

Reducing private sector risk to increase competition and reduce corruption in the electricity sector in Bangladesh

High levels of risk have driven out politically-unconnected investors and reduced transparency and compliance: is it feasible to reverse this and improve the sustainability of investments?

Research Question

Bangladesh had a number of cost-effective private sector investments in the power sector in the 1990s but in the following decade investments dried up, resulting in severe power shortages. To break the impasse the government chose to solicit investments without competitive tenders. Power sector investments increased but some of these investments have been high-cost and there have been allegations of political connections between investors and government. Procurement reforms have not been effective. Why did this change happen and can it be reversed?

Key Findings

Qualitative information suggests a complex relationship between the mode of subsidy provided to the power sector and the types of investors and investments it attracts. As a poor economy, a purely cost-reflective tariff has not been judged to be a viable strategy in Bangladesh. However, different forms of subsidy imply very different risks for private investors. When the subsidy was provided through government land for projects and low-cost international financing, the risk for private investors was low and politically-unconnected investors would bid. Competition enabled the enforcement of procurement rules. Later the form of subsidy changed, from direct subsidies from the exchequer to the state power distribution company buying power from private producers. With the same bottom line this approach increased the political risk for sector players, as payment now depended on the timely and regular release of funds by the exchequer over the lifetime of the project. We believe this contributed to a reduction in the number of competent bidders. Instead of addressing the underlying problem, the government's strategy solved the supply problem but at an unsustainably high cost. We are testing the plausibility of our hypothesis with evidence on plant-level data on costs of generation from 2010-2016 and the relationship with modes of subsidy.

Implications

Power sector investments are long-term investments and forms of subsidy to private investors have a significant impact on risk perceptions. This in effect self-selects the types of investors who bid in tenders and the extent of effective competition that results. Reducing the cost to the public requires maximizing competition at the tendering stage and if the financing structure is low-risk enough for politically-unconnected investors to invest, this creates insider demand for the enforcement of procurement rules. We argue this is essential for achieving moderate levels of enforcement of rules. The financing structure is therefore a critical policy variable to improve the sustainability of the sector. Our findings may be attractive to the government and to development partners for opening up future investments as the country's power demands rise and the sustainability of subsidizing very high-cost generation declines.

Project Summary

In poor countries, cost-reflective power pricing is not a strategy that is immediately viable on political grounds and may not even be good economic policy on welfare grounds if the aim is to develop a broad range of SMEs in manufacturing and promote electrification of poor areas. However, the forms in which subsidy is provided to private sector generators can be a critical determinant of outcomes, and in some cases can result in significant adverse selection of investors. In Bangladesh, a direct budgetary transfer to the power purchasing and distributing company (the Bangladesh Power Development Board or BPDB) appeared to offer private investors their cost of production while ensuring that the full cost is not passed on to consumers. However, if the subsidy that the BPDB requires from the exchequer keep rising with new power plants coming on stream, the sustainability and timing of payments becomes questionable, particularly for investors who are not close to the machinery of the state.

Other mechanisms of reducing private costs of generation may imply significantly lower political risks, for example,

purchasing land has very high transaction costs in developing countries like Bangladesh, and getting access to a lease of government land can reduce start-up costs significantly. There is no subsequent political cost of maintaining the lease unless something very serious goes wrong.

We propose that if only politically-connected companies bid, the ensuing cost escalation cannot be controlled using regulatory enforcement strategies. The only feasible strategy is to induce competent companies to bid. Indeed, once high-cost technologies are installed there may be nothing much that can be done. This research seeks to verify our hypothesis with hard data and to suggest how financing structures can reduce risk for politically unconnected investors, addressing the risk of collusion and increasing competition to create a more productive power sector. This may be the most feasible way of improving regulatory compliance and the enforcement of procurement rules, by expanding the participation of competing investors who have an interest in identifying and reporting violations and demanding redress.

Methodology

Stage 1

Analysing plant-level data (around 100 power plants currently operate in Bangladesh) from 2010 to 2016 from the Bangladesh Power Development Board (BPDB). The data includes dates of commission, installed capacity, present capacity, generation costs, and the amounts purchased.

Stage 2

Analysing plant-level data on whether the plants received IFI credit lines or partial risk guarantees, or received government leased land.

Stage 3

Exploring public perceptions of the political connections of private sector owners of existing power plants, through interviews with journalists in Bonik Barta, a leading Bangla business newspaper. This anecdotal evidence has confirmed that the vast majority of new plants appear to be owned by individuals with political connections.

Stage 4

Our intention is to show that projects that had access to low-interest credit and partial risk guarantees, as well as access to government-acquired land for the project, faced lower risks, and therefore attracted (some) politically-unconnected investors and had lower costs of generation.

Policy and programming implications

Policy measures to reduce the cost of generation in the Bangladeshi power sector, improve regulatory compliance and that reduce political collusion are likely to include strategies of de-risking private investments in feasible ways. Feasible strategies in the past have included the provision of lower-cost lines of credit through dedicated infrastructure banks, and the provision of government land leases to successful bidders.

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