

Public-Private Partnerships in Bangladesh's Power Sector: Risks and Opportunities (draft)

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The paper will initially review the idea of public-private partnerships (PPPs) as it has evolved over the past few decades first in OECD countries, and then in developing countries. Questions will include: How is PPP defined (it means different things to different people and this is an asset)? How is PPP part of the New Public Management (NPM) agenda (fragmentation, competition, incentivization), and how is it part of the post-New Public Management (NPM) agenda (governance, networking, collaboration)? What are the regulatory challenges? What are the risks of PPPs, including corruption risks and how are they best managed? What has been the effectiveness of PPP in terms of NPM (outputs, efficiency) and post-NPM (innovation practices to solve complex problems, new delivery processes that cut through bottlenecks) metrics? What have been the challenges in transferring the concept from OECD to developing countries? Building on this foundation, a case study will be presented of recent developments in the Power sector in Bangladesh to illustrate these issues in a specific context.

1. Evolution of the idea of PPPs in recent years

How is PPP defined?

PPPs are contractual partnerships where responsibilities and risks are shared between the public and private sectors. There are three main elements: (1) private execution and financing of public investment; (2) emphasis on both investment and service provision by private sector; and (3) risk transfer from the government to the private sector. While there are many possible forms, including public policy networks, and urban renewal and community development schemes, the focus here is on long-term infrastructure contracts.

Contracts are structured differently from normal contracts. Firstly, debt and equity investments are incurred by a private sector partner (may be a special purpose vehicle) rather than by government. Secondly, the private sector is paid by user fees, or fees from government, or some of each. Thirdly, the private sector is typically legal owner for the life of the contract. (this and following sections draw from Greve and Hodge, 2011; Farquharson et al, 2011; Roberts, 2011; Hodge, Greve and Boardman, 2010; and Schwartz, Corbacho and Funke, 2008)

Is PPP part of the NPM or post-NPM agenda?

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NPM: promises better value for money, improved accountability, on budget or on time delivery, performance measurement through definition of outcomes, rather than focus on inputs and procedures; enabling government as purchaser to specify outcomes to be delivered by PPP. Heightened collaboration (no single agency can deal with a problem on its own), creating value that is beyond outputs, and innovation: thinking of solutions that neither public sector nor private sector can come up with on their own.

Three dimensions are consistent with NPM: fragmentation (e.g. separating power generation, transmission and distribution into separate business functions), competition (subject to government procurement rules), and incentivization (contracts written to focus private sector on the task to deliver the outcomes.)

PPP has been used a governance tool: for example, New Labor in Britain pushed it to show they were reformist, and pro-business. PPP may also give greater flexibility in applying user fees. New project delivery tool that cuts through labored and paralyzing constraints placed on government: private energies are mobilized to push through projects and achieve results through new methods. Government is seen as action oriented, delivering iconic projects to citizens. Undue political interference is removed. Project implementation is shifted away from government officials, where large infrastructure project may be an unusual event, and accountability for results is weak, to highly specialized infrastructure operators that are highly incentivized to deliver. The tendency of politicians and bureaucrats to under-budget for infrastructure maintenance is also addressed by the PPP contract, which locks in future maintenance that the private operator knows from experience will be needed.

PPP also enables government to deliver infrastructure without affecting public finance position or debt limits. It can be used like a credit card, offering the promise of developing major projects without having to appropriate significant funds until the project is operational, thus transferring costs and risks into the future. This feature was accentuated by liberalization of global capital markets, growing investor enthusiasm for infrastructure projects (the steady income stream particularly appealed to pension funds), and the emergence of global businesses focusing on infrastructure such as Suez Environment (water) and Cintra (highways). The ready access to capital helped speed up projects when fiscal resources were tight, but posed the risk of reducing democratic accountability since initial budget authorizations weren't needed, and contracts with private operators weren't disclosed. In some cases, this could be addressed by government seeking approval to carry PPP assets and liabilities on its balance sheet, for example in cases of limited risk transfer to private sector, where government may be economic owner (if not legal one); yet this rarely happens because of strong incentives to overstate the risks transferred to private operators, so that the debt could be excluded from government accounts.

Regulatory challenges for PPP

There are many issues at play. Should obligations between PPPs and public bodies be regulated as a matter of legal or quasi-legal obligations? In other words, should they be tested by the courts? Or should they be tested by arbitration mechanisms, for example in cases where the courts may not be impartial, or where speed of delivery requires a pragmatic approach? What level of constitutional oversight is needed for PPPs? Should transparency cover input, throughput and output stages, to be consistent with principles of democratic accountability, or should it only cover outputs such as income and profits, as would be

normal in business? Given the complexity of these issues, PPPs work best in countries with formal, advisory bodies to help governments calibrate their regulatory framework.

Challenges of PPP risk management

Risk in PPP can come from weak procurement practices, moral hazard, and a bias for optimism. There is inherent asymmetry in a PPP where the government needs to prevent service disruptions, while the private partner may view disruptions as a way to strengthen its bargaining position. This asymmetry is heightened by the better preparation of the private partner than the government to negotiate, manage and renegotiate PPP contracts. There may also be fiscal risks due to the lack of a long-term budgetary framework (costs may not be incurred by government until many years after project approval). Design, construction, licensing, demand, renegotiation, bankruptcy and operating risks also need to be carefully managed.

Is PPP effective?

Answering this question is difficult, due, inter alia, to the multiple objectives of PPPs, the different disciplines needed to assess these,

Conflicting research findings. Evidence in some cases shows production cost efficiency from PPP, but much of this may be cancelled out by higher transaction cost (e.g. higher cost of private financing, complex contracts, governments need sophisticated transactions advisors to manage process).

Recent global financial crisis raises questions on superiority of private sector ideas. Also, countries leading PPP bandwagon like UK and Ireland are among worst sufferers of financial and economic shocks, which raise questions on the advice coming from such countries financial advisors. The UK government announced in 2009 that it would provide all the debt needed so that PPPs wouldn't be disrupted, underlining the point made earlier about risk had not really been transferred to private operators. But, on balance, evidence suggests PPP performance is probably no worse than traditional public sector operations done under contract with private sector, and better than older forms of public works department projects. PPPs also appear to deliver infrastructure more quickly than through traditional methods.

