Should we implement it at any cost?

Monday, Jul 16, 2012

By *Dr. Ahsan H. Mansur*

Following the cancellation of Padma Bridge loan

agreement by the World Bank, views are being expressed by different quarters regarding immediate implementation of the project with various sources of financing, primarily using our own resources. Various options, including the so-called Malaysian offer about which very little is known, the Bangladesh Bank's reserve and insurance sector funds, are being talked about as the sources of financing for the Padma bridge project. Certainly, Padma Bridge is the largest and most important project undertaken by Bangladesh in its history. It has wide range of ramifications for socio-economic development of the south western part of Bangladesh and for the country as a whole. It is also true that delays in implementing the project would lead to cost escalation making the project more expensive in future. However, these arguments may certainly not be compelling enough for its immediate implementation at any cost. The purpose of this write-up is to explore the various options put forward from different quarters and their consistency with the overall macroeconomic stability of Bangladesh.

Use of Bangladesh bank's foreign exchange reserve: Currently, the level of foreign exchange reserves of Bangladesh Bank is hovering around US$ 9.5-10 billion range. With the projected import payments for the fiscal year 2012-13 (FY13) at around US$39 billion, the reserves will not cover even 3 months' imports payments, a level considered important for smooth functioning of international trade and payments. As the Padma Bridge is an import-intensive project with about 75 per cent of the total project cost going toward imports of goods and services, it will require about US$2.2 billion worth of imports. During the implementation period, this amount of foreign exchange will be eroded from the reserve, if we do not have any external financing associated with the project. This may bring reserves down to two

months' import coverage.

Moreover, we need to ask a couple of questions: (a) Is such project financing consistent with the mandates of a central bank?; and (b) What would be the macroeconomic consequences of such a major undertaking?. Several years back in India, when its foreign exchange reserves level crossed US$300 billion, some powerful national politicians and government ministries wanted to finance some mega infrastructure projects using around US$100 billion of reserves. Reserve Bank of India had rightly put its feet down arguing that financing infrastructure was never the mandate of a central bank. Wisdom prevailed, and the government of India refrained from this kind of financing arrangement. Foreign exchange reserves are kept as a buffer stock to protect the international financial transactions. Infrastructure funding is important but this is not the core mandate of any central bank. It is the responsibility of the government to finance these projects from their own budget or under PPP arrangement. So financing out of the foreign exchange reserves should be ruled out-it is neither desirable nor feasible under the prevailing circumstances.

Borrowing from the capital market: Bangladesh capital market is suffering from both confidence and liquidity crises. Daily turnover has come down to much less than Tk. 2 billion from the recent peak of more than Tk. 30 billion at the end of 2010. Borrowing from the capital market may worsen the current market situation and outlook. One needs to understand that capital market and money market are interconnected. So borrowing from the capital market will divert resources either from existing investments in stocks driving down their prices further or divert resources from other parts of the financial system lured by higher returns. Not only will government borrowing rate go up but at the same time it will lead to further tightening of the money market.

Use of insurance fund or money market instruments: The role of insurance companies is to protect interests of its policy holders. They can invest in stocks, money market instruments (like term deposits/CDs), government securities (like longer maturity treasury bills), and in other assets in different proportions based on appropriate investment guidelines. What this scribe presumes is that insurance companies have already made such investments and there cannot be much idle resources in that industry. Accordingly, use of insurance fund will (i) require withdrawal of funds from the capital market or money market; and (ii) make most of the life insurance funds invested in government securities which may not be a desirable

outcome. The use of money market resources for Padma Bridge financing by issuing government bills or bonds will lead to sharply higher public sector borrowing. This will again lead to crowding out of the private sector, further tightening of the market, and further increase in lending rates across the board.

