

INFRASTRUCTURE DEVELOPMENT FINANCING

THE PPP CONCEPT

Delivered By Amr Kamel

1. INTRODUCTION

It is a privilege for Afreximbank to be invited to address this high level Forum on Agricultural financing in Africa which is being hosted in Libreville, the Republic of Gabon. I wish to express our gratitude to the organizers, the government and people of Gabon and the Inter African Coffee Organization (IACO) for hosting this important conference at this important time.

The world is going through a very turbulent period with problems in the financial sector which have not been witnessed at this scale for at least 70 years since the time of the Great Depression. There is widespread agreement that the repercussions for the world are going to be a tightening of credit and a strong possibility for a global recession. The implications for Africa will be less availability of credit - which translates into less funds for development - at a time when massive investments are needed in infrastructure as it provides the foundation for a well oiled modern economy and is positively correlated with aggregate agricultural growth; hence the need for innovative and non-traditional approaches to financing infrastructure projects.

A technique which has proven successful in many parts of the world is Public Private Participation (PPP). During this session we aim at outlining the correlation between agricultural growth and infrastructure development; the major problems facing PPP in Africa; as well as reviewing the various forms of PPP and how this technique can be improved to encourage investment in Africa.

2. WHAT IS PROJECT FINANCE

Project Finance is defined as financing of a project in which the lenders look principally to the cash flow generated by the operation of the project for the source of funds from which the loan will be repaid. Project finance is also referred to as limited or non-recourse lending where the general credit worthiness of the project sponsor is usually not a significant factor, either because it is an entity without other assets, or because the financing is without direct recourse to the sponsors. It is usually the most suitable means of financing infrastructure projects.

3. CORRELATION BETWEEN AGRICULTURAL GROWTH AND INFRASTRUCTURE DEVELOPMENT

The significance of agricultural production in the economy is high in Sub-Saharan Africa. In that region 12 out of 36 countries whose data are available have agricultural shares of GDP greater than 30 percent and agricultural contribution to total exports greater than 10 percent; whereas this magnitude of agriculture contribution to GDP is not achieved for any country in other regions. It means that agricultural sector development remains crucial for growth in Africa.

It is natural to expect that aggregate agricultural growth is positively related to infrastructure development. However, it is questionable what type of infrastructures need developing to promote agricultural production and competitiveness. For example, it can be shown that infrastructures would influence coffee and dairy production differently, and different infrastructure services have to be improved to accelerate agricultural growth.

Infrastructure stocks have normally been found conducive to economic development because infrastructure improvements could reduce transportation and transaction costs for producers. Without effective access to the input and output markets, agriculture production could not be viable.

A study by the World Bank demonstrated that in some African countries, a 1 percent improvement in key aspects of infrastructure could raise GDP by about 0.1 - 0.4 percent, and by possibly by several percent in some cases.

Infrastructure that farmers indirectly rely on differs from commodity to commodity. If inputs and outputs are mass-transported, railways may be an essential infrastructure. If a modern system of “factory farming,” which requires various inputs and agricultural machinery, is adopted, production efficiency would be affected by electricity and water supply infrastructure. If informational market access is important for effective production and export purposes, a telecommunications network is essential. Complementarity between types of infrastructure is also important to achieve the full growth potential of agricultural development. A large investment in irrigation without roads does not make sense if roads are essential for access to the market.

4. PROBLEMS FACING INFRASTRUCTURE PROJECTS IN AFRICA

Infrastructure projects in Africa are typically medium in size, short term in nature, and dependent on official support.

Sub-Saharan Africa receives only a small share of private investment in infrastructure. One reason for this is its difficulties in getting project finance—difficulties that stem from the weak creditworthiness of most African countries, the limits of local financial markets, and the risk profiles typical of infrastructure projects. Whether the region can attract more private foreign currency funding for infrastructure will depend in part on the ability to reduce foreign exchange and other related country risks (political, legal, regulatory, credible off-takers, ...etc.). But in some countries local currency sources, especially local capital markets, also offer good potential.

Three related sets of factors limit Africa's ability to tap both foreign and local currency markets to raise private finance for infrastructure, especially long-term debt finance.

