

TECHNICAL REPORT

Strategic Alternatives for the ECOWAS New Financial Group (formerly the ECOWAS Fund)



SUBMITTED TO
USAID, West Africa Regional
Program

IN RESPONSE TO
PCE-I-09-98-00016-00

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November, 2001

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Glossary

AsDB	Asian Development Bank
ADB	African Development Bank
ADF	African Development Fund
AIF	Africa Infrastructure Fund
BOO	build-own-and-operate
BOT	build-own-and-transfer
BOO/BOT	BOO or BOT
DBSA	Development Bank of South Africa
EBID	ECOWAS Bank for Investment and Development
ECOWAS	Economic Community of West African States
ENFG	ECOWAS New Financial Group
ERDF	ECOWAS Regional Development Fund
ERIB	ECOWAS Regional Investment Bank
EX-IM	Export Import Bank
GDP	gross domestic product
IDB	Inter-American Development Bank
IFC	International Finance Corporation
IMF	International Monetary Fund
IPP	independent power producer
MBIA	Municipal Bank Insurance Association
MC	member country (in ECOWAS Treaty)
MIF	Multilateral Investment Fund
MIGA	Multilateral Investment Guarantee Agency
MTN	Mobile Telephone Networks
MTNC	Mobile Telephone Networks Cameroon
OPIC	Overseas Private Investment Corporation
PPIAF	Public-Private Infrastructure Advisory Facility
PPP	public-private partnership
PSIDF	private sector infrastructure development fund
RMC	regional member country
SADB	South African Development Bank
SAIF	South Africa Infrastructure Fund
TDA	Trade Development Agency
USAID	U.S. Agency for International Development
WTO	World Trade Organization

Foreword

This paper was prepared by Michel Margueron of Nathan Associates Inc. for USAID's West Africa Regional Program. It offers guidance to the executives of the newly structured fund of the Economic Community of West African States (ECOWAS) and its Board of Governors to help determine new fund policies and strategic alternatives. The restructured fund is referred to as the ECOWAS New Financial Group (ENFG) and comprises the following organizations:

- ECOWAS Bank for Investment and Development (EBID)
- ECOWAS Regional Development Fund (ERDF)
- ECOWAS Regional Investment Bank (ERIB).

In the past, the fund operated at its own pace and more or less with its own resources. To become a leader in the region, ENFG will have to recalibrate the scope of its intervention while excelling in the market niches in which it chooses to operate. Because it will be seeking donors' facilities and possibly private loans and participation, it will have to meet industry returns and liquidity criteria. To qualify for external funding, it will have to use the New Basle Capital Accord as a benchmark for all its activities. And to define its role, it will have to enter into discussions with other international and regional funds.

This paper aims to guide ENFG to these goals by discussing and offering guidance on strategic planning, operational improvements, and financial resource mobilization. It also provides analysis of the development of public-private partnerships (PPP) in the West African region, concluding that these offer great potential to ENFG to be a regulatory adviser, developer, and lender.

Introduction

For the past 25 years, despite differences in ideologies and economic models, 15 governments in the West Africa region have consistently confirmed their determination to integrate the region into an economic, social, and monetary union. For various reasons, progress has been slow. But the commitment remains, and integration is becoming a reality.

BACKGROUND

A treaty signed in 1975 formed the Economic Community of West African States (ECOWAS). The treaty called for an Executive Secretariat in Abuja, Nigeria, to manage political integration and for a fund (ENFG) in Lome, Togo, to

- Provide compensatory financing and other forms of assistance to member states that have experienced losses because of trade liberalization in the ECOWAS region;
- Guarantee foreign investments executed in member states with respect to enterprises established in response to the ECOWAS trade liberalization program;
- Facilitate the mobilization of investment resources in member states of the community; and
- Help to promote investment projects in least-developed member states of the community.

As the policy body, the Executive Secretariat in Abuja benefited from community support for the implementation of converging regional regulatory legislation. But the fund met serious difficulty in mobilizing member state contributions. It took the fund 20 years to receive in two installments about \$85.29 million in paid-in capital. From that amount, about \$26.4 million were allocated to the construction of ECOWAS buildings in Lome and Abuja, and \$20.6 million are still in arrears.

Because of such delays and budgetary allocations, the fund's credibility among the international and regional financial community has suffered. And its activities have been hampered by its statutes and operational procedures, rather than its credit assessment performance. For instance, the fund

- Lacks a policy on asset/liability management, leveraging, or participating out its portfolio.
- Operates as an offshore regional financial institution with no supervision by a specific central bank as a bank of last resort, so creditors have no recourse to shareholders, the member states.
- Suffers from a lack of paid-up capital, which has led to small and inconsistent activities that in turn harm its image in the market.
- Lacks a credit department to balance the recommendations of operation officers, a long-term country strategy, and country and industry concentration ceilings.

