INSTITUTE OF CHARTERED ACCOUNTANTS OF JAMAICA

Feasibility of Privatizing Utilities in Jamaica

What is left to be done?

Richard L Downer, CD, FCA

5/11/2015

Jamaica has had a roller coaster ride with the ownership and regulatory framework of utilities. The bad effects of the policies of the 1960s and 1970s set back Jamaica's development considerably but since the late 1980s things have been steadily improving. Much remains to be done in the electricity subsector which is hampered by a monopoly that runs until 2028 but the telecom sector is now exemplary. The privatization of water was "picking up steam" but it may be "back on ice". This paper sets out lessons learned and opportunities that still exist in relation to utilities in Jamaica as part of a series of articles at the time of 50th anniversary of the Institute of Chartered Accountants of Jamaica.

Table of Contents

Introduction

If there was anything we should have learned in Jamaica over the past 50 years, it is that state monopolies are worse than private monopolies – but does it always apply to utilities? History shows that private utility monopolies can "turn bad", even worse than state-owned ones, if the regulatory system is inadequate. Another thing that has become apparent is that it is possible to introduce competition to industries that used to be considered natural monopolies.

In Jamaica the electric and telephone systems have been privatized, so why address the question as to whether it is feasible? I'm going to look at it in perspective and consider whether the privatizations so far have worked and what lessons have been learned, but also I will look at the practicalities concerning what more can be done.

Those who are deeply interested in the historical detail and policy issues and options for our utilities should read Revitalizing the Jamaican Economy: Policies for Sustained Growth, a 295 page book published by the Inter-American Development Bank in 2004. What I have written in this article is largely from personal involvement and observations over the years as auditor of the electricity and telephone companies and being responsible for all large privatizations done using IPOs in Jamaica. I have also been helped by what I have learned from performing advisory assignments on the privatization of utilities all over the world. However I have also leaned heavily and acknowledge with gratitude the help of Zia Main, recent former Director General of the Office of Utilities Regulation in identifying competition opportunities in electricity, sources that provided current information and insights of the water utility and Alvaro Casserly, former Secretary to the Public Utilities Commission in the 1960s and former JPS Treasurer, for refining historical facts.

Sound policies and execution for privatization and regulation are prerequisites

To start at the very beginning, it may seem like stating the obvious - but without a formal government produced privatization policy that ranks objectives and describes modalities, more harm than good will result from transactions.

The current privatization policy

The government of Jamaica's (GOJ's) 2012 privatization policy document Policy Framework and Procedures Manual For the Privatisation of Government Assets: The Privatisation Policy happens to wrongly attribute the ranking of objectives that were actually adopted in the 1980s as originating in 1991, but that is not the main subject at hand. That policy, drafted as a cabinet submission by me in 1986 that was adopted, formally ranked the two highest objectives of privatization as:

- To improve the general efficiency of the economy
- To democratize ownership of productive assets.

Lower on the scale was raising funds for the fiscal budget, important as that also is. So said in 1986, so done in 1986, and large scale privatizations commenced that year by way of initial public offerings (IPOs).

The 2012 policy objectives are ranked as follows:

- secure greater efficiency and competitiveness in the operations of the enterprises;
- reduce the drain on GOJ's fiscal resources;
- enhance the GOJ's fiscal and debt management programme;
- facilitate the transfer of capital, technology and management procedures;
- widen the base of ownership and direct equity participation in the economy;
- maximise efficiency in the provision of public services by outsourcing them to private firms where this will deliver greater value for money than continued operation within the public sector.

It is a sound set of objectives but sadly the objective of promoting individual ownership has now slipped to 5th place from 2nd place. I explain why I say sadly below.

Virtues of widespread ownership

There is an old saying: "when nobody owns it nobody cares". Public behavior is better in societies where there are equal opportunities and individual property rights which are stringently and fairly enforced under a sound legal framework, especially if the citizens themselves own things worth conserving.

