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D R A F T

CAPITAL PROJECTS  
FOR ANE

THE ANE CAPITAL PROJECTS  
WORKING GROUP

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## 1.0 Overview

The purpose of this paper is to propose a policy whereby ANE can become more involved in promoting and financing capital development projects. We have for sometime been moving away from our almost exclusive rural development focus of the 1970's to strategies which are more growth oriented and dependent on sound capital infrastructure. Accordingly, our assistance should be broadened to encourage capital projects with a large share of A.I.D. dollar procurement from the US consistent with our present untying agreements. Financing alternatives range from straight capital grants to mixed credits; however, the blending of A.I.D. grant funds with other sources of financing is preferred. Financing sources for such development projects will include A.I.D. bilateral funds, a new ANE Regional Capital Projects Facility, EX-IM grants/credits, TDP, multilateral and regional banks, other bilateral donors, and commercial financing sources.

## 2.0 Discussion

2.1 Except in a few selected countries, A.I.D. over the last decade has withdrawn from financing large capital development activities where U.S. contractors and commodities traditionally played an important role in achieving development objectives. These projects not only provided critical infrastructure for private sector-led growth but also opened markets around the world for our exports. Today the development scene finds us concentrating large portions of our resources on development programs which finance non-U.S. goods and services. The companion ANE Policy on Local Cost Financing identifies a number of reasons why our financing should be increasingly directed to U.S./Code 941 procurement. These coupled with our growth objectives strongly suggest greater ANE involvement in capital development related activities. For example:

- Many of our country strategies rely on adequate and functional capital infrastructure and in many cases we are directly involved in helping to insure such availability through project (technical assistance and training) and non-project assistance (institutional and policy reform).
- Our open markets initiative requires greatly improved infrastructure, e.g., telecommunications, power and transportation.
- We have been moving away from small, diffuse basic human needs types projects which are local currency dependent.

- Our grant resources, through joint or parallel financing schemes, provides A.I.D. with a special capability to lever financial resources available for capital projects.
- ANE wants to be responsive to USG efforts to establish fair and open market competition internationally and to support USG negotiating aims in this regard.
- Staff constraints dictate that we move away from large numbers of small, highly dispersed projects toward fewer larger projects and programs to ease monitoring and accountability burdens.

2.2 Broader policy and legal considerations in opening up A.I.D.'s activity in capital development are not considered restrictive and in fact many of our country programs, especially those receiving ESF, have been engaged in infrastructure projects for years. Our legislation recognizes the importance of infrastructure in achieving our objectives under ESF and DA. ANE policy will now more clearly reflect the importance of capital projects in meeting our developmental objectives, seeking opportunities -- as the legislation directs -- for collaboration with multilateral banks.

2.3 As further background in November 1989, the Economic Policy Council of the Cabinet (EPC) decided on a new approach for dealing with tied aid credits. Emphasis was placed on using the EX-IM War Chest selectively to initiate offers in countries and sectors of commercial interest to U.S. exporters where tied aid credits are used extensively. Several of these countries have ANE programs whose strategies recognize and support EX-IM's sector targets.

The EPC approved the following approach:

1. Eximbank and A.I.D. should identify possible projects where the War Chest, either alone or in conjunction with A.I.D. funds, could be utilized. The USG should also consider establishing tied aid credit lines in appropriate sectors in key countries.
2. Tied aid credit offers, even if extended under a credit line, would be initiated on a case-by-case basis, driven by negotiations.
3. While the U.S. should consider projects in recipient country development plans, particularly if A.I.D. funding is to be used, the USG should not limit its consideration to such projects.

4. Use of the War Chest should generally focus on the sectors for which the U.S. seeks to untie aid in markets where tied aid is used extensively, particularly certain Asian and North African markets. These sectors are telecommunications, transportation, power and construction equipment. However, the War Chest may be used in other sectors and markets, particularly in the context of matching or overmatching to counter violations of the March 1937 OECD tied aid credit agreement.
5. To avoid undermining existing discipline and transparency, U.S. tied aid credit offers should comply with the terms and notification procedures under the Export Credit Arrangement.

While A.I.D. is not an export promotion agency, the EXIM does offer resources which can, in addition to meeting trade objectives, contribute to our development objectives.