- Lacks adequate human resources. Few of the executives have banking experience, because they come from ministries and administrative bodies, and very few are bilingual—even though the fund operates in French, English, and Portuguese.
- Is unprepared to cope with the effects of direct bilateral assistance to ECOWAS members. ECOWAS countries have substantially different resources, cultures, former colonial ties, and directions of trade with England, France, and Portugal. These differences explain why bilateral agencies help a certain country or group of countries rather than others. As bilateral assistance is funneled directly to member countries, the fund is mostly bypassed. So far, the fund has operated mostly on its own with little or no possibility of leveraging itself.

Partly for these reasons, the fund has been unable to mobilize any substantial commercial lines of credit from the financial community unless they have been fully secured. The perception has been that the fund is essentially the financing arm of political and economic undertakings although its portfolio is of relatively good credit quality.

In the mid-1980s, the African Development Bank (ADB) began working with the fund but interrupted its activities because of its own internal financial difficulties. At the same time, offshore bilateral and multilateral assistance was seriously curtailed, in line with the World Bank and International Monetary Fund (IMF) Structural Adjustment Policy (SAP) programs. Lending to the fund would have given resources to member countries that could have hampered the privatization process required under the SAP.

THE FUTURE

With the advent of globalization, the West African region has the opportunity to benefit from its 25-year-old resilient and steadfast will for an economic union. But challenges are significant. The correct policy decisions remain with member governments and the ECOWAS Secretariat, and the fund must rise to the challenge and become competitive, well managed, and forward looking.

Accordingly, the fund's 15 shareholders in West Africa have confirmed the fund's regional purpose and objectives while mandating drastic streamlining and structural realignment. The fund has two competitive advantages:

- Current needs for regional services and infrastructure requirements could easily exhaust government and donor financing, and
- Shareholders/governments provide the fund with preferential ties among all regional regulatory bodies.

To make full use of these advantages, the fund is restructuring itself into three complementary units—a holding company, a commercial investment bank, and a regional development fund offering concessionary terms.

Despite this new financial architecture and renewed financial support from its shareholders, the fund—hereafter called the ECOWAS New Financial Group (ENFG)—is acutely aware that it will be unable to meet daunting regional, municipal, and infrastructure needs alone. It will have to seek new techniques and alliances to make a difference.

The remaining sections of this paper provide guidance on ENFG strategic positioning and strategic options, fundamental requirements for the new structure, long-term policy, and action plans for implementing strategy and project finance training, and guidance on the introduction of new financial vehicles and lending concepts. ECOWAS financial data is provided in Appendix A; a discussion of the build-own-operate (BOO) and build-own-transfer (BOT) concept is provided in Appendix B.

Strategic Positioning

In this era of increasing globalization, ECOWAS can position itself to build enough critical mass to attract investors into the region and demonstrate its commitment to a regulatory environment that fosters economic growth. ENFG should emphasize quality over quantity and take specific actions to improve the regional climate for investment.

QUALITY VERSUS QUANTITY IN THE MARKETPLACE

With its “new corporate structure” and a close working relationship with 15 member administrations, ENFG has the opportunity to become a reliable adviser and a facilitator on most financial, fiscal, and regulatory activities in the region. For instance, the 1975 Treaty establishing ECOWAS granted fiscal exoneration status for all its activities. This means that ENFG has a lower dividend yield requirement than that of private investors. For instance, to achieve the same return on investment, ENFG may require a 5.04-percent yield whereas a private investor might ask for a dividend of 12 percent. In view of its lower dividend requirements, the ENFG could work in conjunction with the private sector in joint venture investment opportunities.

To take advantage of this tax-exempt status, a project development department should be created immediately in the holding. This department would subcontract specific services from offshore companies for the construction of a project. As an equity partner in a project, the department would contract some services that, under its fiscal umbrella, would reduce project costs (e.g., no value-added tax on services rendered, no local tax, and possibly tax exemption for temporary executive talents seconded or hired by the holding). This approach would turn the holding to profitability earlier than otherwise expected.

To justify its presence in such partnerships, ENFG will have to find a specific role and provide new financial instruments to maximize. It should not enter a new venture for the sake of the opportunity. Otherwise, its financial contribution to large projects will remain insignificant if not trivial.

FOSTERING THE PROPER CLIMATE FOR INVESTMENT IN THE REGION

ECOWAS member countries in sub-Saharan Africa account for a mere seven percent of the total build-own-and-operate or build-own-and-transfer (BOO/BOT) partnerships established worldwide since 1984. This low rate of BOO/BOT use is attributable to ignorance of the concept and some bureaucratic bottlenecks in the region. But foreign investors’ ignorance of geography also figures in the low rate of BOO/BOT use. Such ignorance creates a perception of higher country risk than is warranted in most cases. In fact, however, multimillion dollar investments in the mineral or hydrocarbon sectors around the world are rarely hampered by political risks even at the height of

civil unrest; trade activities survive most crises; and companies take political risk guarantees and organize their corporate structures and borrowing patterns to offset political risks.