Macroeconomic implications of relying on domestic resources: It should be noted that any form of domestic financing will create liquidity crunch in the money market and subsequently interest rates will probably be much higher than the current high levels. This high cost of fund for the project also puts a big question mark on the viability of the project. How would a project like Padma Bridge, which is viable on economic and social development reasons at the low interest rates (0.75 per cent per annum) and long grace period (10 years) and tenor (40 years) offered under IDA terms, be viable when the financing is secured on commercial terms with 5-year tenor and virtually no grace period? Certainly, a huge sum of subsidy would need to be paid out of the government budget every year for a long time to make the project financially viable.

Even if the project is carried out with domestic resources with large subsidies paid from the budget over a long time, its balance of payments implications must not be overlooked. Thus under the current fragile macroeconomic environment, implementing the project from domestic borrowing alone–be it from the capital market or insurance funds or using money market instruments–will not be advisable. Accordingly, mobilizing external resources should be a central element of any Padma Bridge financing plan to ensure its implementation in a sound macroeconomic environment.

Way forward and what options are we left with? Outlined below a strategy with three steps to put together a financing package at acceptable terms and without any significant adverse macroeconomic impact on the domestic economy.

The first step should be to seek assistance from an important official bilateral source or borrowing from a consortium of official (bilateral and multilateral) donors. Bangladesh government may request a friendly country like Japan to reaffirm its support for the project and increase the level of its investment in the project. If Japan agrees to do so, this will increase credibility of the financing package. Using Japan’s funding as a centre piece, government can ask the IDB and countries like China, India or other friendly Middle Eastern

countries to invest in the project. Bilateral or a consortium of bilateral and multilateral official financing will entail concessional terms including much lower interest rates. Borrowing from such a consortium will also help avoid the problem of specific suppliers generally attached to bilateral credit and ensure procurements at competitive prices.

At the second step, the government with Japanese support may approach the Asian Development Bank (ADB) to reconsider its current stance and take a lead role in the project. Bilateral donors like Japan will prefer the lead role of a development institution like ADB to supervise the project. Bangladesh government does not have the expertise in supervising a project of this scale and without the lead role of an organization like the ADB bilateral support from a country like Japan is unlikely to materialize.

The combined support level from these sources may not exceed US$1,500 million (previous combined commitment level from ADB, Japan and IDB was US$1,155 million). Since domestic financing for the project should primarily be limited to finance the domestic component of the project, such financing should not exceed 25% of the total cost. Thus budgetary support for the project should be limited to US$725-800 million (Tk. 20-25 billion per year for 3 years).

As the final step, the issuance of sovereign bond may be considered to supplement external and domestic financing. Issuance of sovereign bond will minimize BOP pressures but the repayment cost for this portion of the financing package will be much higher than bilateral and multilateral sources. Nevertheless, if access to such borrowing is limited ($600-$700 million), the debt servicing burden may be manageable. Since the sovereign bond issue would be considered as a debut issue for Bangladesh, the size of the issue should be such that it would be oversubscribed by the international investors.

Whatever option the government chooses, it has to deal forcefully with the allegations of corruption. Bangladesh needs to set an international standard in every step of implementation of the project. This will not only serve public interest best but also enhance credibility to the donors and international investors. The authorities should be careful and constructive to create the best possible environment for safeguarding public resources throughout the implementation process. Bangladesh needs to demonstrate decisively that whatever mistakes might have happened in the past will not be repeated in future. If we are successful in demonstrating that, we may also reconsider the option of asking the World Bank

to reconsider its position on financing, as originally suggested by the minister of finance. This option will require less time for recommencement of the project and possibly with lowest financing cost.

Padma Bridge is the biggest project in the history of the Bangladesh. Like any other project it should be evaluated on the basis of associated costs and benefits. If we get emotional and over emphasize the political and economic benefits of the project and fail to properly estimate the costs arising from the different sources of financing, we may end up with a disastrous outcome. Implementing the project at the cost of macroeconomic stability will be suicidal and must not be an option. We need to consider only those options which will make the project viable, without creating macroeconomic instability. If we fail to put together such a financing package that we can afford as a nation, we should wait for the right time to implement it.

E-mail: ahsanmansur@gmail.com