### 3.0 Policy

#### 3.1 General

In planning new programs and activities, ANE Missions, given A.I.D.'s country development objectives and resource availability, are encouraged to assist capital projects and infrastructure critical to development and private sector led growth. Under this policy, the intent is to promote development by relieving key physical and related policy and operational constraints. However, the means by which we achieve this must be molded to fit each country's situation and developmental priorities. The challenge will be to develop innovative mechanisms and financing arrangements which will lever our resources, maximize benefits to the developing economies and further our trade negotiating aims.

#### 3.2 Country Considerations

All ANE Missions should consider this policy applicable to them regardless of the state of development of the host country or availability of bilateral resources. However, given the intention to eventually use bilateral funds for this purpose and the need to focus our capital development resources, our larger, more developed country programs are viewed as presenting the greatest opportunities for multisource leveraged financing of capital projects, e.g., the Philippines and Pakistan. Additionally, our advanced developing countries may offer unique opportunities for innovative capital project financing. Nevertheless, all Missions are encouraged to seriously consider moving more directly into capital project assistance.

The terms of blended financing (i.e., grant element) would be established based on a country's economic status -- poorer countries receiving greater concessionality.

### 3.3 Sound Development

A sound development project should produce a rate of economic returns for the host country that compares favorably with alternative investments. Missions contemplating involvement in capital projects should develop some sense of the most promising areas for achieving high returns to infrastructure investment, preferably based on a careful strategic exercise that takes into account the country's economic situation and prospects, and the sorts of infrastructure networks (transport systems, power systems, telecommunications, etc.) required to support growth. The most promising investments within such sectors should flow from sectoral or system analysis, e.g., a least-cost expansion path for a power system. However, there is no presumption that a Mission should have to develop its own infrastructure strategies: in most cases a critical review of IBRD, IFC, or host government strategies should suffice. In particular, the Mission should satisfy itself that the policy environment affecting the sector is sufficiently reasonable to justify expectations of favorable returns to investment in the sector; and that some acceptable process of investment prioritization has taken place.

With this broad infrastructure strategy as background, the A.I.D. Mission should be well positioned to undertake economic and financial analyses of specific project proposals, using standard project analysis techniques. At the same time, the Mission should be prepared to engage in policy dialogue in the sector to reduce any distortions likely to limit the developmental impact of the project. The Mission should also be ready, where appropriate, to urge private ownership and/or operation as well as the benefits of competition and/or the need for an appropriate regulatory regime in the sector.

With regard to its strategy for using the War Chest, EX-IM Bank has targeted four priority sectors for attention: transportation, telecommunications, power, and heavy construction equipment. The first three are sectors where one could reasonably expect strategic planning and investment prioritization to have taken place. The fourth is more ad hoc. For an A.I.D. Mission to shift any of its country-specific resources or for the ANE Bureau to agree to use the Capital Projects Facility to support projects in these sectors will require evidence that contemplated projects offer favorable economic rates of return and the prospect of financial sustainability; and that they fit within an acceptable strategy of plan for the sector.



### 3.4 Sectors

ANE does not restrict the sectors in which capital projects can be assisted. As with EX-IM, transportation, power and telecommunications are natural candidates in most of our countries. At its foundation, any capital project should meet the "Sound Development" test and facilitate our open market objectives.

### 3.5 Financing

In developing financing packages for A.I.D. assisted projects, OECD rules regarding tied aid must be followed. The rule basically states that either:

- The grant element of the USG financing package must be at least 35%. At and above this point the financing becomes concessional;

OR

- The grant element, which must be used for technical assistance and/or training, must be less than 3% or \$1.0 million, whichever is less. At and below this point the grant is considered de minimus.

