Financing strategy for an Infrastructure Transformation Plan

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By *Dr. Ahsan H. Mansur*

We all know that Bangladesh has serious infrastructure deficit. Poor infrastructure is negatively impacting all growth fuelling indicators such as foreign direct investment (FDI), domestic investment, business ecosystem, consumer confidence, employment generation, connectivity and trade. As a result, Bangladesh comes out to be one of the worst performers in all international measures by prominent institutions like the World Bank and World Economic Forum.

In the “Ease of doing business” indicator, Bangladesh is 174 out of 189, whereby it has dropped by two ranks since 2015. It scores lower than India and Pakistan. Bangladesh ranks 189 out of 189 in “Getting Electricity.” It ranks 109 out of 144 countries in “Global Competitiveness” report, scoring worse than India, Sri Lanka and Thailand. In the index for “Quality of Infrastructure,” Bangladesh ranks 130 out of 144 countries. In “Global Enabling Trade Index” Bangladesh ranks 123 out of 138, indicating that the cost of trade is high in Bangladesh.

At a time when Bangladesh has been suffering from serious infrastructure deficit, efforts to expand the infrastructure programme has been frustrated by chronic shortfall in budgetary resources, serious cost overruns, and lack of action in diversifying foreign financing. Paradoxically, while suffering from serious resource deficiency, Bangladesh has been rapidly reducing its foreign debt burden by not accessing foreign capital adequately so that foreign debt to gross domestic product (GDP) ratio declined by 19 percentage points over the last decade to only 13% of GDP by fiscal year (FY)15.

It is comforting to observe that Bangladesh has had a solid track record of expenditure control and debt management. It has consistently adhered to prudent fiscal and debt

management strategy under which fiscal deficits have been contained within 3.5-4.5 percent of GDP. While this conservative approach has served Bangladesh very well during 1970s through 2000s, it is time to re-evaluate certain aspects of the strategy. Total debt has come down from 45% of GDP in FY05 to 34% in FY15, which is entirely attributable to a decline in the foreign debt. Financing of the fiscal deficit has been excessively tilted to high cost domestic borrowing while the foreign aid pipeline now exceeds $22 billion.

The core question therefore remains: Has Bangladesh been over cautious in managing its fiscal deficit and debt, while ignoring the much needed infrastructure expenditure to support growth and further reduce poverty? Leading experts have a virtual consensus that Bangladesh certainly has the potential for much higher growth, even at double digit rates. But for such vibrant growth, Bangladesh will require to increase significantly its overall investment, and in particular, on infrastructure. All major sectors will require massive amounts of investment: road, rail and water transport; deep sea ports and river ports; power generation and distribution; mass rapid transit system in Dhaka; economic zones across Bangladesh; etc. The power sector alone will need $60 billion in new investment in the next 15 years.

Bangladesh currently has a growth momentum and is also benefitting from demographic dividend which will last for another 30 years or so. Hence, the time for infrastructure support is now. If Bangladesh does not capitalize on the current economic momentum and population dividend, the opportunity for transforming the nation to a high middle income and eventually to an industrial economy may be lost — and lost for good.

While the National Board of Revenue (NBR) reforms are being strengthened, the reforms will not manifest results as fast as per requirements for the infrastructure spending. In light of this reality, Bangladesh has two options: (1) it can wait indefinitely for the NBR revenue to gain momentum; or (2) adopt a proactive Infrastructure Transformation Plan (ITP), by using the fiscal space generated in the previous decade.

A major ITP will catalyze the pending infrastructure projects, right away. Private capital inflows may be attracted for power generation, but much more difficult to attract for power transmission and distribution, highways, bridges and other long-gestation projects. A sizable public sector investment plan is thus important, with or without private participation. The ITP

should be time bound, covering a five-year period from FY17 through FY21. The proposed ITP strategy should have three major components: a Financing Plan, an Implementation Plan, and a Capacity Development Programme. The proposed plan will accelerate the infrastructure investment by increasing government infrastructure spending by an additional $26 billion over the next five years. Such investment, combined with the implementation of the Seventh Five Year Plan, will help propel GDP growth to more than 8.0% by FY21, despite the revenue and investment shortfalls experienced under the 7th Plan so far.

THE PROPOSED FINANCING PLAN: Taking into account the fiscal space Bangladesh currently enjoys, an easing of the fiscal policy is proposed until FY21. Currently, roughly 2.0% of the GDP is spent on infrastructure, and the share remains broadly similar under the 7th Plan. The Proposed Financing Plan will increase this spending by an additional 2.0% of GDP, taking total infrastructure spending up to 4.0% of GDP per year. With an increase of $26 billion, a total of $52 billion in infrastructure spending can be budgeted over the next five years. In short, the proposed Financing Plan doubles the size of infrastructure spending budget and its pace of implementation.