First, most African countries have low or nonexistent sovereign credit ratings; a key impediment to providing relatively broad access to financial markets. The countries that have obtained (or have an estimated) foreign currency debt rating of at least BB- represent only 43 percent of regional gross national income (GNI)—and this share is dominated by South Africa. In all other developing regions the share

would be more than two-thirds of regional GNI, and in East Asia and Pacific, close to 100 percent.

For most African countries foreign commercial lending is therefore difficult to access and typically limited to short-term transactions. The ability of infrastructure projects to tap long-term foreign currency lending has depended on a mix of factors that mitigate risk. These include the ability to generate foreign currency revenues and strong support by official (bilateral or multilateral) agencies. Economic links to South Africa (through exports or through ownership by South African investors) also usually help, because they create opportunities to tap that country's sophisticated financial markets.

Second, most local financial markets have limited capacity to finance infrastructure projects. Only South Africa has domestic banks and a local capital market capable of consistently providing local currency financing for infrastructure projects on suitable terms and in significant amounts. In virtually all other African countries local long-term financing has been limited, and infrastructure projects have needed substantial credit enhancement (for example, through guarantees), provided mostly by official agencies, to attract local currency debt.

Third, features typical of infrastructure projects raise the risk of investments. Compared with projects in many other sectors, those in infrastructure tend to have longer payback and build-out periods and to be more susceptible to political and regulatory interference, which increases the regulatory risk such investments may be facing.

Together, **these factors have helped shape the characteristics of infrastructure projects with private participation in Africa:** The projects have typically been small relative to those in other regions, and many have been financed entirely with equity. Projects with economics permitting faster payback and shorter-term debt (such as telecommunications) have tended to be favored over those with long payback periods and requiring long-term financing to offer services at an affordable price (such as toll roads), and projects have often depended crucially on support by official agencies.

With governments facing chronic budget constraints and increased demand for the expansion of infrastructure and public services, the private sector can help increase infrastructure investments, especially for large projects, while reducing the budgetary and fiscal constraints

on governments. The private sector can also provide governments with a source of revenue through user charges, enabling them to concentrate their limited resources on social sectors, including education, health and rural services.

The private sector can help improve efficiency, innovation and managerial capabilities, which can lead to reduced tariffs for consumers and improved quality of services.

5. THE PPP MODEL

- Public-Private Partnership is a collaboration between the Public Sector and the Private Sector working in co-operation and partnership to provide infrastructure and services. It is one of a range of alternative structures that fall between conventional procurement through state ownership at one end of the continuum and full privatization at the other, usually for the construction and/or management of a specific asset or a group of assets. Its benefits are that it:
 - Helps to assign risk to the partner best equipped to deal with it.
 - Helps to secure specialist skills and experience not readily available in the Public Sector, for public interest projects.
 - Enables Public Sector funds to be used for other programs, where private sector financing is part of the PPP package.
- Various Models of PPP exist, namely:
 - Concessions – transfers the rights to develop and operate defined assets, within a defined area, over a defined term
 - Other PPP models include BOO (Build, Operate & Own), BOT (Build, Operate & Transfer), BOOT (Build, Operate, Own & Transfer), DBFO (Design, Build, Finance & Operate), DBFOT (Design, Build, Finance, Operate & Transfer).
 - They should not be confused with “privatization”, which involves a transfer of ownership of the assets

- PPPs are common in asset intensive and/or Utility type industries, eg, Roads, Water, Power, Airports

6. WHAT CAN BE DONE TO IMPROVE PPP'S IN AFRICA?

- Conduct a thorough needs analysis of infrastructure and basic services and consider all the options to meet these needs. (Government)
- Carry out a thorough feasibility study that: (a renowned consultancy firm in the selected infrastructure field):
 - compares public sector provision with private sector provision and that takes into account affordability, value for money and risk transfer;
 - considers the rate of return on equity acceptable to both parties;
 - uses accurate information in its calculations and projections ;
 - avoids unnecessarily high design specifications;
 - considers all the financing options before committing to one model ;
 - involves all the necessary stakeholders;
 - identifies all the risks of a particular project, allocates particular parties and devises risk mitigation strategies; and
 - requires treasury approvals at key stages of the project preparation process.
- Work out a multi-year budget framework to assess the affordability of projects for specific government institutions. (Consultant)
- Address the issue of cost recovery and how infrastructure is to be financed.
- Encourage competition to drive innovation and bring down prices. (Government)
- Build effective regulation by: (Government)