What are the challenges of transferring PPP to developing countries?²

Like many other policy transfers, taking the notion of PPP from OECD to developing countries can be problematic. Batley and Larvi (2004: 5-6, 29-30) point out some key differences in context between developed and developing countries. First, the pace and nature of reforms in developed countries are designed and carried out by the respective governments, and with the democratic support of their electorates. By contrast, reforms in developing countries are often designed by international agencies, and not fully understood or supported by citizens. In some cases, these reforms may be carried out by bureaucratic and political elites with the intent of preserving their existing interests, although the eventual outcome could be different (Cheung 2005: 276-7). Secondly, common reform packages designed in developed countries are being transferred to a highly diverse set of countries, including transition

² This section draws from Wescott, 2009.

economies, weak capacity and post-conflict states, post-authoritarian democracies, and Confucian meritocracies. Many of these developing countries have much deeper fiscal crises and sharper declines in public service than developed countries, yet programs often use OECD country designs as models. Where programs vary, the reason is often more failure to meet negotiated conditions, rather than responding to differences in context. Thirdly, implementation of reforms in developing countries is uneven, with stroke-of-the-pen reforms often moving quickly, while necessary structural changes move slowly or not at all. The latter are impinged by chronic institutional weaknesses including corruption, lack of competitiveness in procurement, and weak coordination among government departments. Finally, the infrastructure requirements of developing countries are much more chronic than in developed countries. Due to sharp cuts in public investment under structural adjustment (in Latin America it declined by 50% from 1988-1998[Roberts, 2011: 119]), infrastructure in many developing countries started being severely strained by rapid growth and urbanization from the 1990s

In addressing these challenges, PPPs are more likely to succeed when there is a formal PPP advisory body in government, when there are close links between PPPs and the government's fiscal support (e.g. India's viability gap fund that can pay up to 20% of the cost of a project), when careful attention is paid to project preparation, revenue and cost estimates, and competitive procurement, where all parties adhere to contractual commitments, and where consideration is given to ensuring that social benefits outweigh costs to affected persons (Hodge, Greve and Boardman, 2010: 535-43)

2. PPP in the Bangladesh Power Sector

Background

Bangladesh's power sector is experiencing a crisis, which while not new, has become particularly problematic in recent years. A 2003 survey found that 73 percent of firms viewed electric power as a major or severe constraint, a finding confirmed by a 2007 survey and two recent World Bank missions.

Bangladesh has a power shortage that is costing an estimated two per cent per annum in economic growth. It has no more than 4,600 – 5,200 megawatts of available generation, but peak demand reaches 6,500 megawatts, leading to a power shortage estimated to cost 2% of GDP pa. Only about 1/3 of rural households have access to electricity, and Bangladesh's electricity consumption per capita is 236 kWh per year, one of the lowest in the world. With promises to add 11,500 megawatts by 2015, the government has recently awarded a large number of contracts to build large power plants to the private sector. However, significant construction work is yet to begin. To address the interim shortfall, the Government has contracted about 2,200 mW of power for 3-5 year terms, using liquid fuel.

Bangladesh's control over its power future is in jeopardy because the Bangladesh Power Development Board, the main aggregator of bulk power, may become financially insolvent, a major issue that needs to drive reform. The short-term power contracts contributed, inter alia, to a deficit of US\$600 million for FY11, covered by a direct transfer from the government of US\$550 million, accounting for 4% of the national budget. Although the Bangladesh Energy Regulatory Authority increased bulk and retail tariffs by 70% and 35% respectively since February, 2011, the deficit for the sector is projected to be around US\$1 billion in FY12. For the power tariff to reach the overall cost of power under the Power Sector Master Plan (PSMP) at US\$0.096³ kWh, the bulk tariff would need to be raised by 330% (assuming the gas price is adjusted to the international level in five years, equivalent to an annual increase of 27%.⁴ The excessive

³ Taka to US\$ conversion based on June 4, 2012 exchange rate of 81 Taka = 1US\$

⁴ Source: Power System Master Plan Study 2010.

reliance on a single energy source, natural gas, adds to the country's challenges: natural gas fuels 83 percent of power generation, renewable energy less than 1%, and the rest from oil and coal. In addition, by selling to consumers at regulated prices below international market prices Bangladesh is prolonging the shortage situation: consumers have few incentives to conserve, and thus rationing is being implemented, restricting, for example generation from the liquid fuel plants to peak demand hours.

Coal use could increase further if a large proposed plant relying on imported coal goes ahead. In the long term, energy from domestic coal might increase given that 2.5 billion tons of coal reserves have been found, enough to fuel all electricity generation at current levels for about 25 years. Bangladesh's terrain limits its potential for hydropower, but the hope is that other renewable sources, while currently negligible, might be rapidly expanded.

PPP in Bangladesh's Power Sector

PPP plays a key role in the power sector today, and is slated for a greater role over the next few years. By 2010, the private sector was generating 38 percent of the country's electricity. By comparison, in 2008–9 India's private sector generated less than 15 percent of the country's electricity despite greater international interest in its infrastructure sector. The government of Bangladesh plans to attract an additional US\$9 billion of investment in power generation by 2015, of which it expects US\$8 billion to come from the private sector. If it were to achieve this scale of private investment in generation, then even ignoring short term, rental power projects, the proposed additional capacity would raise the private sector's share to around 65 percent of total generation capacity (Government of Bangladesh 2010). The government recently awarded four Independent Power Producer (IPP) deals. Three of the four were awarded to the locally owned group – Summit. Summit was awarded Bibiyana I and II (335 MW each) and Meghnaghat IPP (341 MW) while Ranhill Power of Malaysia was awarded Bhola IPP (225 MW). Bibiyana I, II and Bhola are combined cycle gas based power project while Meghnaghat is a dual fuel combined cycle project. Availability of gas at Bibiyana I, II and Bhola are not of concern as all these three projects are located near the gas fields. However, there has been no significant progress towards implementing these projects.

As in many other countries, Bangladesh has sought private sector support for power to obtain better value for money, on time delivery, performance assurance, and access to financing. As in other countries, policy since the 1990s has advocated increased arm's length regulation, competition and privatization or corporatization, to address inefficiency, poor service and persistent losses of former arrangements. Regulatory improvements helped reduce the burden of subsidies on the budget, and the risk of financial insolvency of entities such as the Bangladesh Power Development Board.

Despite these improvements, the Bangladesh has been unable to implement major new PPPs since 2001, and the power shortage persists. Reasons include a high risk premium, small number of bidders, irregularities and rent capture, protracted decision making, and few IPP successes.

High Risk Premium

The implicit risk premium for financing private investment in generation is relatively high and growing. Power plants with the capacity to generate a few hundred MW involve significant investment, upwards of several hundred million dollars for plants with lifetimes of well over a decade. IPPs investing in these projects aim to sell to the government, which typically buys the power at a higher price than that at which

it can feasibly sell it to final consumers. Contracts with the government are for the cost of power generation net of the input cost of fossil fuels, so the overall implicit subsidy to the generation sector can grow for a number of reasons, including a rise in the price of fuel and an increase in the number of power plants. Feasible increases in the selling price to final consumers are unlikely to change this situation. The likelihood of the government defaulting in the future depends on contingencies, including success in discovering domestic fuel sources, commitment of fuel supplies (like gas to alternative uses, price increases for imported fuel, rate of growth in generation capacity, and feasible increases in tariffs for final consumers. A significant increase in generation capacity alone will increase the overall burden of fiscal transfers and thereby reduce the credibility of the government's promise to adhere to contracted prices. While contracts with the government appear to be watertight on paper, many of the underlying risks cannot be adequately insured against, resulting in a non-negligible risk of the government defaulting or renegotiating contracts in the future. The outcome is an implicit risk premium in raising financing for these kinds of investments.

