25th June, 2003 Daily News

Negotiating foreign loan agreements for the construction sector

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It is indeed heartening to note the pledges made by the international community to provide Sri Lanka with unprecedented funding packages for the programme "Regaining Sri Lanka" at the Tokyo Conference held on June 9th and 10th.

From this massive pledge of US $ 4.5 billion spread over a four year period, the Asian Development Bank has pledged US$1 billion and the World Bank US $ 900 Million. I do not havé the figures that have been pledged by the Japanese Economic Banking Corporation and the European Union. Undoubtedly, a larger percentage of these pledges, from wherever they come, would be diverted to construction related activities. It is common knowledge that the disbursement of these funds has, to be done consequent to project related loan agreements which in turn follow the guidelines of these agencies.

In as far as the development activities in the North and East, it is reported that the funding would be administered by the World Bank. If this is so, it is indeed very heartening to those in the construction industry who know precisely the objectives and commitment of both the World Bank and the Asian Development Bank. It is also known that what goes into the loan agreement holds fast during the execution of the related project. These agencies have a mandate and a commitment to the development and strengthening of the domestic operators as a priority, in the process of the utilizing the funds for development purposes.

However, our past experiences have shown, beyond doubt, that our negotiators are either ignorant of this fact, or prefer to act indifferently. The result being that this most important aspect and commitment of the funding agencies is glossed over during negotiations.

Notwithstanding these laudable mandates and commitment it would be foolhardy to expect the funding agencies to bend head-over-heels and pressurize the inclusion of such conditions into the loan agreement. The pressures must necessarily be exerted by our negotiators.

It is in this context that the writer has considered it opportune to publish vital considerations that our negotiators should be fully conversant with, and not be reluctant to introduce them into loan agreements.

I have no doubt that John Cooney of the Asian Development Bank and Peter Harold of the World Bank will be only too glad to assist our negotiators in this regard, and would be willing to accommodate these considerations.

Apart from the directed funding from the World Bank and the Asian Development Bank, as the World Bank is to administer the funding packages it is prudent to be aware of the bank policies.

Let me first identify the underlining principlrs and realization of the international funding agencies with particular reference to the World Bank and the Asian Development Bank.

The banks recognize that the private sector contributes substantially to the growth of national income, investment, employment, export earnings, and transfer of technology. The private sector is seen by the banks as the main vehicle for the economic growth of the developing countries. A priority objective of the banks is to help its Developing Member Countries (DMC's) to establish a healthy environment for private sector growth.

The banks perceive that the only way to achieve this goal is mainly by engaging in policy discussions and dialogues with Developing Member Country governments, on various aspects of policy, and the statutory, regulatory and fiscal framework that has a bearing on the growth and development of the private sector.

The banks resident missions are mandated to facilitate the bank operations in the respective countries they represent. The resident missions are delegated with the task of strengthening the working relationship between the banks and the governments in processing and implementing projects and programs funded by them.

The resident missions further maintain dialogues with the authorities on policy and other issues and even coordinate with other bilateral and multilateral donor agencies.

Their missions are responsible for developing operational strategies, with associated economic policy issue analyses, developing country programs of assistance, project formulation and implementation.

They also undertake economic reporting & data collection and assist governments in aid consideration to enable the bank to respond better to the changing needs in operational policies. It identifies new directions in terms of their impact vis-a-vis the bank objectives and the need of the developing countries.

Eventually it is the resident mission offices that significantly contribute in the formulation of policies, strategies and approaches in relation to capacity building and acts as a focal point.

Construction, if measured accurately, contributes 8-10% to the GDP and absorbs 40 - 70% of the Gross Fixed Capital Formation. These monies will increase significantly with the most recent pledges at the Tokyo Conference. Therefore the country needs to ensure that all the opportunities are provided to develop this sector through the private sector, who in turn will be the major contributor to the country's economic growth & stability.

Construction sector: now playing vital role

Sri Lanka's development programs are diverted largely to infrastructure development, rehabilitation and reconstruction and new construction. This by itself it a clear indication of the role the private sector constructors can play to accomplish such programs, develop the private sector and enhance the economy and its growth.

The main source of funding for this purpose is derived from external funding sources, whose presence in infrastructure development, rehabilitation and reconstruction have been very significant and will continue to increase significantly.

These funds are obtained through the usual several sectoral loan agreements, drawn up between the government and the funding agencies, within the macro funding made available from time to time. It is in this context and, it is well within the underlying policies of these funding agencies, that this paper is documented for serious consideration of both the government and the funding agencies.

We are very fortunate to note that construction has been recognized in Sri Lanka by the funding agencies as a major economic growth sector. It is with this conviction that the banks are steadily increasing their loan allocations to construction related activities. Substantial allocations are set aside for road rehabilitation, reconstruction and other infrastructure development.

The banks, in appropriate cases, have just begun to permit the procurement of domestic construction services without always going through international competitive bidding (ICB) procedures.