- Developing transparent, credible and effective regulatory agencies that are adapted to the specific needs of the country; and
 - In the absence of effective regulatory agencies, creating a department within the relevant ministry Independent and has sufficient resources.
- Provide political guarantees to investors where appropriate. (Government)
- Develop capacity at national, provincial and municipal level by: (Government)
 - sharing expertise and experiences with other governments and government departments;
 - creating a PPP ministry or National Treasury to plan, negotiate, implement and monitor PPPs;
 - establishing PPP Facilitation Units in national and regional Development Finance Institutions (DFIs); and
 - developing good transaction skills (legal, financial, negotiation and industry specific skills) in the relevant government institutions.
- Root out corruption by: (Government)
 - Implementing mechanisms to guarantee transparency at all stages in the tendering process. These mechanisms must include setting procurement specifications, open public hearings for major government contracts, and the final selection of contractors; and
 - Involving independent agencies to oversee the bidding process and commit government and private bidders to an integrity pact.
- Pre-empt public complaint and suspicion by: (Government with good private advertising support)
 - preparing the ground for private structural reforms and raising tariffs to approach cost recovery levels (where appropriate);
 - communicating decisions around privatization and PPPs to the public to build on;

- providing policy clarity in the areas of free basic services in concession areas;
 - considering the extent to which a project or particular bidder will contribute to the local society;
 - assessing the political commitment to a particular project from government institutions.
- Provide a range of service options by:
 - Considering multi utility provision in areas where cross subsidization makes economic sense and will lead to cost savings for consumers
 - encouraging small-scale operators in underserved areas; and providing appropriate, affordable alternatives for poor and underserved consumers.
- Define the investment obligations of the private sector. (Government)
- Provide incentives and penalties for network extension (or lack thereof). (Government)
- Enter into management contracts with an emphasis on the transfer of skills to local staff. (Government)
- Form partnerships with experienced private operators with proven track records. (Selected investor)
- Include criteria for partnerships with and subcontracting of local firms in evaluating bids. (Selected investor)
- Develop an approach for dealing with unsolicited bids.
- Consider all the labor issues and address the opposition from Labor Unions. (Government)
- Conduct country-specific reviews of the Institutional and legal environment for PPPs. (Government + selected investor)

7. COMPARISON BETWEEN PP, PPP AND FULL PRIVATISATION

| | Public Procurement | PPP | Full privatization |
|----------------------|---|---|---|
| Definition | <ul style="list-style-type: none"> • Supply by the private sector of works, goods or service as defined by the public authority. | <ul style="list-style-type: none"> • PPPs introduce private sector efficiencies into public service by means of a long-term contractual arrangement. They secure all or part of the public service, call upon private funding and private sector know-how. | <ul style="list-style-type: none"> • Privatization means transferring a public service or facility to the private sector, usually with ownership, for it to be managed in accordance with market forces and within a defined framework. |
| Main features | <ul style="list-style-type: none"> • Contracting authority establishes clearly what is to be built, how and by what means. • Invitations to tenders are accompanied by very detailed technical specifications regarding the type of work being procured. • Price quote is the single most important criterion in the evaluation of bids. • The procurement process is short-term in nature and does not involve long-term occupancy of infrastructure assets, and thus does not lay emphasis on the operational phase of the project. | <ul style="list-style-type: none"> • Contracting authority establishes the specifications of a project and leaves to the private sector the responsibility of proposing the best solution, subject to certain requirements. • Price is one of the many criteria in the evaluation of bids. A lot of emphasis is on the technical and financial capability of the bidder, financial arrangements proposed, and the reliability of technical solutions used. • Given the long duration of the concession period, emphasis is on the arrangements proposed for the operational phase. | <ul style="list-style-type: none"> • Privatization authority prepares the divestment plan. • Involves transfer of ownership to the private sector. • Is generally a complex transaction with carefully designed contracts and a multi-stage competitive tender process. • Generally, the public sector withdraws from management of the entity on privatization. • Almost all risks are borne by the private sector. |

