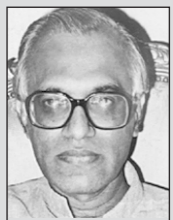


Comments on Tata investment proposal



WAHIDUDDIN MAHMUD

[This piece is Part I of a 3-part series that contains the full text of a report prepared at the request of the Board of Investment, Government of Bangladesh.]

FOREIGN direct investment (FDI) brings in the host country, but it also creates long-term debt obligation in the form of future repatriation of profits earned by the foreign investors. The non-repatriated part of the future stream of value-added from the investment directly contributes to the growth of the country's gross national income (GNI); and this mainly consists of the wage income of the domestic workers employed by the project and the tax revenues of the government.

The desirability of FDI, however, depends on its "net social benefit" accruing to the host country, the estimation of which is much more complicated. As in the case of social cost-benefit analysis of domestic investment projects, all inputs and outputs need to be estimated at their "economic" prices, which represent their "real" value to society (the so-called opportunity costs). This is important because domestic prices are often largely distorted. For example, any subsidies on input prices that make actual prices lower than their "economic" prices have to be deducted in estimating the benefit of FDI. Likewise, when FDI produces for a domestic market that is highly protected by import tariffs, the value-added that it creates in terms of domestic currency is

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much higher than its true worth in terms of foreign exchange (that is, at international prices). This is not to argue that FDI should not be given the benefit of any subsidized inputs or other incentives like tax breaks, but that these should be taken into account in assessing the benefit of FDI. There is a need to provide reasonable incentives to attract FDI. But, unless the benefit for the country is assessed in relation to "economic" prices, one cannot be sure that the proposed investment is genuinely profitable enough to result in a win-win situation.

Fortunately, not all FDI require such detailed evaluation to see that the country is getting a fair deal. This would include FDI that work within the market discipline, such as those in labour-intensive manufacturing industries catering to the export market or a highly competitive domestic market. The very fact that foreign investors are attracted to make such investments under market determined competitive prices is itself an indication of a win-win situation.

On the other hand, the economic benefit from FDI that operate in a non-competitive domestic market is not self-evident. These include the FDI involving "administered" prices, such as under purchase or sale contracts with the government. Some of these FDI, such as in electricity generation, may be potentially highly desirable because of their being in strategically important sectors; but their benefit depends on the terms of agreement regarding prices and other incentives. International competitive bidding can be a mechanism to ensure that an

"exploitative" arrangement is not imposed on the country; but this is easier said than done. Even a competitive bidding process does not do away with the need to determine whether the investment is at all genuinely profitable so as to be able to yield a win-win result. The problem is compounded by the fact that, for a country like Bangladesh having a poor international country-risk rating, the perceived risks of investment will be factored in while prospective foreign investors offer their bid. Also, in a perceived risky environment, foreign investors may have a too strong preference for getting their profits sooner than later, which may result in an overexploitation of exhaustible resources like minerals.

Another problem may arise from the fact that FDI in the "non-tradable" sectors, such as in electricity generation, telecommunications or other infrastructure provision, do not directly contribute to earning or saving foreign exchange. True that these investments provide funds for making strategically important investments that may greatly contribute to overall economic growth. But the fact that there is no immediate involvement of the country's resources may lead to the neglect of the problem created by too large future obligations for profit repatriation. In going for such FDI, the implications for the long-term viability of the balance of payments should be taken into account.

In promoting the case for FDI, some indirect benefits are often cited. While these benefits may be quite important, their nature needs to be properly understood in eval-

uating FDI, particularly since these benefits are largely of an intangible nature. The following are three most commonly cited benefits in the context of Bangladesh:

First, beyond the direct economic impact, the investments may yield indirect benefits by creating jobs and promoting economic activities in other related sectors through the so-called forward and backward linkages that is, by purchasing inputs (or outsourcing) and/or producing goods that are inputs for other activities. Whether creating demand for other sectors is an additional benefit from FDI depends on the nature of production constraints in those sectors. In a capital-scarce and labour-surplus economy like Bangladesh, the expansion of most production activities is not constrained by demand deficiency, but by a lack of investment to create additional production capacity. However, there are many low-productivity labour-intensive activities, mostly services, which can easily respond to increased demand without much investment. The employment and incomes generated in this later way can be considered as a genuine spill-over benefit from the inflow of FDI. As regards forward linkages, the benefit will depend on whether the FDI is for producing essential inputs for other activities that would not be otherwise produced because of lack of technical know-how or would be available only at a higher price, say, from imports.

