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CONFIDENTIAL

Cabinet Submission

Alternate Financing

Cabinet is being asked to approve the tabling of the attached Ministry Paper entitled Alternate Financing in Parliament on April 20, 2000.

CONFIDENTIAL

Omar Davies

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Minister of Finance and Planning
April 4, 2000

Ministry Paper No......

Alternate Financing

Introduction

The Government's ability to provide adequate resources for the development and maintenance of infrastructure is constrained to a great extent by the high levels of debt repayments on Central Government's account and the cost of rehabilitating the financial sector.

In satisfying these debt obligations, efforts must be made to contain and reverse deterioration in the physical infrastructure relating to roads, transportation, energy, water and waste disposal. If the present infrastructure is allowed to deteriorate without Government's intervention, then the replacement cost may well be at such a level that the country will not be able to afford the financial resources required. Such a situation would have negative effects on growth prospects and on the lives of all Jamaicans for decades to come. Consequently, innovative means must be found to finance infrastructural requirements while at the same time achieving the fiscal targets in relation to Central Government.

One strategy which has been considered and tried is one in which the Government and the private sector forge a strong partnership with a view to providing the required capital for infrastructural development. This partnership is aimed at improving overall efficiency, promoting economic growth and alleviating the pressures on the fiscal budget. Efficiency would also be enhanced by a steady flow of cash to projects during their implementation phase.

The challenge is to establish an environment in which the State and private capital can perform their respective roles in a complementary manner, thereby enabling sustainable economic development.

Several schemes have been advanced to meet these objectives. These are schemes in which the private sector build-own-operate-and transfer (BOOT), build-own and-operate (BOO) or build and transfer (deferred financing). In these schemes the building is done by the private sector, ownership may be either public or private sector and transfer is effected when the completed project is handed over to the State. This paper will focus on BOOT and the Build and Transfer schemes.

Build-Own-Operate and Transfer (BOOT)

Under this scheme, the private sector builds the project, owns and operates it for a specified time. The private individual/institution will then recover the cost of construction plus earn an agreed return on the investment over a prescribed period, at the end of which, the asset is transferred to the State.

Projects under this scheme would have to be carefully designed and managed to ensure efficiency, transparency, and minimum risk to Government. The private sector company gets the exclusive right to earn revenue under a concession agreement, builds a project, operates it for a stipulated period of time to repay the project debt and earns a reasonable return on equity, then transfers the project assets to the Government.

The terms of the agreement negotiated with the private sector should, *inter alia,* include:

i. no requirement for financial obligations on the part of Government during the life of the projects;

ii. the mode and the basis for the transfer to the Government; Government will take over the asset in keeping with the terms of the agreement;

iii. quantity and timing of resource needs and when future budgeting provisions should be made;

iv. an allowance to make the builder/operator responsible for the proper maintenance of the facility while the agreement is in force.

This concept will eliminate Government's exposure to the risks associated with these investments and enable the private sector to obtain returns on their investments consistent with the risks involved. The Government however has to be very careful that it does not get involved in indiscriminately guaranteeing the loans required to set up these projects. These guarantees are contingent liabilities on the budget, and if the loan becomes non-performing then servicing would be to the account of the Government. If the project is guaranteed, the Ministry of Finance and Planning must monitor the financial performance. The portfolio ministry/agency would have responsibility for monitoring the technical specifications and ensuring compliance with prevailing regulations.

Government does not therefore have to provide financial cover, managerial participation and administrative costs associated with major projects financed under this scheme.

This type of financing is most suitable for a utilities project, i.e. the supply of energy, water or sewerage, where the project can be sold to the consumer to provide an income to the builder. In this case, the guarantee could be in the form of specified purchases, i.e. gallons of water, or kwh of electricity.

Build and Transfer (Deferred Financing)

Under this scheme the contractor secures financing with a guarantee of repayment by the government. A financial institution provides the financing to the contractor and the obligation is then transferred to the Government in an orderly fashion.

In practice, a contractor secures a loan from a financial institution. The contractor then executes the project, and the Government then takes over the debt. Financing must be associated with moratorium on repayment for one year after project completion. The budgetary implication of this scheme is that the Government has to make budgetary provision at the time when payments are made against certification.

The deferred financing mechanism has been successfully utilized by the Government on an experimental basis. This will now be formalized and appropriate policy measures put in place to ensure the successful continuation of this programme.

The major advantages and disadvantages to these methods of alternative financing are set out below.

Advantages

Schemes such as these provide:

- flexibility in engaging in infrastructure development;
- opportunity for dealing with urgent and immediate works with little requirement, if any, for public funding during the year of construction;
- opportunity for Government to meet social objectives;
- Government with the opportunity to be an independent and impartial supervisor of projects through monitoring by the relevant ministry which should ensure value for money;
- further opportunity for strong partnership between Government and the private sector, in the development process through new financial arrangements and strengthening capacity in the private sector;
- a consistent flow of funds to facilitate timely completion of projects.

Disadvantages

- Increases the debt service obligations of Government, as lenders usually demand higher risk premiums in such instances.
- If not implemented appropriately, can be a potential challenge to transparency of Government expenditure
- If not carefully implemented, there may be a tendency to approve public works to contractors with access to funding and not grant approval based on prescribed transparent procurement procedures.

In order to moderate the negative potential of these schemes financing the following recommendations are proposed:

RECOMMENDATION

(1) Deferred financing should only be used for major infrastructure projects approved by Cabinet e.g. major road constructions (excluding routine maintenance) and construction of schools and health facilities.

(2) The award of contracts for projects under Deferred Financing should consider loan financing terms separately. Great focus should be placed on the engineering resource, technical, civil and legal considerations.

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(3) Contractors must be able to secure credit from a reputable financial institution and be drawn from a list of Approved Contractors who satisfy the following criteria:

- Experience
- Qualification(s)
- Performance record;
- Tax Compliance;
- Capacity (managerial, technical and financial, as necessary) and
- Demonstrated compliance with GOJ sustainable development initiatives (i.e. environmental legislation, regulations, standards and occupational rights and freedom).

(4) All contracts for the provision of works, goods and services shall include inspection and other quality requirements, including warranty clauses where appropriate. No contract shall preclude GOJ from performing the inspection, and non-conforming works, goods and/or services may be rejected without liability to GOJ.

(5) Any contractor that claims to have suffered loss or injury due to a breach of a duty imposed on the procuring entity by Government policy and/or legislation is entitled to seek fair and impartial review.

(6) The Ministry of Finance would have the sole responsibility for determining the final terms of financing from a list of not less than three (3) sources of financing.

(7) The Ministry of Finance and Planning in conjunction with the implementing Ministries /Agencies would have responsibility to present to the nation, through Parliament, a Ministry Paper setting out the scope of the project, the levels of financial commitments, the physical targets, the expenditure to date, achievements and the phasing in of the Government's obligations from a budgetary point of view.

(8) Payments must be made on the basis of certifications to satisfactory completion consistent with predetermined performance criteria.

(9) Resources would be provided in the relevant portfolio ministry's budget to meet the cost of payments as they become due.

(10) Established quantity standards for the relevant industry in Jamaica must be observed. In order to satisfy the transparency criteria to the public, there must be full and complete disclosure at all the relevant stages.

(11) In selecting the firms which compete, the Government's procurement policy and procedures must be vigorously applied.

(12) Full documentation showing all related transactions is to be retained for audit purposes.

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March 31, 2000