It is most gratifying to note that the banks have realized and accepted the growing domestic construction capacities, and recognizes the regulatory framework that our country adopts such as the registration of contractors in appropriate grades, in the relevant field of construction that they are competent in, by the Institute for Construction Training & Development (ICTAD). The brief outline on the banks policies, indicate they are all fast moving in the desired direction. Yet it must be admitted that all of us, i.e. the banks, the government and the constructors, have still to stabilize themselves through more intensive dedication and commitment, if the forward march is to achieve the desired results within the desired time.

The ICTAD and its registered constructors see the need for continuing improvement to the construction sector. The ICTAD has identified these growing needs. This paper is therefore to place on record the realization of the needs of the day, and to further record the full understanding of the combined inputs needed for the achievement of poverty alleviation, human resource development, social infrastructure development, national productivity and so on. In simple terms we are conscious that to achieve our ultimate goals, we have to put into place what might be termed the "ideological Mix".

There still seems to exist a great void that continues to slow down domestic growth in the construction sector. This paper highlights the need for increased domestic inputs to this sector, for which prudent, employment of loan/grants from the banks should be judicially addressed.

If one measures the total volume of loan/grants provided by the Banks to the construction sector, it is seen as significant, likewise if we examine the mix of its distribution between the domestic; and the expatriate, it is seen as dangerously unbalanced. The scale is tilted heavily to the expatriate side. It is not uncommon, for us to hear from our Government, that the domestics are subjected to rigid bank rules. The Government does not seem to realize that banks convey their policies, not by rigid rules but by flexible guidelines.

On the other hand, we learn from the banks that it is the government who is responsible in tightening the rules, rather than being flexible with the bank guidelines.

It is timely now for all of us to put the records straight, and we do hope that this paper will serve the purpose. We are all more than aware that the large funding packages will come from several industrialised countries, and therefore, by all means, such countries must reap some benefits.

Yet we all must realize that the cornerstone of the approach of the bank is factoring of the DMC's priorities and preferences, which will achieve its development objectives and thematic priorities.

I have used key words such as "flexibility", "traditional mix", "thematic priorities", and have considered them necessary elements that have to be developed if we are to achieve sustained economic growth in and through the construction sector.

I will now prioritize the key areas where remedial action that has to be taken.

Flexibility

* We clearly see a flexible approach of the banks in encouraging and accommodating domestic contracting procedures.

* We are encouraged that the Government is moving towards the understanding and recognition of the economic benefits by promoting the domestic construction sector in principle.

* We see ourselves joining hands with the Government and improving productivity, quality and enhancing employment with a commitment to nation building.

* Yet it is quite evident that both the Government and the bank must convince *themselves that operational flexibility must necessarily* be intensified and applied to meet the fast changing environment and philosophies.

Traditional mix

* The present mix between domestic and Foreign is unbalanced.

* The Government seems complacent with this situation.

* The domestic constructors are being driven to the wall.

* This sees the straining economy being aggravated and would continue further unless the banks and the Government take meaningful steps to gainfully use the construction sector by supporting and strengthening domestic inputs.

Recommended considerations

To achieve our common objective we need the combined support of the banks and the Government to:

- Increase and improve on the emerging procurement procedures for the construction sector.

Suggested mix:
30% ICB
40% LCB
30% LBP (Limited bidding procedures)

Limited bidding procedures that are provided under the bank guidelines, to be made more flexible to accommodate and limit civil works to be procured from domestic contractors who are registered with the ICTAD.

- Define "LCB procedures" more precisely
- Increase LCB procurement procedures.
- Ensure the realization of the philosophy of the "Competition on the same level playing field".

For which local conditions that govern LCB procedures, should, inter-alia, include:

a) Packaging of projects to reasonable sizes to provide local competitive participation.

b) Restrictions that govern the number of packages that could be awarded to a contractor should be applicable to all bidders.

c) Local taxation and customs systems should be applicable to both the domestic and foreign organizations, and their personnel alike. Organizations and their personnel should be made liable for payment of all taxes in Sri Lanka.

Foreign organizations and their employees should strictly abide by the Inland Revenue Act including maintaining records, observing Sri Lankan accounting standards and filing returns.

d) Complete ban on employment of foreign unskilled labour. EPF, ETF payments and other local labour regulations should be strictly enforced irrespective whether the contractor is foreign or domestic.

e) All payments on the contract to be in Sri Lanka Rupees only, for all contractors.

f) Borrowing of Working Capital should be only from local banks in Sri Lanka and at local Interest rates.

g) If (f) cannot be implemented, Interest rates on lending to be equated - if *unbalanced then a percent*age preference to be given in evaluating the bids.

h) Expatriate professionals should meet the recognition criteria prescribed by the Sri Lanka professional bodies.

i) Expatriate skilled workers to be permitted only if local parallel skills are not available and they should meet the Sri Lanka Trade Testing Standards.

j) Expatriate organisations should meet the same grading criteria as for of the domestic organizations (temporary registration with ICTAD should be a requirement).

k) Expatriate organizations competing on LCB projects should join the local contracting community by joining the National Contractors Association as temporary or expatriate members.

l) All laws of Sri Lanka to be applicable including arbitration

m) All Insurances to be taken in Sri Lanka from domestic insurers.