As the table illustrates, the criteria used to choose the private partner for PPPs are more complex than just who offers the best price and who conforms to the technical specifications. PPPs emphasize the actual delivery phase of the project, such as the provision of water and sanitation services, or the operation and maintenance of a hospital. Under a simple tender, government bears the responsibility for specifying exactly what is needed. PPPs envision a more open relationship in which business is encouraged to propose alternatives rather than blindly providing what is demanded. The private operator will often need to design the best solution according to the government's specifications, offer technical expertise and provide viable financial arrangements for the project, and to bear the associated operational risks.

In practice, privatizations of public utilities – particularly monopolies – usually occur within a regulatory environment that can impose detailed service and investment obligations, such as rollout schedules to rural areas or price caps for poor consumers. Many privatizations have run into controversy because governments failed to set up a strong regulator to control prices and to require companies to extend services in poor areas.

In response, many public utility deals are being recast as PPPs with much greater emphasis on defining precisely how prices can be changed and what services companies are required to provide in poor areas.

The consistent failure of African governments to provide adequate services to their people is well documented and not easily remedied. Governments simply lack the money and resources to maintain and extend existing infrastructure, and they also lack the incentive to do so.

However, private participation by itself will not solve the region's infrastructure investment problems. To succeed, private participation in infrastructure requires fiscal reform and improvements in public sector management. It also requires careful attention to the basics of project design, including identifying and allocating risk and ensuring sound procurement practices. Developing successful projects requires some things in short supply in the developing world – time, money, and sophisticated skills.

Moreover, private participation does not always work well in every infrastructure sector or every developing country. Even if projects are well designed and essential reforms implemented, meeting Africa's infrastructure development challenges will also require substantial increases in government budgetary allocations and official development assistance.

8. CONCLUSION

In theory, PPPs may have the potential to solve sub-Saharan Africa's profound infrastructure and service backlogs, where nearly 600 million people lack access to electricity, almost 300 million have no access to safe water.

PPPs potentially bring the efficiency of business to public service delivery and avoid the politically contentious aspects of full privatization. PPPs allow governments to retain ownership while contracting the private sector to perform a specific function such as building, maintaining and operating infrastructure like roads and ports, or providing basic services like water and electricity.

But there are several negatives as well. The private sector is not always more efficient and the service provision is often more expensive to the consumer. Big government contracts are complex and demanding and prone to abuse by unscrupulous individuals, firms or politicians, unless controlled by disciplined, highly transparent procedures.

This review of PPPs suggests that, above all, governments must fundamentally improve their systems for dealing with the private sector to realize the efficiency and effectiveness gains that these partnerships promise.

Case studies have shown that those partnerships that have been most successful in Africa have been characterized by thorough planning, good communication, strong commitment from both parties and effective monitoring, regulation and enforcement by government. The issue of pricing is crucial both to avoid political fall-out and to ensure the viability of the contract for business.

Countries entering into PPPs must recognize that they will require professional contract drafting and monitoring skills. States should first

start with small PPPs, such as building and maintaining government offices, to learn and develop the ability to work more effectively with larger PPPs.

Agricultural development is one of the key for growth in Africa. Agricultural production could be promoted by different infrastructures, depending on commodity. Complementarity between types of infrastructure is also important to achieve the full growth potential of agricultural development. Roads and irrigation facilities could strengthen production efficiency in the coffee and cocoa industries. Telecommunications infrastructures are also important for branding these commodities. Conversely, dairy production requires more water in rural areas. One of the policy implications is that African countries might have to invest more in communication technologies as well as water and transport infrastructures to improve their agricultural marketing competitiveness.

Finally, overall PPP is considered a reasonable Infrastructure solution for Africa. Their successful implementation is complex and challenging, but with appropriate monitoring and evaluation, these partnerships can operate a business which will deliver a service to its community successfully to the benefit of both the Public and Private sectors.