Financing sources for capital projects could take on a range of options which could include any combination of the following:

#### a. Regional Capital Projects Facility

This new regional project will initially be funded at about \$5.0 million but will grow over the next several years. At first, the Facility will be used primarily as a mechanism to coordinate and support mission efforts to assist in capital project financing. It will cover project development, feasibility studies, technical assistance, training and, possibly, capital costs associated with promoting specific capital projects. Priority will be given to those using innovative financing mechanisms or responding to U.S. policy priorities, e.g., those where development and trade objectives share common ground. During the first year, missions will not be required to cost share with the Facility. However, as the Facility grows and is in a better position to help finance capital expenditures, missions will be expected to contribute bilateral funds on a cost sharing basis with the Facility.



b. Bilateral Funds

Mission programs will be the most important internal A.I.D. source of funding for capital projects. Missions may design separate programs for capital project financing e.g., an intermediate credit institution type activity or a line of credit consistent with FAA Section 611 and feasibility standards or Mission may design projects targeted at a specific activity, e.g., xyz gas turbine plant. Financing could include construction services, equipment and materials, technical assistance, training as part of more innovative packages for "Build, Own, and Operate", other turn-key arrangements or more traditional A.I.D. procurement. Additionally, assistance could take the form of sector type assistance for policy and institutional reform. Missions are encouraged to develop such bilateral capital projects/programs.

c. EX-IM

It is ANE's intention to cooperate fully in the implementation of the November 1989 decision of the EPC (see Section 2.3) and to actively seek project opportunities where ANE/EX-IM objectives coincide. Congress has appropriated \$108 million for EX-IM's grant Tied Aid Credit Fund (War Chest) in FY 1990. Use of these grant funds is not contingent on A.I.D. contributing to the financing package; however, to use EX-IM's grant financing there must be evidence of unfair trade competition on behalf of a U.S. company's competitor(s) or the strong likelihood that such unfair practice will occur. This will likely be the case in many ANE countries. Accordingly, the EX-IM grant funds represent an additional resource which ANE would like to apply toward viable capital development projects.

d. Trade and Development Program

TDP has cooperated with ANE Missions on a number of occasions. TDP represents a resource both in terms of its staff capability, business networks and funding. ANE will continue to cooperate with TDP in the implementation of the Capital Projects Policy.

e. Other Donors

Multilateral and regional banks and other bilateral donors have programs with which A.I.D. will continue

to cooperate through cofinancing mechanisms. Trade objectives are of a major concern in such cofinancing arrangements and any such arrangements must insure that U.S. trade interests are maintained or improved because of the cofinancing.

f. Commercial Sources

Commercial financing represents a major source of resources for most ANE countries and one we have not well utilized in recent years. Blending our grant funds (and possibly those of EX-IM) with commercial financing can significantly lever our resources. ANE Missions are encouraged to develop financing packages which better utilize these private resources for capital project financing.

3.6 Private Sector

ANE and its missions will not consider financing capital projects which run contrary to our policies of privatization of productive sector enterprises.

Capital projects whether "public" infrastructure or productive enterprise which promote some combination of construction, ownership, operations, and control by the private sector will have highest priority in allocation of ANE Regional/Mission resources. Since most of the infrastructure sectors which may be targeted are owned and controlled by governments, creative financing arrangements coupled with privatization reform, in some cases, will be needed to meet this objective, e.g., the Pakistan private sector power program. Reasonable private sector equity participation in a capital enterprise is in the range of 20 to 30 percent.

4.0 Process Considerations

4.1 Competition

In dealing with the broad range of capital projects which may be considered under this policy, competition will be key to its successful implementation. As a policy ANE strongly encourages free and open competition. In some cases, especially where unfair international competition has triggered an A.I.D. or EX-IM response, competition as the tool for ensuring product quality and price may be less than optimal. In these cases efficiency tests will be required as discussed later in this section. To encourage fair competition for A.I.D. financing, the "Rules of the Game" will be open and understood and the process of selecting projects and suppliers/contractors predictable and transparent.



Competition can be viewed from two perspectives: (1) the international competitiveness of the contractor's or supplier's product and (2) competition for A.I.D. funds among U.S. contractors and suppliers.

4.11 ANE will not support a contractor or supplier whose product does not meet or exceed acceptable international standards and/or is not price competitive in non-subsidized markets. Open competition will generally alleviate this concern. However, where inadequate competition leaves questions regarding product standards or price, A.I.D. must assure itself that product standards meet reasonable efficiency tests (see Section 4.13).

4.12 The second question of competition relates to the expenditure of A.I.D. funds for a specific project or procurement. This will vary based upon the circumstances. Basically, all U.S. qualified companies should have fair and open access to A.I.D. funding.

In practice the following guidelines are offered.

