OPM.114/59/II

No. 726B

MEMORANDUM FOR CABINET BY THE
HON. MINISTER OF TRADE, INDUSTRY AND AGRICULTURE
FINANCING OF POWER/WATER STATION PROJECT

The Malta Electricity Board has already adjudicated international tenders which have been submitted in connection with Stages II and III of the Board's expansion programme. This expansion is expected to begin to give increased electricity output late in 1969, and additional water (from distillers) in February/March 1969, as firm orders have now been placed.

2. The cost of Stages II and III, including the reinforcement of the distribution system has been estimated at £5,126,000. It has been assumed that funds to meet the cost of the 3 distillers (£1,675,000) will be made available by Government whereas the Malta Electricity Board will have to finance out of their own resources some £451,000 leaving a balance of £3,000,000 which must be found from other sources. It should be pointed out that, in addition to the £451,000 already mentioned the Board must find £1,472,000 from their own resources for the capital expenditure programme.

3. It has been agreed that the question of the procurement of funds to meet the Board's expansion programme cannot be divorced from the need to consider and solve the problem of the Board's general finances. The Ministry of Trade, Industry and Agriculture, the Ministry of Finance, Customs and Port, the Economic Planning Division of the Office of the Prime Minister and the Malta Electricity Board have made a review of the situation. As a result of this review, the conclusion has been reached that it is inevitable that the expansion project should be financed by a loan or loans and that some form of relief should be made to the Board to strengthen their financial position so that they can meet the criteria laid down by the first Loan Agreement.

4. Recourse to the World Bank for a second loan to finance Stages II and III is no longer feasible, because the I.B.R.D. is debarred by its constitution from assuming responsibility for contracts which have already been entered into. This leaves no alternative now but to issue a local loan.

5. It is desirable to issue a straight Malta Electricity Board loan, as this arrangement would not affect the National Debt position of Government although it would be a contingent liability. In view of the agreed need of ensuring a successful outcome, it is advisable to have the Malta Electricity Board loan guaranteed by Government. It is to be pointed out that in the case of the World Bank Loan, a guarantee was given by the British Government. Ad hoc legislation would be needed for this purpose since no existing legislation empowers Government to guarantee loans of this sort.

6. To enable the Board to continue to meet its obligations to the World Bank, in terms of Section 5.06 of Article V of the Loan Agreement, the proposed loan would have to be on terms not less favourable than those outlined hereunder, (the choice depending on the extent to which annual amortization is to be reduced to admit of a higher interest rate):

(1) A tenor of 20 years at an average interest rate of 3 7/8%.

(2) A tenor of 30 years at an average interest rate of 6%.

These terms take into account the fact that the proposed loan will have to be collected in tranches over the next three consecutive years and it will be necessary for the Malta Electricity Board to invest temporary surplus cash under short-term arrangements.

The Ministry of Finance, Customs and Port are of the opinion, however, that such terms are at present unobtainable, in view of the exceptionally high interest rates now ruling in London and the undeveloped state of the local capital market. It will therefore be necessary to approach the World Bank to negotiate a special dispensation from this particular section of the Loan Agreement.

7. Financial Assistance to the Board

The issue of a Malta Electricity Board loan presupposes an amelioration of the Board's finances especially for the next five financial years if the Board is to be expected to meet its projected capital expenditure and debt service.

8. It has been estimated that by 1971/72 the Board will end with a cumulative deficit of £1,746,000. This deficit takes into account a total of £2,200,000 in respect of the Board's interest liability on the value of the assets and the permanent loan up to 1971/72.

9. The following alternative propositions, calculated to improve the Board's finances have been considered:

(i) A 33% overall increase in tariffs estimated to generate additional revenue for the next five years amounting to £2,346,000.

(ii) A 15% overall increase in tariffs, plus a waiver of all arrears and interest to 31st March, 1968, and a reduction of £120,000 per annum in interest on the value of assets for the remaining 4 years estimated to yield £2,346,000.

(iii) A complete waiver for 5 years of the £350,000 per annum interest (plus the £450,000 arrears at March 31, 1967) on the value of the assets and the permanent loan taken over on September 7, 1963, estimated to yield £2,200,000.

(iv) Government to waive the accumulated arrears of interest as on 31st March, 1967 - £450,000 and to undertake also to waive any amounts which become due as interest but which the Board will not be in a position to pay over the next five years.

10. RECOMMENDATION OF THE MINISTRY OF TRADE, INDUSTRY AND AGRICULTURE.

It is the view of the Ministry of Trade, Industry and Agriculture that in the present stage of our tourist and industrial development it is advisable not to disturb current electricity rates unless this is absolutely unavoidable and since it is felt that other arrangements are possible which would meet the needs of the Electricity Board and could peg electricity rates for the next five years, no further consideration has been given to alternatives (i) and (ii).