Second, FDI may save foreign exchange by producing tradable items -- exports or import-substitutes. This will be an addi-

tional benefit depending on whether there is an effective balance of payments problem that constrains economic growth. In such a case, a taka worth of output that can be internationally traded will carry a premium over a taka worth of non-traded output hence the likely benefit arising from FDI's contribution to the balance of payments. Recent development experience in Bangladesh suggests that the balance of payments can indeed be a problem at times of accelerating economic growth.

Third, the claim that an initial FDI may promote investor confidence and reduce the perceived country risks by foreign prospective investors -- hence the case for providing it some extra incentives. While this may be correct, an "unfair" deal may create future resentments and other problems that will do damage rather than promote the investment environment. The best way to improve the country-risk factor is to address the underlying causes rather than offer too generous concessions to foreign investors.

Tata's investment proposal is a complex one with several components. Of these components, the proposed urea plant is an entirely separate project with no link with the rest of the investment proposal; as such, its merit is better judged separately. This aspect is mostly blurred in the way the overall impact of the project on the Bangladesh economy is discussed in the report of the Economic Intelligence Unit (EIU) as well as in much of the documentation produced by Tata. The other part of the investment project is an integrated one involving steel production, power generation and coal mining. Even for this integrated project, the possibility of generating power by gas and thus leaving out the coal mining component may be kept open as an alternative, given the many unresolved issues regarding coal mining.

About the EIU report, it is mainly concerned with the likely economy-wide or macroeconomic

impact of Tata's investments; it has very little to say about the likely net social benefit of the project in terms of a cost-benefit analysis as discussed above. It does not deal with the key issues nor make any attempt to quantify the key variables that will directly determine the part of the project benefit accruing to Bangladesh -- such as the pricing of gas and the future streams of wage incomes and tax yields generated from the project. Instead, the EIU report mainly dwells upon what may be called indirect project benefits, such as those arising from the impact on the balance of payments and from any backward and forward linkages. As noted above, these indirect benefits may be additional considerations in deciding on the desirability of the project, but these are not the basic ingredients for estimating the net benefit of the project. Even in estimating these indirect benefits, the EIU report does not often take into account some of the common caveats of such estimates, some of which have been mentioned earlier. We come back to these issues towards the end of this report, but for the time being, let us concentrate on the basics.

Steel production is highly energy-intensive, while urea production is a non-energy use of gas. According to the data available from Tata, the urea plant will produce \$127 worth of value-added annually by using 0.04 tcf of gas (total of 0.8 tcf in 20 years). The value added from steel production will be \$495 million annually against the annual use of 0.028 tcf of gas (0.7 tcf in 25 years.). If captive power generation for the steel mill is to use gas instead of coal, the total annual use of gas for steel production will be 0.033 tcf (0.825 tcf in 25 years). Including power generation and coal production, Tata's total project, when in full operation, is estimated to generate \$972 million value-added annually.

The critical importance of the pricing of gas in determining Bangladesh's benefit from Tata's investment can be readily seen

from some aggregate figures. If the price of gas were to be reduced by \$1 (which will be a subsidy if the real "economic" price of gas is taken as the benchmark), this will reduce Petrobranga's sale proceeds from this project by \$68 million annually (by \$83 billion if captive power were to be generated from gas). Against this, the direct benefit will include the part of value-added accruing to Bangladesh in terms of wages and salaries of local employees and the tax revenue of the government. The salaries are estimated to be \$20-\$30 annually (the true social benefit may be half of this if we assume that the "shadow" wage rates representing the opportunity cost of labour in Bangladesh is half the market wage rate). This is a very low proportion of the estimated total value-added -- about 2 to 3 percent. This is an implication of the fact that although the production processes in the various components of the project are highly resource-intensive, their labour-intensity is extremely low.

Tata estimates that the annual taxes payable after the tax holiday period will be approximately \$120 million per annum. This would include mainly corporate tax on profit at the prevailing rate of 40 percent, and also royalties for coal mining and other indirect taxes (presumably net of various tax exemptions sought by Tata as part of the incentive package). Applying a time discount rate of, say, 8 percent annually, the above tax revenue can be estimated as equivalent annual revenue for a 20-year project life. This works out to be \$38 million annually if we assume that the tax holiday is for the initial 10 years, but the amount rises to \$63.5 million annually for a six-year tax holiday period.