The current financial crisis in the West has further raised the risk aversion of international banks, and therefore the risk premium for developing countries like Bangladesh. The relatively limited financing available from local banks, the realistic costs of organizing international financing packages based on market perceptions of risk, and the relatively limited cover currently available for partial risk guarantees from international financial institutions mean that the government is unlikely to raise the US\$8 billion in private investment targeted for power investment without a significant increase in the cost of capital, and therefore in the cost of power (Asian Tiger Capital Partners 2010). As an example, even to raise a relatively small US\$40 million term loan for a small power project, Summit needed 5 co-arranging banks (4 of them state owned) and another 15 banks in the lender group. The interest rate is thought to be 14.5 percent or 200 base points higher than that available through the IPFF (World Bank 2010, p. 15).

Small Number of Bidders

Only a small number of players with close relationships with the government remain at the final stages of bidding for significant power generation projects. A recent example is the bidding for the Bibiyana I 450 MW gas-fired IPP. Sitting atop a known gas field should have significantly reduced the risks for this investment compared with other projected investments in generation, yet in mid-2010 only two bidders remained at the final stage. Both bidders had invested significantly in relationships with the government. Indeed, one of the bidders was the Summit Group, whose chief executive officer is the brother of the commerce minister. Typically, the limited number of bidders is taken as evidence of limited transparency and as a reason for the high costs and uncertainties of bidding. This may be partially true, but given the high levels of risk against which firms cannot be effectively protected, the situation whereby only firms that have already invested heavily in relationships with individuals in positions of power are likely to risk proceeding to the final stages of the bidding process is not surprising.

Irregularities and Rent Capture

Irregularities and rent capture are significant problems at the procurement stage. In contrast to countries like India, where significant leakages in the power sector occur at the distribution stage, in Bangladesh the most acute problems appear at the procurement stage of power projects. Procurement irregularities have resulted in persistent problems with the World Bank about appropriate procedures and transparency. Rent capture at the procurement stage also often means that technical specifications are tailored to ensure that

bidders preferred by particular insiders are favored or that specifications are deliberately made extremely demanding to raise the prices of outsider bidders while insiders can expect lax monitoring of specifications (World Bank 2010, pp. 17–19, 22–30). This suggests that even firms with significant investments in relationships are hesitant to aim for long-run profits based on power generation and are more likely to leverage their relationships to capture rents at the procurement stage.

Protracted Decision Making

Contract awards are subject to prolonged delays and are often blocked by rival factions at the final stages. The absence of significant IPP investments since 2002 is remarkable and distinguishes Bangladesh from most other developing countries. This is despite repeated attempts at replicating the experience of the two early, and extremely successful, Haripur and Meghnaghat IPPs. In subsequent cases, insiders couldn't agree about the award of the contract in question, which was then blocked at a late stage. Examples include the decision not to award the Sirajganj 450 MW IPP in 2004. This was ostensibly on the grounds that the sponsor (Summit) did not have adequate experience, even though the Bank made the case that the tariff the sponsor was offering was competitive and the procurement procedures were tolerable.

The first round of Bibiyana I also ended in a stalemate because of unrealistic bidding and construction timetables that deterred outside bidders, while the local bidder (again Summit) was disqualified. This time the bidder was disqualified for not meeting the net worth qualification requirement during a particularly rigorous review by IFC transaction advisers, who applied global accounting standards to Summit's reported financial statements. The sole remaining bidder was the Malaysian firm Powertek, but the caretaker government rejected its bid price. The multiple decision-making points, the weak technical assessment capacities within the government, the existence of different factions within the government supporting different sponsors, and the risk aversion on the part of some bureaucrats fearing future charges of corruption are among the reasons cited for what occurred. For obvious reasons, the presence of significant procurement rents exacerbates all these problems and raises the stakes for different factions within the government aiming to get contract awards for their clients.

Few IPP Successes

To date Bangladesh has seen remarkably few major successes in IPP projects. Indeed, no significant private investments in power generation have taken place since the Haripur and Meghnaghat investments, which became operational in 2001 and 2002, respectively. In both these cases, the cost of capital was reduced as a result of the World Bank's and other international financial institutions' involvement, directly in the case of Meghnaghat through the financing provided by IDCOL and indirectly in the case of Haripur through the provision of a partial risk guarantee. Procurement processes were effective in both cases and achieved two of the lowest costs per kilowatt-hour in the IPP sector, and even relative to average public sector generation costs (World Bank 2010, p. 16).

Analytical Framework for analyzing constraints to new Power PPPs

figure to identify the main directions of causality and identify the political economy implications of attempting reforms that address particular areas of concern.

There is a Risk of Government Insolvency

Arrow 1 indicates the general problem with IPP investment in developing countries and some specific problems with the projected increase in foreign participation in Bangladesh. Classic public good problems of nonexcludability and nonrivalry do not generally constrain private sector investment in power, because power is not a pure public good. Nevertheless, market failures are significant because of possible contract enforcement problems resulting from political risks and unforeseen future events. Significant additional uncertainties about foreign participation in extraction also arise in Bangladesh that over long periods give rise to substantial structural risks for IPP pricing.

To reduce the risks private sector investors face PPP contracts specify a number of contingencies the government will cover. In particular, they typically guarantee payments for a minimum purchase at a pass-through price—with the government absorbing the risks of fossil fuel price inflation—often with partial risk guarantees from the World Bank. However, even contingencies that a contract covers may be difficult to enforce in the future if the government's financial condition deteriorates, particularly given local courts' weak enforcement capacity. The risk an individual plant faces given current conditions is quite different from the systemic risk that all plants would confront if, say, in the future the BPDB, and ultimately the government, became unable to service a significant portion of power sector commitments.

This risk is particularly serious if the government is contemplating a significant expansion of IPPs and substantially subsidizes sales of power to final consumers as is currently the case. As a result, the solvency of future governments may become significantly worse in direct proportion to the current government's success in implementing IPP projects (as described later in connection with arrow 9). Given the difficulties of predicting the financial conditions of governments and economies in the future, power sector contracts are fundamentally incomplete. The risk is not one of expropriation, but of potentially disruptive transaction costs incurred in renegotiating contracts in changed local and global circumstances in the future. These features of the sector mean that power plant construction faces uncertainties that full contracting cannot readily address, and this in turn has two important effects as discussed in connection with arrows 2 and 3.

Higher Risk Premiums Lead to Higher Financing Costs

Arrow 2 indicates the most obvious implication of these noncontracted risks, namely, the risk premium results in higher private sector financing costs for power sector projects. This explains our second characteristic of the sector noted earlier: the relatively high financing costs facing private financing in power sector projects. This risk premium is both dependent on risks such as BPDB involency, and a determinant of other characteristics of the market that in turn affect these risks. This circularity opens up the risk premium to the possibility of cycles of causality. Regardless of what a PPP contract guarantees, the market is likely to factor in a growing risk premium if it perceives the government's ability to deliver on contractual commitments to the sector as having deteriorated. For instance, the unsolicited and extremely expensive rental contracts that the government entered into in 2010 are already likely to have had this effect on market sentiment regarding the government's commitment to protect the BPDB's future

solvency. As a result, the risk premium built into the average cost of commercial financing for the next IPP is probably already somewhat higher than in the past.