Started by building societies

Building societies in Jamaica were founded on the premise that if people have a stake in the formal economy through home ownership they will act in ways conducive to economic growth and public order. However the number of mortgagors in the building societies is relatively small, since residences are a "big ticket" item. The objective of giving vast numbers of "ordinary people" the opportunity to have a stake in the formal economy can be more easily achieved through share ownership as the outlay does not have to be large. Through privatization, governments have the unique golden opportunity to promote this.

Transparency

Another advantage in deliberately doing IPOs is that it is a transparent process – the deal in its entirety is laid out in a prospectus and there can be little suspicion of side deals.

Overcoming the size obstacle

An obstacle to being able to do a large IPO is the Jamaica Stock Exchange's sensible requirement, for listing, that 20% of the issued shares must be in the float. In the case of a utility with a decent debt:equity ratio, even 20% would represent a very large dollar value – perhaps too large for the local market to take at one bite. A solution would be to allow such shares to be paid for in installments and this has been done in several UK privatizations with the following advantages:

- Installments were spread over more than a year and this encouraged more applications
- As dividends were paid in full in relation to partly paid shares there was a very attractive yield which better assured the take up of the IPO
- A profit-taking sell off immediately after the IPO would not happen if shares could not be traded until fully paid (but trading in partly paid shares can be allowed).

Foreign equity investment instead of foreign debt

Privatization is all about equity investment. Inevitably, privatizing utilities means that the core investors will be foreign if technology and large capital sums are needed.

This is a convenient point to deal with an age old and needlessly controversial reality that we should have got out of our system by now but unfortunately have not.

Growth needs investment and investment requires returns and foreign investment obviously requires its returns in foreign exchange. Some of the economic efficiency paybacks to the community of the foreign investment in telecoms that make our economy more competitive are pointed out later in this article and there are similar examples of macro benefits to Jamaicans from foreign investments in other industries – so we can export more as we become more competitive. But in deciding between servicing an investment made by debt instead of equity it seems clear that equity has big advantages for a country as a whole, since:

- Debt principal must be repaid but equity capital is permanent and need not be repaid.
- Dividends on equity are usually only higher when times are good for the economy as a whole and that is when they are affordable.
    - When the economy is bad and profits are low, dividends are usually curtailed or lower and that is when the relief is needed.
    - Interest, on the other hand, inexorably must be paid even if the economy is not doing well
        - Interest rates increase and principal payments can be accelerated in such times, thus exacerbating the situation.

If the amount of foreign dividend payouts were totted up it would be a small fraction of foreign debt service payments and it would be good to reverse this order.

Currently the transshipment port is to be privatized by means of a long-term concession, which will include the expansion, financing, operation, maintenance, and transfer of the terminal. Norman Manley airport is also to be privatized. It would be desirable for the government to require that at least a portion of the equity in the operating ventures to be made available to local investors through an IPO.

Another opportunity is the government's residual 19.9% stake in JPS discussed in more detail later.

The Regulatory Framework

The privatization policy document of 2012 wisely sets out the need for sound utility regulation very strongly:

> "… it is imperative that consideration be directed towards ensuring that regulatory frameworks are developed in a manner that balances the needs of consumers and investors. Such efforts may require the creation of new or amendment of existing legislation, the issue of orders, notices or regulations and the provision of statutory approvals.
>
> "Two recent institutional efforts to address these regulatory gaps were the creation of the Office of Utilities Regulation (OUR) and the Fair Trading Commission (FTC). In spite of these developments, the regulations of natural monopolies such as the air and sea ports and utility companies will inevitably pose significant challenges. As such, it is important that the regulatory framework be reviewed prior to the start of privatisation transactions and in some cases the review of the framework will continue during the privatisation process".

Zia Main, former Director-General of the OUR pointed out to me that an improvement in the privatization policy document would be to emphasise that the rules of the game should be finalized before privatization begins and should not evolve during the process as implied above.

Later on I will show why the poor regulatory frameworks (before the OUR was created) set Jamaica's development back by about 30 years. Indeed in the case of JPS the unbundling of the segments of the undertaking (generation, transmission and distribution) discussed later in this article was put forward to the government before the last JPS privatization but it was flatly rejected. Now we are desperately trying to do this very unbundling! We were nearly similarly trapped in the case of telecoms too as will also be explained herein. Since the JPS license has 13 more years to run are we going to see a repeat of development of the country being set back?