The above aggregate figures suggest some broad features of the benefit to be derived from Tata's investments:

(a) If we consider the net benefit from the direct investment impact, this will be quite sensitive to the pricing of gas. While some amount of subsidy in gas sales (compared to the "economic" price of gas, see

later discussion) may be accommodated, a large subsidy may easily make the net direct benefit negative.

(b) The period of tax holiday can make a large difference to the net benefit, since tax revenues seem to be the main direct benefit from the investments.

(c) Tata's projected profits from the investments seem to be large enough, particularly for the steel-power complex, so as to provide ample scope for bargaining in order to arrive at a fair win-win deal. There also thus does not seem to be any strong case for allowing tax-breaks or other incentives beyond what are allowed under the existing structure of incentives for such investments. Special incentives beyond the existing rules also create precedence for giving such incentives to other prospective investors.

The last point is a bit problematic because the information that is available from Tata's documentation and the EIU report is rather insufficient and, in some respects, also appears inconsistent. To make decisions regarding the separate components of the project (the urea plant in particular), component-wise detailed information is necessary. There seems to be also very large discrepancies between the estimates of Tata's annual profits as implied by the annual tax revenue to be paid after the tax holiday period and as can be directly estimated from the annual value-added net of taxes and salaries (the latter seems to be much larger). To help evaluate the investment proposal component by component and, thereby, negotiate the terms of contract, Tata should be encouraged to share more detailed information for each component.

Wahiduddin Mahmud is a renowned economist. Part II of this report will appear tomorrow.

WORLD WATER DAY

Water and culture in Bangladesh

In many parts of the developed world, people take it for granted to turn on a tap for safe and clean water to drink, to cook, to wash -- yet, more than one billion of our fellow human beings have little choice but to use potentially harmful sources of water. In 40 of the 50 diseases prevalent in Bangladesh, including diarrhoea, dysentery, typhoid, parasitic worm infestation and polio, unsafe water is one of the main elements of transmission.

KAZI SHAMSUL AMIN

WE plan our cities near water; we bathe in water; we play in water; we work with water. Our economies are built on the strength of water transportation -- and the products we buy and sell are all partly water, in one way or another.

Our daily lives are built on water, and shaped by it. Without the water that surrounds us -- the humidity of the air, the roughness of the river's current, the flow from the kitchen tap -- our lives would be impossible.

In recent decades, water has fallen in our esteem. No longer an element to be revered and protected, it is a consumer product that we have shamefully neglected. Eighty percent of our bodies are formed of water, and two thirds of the planet's surface is covered by water: water is our culture, our life.

Each year, March 22 -- World Water Day -- marks a permanent effort to promote access to safe drinking-water and sanitation. It is a springboard for raising awareness about water, stimulating debate and focusing on the dangers that derive from inadequate access to safe water and basic sanitation.

The theme "Water and Culture" of World Water Day 2006 draws attention to the fact that there are as many ways of viewing, using, and celebrating water as there are cultural traditions across the world. Sacred, water is at the heart of many religions and is used in different rites and ceremonies. Fascinating and ephemeral, water has been represented in art for

centuries -- in music, painting, writing, cinema -- and it is an essential factor in many scientific endeavours as well.

Each region of the world has a different way of holding water sacred, but each recognizes its value, and its central place in human lives. Cultural traditions, indigenous practices, and societal values determine how people perceive and manage water in the world's different regions.

In many parts of the developed world, people take it for granted to turn on a tap for safe and clean water to drink, to cook, to wash -- yet, more than one billion of our fellow human beings have little choice but to use potentially harmful sources of water.

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Urban poor paying price

A recent study conducted by the Centre for Urban Studies (CUS) estimated that the slum population of Dhaka is 13,17,000 living in 2,328 slums and 679 squatter settlements. As of 2001, the total number of slum dwellers is 31.5 million. To accomplish the demand of 13 million people in Dhaka, DWASA alone is extracting about 1500 million litres of water from the ground every day against its actual demand 2000 million litres. The rest of the demand is being fulfilled through the private initiatives which is also ground water based.

Among the six divisional headquarters, only Dhaka and Chittagong have water supply authorities (DWASA and CWASA),

Water is being supplied by the City Corporations in all the four remaining divisional headquarters. Although a significant percentage of urban people live in slums, they do not have the right of piped water connection as they do not own their lands.