In turn, high financing costs have a number of important effects on investment in the sector. Indeed, the cascading, and possibly self-fulfilling, effects of high risk premiums that follow from the causal analysis partly explain why the public sector, or at least public financing and/or financing by international finance organizations, has historically played an important role in the power sector in developing countries. For example, both the public sector and state-assisted financing for the private sector continue to play this role in India despite the significant opening up that has happened in that country.

The market failures that prevent full contracting mean that a significant role for public financing of power sector projects may be more efficient than private financing, even though power is not a pure public good. In particular, in very poor countries, private sector perceptions of risk may suggest a price for power generation that is too expensive for emerging industry and retail customers, thereby requiring unsustainable government subsidies if the cost of capital cannot be reduced ex ante. These considerations have already led to a budgeted subsidy to the BPDB for fiscal 2011 of up to Taka 38 billion (US\$469 million) (Centre for Policy Dialogue 2010; World Bank 2010, pp. 19–21). This amount could rise in future years. As the market adjusts to successive increases in subsidies, this is likely to result in plants facing higher production costs, and therefore, to a need for even higher subsidies.

The recently completed Action Plan for Power Sector Financial Restructuring and Recovery (FRP) prepared under the World Bank's Power Sector Development Technical Assistance project provides detailed analysis and recommendations to clean the sector's balance sheet. Recommendations include policy decisions required to make adjustments and write-off of disputed amounts in inter-company transactions. This report suggests that those recommendations be implemented by the appropriate authority (company Boards/Ministry) in a timely manner so that the real benefit of the FRP exercise can be fully realized and the sector entities can start with a balance sheet that is reflective of true and fair value of their assets and liabilities.

Investment in Relationships Required to Mitigate Risks

Arrow 3 indicates the other important and simultaneous effect of the high risks associated with IPP investments: private investors know that whatever the contract says, given possible adverse future conditions the contract may be difficult to enforce, and that many unknown, and therefore non-contracted risks, can also affect the overall viability of their investment. As a result, a rational approach is for firms to invest in "relationships" with the government to mitigate these risks by keeping open preferential and personalized channels of negotiation that allow ongoing informal contracting. If difficulties with payments or access to fuel arise in the future, investors know that contacts and informal bargaining are more likely to yield results than contracts and formal redress processes. Given the high costs, or even implausibility, of enforcement through the formal legal system, firms recognize that they are more likely to be able to negotiate any required changes on an ongoing basis, or to ensure that they will be higher up the chain of claims, if they can call on long-term relationships with politicians and bureaucrats in critical positions. While this is not a sufficient guarantee, because the same politicians and bureaucrats will not retain their same positions for the lifetime of a power project, firms are unlikely to even begin to engage in this sector without such relationships.

Arrow 3 therefore explains our third characteristic: only a small number of players remain at advanced stages of bidding in this sector. As complex negotiations cannot rely entirely on legal procedures given the weak legal framework, only firms that have strong relationships with insiders are likely to persist. As these privileged relationships are based on family ties, friendships, and other relationships developed through existing businesses, probably only a relatively small number of firms have the informal capital to enter into negotiations. This also explains why firms as diverse as furniture and cement manufacturers have demonstrated a comparative advantage in the bidding process for investments in Bangladesh's power sector. Their comparative advantage is based not on their technical expertise in the power sector, but rather on their extensive informal contacts with government and the bureaucracy.

Risks for Bidders Increase Because of Corruption

Arrow 4 indicates that the conditions also enable collusion and corruption that further increase the risk for investors, because subsequent governments are likely to reexamine contracts if firms do not rapidly establish new relationships. Thus while structural reasons give firms and individuals with established relationships with the government and the bureaucracy an advantage, they also enable collusion between insiders. Even if firms and governments did not initially plan to engage in corruption or collusion, the high level of contingent risks that cannot be contracted for can create strong pressures for long-term, personalized relationships between business and government, and once such relationships exist, preventing a slide into additional privilege-seeking collusion is difficult. Firms therefore have every incentive to keep some funds for this purpose on reserve. This argument is not intended to excuse the ongoing corruption and collusion of participants, but to demonstrate that standard anticorruption tools, such as greater transparency in the award of contracts, are unlikely to address this type of corruption. The personalized relationships are not the result of limited transparency. Rather, the limited transparency is a result of the relationships required to sustain investments given the current situation. Ironically, even if a firm resists capturing additional advantage using its relationships, signaling this to the general public or to subsequent governments is extremely difficult given the structural factors that ensure the uncompetitive nature of the market and the clear presence of strong personal relationships.

The acrimonious relationship between the government and the opposition is characteristic of a “competitive clientelist” political settlement⁵ (Khan 2010b). In this context, a ruling coalition's ability to offer credible formal assurances to potential investors is severely limited. If the relationships between the ruling party and investors are perceived by opponents to have resulted in rent sharing with the ruling party, after an electoral victory an incoming government may question the process whereby the contracts were awarded as a way of punishing investors who were close to the outgoing government. Bangladesh has a history of new ruling coalitions targeting particular companies on technical or legal grounds if the incoming coalition perceives them to have had significant economic relationships with the previous regime. These companies will sooner or later establish new relationships with the new ruling party, and thus their problems tend to be temporary. Arrow 4 simply shows that this requires resources and involves additional uncertainty.

⁵ A political settlement emerges when the distribution of benefits supported by a country's institutions is consistent with the distribution of power in society, and the economic and political outcomes of these institutions are sustainable over time. A competitive clientelist settlement is characterized by intense competition among political elites.

Arrow 5 shows that high financing costs can contribute to a preference for procurement rents as opposed to production or distribution rents. The former result in significant up-front rents, whereas the latter can create a stream of somewhat more modest rents throughout a project's lifetime. While the total of the latter may end up being significantly higher, if parties are unsure about the economic viability of a project over time, perhaps because of doubts about the government's ability to provide ever greater subsidies, or have short time horizons, they may prefer procurement rents over production and distribution rents.

Adverse Selection Leads to Few Bidders and Even Higher Risk Premiums

The preference for procurement rents also has other effects. Arrow 6 suggests that in this context adverse selection of bidders is likely. Those who are unwilling to play by the rules of capturing and sharing procurement rents will be weeded out because the structure of incentives will not attract them, nor are they likely to find champions among government insiders. This in turn reinforces the finding that only a small number of serious players participate in bidding. In addition, the characteristics of these bidders and the likely adverse effects on the quality of procurement feed in (arrow 4) and further increase the risks for the future sustainability of projects, and therefore eventually (arrow 2) lead to an even higher risk premium for the sector. This is one example of the cumulative causation that can lead from high risk premiums to even higher risk premiums over time.

Intense Competition Results in Protracted Decision Making

Arrow 7 suggests another equally serious consequence of high financing costs and the preference for procurement rents. Procurement rents can offer significant up-front rewards to those individuals and factions in the government and the bureaucracy who are championing particular sponsors. While greed and limited accountability do drive some corruption in developing countries, political leaders also have a structural requirement for rents to sustain the political system (Khan 2006, 2010b; North, Wallis, and Weingast 2009). However, the types of rents that are available matter greatly in determining the rent capture strategies of different actors and their economic outcomes. A focus on procurement rents has particularly adverse implications not only for the quality of projects, but also for the intensity of conflicts within the ruling party and the bureaucracy. Different factions within the government typically champion rival bids and have strong relationships with competing suppliers.