Phase I - Early history of utilities in private ownership

If the history had been different the present would be different. To understand why we are we where we are, we need to understand the past. There are phases that we went through and it is still evolving.

In Phase I, the electric and telephone utilities in Jamaica started out as private enterprises over a hundred years ago (in the 1890s), just a few years after the technologies were invented.   After changes in the identities of the controlling private shareholders they were nationalized in the 1970s and then privatized again 20 to 30 years later. Water of course has a longer history, all in government ownership.

Electricity

In 1892 the first public electricity service in the Island was supplied by the Jamaica Electric Light Company from a plant at Gold Street, in Kingston. In 1897, another company, the West India Electric Company, built a hydroelectric plant on the Rio Cobre River at Bog Walk.

As electricity use spread, individual towns in Jamaica had their own vertically integrated private electricity companies, the one in Montego Bay being owned by American investors using Great River as its power source and the one in Mandeville, Spauldings and Christiana being owned by the Lord family ("Oh Lord! let there be light" customers used to say when there were outages), for example. The exception was that the electric supply in Sav La Mar was operated by the local government.

The local electric companies produced current at different cycle frequencies so you could not automatically expect to use electric motors, clocks and record players (which used alternating current in those days) for example, in different places in Jamaica. JPS, having bought up the local electric companies in other towns , standardized the frequency to the mid-point of 50 cycles (even going to households and changing the gears on appliances). Up to this point the history is very similar to that of the United Kingdom and other countries.

With frequency conversion came a World Bank loan and this required that the 20-odd licensees held by JPS that were renewable annually (no wonder there was no serious investment up to then) be consolidated into one 25 year island-wide license. JPS built an island-wide backbone transmission grid in the following decades. A regulator was set up (on paper) along the lines of the US public utility commissions to regulate the rates that could be charged and set service standards, but it was not staffed with experts (though they hired consultants from Montreal Engineering to help in rate hearings) and was not sufficiently independent nor was there any set of local legal precedents, so execution was poor, actually very harmful.

Telephone

In 1892 the private telephone company in Kingston with about 300 subscribers owned by foreign interests was challenged by a group of local businessmen who wished to set up a competing network. There was a spirited debate in the Gleaner about the merits of this, the main arguments against centering on this being a natural monopoly, as colourfully expressed (and that's why the extracted quotes are long) by the manager of the incumbent West India and Panama Telegraph Company at the time, as follows:

> " In every line of business excepting a Telephone Company, two or more firms or Companies can exist …
>
> "…Two Exchanges cannot exist for any length of time; one at least, must succumb, but as the dying of one is a slow process, the subscribers during the time must put up with a deranged service. And as in the fight for existence, considerable money will be sunk, even the surviving Exchange will be crippled and unable to give as good service as the old Exchange had; and to recoup themselves the Exchange will either raise the rates higher than ever or continue to give miserable service…
>
> "…my Company commenced operations in Jamaica when they could not get the community to invest one penny in the enterprise. My Company took the risk of a new business, when the people here were unwilling themselves to do -- after being invited. … We were first in the field, and as such we should be rather encouraged in our desire to have a Model Telephone Exchange…
>
> "In many other places the Telephone Exchange is not only given sole right to operate, but also subsidized, so that the best service can be maintained. We do not ask that, we only beg for protection and encouragement."

Later in this article you will see that these arguments were still thought to be valid in 1988, about a hundred years later!

Phase II - The politicization of the utilities and "quasi-expropriation"

When Jamaica became independent in 1962 there was a period of "nervous nationalism" (as the prominent columnist Morris Cargill used to put it) and there was intense distrust of the private sector by the civil service.

Initially, JPS was controlled by Canadian investors. Stone & Webster, a Boston based company that owned electric utilities all over the USA were the consultants and engineering managers. In time Stone & Webster became the largest (at 20%) shareholder and the general manager. The shares of JPS' Canadian holding company were held by investors in the USA, UK, Jamaica, other Caribbean countries and even Australia. The 1966 license required that there should be a local IPO for the Jamaican company and the board of directors should all be Jamaicans.

