



Imperatives for higher investment to meet Sixth Plan targets

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Sadiq Ahmed concluding his two-part article on the Sixth Five Year Plan

Inflow of FDI (foreign direct investment) has historically been low in Bangladesh. Data from Bangladesh Bank suggests that the inflow of FDI virtually remained stuck between \$600 million and \$900 million during FY05-FY11 suggesting that foreign investors do not find Bangladesh as an attractive destination for their investments (Figure 5). There were somewhat higher inflows in FY12, approaching the \$1.0 billion mark for the first time in the history of Bangladesh.

During the same period average annual inflow of FDI in Vietnam, Pakistan, India and China were respectively \$4.2 billion, \$2.5 billion, \$18 billion and \$75 billion. These figures suggest that despite the good intentions of the Sixth Plan, Bangladesh has not yet succeeded in attracting FDI in relation to competitors.

✘ A part of the impetus to FDI was expected to come from the government's much-heralded public private partnership (PPP) strategy for financing infrastructure. The Sixth

Plan expected that the share of PPP financing in total investment will grow from the 0.5 per cent of GDP (gross domestic product) level in FY10 to 2.5 per cent of GDP by the end of the plan period (FY15). In practice, there has been hardly much dent in implementing this initiative.

More specifically, although, the Government allocated funds in FY2010-FY2012 budgets and established a PPP cell in the Board of Investment (BoI) to operationalise the PPP initiative, little progress has been achieved so far due to several implementation challenges. These include pricing and financing aspects, regulatory and legal frameworks, competitiveness in the bidding process and a careful match between assets, liabilities and cash flow. Additionally, lack of leadership and technical staff has constrained progress. The government review of the financial and economic viability of PPP projects is crucial because success depends largely on costing and pricing issues, as well as generation of the revenue stream. The legal framework must lay down obligations of the government to private sector partners, keep provisions for cost recovery and address issues of compensation and redress mechanisms. Imminent actions are required to establish a comprehensive policy and regulatory framework to ensure competitive and transparent bidding, sharing of risks and rewards and dispute settlement mechanisms.

The inability to attract much larger FDI and the lack of progress with the PPP strategy are missed opportunities that need to be corrected quickly to support higher growth, investment and exports.

Buoyed by relatively favourable rating by international credit rating agencies (Standard and Poor's and Moody's), Bangladesh is preparing to float a sovereign bond to the initial tune of \$500 million. This is consistent with the strategy of the Sixth Five Year Plan (SFYP) to diversify the sources of foreign resources within the framework of a prudent debt management. The borrowing environment for Bangladesh is relatively comfortable and competitive with countries like Sri Lanka and Pakistan that already have a market presence. However, the actual outturn once Bangladesh goes to the market will provide more insights on the prospects of this source of external financing. So the implementation remains incomplete. Foreign aid: In spite of its status as a member of the least developed country group, Bangladesh's dependence on foreign assistance (ODA) has declined very significantly since independence. The country was heavily dependent on aid during the first two decades

of independence. Even during 1980-90 new net commitment of ODA was around 8.0 per cent of GDP. Since then, ODA as a share of gross domestic product (GDP) has declined rapidly, falling to around 4.0 per cent of GDP at around the beginning of the millennium. The role of official aid further declined over the past 12 years with new net inflows approaching 2.0-3.0 per cent of GDP (Figure 6).

ODA – persistent story of mismatch between commitment and disbursement: In addition to dwindling aid inflows, a major problem is the consistently wide gap between disbursements and commitments/planned spending of Development Partners. In just six of the 18 years under consideration have disbursements exceeded planned spending (Figure 7). Since FY2003, disbursements as a share of commitments have consistently been well below 100 per cent. As a result of this persistent gap, the pipeline of foreign aid increased to a record high level of about \$12.4 billion in 2012. Such prolonged under-disbursement of committed aid is indicative of several issues that have been a deterrent to higher disbursement of planned assistance.

The explanations of the observed mismatch are to be found in the discussion on aid effectiveness that has now taken centre stage. According to an independent Evaluation Group Survey carried out in mid-2008, Development Partners are critical of the way in which aid is spent in Bangladesh and consider governance and weak quality of country systems, especially procurement, as main impediments to realising development potential. (Development Partners 2009. Donor Coordination and Harmonisation in Bangladesh: A Joint Evaluation Paper. Dhaka: ADB, DFID, JICA, World Bank.) This is corroborated by an Operations Evaluation Department Survey also carried out at the same time that pins the blame squarely on government-related problems such as “...delays, policies or decisions delaying or obstructing the projects, difficult government systems and procedures, lack of coordination with other agencies, and lack of (qualified) government staff”. (Development Partners 2009. Above cited.) Weaknesses also emanate from the development partner (DP) side. Delays caused by DPs, difficult forms, procedures and paperwork and enforcement of the donor agenda also contribute to lower disbursement of ODA than planned.

In spite of reduced reliance on aid, Bangladesh has participated in all initiatives to enhance aid effectiveness and has endorsed the joint commitments contained in the Paris Declaration

(PD) of 2005. The PD “...stipulates that new partnership relationships and ways of working between developed countries and partner countries are essential if development results are to be assured, aid well spent and aid volumes maintained”. (DAC 2010. Evaluation of the Implementation of the Paris Declaration: Phase II. PD Evaluation Secretariat.) Since then the government has taken significant steps to promote all the Paris Principles – ownership, alignment, harmonisation, managing for results and mutual accountability. In fact, the 2008 DAC evaluation of the PD assessed the country’s progress against these five principles of the PD. Although, the evaluation report (NRP 2008. Evaluation of the Implementation of the Paris Declaration: Case Study at Country Level Bangladesh. Dhaka: Natural Resources Planners Ltd.) noted some improvements in above five areas, there is room for improvement.