- a. This policy and resulting programs will be widely advertised to relevant elements of US industry.
- b. If the project is a straightforward A.I.D. financed or cofinanced project for which no US company has established a prior "claim", then the projects should be competed in a normal fashion.
- c. For projects internationally competed by the host government with reasonable notification of the procurement, this will suffice as reasonable competition for A.I.D. purpose although efficiency tests for product standards and price may be required.

If the project/contract is one that is being supported by mixed credits offered by other donors, on where experience indicates the likelihood of such support, the "defensive" requirement is met. Concessional financing by A.I.D. or EX-IM can be used to compete with foreign or potential foreign suppliers.

- d. Projects which involve substantial equity (20% - 30% or risk-sharing by the private sector need not be formally competed although efficiency tests may be required.

- e. A.I.D. specific procurements resulting from the award of a turnkey type capital project to a US. supplier need not be competed again or separately since the turnkey or prime contract was made on a reasonably competitive basis.
- f. Uncompeted capital procurements resulting from US suppliers aggressive and market-oriented effort would be considered but approved only under very exceptional circumstances, e.g., the proprietary nature of the product. In such cases, the procurement would have to meet price and product efficiency tests. This may be difficult in situations involving new technologies requiring large amounts of technical assistance and training. Still the matter must be addressed and reasonable test applied.

#### 4.13 Efficiency Tests

These are important where broad, open competition has not occurred. While as a policy A.I.D. encourages such competition, there will inevitably be cases where the competition question arises.

A.I.D. financing will not subsidize inefficient U.S. production or non-competitive pricing. The proposal of the U.S. supplier should demonstrate that in the absence of subsidized financing or other subsidies to foreign competitors, its products/services package can compete on the basis of price and quality. Firms with considerable international experience and a track record of exporting similar goods and services without the benefit of subsidized financing should be able to demonstrate, prima facie, that they are internationally competitive. Firms that traditionally rely on export subsidies will have a more difficult time establishing this point.

Bilateral or regional funds should be used when necessary to perform efficiency testing prior to commitment of any A.I.D. funding for capital expenditures.

#### 4.2 Process Management

##### 4.2.1 ANE Bureau

The ANE Capital Projects Working Group has responsibility for policy development, reacting to policy questions and monitoring general policy implementation. The Working Group is chaired by the Director of ANE/PD, cochaired by ANE/PSD and

includes representation of relevant ANE offices, PPC and GC. A major function of the Group over the next several months will be to provide more detailed guidance on the implementation of this policy to missions.

ANE/PD, coordinating with appropriate technical offices, will have day-to-day "operating" responsibility for capital projects. This will include:

- Backstopping mission programs,
- Monitoring and reporting on program implementation,
- Maintaining operating liaison with EX-IM, TDP and other potential financiers on program and project level activities.
- Assisting US companies in learning about the program and potential trade opportunities.
- Managing the ANE Regional Capital Projects Facility.

#### 4.2.2 Missions

As part of this new policy focus, missions will be expected to investigate and decide whether their country programs and strategies have the human and financial resources for a capital assistance program or whether they should participate in the program on a case-by-case or transactional basis. Missions may establish country-specific capital projects or programs and organize and staff to effectively implement the ANE policy. Missions will consider their own strategic targets -- specific sectors, geographic areas, project size preferred financing sources and terms, associated policy and institutional reform, etc.

The manner in which missions manage their involvement in capital project activities is at their discretion. As with other projects the mission will manage the host government relationship including introduction of this policy and its developmental as well as trade rationale.

As a first step missions should assign an individual/office as the point of contact. ANE will be prepared to work with the Mission in advancing this concept, designing projects/programs helping to arrange financing packaging, etc.



#### 4.3 Mission Staffing

For those missions which move into capital development, the question of staff to efficiently execute the program may be a concern. In terms of overall staff resources, ANE does not contemplate any staff increase. On the contrary, over time staff requirements should lessen. ANE acknowledges that this will not occur in the short-term.

More significant than overall numbers will be the requirement for experienced, quality personnel. We have lost much of our broadbased expertise in this area. Fortunately, ANE still has some well qualified personnel to begin the transition. Depending on Mission responses, ANE will prepare a staff development program to help supplement this talent.

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