In the late 1960s the recently established Public Utility Commissions were interfered with by politicians wishing to keep rates down and rate hearings became circuses and platforms, and in that hostile climate and the absence of expert regulators, the private companies ceased investing meaningfully. After a few years of pressure including *ad-hominem* attacks on its manager, Russ Carney, Stone & Webster gladly left (in 1971) after the government bought out its 19% interest and became the largest shareholder and in 1974 it bought out the remaining shareholders.

In the mid-1960s the British company that owned the sole telephone utility stopped investing when its 1945 license was replaced with one that was vague as to how rates would be determined, in a climate known to be hostile – another example of a private utility "turning bad" because of a poor regulatory environment. The result of the non-investment was that, for example, it was quicker to drive to Spanish Town than to get through on the telephone. One had to wait minutes to even get dial tone. In the mid 1960s there was no telephone service in Negril.

The clever British telephone company was able to sell its shares in about 1969 to an American company, Continental Telephone, which then invested in the modernization of the system to electronic instead of step-by-step exchanges. But despite great service improvements Continental too was met with hostility when rate increases were sought and the manager from the US company , Malcolm Holmes, was shamefully mocked in a television interview because of his manner of speaking and he was also (not fatally) shot by a protestor during a labour dispute. Continental too left Jamaica and Government took over the company in 1975.

The well-run Kingston urban transit company, Jamaica Omnibus Services, owned by a British registered company but suspected of having South African connections, was also starved of rates and stopped investing and only too happily exited Jamaica as the dismal deteriorated service was taken over by government.

The process of starving utilities for rates has been aptly described as "quasi-expropriation" - that may not have been a conscious political objective when this began in the 1960s, though it suited the policy of the 70s. The Public Utility Commissions were ill-equipped to match the skills of experienced operators and their advisers and were suspicious, and Commissions had too much discretionary power in an environment of few supporting legal processes and precedent, so they just said "no" to everything. A prerequisite to having public utilities in private ownership is experienced regulators and a robust supporting legal framework. The British predecessor of Continental smartly recognized that this was absent and fled, saving itself the money that Continental lost.

Well, the dog chased and caught the car – now what does he do with it?

Phase III - Life under state ownership

The rate-making process for these three undertakings thereupon became solely the province of government decree and investment funds had to be sourced from overseas Exim Banks and multilaterals for a while as debts since no private capital was forthcoming, unsurprisingly. Political appointees were installed as board members and there were "jobs for the boys" of course. Private sector monopolies had been converted to public ones and service declined even as rates went up. Profits, if any every now and then, were deployed to other arms of government either as dividends or cross-subsidies but often the government had to directly subsidize losses of the utilities in cash. Jamaica fell into the typical trap that state-owned utilities inevitably find themselves: the state owned water entity, street lighting authorities and other government customers (even ministries) do not pay the state owned electric supplier which therefore does not pay the state-owned fuel supplier or pay over its payroll withholding taxes, so massive "funny money" receivables and payables (un-monetized cross-subsidies) were carried on the balance sheets of zombie enterprises and government departments in a very inflationary way (as that is equivalent to printing money).

With devaluations, asset replacement costs and debt service costs escalated and new investment was inadequate since local currency rate increases lagged behind cost increases and were politically set. Government had no foreign exchange and no private capital would get near to Jamaican utilities so service levels declined.

Like all politically imposed price controls the protected "goods" (through artificially low rates for the utility services) were not actually available. One had to wait years to get a telephone - many gratefully settled for "party lines" (shared service) if they were lucky or "knew someone". There were frequent electricity outages and the widespread "stealing-of-electricity-is-ok" culture was established and entrenched as politicians winked at the practice. After all, nobody owned it so nobody cared.

The investment climate generally and for utilities in particular was very poor until reforms began in the 1980s including privatizations of NCB and the Cement Company but investors were still very wary of Jamaica, so the utility privatization terms were not as good as they could otherwise have been.