Typical explanations for the protracted decision making and delays in the power sector are the lack of technical capabilities within the power bureaucracy in Bangladesh and multiple decision-making points within the ministry, but other explanations are possible. If the primary source of rents comes at the procurement stage, the conflicts between factions and groups within the ruling party and the bureaucracy are likely to be more intense than if the rents came from production and distribution. Large sums that can be made over short periods greatly increase the stakes in intraparty and intrabureaucracy factional conflicts, particularly if the power sector's overall financial vulnerability means that a significant stream of projects over time is unlikely. This can help explain the protracted decision-making procedures and the high probability that disaffected factions will block projects at the last moment.

The location of the power portfolio directly under the prime minister underscores the importance of power sector rents and the sector's strategic importance, yet multiple points of decision making are retained; indeed, the current prime minister works not only with a state minister, but also with a power adviser. We know informally that other powerful individuals both in the party and the bureaucracy also participate in the decision-making process under the prime minister's umpiring role. This structure is perhaps not accidental and suggests the sensitivity of managing factional conflicts about rents within the ruling party. The aim appears to be to enable factions to compete for these rents because attempting to override powerful factions entirely may be extremely costly for the ruling party. Unfortunately, the nature of the rents available makes this competition dysfunctional (low quality investments are the likely outcome) as well as intense.

The intensity of these intraparty conflicts can be better understood by remembering that in a competitive clientelist polity the ruling parties are themselves coalitions of factions. Individual investors will have relationships with particular individuals and factions within the ruling party. If the incentive structure is such that bidders are likely to make significant procurement rents at the early stages of a project, factions within the ruling party are likely to scramble to be associated with lucrative investments from which they can benefit. This increases the stakes, and therefore the intensity of the conflict about the award of particular projects. If the rents were to accrue over time, bigger coalitions would be needed to compete for projects and the intensity of conflict would likely decline, because for many beneficiaries within the party competing projects would not offer zero-sum choices. To make matters worse, given the solvency issues discussed earlier, having a large number of investments credibly take off within the lifetime of a single government is unlikely, and thus factions are likely to contest big power or infrastructure investments intensely. Intraparty competition can appear to take the form of government indecision about projects and procrastination in granting contracts. In extreme cases the outcome is that no decisions are made.

High-Cost Successes Raise the Risk of Future Government Default

Arrow 8 indicates that successful IPP projects are likely to be few and far between. Finally, arrow 9 indicates the paradox that after a few successes, subsequent projects may become less viable if the gap between the buying and selling prices in those projects already signed implies a significant growth in transfers to the BPDB from the budget. The more strained BPDB and government finances become, the higher the risk premium (arrow 2), and the more binding the succeeding constraints.

This explains why the early IPPs, Haripur and Meghnaghat, went through so much more easily than subsequent attempts at closing deals. Bibiyana I and perhaps one or two more projects currently under discussion may eventually go through. Bibiyana I in particular has relatively low risks given that supplies of gas are technically assured. However, without a strategy for breaking the interdependent links identified in figure 4.1, the government is unlikely to achieve the scale of power sector investments that it is projecting and that Bangladesh requires.

Evaluation of Policy Responses

A number of policy responses have emerged to address these risks: Strengthening procurement, making available adequate long-term financing, establishing a formal, PPP regulatory body

Strengthening procurement The most common policy responses to the constraints the power sector faces have attempted to directly address the small number of bidders and the apparent focus on capturing procurement rents. Development agencies and partners, including the World Bank, have insisted on transparent procurement guidelines and bidding procedures. Moreover, political reforms, in particular reforms supporting greater political accountability, have sought to address protracted decision making and blocking by making political parties more accountable to the voting public, and therefore less responsive to the internal factional conflicts that prevent them from delivering on promises to the electorate. If some of these strategies had succeeded, one or more of arrows 4, 6, 7, or 8 may have been eliminated or significantly weakened, with the possibility of setting up positive or virtuous cycles instead of the current negative or vicious cycles. In addition, general good governance and rule of law reforms have attempted to improve contract enforcement in courts, and thereby reduce risk premiums (arrow 2) and the need for personalized relationships to support informal contracting arrangements (arrow 3).

However, the various reform efforts have not yielded significant results and the interdependencies in figure 1 suggest why. Many of the targeted characteristics are themselves the outcomes of deeper causes, some of which are shown in the figure. For instance, the small number of players that remain in final bidding, and the fact that procurement rents are more attractive than production and distribution rents, which may appear to be the result of poor procurement and bidding procedures, are actually the outcomes of deeper problems associated with high risk premiums and contracting costs in the context of structural uncertainty. Good governance reforms in poor countries have generally failed to reduce risk premiums and personalized relationships because good rule of law is an expensive public good that developing countries cannot immediately pay for. A focus on transparency and procedural reforms in this context can make some difference, but not enough of one to alter the interdependent causal links shown in figure 1.

Moreover, the politics of developing countries require the allocation of rents to powerful factions as part of the political process of maintaining political stability, and this too militates against the achievement of impersonal, rules-based allocative systems (North and others 2007; Khan 2010a, 2010b). Thus the disappointing results of the reforms attempted during the administration of the 2007–9 caretaker government, which hoped to achieve greater political accountability within the political parties, are not surprising. Given this general context, the failure of rules-based procurement and bidding processes to emerge or of political parties to become more accountable to the extent that they can make faster decisions in the public interest are also not surprising.

The implication of these observations is that a sole focus on building impersonal, rules-based allocative systems is unlikely to make a significant difference to observed outcomes, even though continuing pressure for reforms in these areas may be desirable. Furthermore, an excessively ambitious set of expectations for private sector investment in the power sector may paradoxically send negative signals to serious financial analysts looking at the viability of such investment over time and the BPDB's capability of servicing its obligations if more than one or two of these investments came to fruition.

Moderating the pace of expansion to make government financing more credible would be relatively easy. In addition, the government and its international development partners could directly influence the cost of

financing, and given the interdependence summarized in figure 1, this could have significant effects on the viability of expanding electricity generation capacity.

Making available adequate long-term financing

Private sector participation in power generation is important but public partnership is essential to address the market failures in financing investments in a context where the current purchasing power of most consumers remains low. A rapid expansion of the private sector without attention to these issues can result in a sequential increase in the risk premium as cash subsidies to distributors escalate. A promising way forward is to focus directly on the unavailability of attractively priced finance caused by the risk premiums implied by the interdependent political economy constraints summarized in figure 4.1. While other political economy factors are difficult to change directly, a significant shift in the cost and availability of financing could alter or weaken some of the interdependencies sufficiently to achieve sustainable progress. A properly designed intervention in the area of financing also opens up the possibility of changing the interdependent political economy constraining the sector.