The primary pool of funding for the proposed financing plan should come from external sources. Capital is very cheap globally at the moment and Bangladesh should take advantage of the unusually low cost of capital. It is simply smarter to opt for external sources instead of the high cost domestic ones. According to the World Bank, Bangladesh needs an infrastructure spending of $10 billion per year. The Proposed Financial Plan will help realize that target.

The first priority for Bangladesh should be to tap into traditional official multilateral and bilateral sources. All multilateral organizations have commitment levels which are well above what Bangladesh has been using every year. Bangladesh can also significantly increase its access to these multilateral sources by opting for a blend structure by moving away from the traditional International Development Association (IDA)-the only soft-loan financing window of the World Bank.

As a founding member of Asian Infrastructure Investment Bank (AIIB), Bangladesh should access its resources. Potential access to BRICS (Brazil, Russia, India, China and South Africa) Bank should also be considered. Bangladesh has been constructing infrastructure projects

with bilateral assistance on concessional terms. The Japan International Cooperation Agency (JICA)-funded projects, including the Dhaka Elevated Rail, are good examples in this regard. Chinese and Indian funding for projects would also be vital. In sum, the multilateral organizations can provide an additional $1.5-$2.5 billion per year under different arrangements, while additional funding from bilateral sources can provide $1.5-$3 billion.

Broadening the external financing base is also important. Globally, emerging economies are experiencing large inflows of capital. Bangladesh should avail this opportunity. Bangladesh has BB-rating and can tap the international capital market by issuing sovereign bonds. The proceeds must be earmarked for infrastructure financing. By branding the bonds as "Bangladesh Sovereign Infrastructure Bond", they would become attractive to the investors and their domestic use "ring-fenced." The first year Bangladesh can issue five-year bonds worth $1.0-$1.5 billion and then steadily increase the amount based on its needs to $2.0-$3.0 billion. The tenor of the bonds may also be increased to 10 year and thereafter to 20 years or more. Indonesia and the Philippines are regularly issuing sovereign bonds with tenors of 20 and 30 years.

Overall, mobilizing $4.0-$6.0 billion per year for infrastructure financing is highly plausible!

IMPLEMENTATION PLAN: Selected projects for the ITP must fulfill economic feasibility. Projects less than $500 million should not be included in the ITP in order to keep the list short but focused. Dedicated teams from the implementing agencies should work closely with their counterparts in the Economic Relations Division (ERD) and Finance Division. Compromising on these issues would simply delay the financial closure of projects. Issues like access to roads or new connecting roads, land acquisition for the projects, access to power, and tax incentives, must be settled before any project is taken to financiers. Such issues delay project implementation or lead to cost overruns.

CAPACITY DEVELOPMENT PROGRAMME: Bangladesh has serious implementation capacity constraint. Every year Annual Development Programme (ADP) resources, which include infrastructure funding, remain unutilized despite huge unfulfilled needs across all sectors. Thus, expanded infrastructure programme must go hand-in-hand with capacity development.

Human resource development for long-term infrastructure project management has to be well-planned, with programmes for specialized technical and management training for Project Directors (PDs), Deputy/Assistant PDs, auditors, accountants and other important project staff, at both home and from abroad. Concerned ministries have to create a pool of eligible project designers and implementers. The focus should be on a few ministries with major infrastructure programmes.

At the core of a successful project are the people working on them. Holding a PD post should not only be about implementation skills but it should also be considered a matter of pride. An incentive structure which rewards timely completion of large projects ought to be set up. A programme to train young and mid-level line ministry staff needs to be designed and adequately funded. Quality control for the projects needs to be done by independent bodies and through multi-stage audits.

NO ALTERNATIVE TO NBR TAX REFORMS: The success of this proposed Plan will depend on the choice of projects, administrative capacity building for implementation, and oversight mechanisms put in place. Under the Plan, foreign debt will increase by 9.0 percentage points to 22.6% of GDP. Bangladesh had that level of debt burden only several years ago. At its peak, Bangladesh's foreign debt was more than 40% of GDP and at that time the country's growth rate was much lower (in the range of 4.0-5.0 per cent). The interest payment on foreign debt will increase by 0.3 percentage point to 1.5% of the GDP by FY21, a very modest increase. Repayments of principal amounts will fall due after the proposed five-year period and can be serviced through rollover of sovereign bonds.

The proposed plan is simply an interim measure to boost investment at a time when revenue is lagging. Efforts must still be on undertaking tax reforms, strengthening tax administration, and improving public enterprise finances. There is no long-term alternative to mobilizing higher revenues for funding the expanding physical and social infrastructure programmes for an emerging economy like Bangladesh. The measures in the Proposed Financing Plan will only allow Bangladesh to expand and expedite implementation of its infrastructure while reforms on the revenue side are yet to deliver.