Phase IV - Telephone reprivatization

Deepening and broadening of the capital market objective

In 1988 the telephone system was the first utility to be reprivatized. A good feature was that a public share offering was part of the transaction. The transaction took place contemporaneously with the arrival of Hurricane Gilbert and underwriters had to take up shares that could not be placed in the normal way, so the share had an unfortunate start. Nevertheless the transaction did happen and Cable & Wireless replaced the government as the controlling shareholder, gaining a long-term private monopoly franchise. The rate setting regime had to be made very clear and very simple and automatic this time (a guaranteed return on audited balance sheet equity with assets being valued at replacement cost) and timely since objections to the calculations had to be lodged in a specific time frame. It was overly generous in hindsight , but it was needed to regain credibility. The objective of deepening and broadening the capital market was furthered as there were some thousands of private individual shareholders (despite the hampering hurricane) including employees, individual investors, local institutions and pension schemes.

Improving the efficiency of the economy

Monopoly granted

The bad aspect of the transaction was that a long-term monopoly concession was demanded and given and this hampered the rate of expansion of the supply although there was huge investment in the system - and efficiency gains were indeed brought about in the early years following 1988. The thinking was that in order to have an investor massively expand the system (and to avoid the need for duplicating the poles, cabling and exchanges), then a monopoly had to be granted. At the time new technologies (like cellular service) were only nascent - cellular phones did not become available to the public until 1991 in the USA, three years after this privatization. The argument for granting the monopoly was very much the same as the one put forward in 1892 as quoted above. After a while an overpriced and poor cellular service was grudgingly introduced by Cable & Wireless with capacity limits that made one feel privileged to get connected.

Monopoly broken by Paulwell

However, there emerged a superhero in the person of then Minister Mr. Philip Paulwell who skillfully used Caribbean political alliances to negotiate the breaking of the Cable & Wireless monopoly to allow competition in the sector. Massive equity investments were made by the newly admitted operators (as well as the now fearful incumbent) and service improved dramatically at newly affordable rates. Jamaica moved from being one of the worst served populations in the world in telecoms to one of the best. The economic efficiency gains from voice communications alone may not have been formally quantified but are obvious in terms of expensive trips avoided, now by the even poorest echelons who needed that gain the most, for example. Widespread data services became available to everyone, not just to an elite. There was no longer a need for a regulator to set rates to be charged to end users as competition ensured their reasonableness. This breaking of the monopoly and overturning of the guaranteed rates of return did not benefit the share price of TOJ of course.

The macro steps in this subsector have been taken and fine tuning initiatives are now taking place, like number portability.

Phase V - Electricity reprivatization

Has the great telecom success story been replicated for other utilities? Certainly not so far for JPS. There have been no dramatic efficiency gains or the introduction of meaningful competition nor has there been any beneficial effect on the local capital market, so far – but is there a way for this to still happen?

Staying with chronology, the Office of Utilities Regulation was established in 1997 and was given jurisdiction over transport, electricity, water and telecommunications in terms of rates and standards. The OUR also makes recommendations to the Minister about the licensing of service providers. It has been staffed with professionals and more removed from political interference than the previous arrangements. The OUR is funded bythe entities it regulates and better able to pay adequate salaries so that there is sufficient expertise. However the Fair Trading Commission has not yet taken on the role of ensuring that transactions like mergers do not have unacceptable effects on competition (though surely it has had enough time to develop that capability and the legal framework). Care must be taken to ensure that the roles of the OUR and the FTC are not duplicated or confused, going forward.

The opportunity to democratize ownership in JPS is still available

Starting with the capital market aspect, the two recent privatizations of JPS have been opaque one-on-one deals between the government and the investors and in one case there was no competitive bidding. Having said that, I do sympathise with our negotiators who were trying to sell a dismal asset with a dismal history and uncertain prospects. As in the case of the telecom deal with Cable & Wireless in 1988 there was a large credibility problem because of the antics of governments decades before.

The opportunity

Government has retained a 19.9% share in JPS and this presents a heaven-sent IPO opportunity that would have many spinoff benefits. If there are competent regulators government need not own the shares in protections of the public. Indeed the capital tied up just carries a heavy cost as like everything else it is essentially using borrowed money.

