The Padma bridge options

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I have written and spoken a lot on the issue of the Padma bridge

and my biases are well known. I continue to believe that the design, financing and implementation plan agreed by the government of Bangladesh with the international consortium of donors led by the World Bank is the first best option. We now know the government has decided to withdraw this financing request. This is unfortunate as I believe the process agreed by the government with the World Bank in September 2012 to resolve the longstanding dispute regarding corruption was appropriate and fair. I was also very encouraged to see the progress made by the Anti-Corruption Commission and was hoping to see this process to continue and end on a happy note where the conflict is resolved, financing is restored and implementation starts. But that is not to be.

Life has to go on. There is now a search for alternative options to build this critical infrastructure. Lots of ideas are floating around in the print media and in the TV discussions. A populist idea is to fund and implement the bridge through own resources. This sounds patriotic and appears as an easy-to-do option. However, I will argue below that going this route has serious downside risks. Instead, there is a better option that must be explored vigorously before venturing into this highly risky domestic option.

First and foremost, capacity constraints are a serious impediment to development in Bangladesh. As an example, an estimated $16 billion committed foreign resources are stuck up in the aid pipeline. A major reason for this is limited implementation capacity. In this environment, taking up the implementation of a complex mega project like the Padma bridge without any demonstrated track record of handling similar projects appears to me a dream whose time has not come yet.

Second, we are acutely aware of the serious funding constraint in the national budget. Already there are many budgeted development programmes that face a shortage of resources. Squeezing those programmes to divert resources for Padma bridge can present major implementation problems for those projects.

Third, the budget faces substantial downside risks. Revenue collection targets are not likely to be met. Despite some adjustments in energy prices, the subsidy bill is large. Finally, the treasury is facing a huge contingent liability owing to the Hall-Mark scam. The Tk 3,600 billion that was plundered from Sonali Bank by Hall-Mark is not likely to be recovered. This liability will likely fall on the shoulder of the treasury.

Fourth, the idea of tapping resources from the foreign reserves of the Bangladesh Bank is not a sound proposal. Reserves by definition are intended to provide a cushion from downside risks. It is true that the Bangladesh Bank has been accumulating reserves in recent months owing to a major slowdown in demand for imports and also because of a very favourable inflow of remittances. But this accumulation is from a low base. Even now with a better reserve situation, Bangladesh still has only four months of import cover that is still low when compared with well-managed economies. Additionally, there are serious downside risks to garment exports emerging from the poor labour safety standards in many factories. We also know from the experience of fiscal 2011 that lapses in macroeconomic management can easily squeeze the balance of payments, thereby putting pressure on the exchange rate and running down reserves.

Moreover, this use of reserves to finance treasury operations will set a dangerous precedent for future governments who might start thinking of reserves as a budgetary resource. A similar proposal in early 2008 by the Indian planning ministry to finance infrastructure by drawing on India's then swelling foreign reserves (that had then reached the $300 billion mark) was eventually abandoned by the government as it recognised the downside risks of this policy.

If a home-grown solution is not the way to go, what is a viable option? I believe the second-best option is to seek bilateral assistance for Padma bridge financing and implementation on a turn-key basis. There are many developed countries, notably USA, Germany and France, with superb bridge-building capacities. Among the developing countries, China and Korea are excellent. Exploring bilateral turn-key type options for the Padma Bridge with a few countries like Japan, Korea and China might be the way out.

These negotiations have to be carefully and transparently managed as international evidence shows that bilateral projects tend to be more expensive in terms of capital cost, borrowing terms or both. The good news is that there is a benchmark on all three critical elements of the Padma bridge: project design and components; project cost; and financing terms. This benchmark, which constitutes the first best solution, is provided by the World Bank-led consortium that we have now rejected. However, in the second-best option involving bilateral financing, this benchmark provides an excellent cross check on the quality of what is being offered bilaterally. It will be reasonable to expect some increases in cost over the $2.9 billion. A 5-10 percent increase may be justifiable. Similarly, the terms of the loan will likely be less favourable than the terms in the first-best option (weighted average interest cost below 2 percent). In the present global financing environment, an average interest rate of 3-4 percent will seem reasonable.

I do not see any reason why the design or the components should change. The bilateral negotiations should be held on pricing, financing package and implementation timeframe for the project as already defined now. Getting offers from more than one bilateral donor, if feasible, might serve the interests of competition and partially compensate for the lack of international competitive bidding procedure as in the multilateral funding option. The turn-key implementation arrangement is essential to avoid problems of coordination of the various components, minimise transaction costs and avoid implementation delays.

As the beneficiary, Bangladesh must have some supervisory oversight to ensure the quality and timeliness of project implementation. In the absence of domestic competence, this will need to be procured internationally as advisory services to the government. There are excellent international firms that can provide this service at a reasonable price. Avoiding procurement problems of the type faced in the recruitment of supervisory consultants of the Padma bridge in 2011, which caused the demise of the World Bank-led consortium option, will be essential.