As a result, local mastans (muscle man) take the control of water supply to the slums through illegal connections. They charge much higher than the regular rate and the poor people become bound to pay the same. Against this backdrop, many of the poor slum dwellers have to collect unsafe water far from their residence.

WaterAid interventions

WaterAid is a UK based international charity dedicated to the provision of safe domestic water, sanitation and hygiene education to the poorest, has been working in Bangladesh since 1996.

It has been working in urban slum areas partnering with eight local NGOs, and become successful in convincing DWASA, CWASA and other municipalities to provide water supply connections to urban slums. Water supply authorities became convinced to permit connections to slums in different urban locations after giving guarantee of payment from the NGOs.

Such implementation of water and sanitation project in urban slums has been a major breakthrough. After few years of experience DWASA became confident about such modalities and procedures and became flexible on providing such connections to other slum areas. In that way an institutional change has taken place. This experience was reflected in "National Drinking

Water and Sanitation Policy 1998."

In addition, these water supply projects have also influenced reduction of cost for water services for the target slum dwellers and demonstrated a high willingness to pay almost hundred per cent to DWASA / CWASA for the services. Another important achievement in this project was participation of women. Despite the socio-cultural religious context it was possible for women from marginalized groups living in slums to become active participants in this project and an ownership feeling has gradually developed among the group.

WaterAid partnership with local NGOs has to date constructed 263 community water points and 175 community sanitation options (cluster latrine, sanitation block) in Dhaka and Chittagong.

Rural perspective

From the poetry of Sojan Badiar Ghat by Jasin Uddin to the paintings of Zainul Abedin, we see a clear picture of water culture: a woman carrying an earthen pitcher to bring water from pond or river. Water is related to Bangladeshi women for decades. The weight of water that women in Asia carry on their heads is commonly 20kg, the same as the average airport luggage allowance.

Currently 80 percent of the poor live in rural areas where the rate of extreme poverty is twice as high as in urban areas. Over 95 per cent of the population relies on groundwater as the principal source of drinking water with shallow tube-wells and suction hand pumps being the technologies most commonly used.

Arsenic menace

Bangladesh once claimed of earning a good provision in safe water provision to 197 per cent of the total population. However, after identification of excessive arsenic (more than 0.5 mg/l), safe water coverage has fallen to 70 per cent. Arsenic in groundwater is a major concern with over 13,000 cases of arsenicosis confirmed (August 2002, DGHS) and an estimated 30 million people currently at risk. It has rolled back the last 20 years of gains in providing safe drinking water.

This fall of water coverage has created ache in the heads of government, donors and NGOs. High concentrations of naturally occurring arsenic have already been found in water from thousands of tube-wells, the main source of potable water, in 61 out of Bangladesh's 64 districts (British Geological Survey). The government, along with local and international NGOs, including Unicef, Danida and WaterAid, have started working to save the people from arsenic threat.

Challenges in char, haor and beels

Chars areas are inhabited by the very poor and disadvantaged. Char areas like Fulsori and Shaghata of Gaibandha, Kalihathi of Naria, Domshar and Jazira Tangail are lacking access to basic water and sanitation services. One of the most challenges of the char areas is that the areas submerge in flood waters very often.

Consequently most of the water and sanitation options wash away and submerge in every flood. Fresh water options get contaminated by bacteriologically unsafe water during the flood. River erosion, lack of road networks and standing water bodies are major challenges for livelihood.

Salinity in coastal belt

People in the coastal areas, mostly south-western including Sathkira, Khulna, Bagerhat and Pirojpur, have been facing the hard reality of

drinking saline water for decades. The situation has become worse when the people of these areas started shrimp farming intruding brackish water far inside the coast.

As a result, it added salt to the wound -- more salinity added to the ground water. Finding no alternative most of the people in the area have been using bacteriologically unsafe surface water. A number of NGOs have been working there and successfully initiated pond sand filter method to provide alternative option.

Water culture of CHT wiping out

Names of the many localities in three hill districts under Chittagong Hill Tracts (CHT) generally end with the suffixes like Chhara, Chhari, Long, and Khyang (for example, Satchhara, Bet-chhara, Bagaichhari, Bilaichhari, Shubalong, Kaslong, Rigrri-khyang), etc. In tribal language, these suffixes stand for spring and stream. Many of the localities under Banderban, Rangamati and Khagrachhari named after these springs and these names provide an indication of the important role these springs play in the lives of the twelve ethnic groups of indigenous people living in the CHT for hundreds of years.