Modelled on the NCB, Caribbean Cement and TOJ privatizations, free and discounted shares can be made available to customers and employees up to specified limits and preferential allocation at full price if there is an oversubscription. Since JPS has about 610,000 customers on the books this is the best opportunity to dramatically increase the number of persons who could own a direct stake in the formal economy. The NCB privatization in 1986, thought to be dramatic in this respect, raised 35,000 applications and was hailed as “Jamaica’s Big Bang” by Gleaner columnist Basil Buck. This JPS opportunity would be nearly 20 times the size in terms of democratisation!

The impact

The way I envisage the transaction is this: if JPS is crudely valued at (say) 6x EBITDA the government's 19.9% stake (4,343,810,854 shares) is worth J$13.7 billion. If it allowed each employee 5,000, and each customer 1,000, free and discounted shares, the discount would reduce the proceeds by a maximum of just J$1.7 billion, still netting J$12 billion for the fiscal budget. The market capitalization of the Jamaica Stock Exchange would increase by J$13.7 billion and help place it on the map. If instead the company was valued at net book value then the proceeds would be about 70% of the above numbers. If this IPO would be too large for the local market to take up at one bite then payment could be by installments similar to the UK privatizations in the 1980s.

Keeping investment funds here

Long term financial institutions like life insurance companies and pension schemes, as well as mutual funds, which take in huge sums of money from savers that must be invested every month, would find a welcome way to diversify their portfolios without having to seek out foreign investment to that extent.

Policy authority exists

On page 26 of the 2012 GOJ privatization policy document the door appears to be open for an IPO though the wording is not very clear, as follows:

> "Where a minority stake is held in a publicly traded company as part of a general investment portfolio, then the shares may be listed with a securities firm or firms as determined by the Board of Directors of the agency or Ministry."

JPS is "a publicly traded company" as several series of preference shares are listed on the Jamaica Stock Exchange though its ordinary shares are not listed.

Reality check

But here is the reality check: The Minister has stated that he is determined to revamp the industry structure and, whilst we should all hope that he will be able to introduce a meaningfully competitive framework, the JPS business model would be significantly impacted - so in protection of the new shareholders it would be best not to do an IPO until after the dust settles on that issue, which is discussed below.

Competition opportunities

How can the provision of electricity in Jamaica be made competitive? It's difficult, even though perhaps now theoretically legally possible (I did not say feasible) despite the exclusive license that has been issued to JPS.

Without more, IPPs are not the answer

At present there are independent power providers that sell electricity to the JPS grid but this does not result in a competitive situation as the transmission and distribution networks, both owned by JPS, is the only possible customer at present - and it owns the vast majority of the generating capacity as well and is allowed to bid on new generating projects until 2028.

In an ideal world, if a transmission entity were to be owned separately from the generation and distribution entities, the entire landscape could be changed. The transmission grid could decide from which generators to buy power at different times depending on quoted prices. Local distribution companies, true natural monopolies, would buy from the grid with each having one or more service area monopolies and sell at rates agreed with regulators. However, large end users like hotels and industrial enterprises could have direct deals with generators who would pay a fee to the transmission company for wheeling that power through the grid and this would provide some competition at the distribution level. This is more or less the system that operates in the UK but it is undergoing refinement now to cater to the objective of encouraging more renewable energy generation.

Validity of JPS all-island monopoly license

In January 2015 the Jamaican Court of Appeal seems to have concluded that, although the license held by JPS giving it the exclusive right to transmit, distribute and supply throughout Jamaica that expires in 2028 was within the Minister's authority to issue, that fact does not fetter the Minister's duty to consider other applications to transmit energy in Jamaica and cannot fetter him from issuing other licenses. On the assumption that other transmission and distribution entities can be licensed then competition is theoretically possible. However JPS' investors would probably have a "suable" grievance as the basis on which the investment was made would have been altered to JPS' detriment - so it may not be feasible. I'm sure it can be negotiated and from experience I can say that if one is in a deal with the government or anyone else that is unbalanced, "something's gotta give" and reason will prevail if "win-win" is the objective of mature, good faith, negotiators .