Alternative (iii) is meant to provide the Board with a surplus of about £600,000 by 1971/72 which would be needed for further expansion which the Board advises will have to be undertaken to meet anticipated increased demand. As this alternative would bind Government to waive the interest for five years independently of the actual cash flow situation of the Malta Electricity Board it is recommended because of budgetary considerations, that alternative (iv) be adopted.

11. RECOMMENDATION OF THE MINISTRY OF FINANCE, CUSTOMS AND PORT.

It is the view of the Ministry of Finance, Customs and Port, having regard to the deterioration in the budget position and the increase in the Electricity Board's costs since devaluation, that some increase in tariffs has now become inevitable. The operating ratio (running expenses/sales) has already risen above the limit of 67% prescribed in the World Bank Loan Agreement and it is expected to get progressively worse, rising to 77% in 1971/72.

It is not possible to allow the Malta Electricity Board a complete waiver of interest, as recommended by the Ministry of Trade, Industry and Agriculture. To restrict the necessary rise in tariffs to the more moderate figure of 15%, however, the Ministry is prepared to reduce interest charges by £120,000 a year, as set out in alternative (ii). Anything more than this would put too great a burden on the budget and would almost certainly necessitate an increase in taxation. Such taxation would be particularly resented if it meant that users of electricity were being subsidised at the expense of the public at large, including the poorer members of the community who mainly use other forms of heating.

It has to be pointed out here that the originally estimated surplus of £922,000 in the Consolidated Fund as on 31st March 1968 will in no way be realized. In fact, present indications are that such surplus will be reduced to one of only some £66,000. Practically this is due to the fact that the Electricity Board is defaulting on its £797,000 due to Government up to 31st March, 1968. The implication of all this is that on the year's working the excess of expenditure over revenue has risen to some £1.5m. which was made good out of the surplus of £1.6m. existing on 31st March 1967. Current indications are that even in 1968-69 expenditure is likely to exceed revenue with the difference that there will be no surplus from which such excess could be met. This would seem to make it all the more imperative that the Malta Electricity Board should pay at least part of its dues to Government.

Moreover, the Ministry considers that if nothing is done to stop the Electricity Board's operating ratio becoming increasingly out of line with the undertakings of the Loan Agreement, Malta's relations with the World Bank are bound to deteriorate still further. This is something which the country cannot afford, because it will prejudice any chance of obtaining future assistance not only from the international funds owned or administered by the World Bank itself but also from other outside sources, most of which come under its influence in one way or another. Assuming that a local loan is completely successful, it will not provide any foreign exchange to meet the orders already placed abroad. The proceeds of the loan in Maltese pounds will have to be transferred to the Central Bank to purchase this foreign exchange from the country's external reserves. As a decline in external reserves will reduce the Central Bank's earning assets, it will also affect the amount of profit accruing to Government and hence cause further pressure on the budget, which must not be left out of account. Furthermore, if there is not enough response to a local loan, Government may well have to find the domestic money needed for the capital expenditure as well, thus adding to the strain on the budget.

12. Hon. Ministers are therefore asked -

(1) to agree to the following joint recommendations:-
(a) that a Malta Electricity Board loan(s) of the order of £3 million be raised from local sources for the financing of Stages II and III of the Malta Power/Water Station project and that legislation be enacted to enable Government to guarantee such loan(s) and to provide temporary finance by means of the proceeds of the Treasury Bills or of other short-term Government borrowing until such loan(s) are issued to the public;

(b) that approval be given for a complete waiver of all arrears and interest to 31st March 1968; and

(2) to adopt one of the two following alternative courses:-

(a) that the Minister of Trade, Industry and Agriculture, in consultation with the Minister of Finance, Customs and Port be authorised to waive in full or in part the interest due by the Malta Electricity Board as from 1968/69 to 1971/72 on the value of the transferred assets and the permanent loan, provided the Minister of Trade, Industry and Agriculture is satisfied that the Board is not in a position to meet this commitment or any part of it, after fully taking into account the cash flow situation and the overall commitments of the Board;

OR

(b) that approval be given to a 15% overall increase in tariffs plus a reduction of £120,000 per annum in interest on the value of the asset for the remaining 4 years, provided the Minister of Trade, Industry and Agriculture, in consultation with the Minister of Finance, Customs and Port is satisfied that the Board is not in a position to meet this commitment or any part of it, after fully taking into account the cash flow situation and the overall commitment of the Board.

5th February, 1968.