The indigenous people are not habituated to use modern water technologies, as they have not been introduced to them like the people in plain districts. So the indigenous people have to depend solely on the natural sources of water, particularly on the springs, for drinking, cooking, washing, bathing, irrigation and cultivation.

All villages, therefore, have been built adjacent to the springs. Even people have to shift their age old villages in case of the death of a spring near which the village was located. All of the rivers and tributaries in CHT are simply the confluence of hundreds of springs of this region. The river Karnaphuli, that keeps the Chittagong port functional, is getting water from these

springs. And same thing happen in case of the Sangu, Naf, Matamuhuri, etc.

The hard reality for the indigenous people of the CHT is that the springs of this region are drying out. It is assumed that a hundred years back, there were as many as 200,000 springs flowing over the CHT area. Presently, there are no statistics of how many springs are still flowing. But the local people observed that many springs across the CHT are drying each year.

The vital spring located at Ghagra, on the way to Chittagong and Rangamati is now simply a remnant of the forceful spring of 7-8 years back which had a good depth of water flowing all year round. The Ghumi Ghat Chhara, Satari Chhara, Pengjamrong Chhara, Kolabong Chhara (Mura Chhari Union), Karia Frya Chhara, Manchari Chhara under Miasachari Union are going to face the same fate causing severe water crisis for the indigenous people living there for many years.

The severity of water crisis has not been properly noticed by the governments and donor agencies. Due to the lack of knowledge to the CHT, and inaccessibility for hills and forests, the press media even could not focus the problems and consequently the under privileged hill people are passing their life through a severe water crisis.

Rural interventions

WaterAid's strategy in Bangladesh is to work through local partners to improve hygiene behaviour and access to water and sanitation services for poor communities, with emphasis on: the demonstration of innovative approaches; participatory methods; gender and vulnerable groups; hygiene promotion; monitoring and evaluation and sustainability. To highlight the poverty focus and demonstration affects, project work will concentrate on "difficult" areas where access to safe water and sanitation is poor, building on previous project experience.

WaterAid targeted the high-need areas where access to safe water and sanitation is limited and where the humanitarian costs of their continued lack are excessively high (examples include squatter settlements in urban areas, arsenic affected areas, and settlements on river islands (chars) that are vulnerable to severe annual flooding and erosion). It has also targeted areas inhabited by ethnic minorities who have traditionally been neglected in the provision of basic services, particularly in the Chittagong Hill Tracts region.

WaterAid is also working in areas where pumping for irrigation has lowered water tables beyond the suction limit, rendering previously installed suction hand-pumps dry for significant periods each year (mainly the Barind area in the north-west); and in coastal areas where saline intrusion has rendered shallow tube-well water non-potable and where alternative technologies such as deep tube-wells, spring protection, and rain-water catchment systems are needed.

WaterAid partnership with local NGOs has to date constructed 1,848 community water points and motivated community people to build 94,336 sanitation options on their own.

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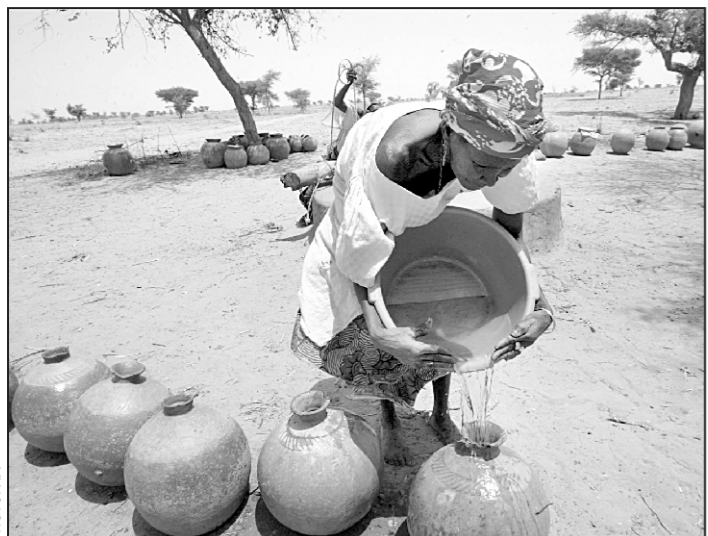


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