list were non-existent or had changed their names or addresses. Only the managing directors or directors of each firm were interviewed. This turned out to be the most challenging aspect of the research effort. These are busy people, constantly running after buyers at home and abroad. The entrepreneurs were understandably suspicious of outsiders for fear that financial and other tax-sensitive information may be revealed during the survey. It took us more than two months to cover this small sample. An earlier effort to get information by mail had met with no success.

<sup>6</sup> From Bardhan (1997) appendix. However, that sample size of only 4 is a matter of concern. The average number of surveys of international businessmen involved in these surveys tends to be low. The perceived corruption score is an average of data from several surveys, the respondents being mostly foreigners working for multinational companies. The scale is 10 for no corruption and 0 for maximum corruption. It is likely that the indices reflect the corruption faced by the foreigners and not necessarily that faced by the citizens of the country.

<sup>7</sup> President of the Federation of Bangladesh Chambers of Commerce and Industry (FBCCI) is Abdul Awal Mitoo. In an interview with the Independent, a daily, he identified corruption as a major impediment to economic growth in the country. NFB, June 5, 1999.

<sup>8</sup> There are other forces unhappy with the *Bangla Bazar* that has repeatedly suffered damage from arson.

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## APPENDIX

**Table 1: Perceived Levels of Corruption in Asian Countries**

Country	BII (1-10 scale)*	CPI97 (1-10 scale)*	GCRI97 (1-7 scale)*
Singapore	2.34	2.34	1.24
Hong Kong	3.00	3.72	1.52
Japan	2.25	4.43	2.07
Taiwan	4.25	5.98	3.22
Malaysia	5.00	5.99	3.97
South Korea	5.25	6.71	4.34
Tailand	9.50	7.94	5.55
Philippines	6.50	7.95	5.56
China	NA	8.12	4.20
India	5.75	8.25	5.11
Indonesia	9.50	8.28	5.56
Pakistan	7.00	8.47	NA
Bangladesh	7.00	9.20	NA

Source: Quah (1999)\*According to Wei, the original BII, CPI, and GCRI were rescaled so that higher scores imply more corruption. Thus for all three indices, a higher score means a higher level of corruption.

**Table 2: The Cost of Bureaucracy and Corruption for a Garment Exporter (Taka per year), 1992  
(35 Tk. = \$1, approximately)**

Licenses and Approvals	Initial Cost		Yearly Renewal Cost	
	Official	Bribes	Official	Bribes
<u>Licenses</u>				
Trade license	Tk.1,500	Tk.2,500	Tk.1,500	Tk.500
Sign board	Tk.12	NIL	Tk.12	NIL
Import trade control	Tk.2,000	Tk.2,000	Tk.2,000	Tk.500
Export trade control	Tk.1,000	Tk.2,000	Tk.1,000	Tk.500
EPB registration	Tk.500	Tk.1,000	Tk.500	Tk.200
Textiles registration	Tk.500	Tk.10,000	NIL	NIL
Bond license: customs	Tk.300	Tk.20,000	Tk.300	Tk.45,000
Factory license	Tk.70	Tk.1,500	Tk.70	Tk.200
Fire license	Tk.4,750	Tk.1,000	Tk.4,750	Tk.500
BMGEA membership	Tk.5,000	NIL	Tk.5,000	NIL
Joint stock	Tk.3,800	Tk.4,000	NIL	NIL
Registration				
Joint collaboration	Tk.50,000	Tk.50,000	NIL	NIL
<u>Government Approvals</u>				
Utilization	NIL	NIL	NIL	Tk.250,000
Permissions				
Interbond-subcontract	NIL	NIL	NIL	Tk.60,000
Inspection: customs	NIL	NIL	NIL	Tk.60,000
Export benefit:				
Bang-Bank	NIL	NIL	NIL	Tk.20,000
Visa: EPB	NIL	NIL	NIL	Tk.12,000

Source: World Bank, Manufacturing Sector of Bangladesh: Selected Issues, Vol. II, 1992, page 41, Table 3.3.

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Munir Quddus  
Professor and Chair  
Economics and Finance  
University of Southern Indiana  
MQuddus@usi.edu