9. CLOSE

I would like to close by providing a brief introduction about the African Export-Import Bank, its establishment and its mandate.

Establishment

- Established in 1993 as a multilateral financial institution.
- Shareholders include African governments, African private investors and non-African investors.
- Authorized capital = US\$750 million.
- Headquartered in Egypt with Branch offices in Abuja, Harare and Tunis.
- Cumulative credit approvals since 1994/95 to 2006 amounted to US\$10.2 billion.

- Return on Equity in excess of 10%.

Mandate

The Mandate of the Bank is to finance and promote Intra- and Extra-African Trade using three broad services

- Credit (Trade and Project Financing)
- Risk Bearing (Guarantees and Credit Insurance)
- Trade Information and Advisory Services

We are Award Winners in Structured Deals

- In 2005, the Bank won the Euromoney Project Finance Magazine Deal of the Year Award for Telecoms in the Europe, Middle East and Africa Category
- The Bank also won Africa Investor Award for “Excellence in Implementing an Africa Diaspora Programme”
- The Bank just won the Trade Finance Magazine “Deal of the year (2007)” Award for a US\$70 million Oil Service Transaction it syndicated.

Despite being primarily a trade finance institution, during the Bank’s 14 years of operations, it has continuously strived to identify and develop infrastructure related projects using advanced and innovative financing structures. This is due to its conviction that to successfully promote trade and agricultural development, one of the necessary conditions is having in place an efficient infrastructure. Here is a brief list of some infrastructure deals which we supported through origination and/or participation:

- USD 20 million granted to Ibom Power (Nigeria) which was a public company that was privatized.
- USD 135 million Syndicated Facility granted to Intels Nigeria (AFREXIMBANK was the Mandated Lead Arranger).
- USD 50 million facility for a national airline carrier in West Africa (Co-Arranged by AFREXIMBANK).
- USD 100 million facility granted to V- Mobile, which became Celtel and is now ZAIN (AFREXIMBANK was Mandated Lead

- USD 120 million bridge finance granted to the power generator AES Nigeria (AFREXIMBANK was Mandated Lead Arranger).
- USD 25 million Syndication favoring Telecom Liberia (AFREXIMBANK was Mandated Lead Arranger).
- USD 120 Million Syndicated Receivables Backed Term Loan in favor of Zambia Electricity Supply Corporation (ZESCO).
- USD 100 million Syndicated Telecommunication Services Financing facility favoring contractors and suppliers of telephone services in Nigeria.
- USD 100 million facility for Lonestar (AFREXIMBANK was Mandated Lead Arranger). The Bank was awarded the 2006 Trade Finance Deal of the Year.
- USD 36 million Syndication facility to finance construction of a Monorail in Nigeria (AFREXIMBANK was Mandated Lead Arranger).

The above list is not comprehensive as it is meant to demonstrate a cross section of the Bank's involvement with financing infrastructure projects.

AFREXIMBANK will continue to explore avenues to support this critical sector and expand its support to it even further. The Bank sees its involvement within the framework defined by NEPAD which has prioritized infrastructure as both a strong driver of African integration as well as the supporting role it plays in promoting intra African trade.

The Bank has several programmes and facilities targeted towards project finance in general and infrastructure finance in particular; these include:

- Line of Credit Programme
 - Letter of Credit Confirmation and Refinancing Facility
 - Reimbursement Guarantee Facility
- Direct Financing Programme
- Syndications Programme
- Special Risks Programme
 - Country Risk Guarantee Facility
 - Investment Guarantee Facility

- Export Development Scheme
 - Project-Related Financing Programme
 - Guarantee Programme Related to Obtaining Large Contracts
 - Guarantee Programme in Support of African Government Commitments to Project Promoters
 - ECA Loans Facilitation Programme
 - Asset-Based Lending Programme
 - Carbon Financing Programme
 - Country Programme

Finally, I would like to wish all those present here, fruitful deliberations and a successful forum and I am confident that - at its close - we will have all gained better and deeper insights into what can be done towards promotion of food security and poverty alleviation in rural areas.

Thank you.