Furthermore, the value and effectiveness of foreign assistance is also frequently undermined by a high degree of aid fragmentation. The ODA environment is becoming ever more complex due to the growing importance and role of non-DAC emerging Development Partners (DPs). These pose challenges to harmonising and aligning aid, increasing transaction costs for both Development Partners and recipients and creating duplication in delivery that is wasteful. Increasing fragmentation in sectors could also lead to rising competition between DPs that could lead to greater focus on results of own projects rather than on broader national priorities, posing coordination challenges. (Nadoll, J. and N. Hussain 2008. Fragmentation and Proliferation in the Delivery of Foreign Assistance to Pakistan. Discussion Paper, Islamabad: UNDP Pakistan.)

Use of official foreign financing in the Sixth Plan: The implementation of the Sixth Plan official aid strategy does not show an encouraging progress. Total aid disbursed (net of amortisation) in FY11 and FY12 is below the amounts projected in the Sixth Plan (Figure 8). ODA figures for disbursement provided by the External Relations Division (ERD) do not match the figures recorded by the Bangladesh Bank in the balance of payments (BOP). The gap is particularly large for grants. The BOP figures show a much lower gross disbursement of grants and loans/credits than recorded by the ERD. This is a serious anomaly that ought to be investigated and corrected. The outturn in FY11 was particularly worrisome. Disbursement of gross official assistance including grants amounted to a mere \$1.7 billion in FY11. After allowing for repayment of \$0.7 billion, net assistance was a meagre \$1.0 billion. The situation improved somewhat in FY12, with gross disbursement rising to \$2.2 billion (2.0 per cent of GDP) while net disbursement grew to \$1.4 billion (1.2 per cent of GDP). Yet, these

resources remain inadequate compared to the development needs of Bangladesh. The shortage of foreign funding reduced the ability to implement major infrastructure investments including the Padma Bridge. This also contributed to higher-than-planned use of domestic bank borrowing to finance the budget deficit, which contributed to inflationary pressure as well as to a rising cost of government borrowing.

✘ A range of issues contributed to this unhappy situation. These include primarily procurement disputes, which led to the cancellation of the Padma Bridge (subsequently restored in September 2012) and also contributed to slower-than-planned use of the aid pipeline, and a lack luster approach of the government to mobilize foreign aid. A part of the government has a negative view of foreign assistance that might have weakened the overall effort of the Finance Ministry and the Bangladesh Bank to procure official foreign assistance.

The way forward: With \$750 per capita income and a head count poverty incidence of 31-plus per cent Bangladesh remains a poor developing country. The government of Bangladesh through its Vision 2021 aspires to attain middle income status by 2021. This requires a lifting of the GDP growth effort from 6.0 per cent per annum to 8.0 per cent per year on average. Achieving this growth rate will require a major effort to increase both public and private investment. The financing of this investment will largely come from domestic resources; yet foreign financing will need to play a complementary role.

This strategic view was clearly recognised in the Sixth Plan and the underlying resource mobilisation strategy was built around this. Two years of implementation record show that there have been shortfalls in both domestic and foreign financing front that has constrained the ability to increase domestic investment. In particular, shortfalls in mobilising foreign financing including the implementation of the public private partnership (PPP) strategy has constrained the ability of the government to implement its ambitious infrastructure upgrading strategy. Shortage of infrastructure services in power and transport continue to hamper the ability to increase the growth rate to 7.0 per cent and above. Policy actions need to be taken immediately to reverse this pattern and increase the domestic and foreign financing of investment.

On the foreign financing front, the Sixth Five Year Plan adopted a sound external resource strategy that has met with serious implementation shortfalls. Efforts now need to focus to

address those implementation constraints. In summary, these actions are:

I Need to jump start the stalled PPP strategy through a more thoughtful and realistic approach that involves the participation of internationally competent staff with a proven track record for managing PPP programme implementation. Most countries engaged in a broad-based PPP programme have felt the need to develop a cross sectoral pool of expertise in a dedicated PPP unit to supplement capacities in the line agencies that contract for PPPs. These fulfill different roles depending on the needs of the situation. In some cases their role is limited to disseminating information on PPPs and providing broad guidance on good practices. In others they have an active role in helping line agencies and ministries successfully contract for PPPs, and in yet others they play a role in approving PPPs developed by other government agencies. In the case of Bangladesh, the relocation of PPP cell as an autonomous body would allow it to attract a cross sectoral pool of expertise to supplement capacities in the line agencies that contract for PPPs. These experts could also play a substantive role in developing PPP projects and attracting foreign financing.

I The biggest potential is to mobilise much more foreign direct invest (FDI). The size of the FDI global market is large and the examples of China, India and Vietnam show that a hospitable investment climate can make Bangladesh a major destination of FDI. The constraints to the investment climate have been well researched and well known and include such issues as power supply, transport bottlenecks, land procurement, corporate taxes and simplification of business procedures. A serious and concerted effort to address these long-standing issues is now essential. The absence of even-handed and non-discretionary implementation of FDI policies is also of concern and must be ensured. Furthermore, the foreign exchange regulatory regime needs further simplification to allow smooth international financial transactions for the private investors.

I Adopt an aggressive approach to much better utilisation of the large pipeline of undisbursed ODA pipeline. The most important constraint here is procurement. The government may need to think out of the box here and adopt options including turn-key type procurement involving the concerned donor agencies and inviting internationally reputed procurement agencies.

I Implement the strategy to diversify sources of foreign resources including bond financing. The preparatory work has been done and the government should take steps to float its bond

within the framework of securing all prudential norms of external debt management. The government should resolve all disputes with the donor agencies and manage aid coordination in an atmosphere of mutual trust and respect.