Since the license is valid, how can competition be introduced?

Unbundling transmission

What is needed for true competition is for JPS to divest either its generating capacity or its transmission system, but the Minister probably does not have the power to force unbundling. The present feeling by some is that unbundling would become automatic over time if new generating capacity owned other than by JPS was gradually increasing, but, unfortunately, JPS has the right to bid on new capacity until 2028 and, given the synergistic benefits, JPS is in a better position to provide better financial bids than others and this may be why it has been difficult to attract high quality bids to date..

Is there then a prospect that there could be other investment in transmission to introduce at least a degree of competition? Right now the opportunity might lie in the fact that the tourism dependent North Coast and the North-South corridor in the West is not well served, causing costly consequences to customers with equipment because of brownouts. An upgraded transmission grid with distributed generation is needed and the latter should be a condition for whoever does the (what can be required by the OUR under the license) upgrade or replacement of the transmission in that area. If JPS declines to do it then a new investor can be sought and that could be the breakthrough. This could be put to the test. The country cannot wait until 2028.

Renewable energy and by-product suppliers

The policy difficulty here is to mandate the price at which electricity is sold to the system by those who generate excess power for their own needs and the new renewable suppliers like solar and wind. If JPS must pay at the same price at which it charges customers (so-called "net metering") this would not be fair to JPS since its billing price includes the recovery of the cost of the transmission and distribution system it paid for. If JPS will only pay at the equivalent of the avoided raw generating cost that price will not encourage renewable energy projects as they are thereby more exposed to the vagaries of the cost of oil than under net metering.

A solution suggested by Zia Main is that the difference should be subsidized for a transitional period for sustainable power generators and, just my idea, that could be one of the features of the US assistance mentioned by President Obama on his recent visit to Jamaica. I don't like artificiality or subsidies but there could be a mechanism like a contingency fund built up from the difference between net metering and avoided cost funded by the Obama initiative that is drawn upon when fuel price levels render avoided cost less than the cost of producing sustainable energy. At the end of the day the sustainable energy production costs must be below the avoidable cost of traditional generation and that could be so if carbon reduction rewards also come into the equation.

Phase VI - Water privatization

A January 2013 Gleaner editorial contained a strident plea for NWC to be privatized. To my certain knowledge this has been considered for decades and been the subject of many studies. None of these studies has advocated "full privatization" but rather the recommendations have been to outsource various discrete functions or general functions in small areas.

The stark fact is that only 20% of the water produced is billed! Of the total potable pipe network, 75 per cent is 50 years and older with the result that water loss due to leakage is estimated at approximately two billion gallons per month or 50 per cent of non-revenue water (NRW). To produce water, much electricity is needed and the cost to NWC of this is J$500 million per month – so pumping water that leaks costs J$200 million per month and other NRW costs another J$200 million per month, a total waste of nearly J$5 billion per year. Much of that cost, being fuel, is in foreign exchange. NRW cannot be zero, however, and the regional benchmark is 35%.

In the 2014 financial year NWC lost J$10 billion in a comprehensive profit and loss sense (but it did have a positive cash flow from operations as some profit and loss charges like unrealsied devaluation losses , depreciation and pension obligations were non-cash items). Indications are that the loss for the latest year ended 31 March 2015 will have been halved, and that is indeed laudable. The NWC could return net profits in the region of J$10 billion dollars per year if NRW is reduced island wide by 50 per cent (after making allowances for "social water") – that would bring us to the regional benchmark. That would be a turnaround of J$15 billion. I believe this is true after cross examining my sources.

A contract for the reduction of NRW in Kingston and St. Andrew was recently approved which should result in the reduction in losses and potentially increase revenue in the largest area supplied by the NWC supply.

Given the financial performance and risk that the projections may not come to pass, private investment simply could not be attracted in a full NWC privatization scenario. But even if NWC was returning a lofty profit I still doubt that it would be possible to attract investment – if good profits were made there would be intense political pressure to reduce rates – even more than there is in respect of electricity.

