



Challenges and pitfalls

Public-private partnerships are all the rage, but fraught with difficulties. **Andrée De Serres** outlines a roadmap for Africa that relies on private finance initiatives

The food crisis, the commodities bubble and a population explosion are highlighting the urgent need for Africa to unlock its vast agricultural regions, ease the flow of goods and improve transportation, education and telecom services. This cost is estimated at US \$400 billion. With a population density twice as high as Latin America that could reach 1.4 billion by 2030, the continent is desperate to open the floodgates of capital. Can public-private partnership initiatives (PPPs) offer a fast-track solution? Or could they exacerbate the risk profile of many states and mortgage the future of several generations to come?

As a kind of “big bang” theory for public policy, this new partnership model offers a way to attract massive new

investments. Yet the stakes are simply too critical for Africa to experience at its own cost. Indeed, several industrial countries such as France, the UK, Australia and Canada achieved success in

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a few cases but recorded major failures under the PPP mode. Their taxpayers were charged hundreds of millions, if

not billions, of dollars to experience complex new business models, often depending on a commercial and financial risk-sharing blackbox between the state and its private partners.

Cinderella story

PPPs often sound like real Cinderella stories for governments to: maintain and improve citizens' access to quality public services, such as water, electricity, transportation, health care, education, and telecommunications. They also provide extraordinary leverage by calling upon private capital and offloading new financial charges to off-balance sheet structures. Ultimately, the idea is to reduce overall expenses, stretch out budget capacity, improve sovereign credit rating and reduce sovereign

debt, and to contain the exposure of infrastructure projects to building and operation.

But the reality of PPP is often quite different; commonly because of three key factors that are underestimated: the complexity of allocating risk-return responsibilities between partners; the illusion of being able to freeze financial and business conditions for durations of 10 to 50 years; and the belief that political changes can easily be contained without impairing a project.

This is why public decision-makers need a comprehensive toolbox with a simple control panel to ensure selection of the most effective solutions among various alternative financial models, in accordance with the country's needs, priorities and resources.

Finding the right project

A frequent argument used by international capital markets is that PPPs can circumvent traditional corruption networks by reducing the effect of distortion and introducing arms-length relations with more transparent business conditions. However, PPPs create a different form of distortion by adding another layer of interest – that of PPP sponsors – beyond those of the state and political lobbies.

PPP sponsors seek first and foremost projects liable to capture the economic rent at the lowest potential risk. The package reaps the benefits of long-term revenue stream, partially or entirely guaranteed by the state, offering the status of a quasi-monopoly because of its public service nature and providing tremendous financial leverage to sponsors. Furthermore, there is the added benefit of a “closed shop”, limiting the access to a very small number of investors ready to pay a premium to get in. Those are all benefits escaping the state and its taxpayers.

Private sponsors want projects that involve physical assets offering essential services to end-users. Morgan Stanley claims that PPPs form an asset class by themselves, thanks to their de-correlation from more conventional asset classes such as fixed income instruments and equities, offering unique duration advantages for pension funds. To be attractive and credible, the income flow must be stable, poorly exposed to economic cycles and indexed

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wonder only 4% of world PPPs were implemented on the continent, with a majority in South Africa and focused on telecom, water and electricity.

Capital headaches

A large chunk of non-recourse loans strictly tied to a project's revenue, with a mix of private equity, generally fund PPPs. The challenge is to demonstrate the regularity and reliability of various income sources to amortise the debt and provide enough return on capital. The most obvious of these is rates charged to users. However, the experience of projects using the French concession or affermage (farm-out) contracts, widespread in French-speaking Africa, shows how difficult that can be. Under a public works concession contract, the design, finance, building and operation of a public infrastructure is delegated by the owner to a concessionaire. The state transfers the control of the project, without losing entirely its regulatory powers. If the public service is not delivered according to the original terms, public authorities can intervene and the concessionaire can lose all his rights.

The downside for the concessionaire is to support all business and operational risks, since the service is to be supported entirely by the end-users or the public. The first conclusion to draw from such experiences is that PPP spon-

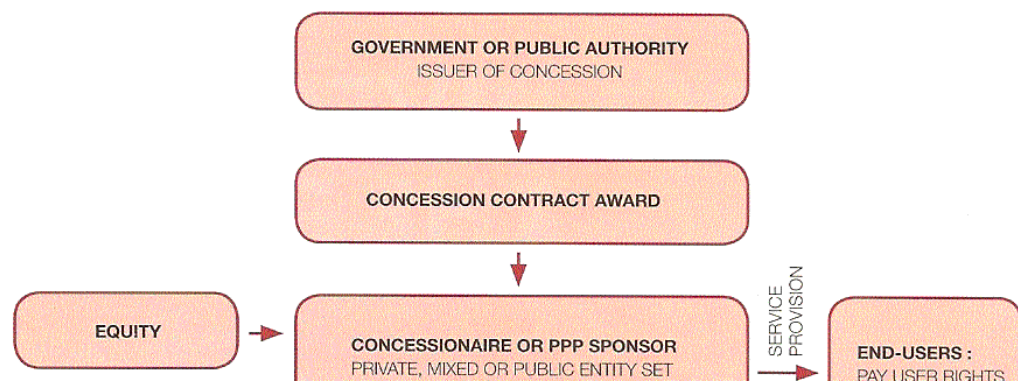
sors generally prefer farm-out agreements, especially in areas of water and electricity, as shown by two large French groups Suez and Veolia. The reason is that such arrangements relieve them from having to fund huge infrastructure projects. They prefer having the state handle those infrastructures or getting other forms of support.

Sponsors and their lenders might be more amenable if other forms of support are provided, such as shadow tolls, investment subsidies, loan guarantees, a price guarantee for raw materials (coal, fuel, cement, or water), or an exit price. Under such conditions, the whole notion of PPP and transfer of risks might be questioned to a point where state commitments may not be considered as off-balance sheet and thus not provide any credit rating relief.

Finding a third way

A third alternative is payments by the government. If there are not enough end-users, if their income is too low to support a minimum threshold of rights or if the service should be made free, the new system of private finance initiatives (PFIs) proposes to have the state pay instead over the life of the services. The PFI novelty is to make bankable commercial as well as non-commercial services such as education, health, and public security. By shifting the government role from producing to purchasing services on a long-term basis from private operators, it frees the state from a debt burden and ensures greater income stability for private sponsors. It gives leeway to the government in how to set concessionary rights for end-users according to its policies. Public payments can be combined with rates charged to end-users, as is often the case for highway, bridge, tunnel and ferryboat projects.

Basic PPP structure



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