The challenges of achieving this are considerable. Typical loan tenors from local commercial banks are in the range of five to seven years and are in relatively small amounts. Club financing and syndications have been the norm, with the largest syndication to date being US\$57 million. Interest rates are also high at around 12.5 percent (8 percent base rate plus a 450 basis points margin). Projects larger than US\$70 million to US\$100 million are likely to be difficult to finance domestically. Note that local lenders, which are usually more relaxed about their domestic business environment than their international counterparts, have also expressed misgivings with respect to the following two problems:

- *Track record of sponsors:* The sponsors of the domestic power generation sector have little or no experience. Financiers frequently mention this issue with respect to rental and small IPPs, where qualification criteria have been relaxed or absent. Examples cited include furniture and denim manufacturers participating in IPPs.
- *Lack of consistency and objectivity:* In the tendering process, lenders cite a lack of consistency and objectivity, which increases political and regulatory risks both for them and for potential investors.

International bank finance is therefore likely to be the major source of project financing for the IPP program. Following the recent financial crisis, the market has seen a “flight to quality,” that is, to well-structured projects with high-quality sponsors, often with strong government support (guarantees). Tenors have shortened significantly, so that 15-year-plus loans are only being achieved with support from international finance agencies such as the Bank Group, for example, through political risk guarantees. Margins have also increased to 400 plus basis points over the London interbank offered rate, although some sign of softening is apparent as markets recover.

The various challenges would need to be addressed so that financing could be available at the lowest long-term rate that Bangladesh can access from international financial institutions like the World Bank. Financing should be offered to power sector investors at a price that affects the cost of generating power, and should be of a magnitude that makes subsequent projects credible. By signaling the availability of a credible flow of funds at an attractive price, international agencies can intervene to break some of the adverse interdependence of causes shown in figure 4.1. A number of sources of institutional finance already exist that have played a critical role in power generation projects in the past. IDCOL’s US\$80

million dollar contribution to Meghnaghat was the largest loan a Bangladeshi financial institution had ever made and contributed significantly to the cost of capital for that project. The government has recently contributed US\$350 million in local currency to IDCOL and the Asian Development Bank is likely to make another US\$165 million available (Asian Tiger Capital Partners 2010, p. 12). However, IDCOL does not currently focus on power generation and it has other priorities. The IPFF is a Bank-supported fund that has disbursed US\$47.5 million in market rate (currently 12 percent) loans since 2006 and has recently been increased by US\$250 million. A number of small power plants have benefited from this financing facility (Asian Tiger Capital Partners 2010, p. 12). IFC has previously invested in the power sector through the Khulna IPP. Given the government's plan for some US\$9 billion to be invested in 6,805 MW of private sector generation capacity and additional related projects in the energy sector, such as gas pipelines, significant potential clearly exists for IFC loans and investments in the sector. Finally, the government has recently established the Bangladesh Infrastructure Finance Fund, seeding it with around US\$240 million. The government is seeking additional investors and lenders to participate in this fund, which is something both IDA and IFC should consider.

These examples show that the importance of reasonably priced institutional financing for infrastructure projects is well justified. Our political economy analysis suggests that increasing the facilities available for power generation by an order of magnitude would be an appropriate course of action, as this is likely to be the only viable way to change the political economy constraints the sector is facing.

Clearly the availability of such a financing facility would have to be combined with dedicated governance arrangements to ensure that the financing available on beneficial terms was only available for projects that satisfied technical and other criteria. The IDCOL experience suggests that this may be achievable and figure 4.1 indicates why this may be the case. By directly intervening in box (ii) (high financing costs) and reducing the financing costs for power generation projects under consideration, this could break or weaken arrows 5, 6, and 7 that lead to the emergence of unviable projects or of sustained blocking of projects.

The lower cost of financing would enable power projects to offer to sell power at a price closer to the final selling price, thereby making the viability of long-term purchase agreements more credible. This could reduce insiders' incentives to focus on up-front procurement rents (arrow 5), thereby enabling the enforcement of dedicated procurement conditions to an acceptable degree. This is because if financing is available at a price that makes power projects credible, financial institutions will have credible leverage for insisting on acceptable procurement methods. With better procurement and weaker incentives for fixing technical specifications, the adverse selection that results in serious bidders dropping out (arrow 6) is less likely. If up-front rents are less in evidence, the intensity of inner party and bureaucratic lobbying (arrow 7) is likely to decrease, with interested parties focusing instead on the long-term rents available from the production and distribution of power. Moreover, if the availability of long-term, low-cost financing makes a project under consideration viable, this increases the likelihood that other projects will follow without the BPDB becoming insolvent. The prospect of subsequent projects is likely to further reduce the intensity of zero-sum conflicts, and with a sufficiently large pipeline of credible projects, this could prevent disappointed factions from blocking projects.

None of these results are likely to automatically follow without considerable attention being given by key stakeholders to the governance design of any such financing facility. However, our analysis suggests that without a substantial facility that can reduce the cost of financing and help improve the viability of investments in the power generation sector, direct interventions targeting the sector's adverse characteristics are likely to fail.

We surmise that a combination of conditions created virtuous feedback in the links identified in figure 4.1 for the Meghnaghat and Haripur projects. The projected role of the IPPs was initially relatively small, the gas supplies were promising, and the cost of financing was reduced because of the involvement of international financing institutions. This combination of conditions lowered the private financiers' perceptions of risk and further contributed to the low selling price the IPP operators offered. In addition, the projects' viability ensured that adverse selection or a focus on procurement rents did not occur to the extent that blighted subsequent projects.

One implication of our political economy analysis is that if the cost of capital has to be kept low and if this requires negotiating a financial facility at concessionary rates and with appropriate governance conditions, the magnitude of the facility available is likely to put a ceiling on the pace of expansion. The result of announcing an ambitious private sector-led program may paradoxically have been to signal a steep increase in risk premiums. Thus the envisaged significant growth in private participation in Bangladesh's power sector, the first of the characteristics described earlier, may be part of the problem in the absence of a convincing explanation of how the BPDB's obligations are likely to be financed over time.

The political economy of cumulative causation in the context of an economy with informal contract enforcement and competitive clientelism implies that high risk premiums can make an eventual BPDB default an almost self-fulfilling expectation, but long before this happens, progress on power sector projects is likely to slow down and project development is likely to be converted into heavily contested games where the attention is focused on rent capture at the procurement stage. We argue that if achieving a lower cost of capital requires a less ambitious rate of increase in the power supply, this may be a price worth paying. Paradoxically, the actual rate of increase in the power supply may be higher if the private financing that is called upon and the rate of subsidy that is implied for the BPDB are both reduced to far more realistic levels.

Establishing a formal, PPP regulatory body

The new PPP Policy Framework holds great promise for power and energy sector development, although whether it will be successful in addressing the above constraints is unknown.

History and Objectives

In 2008 and 2009 the government reviewed the private sector investment guidelines and PPP framework. As a result of its findings, the government committed to undertake the following five strategic actions to transform the PPP framework into an initiative that would ensure extensive private sector participation in infrastructure development:

- reforming the private sector investment guidelines and the associated institutional framework,
- setting up a dedicated unit for PPP budget formulation and implementation,
- making a significant budgetary allocation for PPP,
- providing tax incentives to investors,
- undertaking extensive and continuous publicity of the new PPP initiative.

One year after the government's launch of its new PPP initiative in June 2010, the cabinet approved the draft policy and strategy for PPPs (World Countries 2010).