To quote from Privatisation Of Water: A Historical Perspective (a 235 page paper by Naren Prasad):

> "Are there industries that should not be privatised? The answer is yes because certain government services (like national defense, judicial systems, basic welfare services) are best left with the state. Megginson (another author) recognises that there is one industry where not only privatisation has proved difficult but also the argument of increasing welfare has been more than ambiguous. That is water and sewerage provision.
>
> "It is recognised (by the World Bank and United Nations) that it is extremely difficult to operate a water service profitably and at the same time provide affordable services to all consumers. The multinational companies have had murky experiences in developing countries because of the large capital investments required to maintain the infrastructure.
>
> "…it is generally recognised that after two decades of involving private sector in water and sanitation there are increasing popular protests, dissatisfied governments and investors. The private sector has been withdrawing from the sector and is only interested when the risks are limited (e.g. management contract, leases). As a result, the World Bank started giving investment loans to public operators but emphasises the need for financial sustainability. In other words, it pressures public companies to operate on

> commercial basis which at least covers its costs and where the prices are set by an independent regulator which is not embedded into the daily politics.
>
> "...financing water facilities is unappealing to private investors for reasons such as the 'lumpiness' of necessary investments, payback periods of 20 years or more, and the political difficulties inherent in charging and collecting cost-recovering tariffs. In this case, there is no need to be over optimistic that the private sector will solve the water problem. We caution that even in the best circumstances, PSP cannot replace provision and in some cases, the public sector should be enhanced and given resources.

The thrust of efforts to improve the performance of the NWC (apart from reducing NRW) must be to make it more independent of political interference through strong legislation, including it having a corporate structure with governance, accountability and transparency features similar to what is required under the Companies Act, to promote commercialization. In terms of commercialization, an improvement is that the OUR established cost-based tariffs within the regulatory framework which sets out targets, standards and reporting requirements.

Although full privatization is not feasible given the financial prospects, there are opportunities for the private sector to be in the financing and operating of water treatment plants and waste water treatment plants through Private Public Sector Partnerships (PPP) and Build, Own, Operate and Transfer (BOOT) arrangements. My information is that:

- A proposal was made by NWC for PPPs for water and waste water treatment projects as well as the laying of sewage mains in the corporate area totaling approximately J$ 23 billion.
- After several meetings NWC received firm interest from a number of named major local financial institutions which would form concessionaire companies to undertake a number of the projects.
- The Ministry of Finance advised that the model proposed would need to be adjusted so that the private investors would take the revenue/collection risk so that there was no contingent liability of the government.
- PricewaterhouseCoopers (not my source of any information herein) was engaged as consultants to refine the model and seems to have found a solution. That report has been received but may be on ice.

NWC's objective is to undertake expansion without continuing to borrow (in foreign exchange) from multi-lateral institutions, especially as NWC's revenues are in Jamaican dollars. All aspects of the proposed PPP transaction would be in Jamaican dollars and the characteristic of the investment would be equity and not debt finance, with the advantages pointed out earlier in this article.

Conclusions

- The GOJ's 2012 privatization policy is adequate though there should be requirements to include an element of a public offer and stock exchange listing for large enterprises with moderate risk.
- The regulatory system for utilities is conducive to privatization and the legal framework is developing well. This advance must not be allowed to slip away and revert to the pre OUR days. The Fair Trading Commission needs to develop further however.
- In the case of telecoms, privatization has been successful in terms of providing efficiency gains and widening share ownership and there is nothing fundamental left to be done in that subsector and improvements now will be at the margin.
- The privatization of electricity has not promoted competition nor has it resulted in the democratization of ownership. Both will be very difficult to achieve until after 2028 when the JPS license expires, but it must be done before.
- Water is unlikely to ever be privatized in full but it needs to be commercialized and further removed from political interference. The management has been seeking ways to have the local private sector finance new projects but has the initiative died on the vine?

The author, Richard Downer, CD, FCA, has been an advisor to the governments of 16 countries on utility privatization strategy and transactions and was in charge of several large scale privatizations in Jamaica. He may be reached at: rldowner@hotmail.com