The objectives of this policy and strategy are

- to spell out the principles of partnership with the private sector for undertaking various infrastructure-related projects and public service delivery,
- to define an institutional framework conducive to and efficient at handling PPP projects and effective at protecting public interests,
- to ensure a balance between risk and reward for both the government and private partners with the goal of keeping undertakings attractive to the private sector.

Sectoral Coverage

The policy and strategy document identifies multiple economic sectors as eligible for PPP projects. These sectors include exploration for and production, transmission, and distribution of oil, gas, coal, and other mineral resources; power generation, transmission, and distribution services; airports, terminals, and related aviation facilities; and water supply and distribution, sewerage, drainage, and effluent treatment.

Other eligible areas include land reclamation and the dredging of rivers, canals, wetlands, lakes, and other related water bodies; highways and expressways, including mass transit, bridges, tunnels, overpasses, interchanges, city roads, bus terminals, and commercial car parks; and port development, including inland container terminals and inland container depots. They also include telecommunications systems, networks, and services, including information and communication technology; solid waste management projects; railways; the tourism industry; economic zones; industrial estates and parks; city and property development, including services to support commercial and noncommercial activities; and poverty alleviation projects.

Project Classification, Funding, and Publicity

To expedite project approval and implementation, the government has classified projects into the following three groups:

- large projects with a total investment greater than Taka (Tk) 2.5 billion (US\$31 million),
- medium projects with a total investment between Tk 500 million (US\$6.2 million) and Tk 2.5 billion (US\$35 million),
- small projects with a total investment of less than Tk 500 million (US\$6.2 million).

In June 2009, the Ministry of Finance announced a significant budgetary allocation for PPP in its fiscal 2009/10 budget. This allocation is divided into three categories:

- *Loans and equity*: Tk 21 billion (US\$259 million) to increase financing for PPP projects. The government's initial concept was to channel this money through IDCOL and the IPFF with a view to establishing an infrastructure investment fund later.
- *PPP viability gap fund (VGF)*: Tk 3 billion (US\$37 million) to subsidize PPP projects for which the proposed consumer charge or service price would not support full cost recovery.
- *PPP technical assistance*: Tk 1 billion (US\$13 million) to fund project identification, feasibility studies, and project development by relevant ministries, divisions, and agencies. The government expected that the IIFC would be involved in these arrangements.

The government proposed three types of tax incentives: one for investments at the financing stage (tax exemptions and concessions), one at the construction stage (import tax relief), and one at the management and operating stage (income tax holidays).

The government recognized that it had not developed an effective institutional arrangement to publicize its PPP initiative. To remedy this it proposed formally identifying projects to be undertaken under the PPP initiative and developing an extensive and continuous publicity campaign. The government expected the IIFC to play a role in this initiative, including identifying projects and publicizing the new PPP framework. An originally proposed PPP unit to undertake promotion activities was shelved.

In June 2009, the government also announced that it had prioritized some large-scale infrastructure projects to be implemented using PPP during the next five to seven years. Appendix 5 provides a preliminary list of these megaprojects and also lists a number of smaller, faster-track projects.

Administrative Structure

A number of administrative structures will play roles under the PPP framework detailed below:

The Bangladesh Infrastructure Finance Fund

In his budget speech on June 10, 2010, the minister of finance announced the creation of the Bangladesh Infrastructure Finance Fund to strengthen PPP activities and to encourage potential investors. The government has already allocated Tk 16 billion (US\$230 million) to this fund from the Tk 30 billion (US\$425 million) allocation made for PPP this fiscal year. The government anticipates that this fund will grow significantly when individuals and organizations, both domestic and foreign, as well as international development partners, participate in and contribute to it. The minister stated his hope that the fund will help meet the massive demand for financing for physical and social infrastructure projects to be implemented under the new PPP framework.

The policy and strategy for PPP sets out the new framework for developing strategy and for identifying, structuring, appraising, approving, monitoring, and evaluating PPP projects.

The Public-Private Partnership Advisory Council

The Public-Private Partnership Advisory Council will be established to advise on overall PPP policy and PPP affairs. Chaired by the prime minister, it will meet at least twice a year and will have 22 members, including 14 ministers, 2 advisers to the prime minister, and representatives of the Board of Investment and Bangladesh Bank. Its role will be to

- provide guidance to the Office for PPP and line ministries on how to accelerate PPP projects,
- provide advice on possible bottlenecks relating to interministerial coordination for PPP project implementation,
- review and ensure achievement of national PPP targets.

The Cabinet Committee on Economic Affairs

The key roles of the Cabinet Committee on Economic Affairs with respect to PPPs will be to

- approve PPP procedures, guidelines, and model documents;
- review the contingent liabilities and affordability of PPPs;
- provide in principal approval of medium and large PPPs;
- approve preferred bidders for large PPPs;
- approve PPP contract terminations.

The Office for Public-Private Partnership

The long tug of war over management authority for PPP between the Board of Investment and the Ministry of Finance has ended, with the Office of PPP being established as a separate entity under the Prime Minister's Office. Accountable to the prime minister, it will be an autonomous unit supporting line ministries in identifying, selecting, contracting, and monitoring PPP projects and coordinating among government agencies and private parties to expedite projects. The head of the Office of PPP will report directly to the prime minister and the office will consist of officials with relevant knowledge and experience selected from both the public and private sectors on a competitive basis. A panel of experts will also support the office.

The role of the Office of PPP is wide ranging, spanning the entire PPP cycle and including both project promotion and development and monitoring roles. It includes responsibility for

- initiating, developing, and structuring PPP projects;
- promoting PPP projects to the private sector;
- securing technical assistance funding for conducting prefeasibility and feasibility studies;
- preparing bidding documents;
- securing VGF approval;
- proposing laws, rules, regulations, model documents, guidelines, and procedures for PPP;
- supporting line ministries in tendering and in selecting investors;
- advocating for PPP and building capacity in line ministries and implementing agencies;
- monitoring PPP projects, including linked components;
- facilitating risk mitigation arrangements for private investors;
- developing and maintaining a national PPP website.

Line Ministries and Implementing Agencies

Line ministries and implementing agencies have the primary responsibility for identifying and structuring projects, tendering and awarding contracts, and overseeing project and concession implementation. The relevant line ministry will establish a qualification and tender evaluation committee for each PPP project.

The Finance Division of the Ministry of Finance will have primary responsibility for managing the government's financial participation in PPPs. Its role will include

- Issuing and disseminating procedures and guidelines for the government's financial participation in PPPs as approved by the Committee on Economic Affairs,
- approving annual technical assistance budget allocations for PPPs,
- arranging annual budget allocations for the VGF,
- allocating VGF funds for approved PPP projects,
- channeling infrastructure financing through specialized financial intermediaries.

The Planning Commission has primary responsibility for including components of PPP projects into the Annual Development Program to ensure coordinated and timely progress of PPP projects.

PPP Guidelines

The draft policy and strategy for PPP includes separate guidelines for formulating, appraising, and approving projects of various sizes.

According to the draft policy and strategy, after their adoption, the 2004 private sector investment guidelines shall be "prorogated", or replaced. However, the guidelines address many details of the PPP process that do not appear in the policy and strategy, particularly in relation to risk allocation and the tendering and award process, which should be at the core of any national PPP policy. The draft policy and strategy document and its associated guidelines are clearly deficient as a stand-alone national policy document. Whether the government intends to produce more detailed PPP policy guidelines to supplement the draft policy and strategy is unclear. Areas where the draft policy and strategy should be strengthened include the following:

- a statement of policy objectives—economic, social, environmental, and value for money;
- an explanation of how the policy and strategy document fits in with existing legal and regulatory arrangements and the plans for sector regulation and PPP transaction management;
- a more detailed and comprehensive explanation of the roles and responsibilities of the parties to and stakeholders in the PPP process, including how the Office of PPP will deal with potential conflicts of interest between its promotional role and its regulatory and monitoring and evaluation roles;
- an explanation of the key principles of PPP that underpin the government's PPP policy, such as value for money, public interest, risk allocation, output requirements, transparency, competition, and market engagement;
- an outline of the contents and scope of key approval documents, such as detailed feasibility studies along with technical, economic, and financial appraisals, environmental and social impact assessments, and assessment of PPP options;

- a detailed explanation of the procurement process, including governing principles and the role of the private sector in PPP procurement;
- a detailed explanation of how the government seeks to obtain value for money from PPP, including clarification of its policy and procedures for dealing with unsolicited proposals;
- a statement to provide guidance on risk assessment, measurement, management, and allocation.

One shortcoming is that there is no mention of the environmental and social impact of potential PPP projects in the PPP Policy and Guidelines. The Policy should clearly state that PPP projects will need to be developed with these impacts in mind – their identification, assessment and mitigation. This will be critical for Multilateral Lending Agencies (MLA) and bilateral donors’ support for the government’s PPP initiative; for participation by reputable international investors and lenders - most of which adhere to the Equator Principles⁶; and for civil and public support.

Next steps

The establishment of the new Office of PPP in the Prime Minister’s Office and the new PPP financing arrangements covering project finance, VGF, and PPP technical assistance are all major steps in the right direction. However, some aspects of the new PPP framework clearly need further development to support successful implementation of the government’s PPP initiative. A specific and intensive focus is needed at the line ministry and sectoral levels for the Ministry of Power, Energy, and Mineral Resources; its Power Cell and IPP Cell; the corporatized generation, transmission, and distribution companies; and the regulatory body, the Bangladesh Energy Regulatory Commission. More

Priorities for International Assistance

Given the range of potential points of engagement for the World Bank Group, there is an argument for proposing a comprehensive, integrated, program of activities. Focusing on only one or two of the strategic options discussed above is unlikely to bring about the changes required. Bangladesh may benefit from a more holistic engagement from the Bank across all elements of the PPP cycle (project inception, through close and implementation).

- A cross-cutting program or project with the following elements may help get Bangladesh’s PPP program back on track with explicit political support at the highest level:
- Expansion/completion of the draft new PPP Policy and Framework into a comprehensive policy supported by detailed guidelines and standardized procurement documentation (e.g. pre-qualification and bidding documents). This would include a formal approval and adoption by the Prime Minister of the policy framework.
- Support to establish a competent and professional, independent Office of PPP including capacity building and training, staffing and budget support, public-private dialogue and establishment of a PPP advocacy program.

⁶ The "Equator Principles" are a financial industry benchmark for determining, assessing and managing social and environmental risk in project financing. Almost 70 of the world’s leading financial institutions have adopted these principles. See www.equator-principles.com

- Support to line ministries and state agencies and parastatals to support them to develop, procure and implement PPP project pipelines in accordance with the national PPP policy.
- Support to coordinating non-line ministries during implementation of the national PPP policy. For example, this could be support to the Ministries of Finance and Planning according to international successful practice of planning, coordination, and budgeting to support PPP investments.
- Support to the Government of Bangladesh to create a market for competitively priced local, long-term finance – to be applied to PPP transactions procured in accordance with the new national PPP policy. For example, this could entail a Financial Intermediary Loan (FIL) operation and/or support for the nascent Bangladesh Infrastructure Finance Fund.
- Support to establish a credible Viability GAP Fund to provide public subsidy funds to PPP transactions procured in accordance with the new national PPP Policy (e.g. TA support to establish professional management of the VGF, an IDA contribution to the Fund, and WB partial risk guarantees to back-stop VGF payments to PPP projects)
- Provision of a line of WB partial risk guarantees and MIGA guarantees to provide political risk mitigation for a range of pioneer PPP transactions (e.g. IPPs) that are procured in accordance with the new PPP Policy.

This approach would facilitate the Bank’s high-level strategic engagement with Government on its PPP agenda, providing a new point of entry for the Bank on the PPP dialogue and, potentially, making it easier to gain political buy-in for the institutional and behavioral changes needed to address the political economy problems that affect, especially, the power sector.

A useful model for this kind of comprehensive, programmatic approach would be the Nigeria Public/Private Partnership Adjustable Program Loan Program. The objective of that program is to increase private investment in Nigeria’s core infrastructure sectors. An integrated package of assistance includes capacity building to key ministries and implementing agencies, technical support for legal and regulatory reform, upstream support for project preparation and transaction advisory services to help develop commercially viable PPP transactions, support for the management, monitoring and evaluation of the APL program, and infrastructure financing for projects prepared via the Viability GAP Facility and a financial intermediary loan (FIL) facility. This approach addresses challenges in Nigeria that have prevented PPPs from successfully coming to market. PPP projects are complex and require collaboration of government agencies, private investors, and financial institutions. There is a need for specified roles, responsibilities, effective dispute resolution, and boundary rules (World Bank, 2011).

These are all also requirements for successful PPPs in Bangladesh. Of central importance are the sector reform issues related to rationalizing subsidy arrangements, cost and availability of fuel supplies, technical losses, system theft, collections, and governance of sector finances. The recently completed Power System Master Plan – Bangladesh Long-Term power Development Strategy 2030 and the Financial Restructuring Plan should inform the Government and World Bank support to address the central issues of investment plan prioritization, sequencing, and effective reforms that would begin to address the long-term risk of sector insolvency.

Conclusions

PPPs have become more globally prominent in recent decades as contractual partnerships where responsibilities and risks are shared between the public and private sectors. Research findings on the effectiveness of these partnerships are mixed: while there is some evidence of production cost efficiencies arising from PPPs, much of this may be cancelled out by higher transaction costs. On balance, evidence suggests PPP performance is probably no worse than traditional public sector operations done under contract with private sector, and better than older forms of public works department projects. PPPs also appear to deliver infrastructure more quickly than through traditional methods.

PPP plays a key role in the Bangladesh power sector, and is slated for a greater role over the next few years. However, the government has been unable to add major new PPPs since 2001, and power shortages persist. Reasons include a high risk premium, small number of bidders, irregularities and rent capture, protracted decision making, and few IPP successes. A number of policy responses have emerged to address these risks: Strengthening procurement, making available adequate long-term financing, and establishing a formal, PPP regulatory body. International partners such as the World Bank should consider adopting comprehensive, programmatic assistance seen in other countries. While these approaches seem promising, they have yet to deliver any major PPP power investments.

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