The region's lack of domestically induced propensity for investment—more than political risk—makes international investment bypass the region. The absence of credit rating agencies throughout Africa, and not just in ECOWAS, makes access to international finance by local borrowers difficult at inception. And the lack of secondary markets in the region eliminates the possibility of an exit policy option—something investors seek if there is any exogenous reason to divest from an investment in the region. ENFG must promote global depositary receipts that are negotiable in all major international markets.

Further, the shallowness of domestic markets and the lack of substantial long-term lending facilities denominated in local currencies prevent substantial private investments. Offshore emerging market funds and insurance companies invest mostly in short-term government obligations.

Why don't U.S. institutional investors invest in the region? In the United States, state regulators supervising U.S. institutional investors rely mostly on credit ratings issued by specialized rating houses such as Moody's to assess offshore investments. Institutional investors fear that state regulators will force them to provide what could be perceived as excessive investment in countries that have been or might be graded "C" or "D." Once a state regulator forces a provision on an institutional investor, U.S. credit agencies may downgrade such investors' ratings, and that downgrading in turn affects their cost for the issuance of commercial paper.

This situation should encourage ENFG to set up a credit-rating agency as a first priority to grade major corporations and joint ventures involved in municipal services to facilitate later issuance of global depositary receipts and foreign investments in the area. Because of local salaries, the agency would be much more in line with what local companies budget for even if the agency is under a foreign management contract with a foreign company.

This action should be joined by the setup of a municipal bond insurance association funded partly by ENFG and domestic insurance companies.

Scope of Strategic Options

This section presents strategic options for ENFG, reviews the successes and difficulties encountered by the various forms of public–private partnership (PPP), references experiences of Africa’s dominant economic sectors, and analyzes issues that must be addressed if ENFG is to move ahead, including the following:

- Misperceptions about the ability of some foreign government agencies to provide seed money or long-term donor funding.
- Various kinds of international multilateral financing, the types of debt or equity instruments used, and the extent to which such facilities are mutually exclusive or can be used simultaneously in the same project.
- ENFG’s priority for making itself profitable through appropriate policymaking and structural changes.
- The size of ENFG, definitions of market niches in relation to ENFG’s true capabilities, a design for a grass roots investment strategy, and what constitutes ENFG’s *additionality*.

Here, the approach is to focus not on brute financing but on “gravity points” that tilt a project toward economic feasibility, implementation, and success.

Today’s global trade flows represent a small fraction of global monetary flows. This means that offshore investment opportunity seekers are scouting the world for the right economic and regulatory climate. ENFG should focus on developing a framework for such a climate. It should also provide local currency options rather than hard currency offshore funding to municipal projects that generate domestic revenue.

ENFG must focus on minimizing debt service that drains a project’s operating revenues, especially during its early years. For instance, it could use redeemable preferred shares or provide in specific cases blended rate loans encompassing concessionary and commercial rates, at different phases of the project.

LIQUIDITY AND PROFITABILITY

ENFG must never lose sight of its own liquidity and utmost profitability. Why is profitability so important? It is used to determine ENFG’s commercial borrowing rate and refinancing ability, and it attracts clients. Clients want to be associated with a winner because it improves their own image in approaching their own clientele.

ENFG should maximize profitability while minimizing risk and effort expense. For instance, for the same risk, it is much cheaper to issue a guarantee than to issue and fund a series of notes that must be monitored over several years. A guarantee also provides greater leverage than direct project funding. The return on equity of a guarantee can reach six or seven times that of direct funding.

BOT development versus lending

ENFG should act more as a BOT developer rather as a lender. Because of the capital-intensive nature of such projects, described in Appendix B, ENFG will rapidly use all its industry portfolio internal limits unless it has a syndication capability with regional banks and can refinance itself by selling loan participation in a secondary market. But doing so means that loans must be issued at a competitive rate and funded with interest-sensitive mechanisms which are easier to manage for secondary investors. If a loan rate is too low, ENFG will be forced to sell its notes at a substantial discount to induce secondary investors. Fixed rates should only be used during the construction phase of a project. Once the project is built, it should be refinanced on a variable rate basis to facilitate the issuance of participation.

ENFG Identity

ENFG must find its own identity and not compare itself to other multilateral organizations. It does not have their size or resources, nor are these necessary for its success. ENFG will have to continually reinvent itself and focus on niches rather than competing with other financial institutions. It needs to take a targeted and selective approach that corresponds to its own size, capabilities, and resources.

When considering its support services—accounting, information systems, real estate—management services, and translation—ENFG must regroup the support services of its two operating units into one to be located in the holding. It should then consider outsourcing such activities or turning them into profit-making ventures or service companies that seek outside clients for two-thirds of their activities. This would generate revenue for the holding company.

Because of portfolio concentration, ENFG must also develop a tool that is flexible enough to be applied easily to a variety of industrial, service, or agricultural projects.

ENFG Liquidity

Further, ENFG needs to improve its liquidity. It must assess its portfolio and consider a debt/equity swap of its nonperforming portfolio. It must also consider options such as the sale and lease-back of its buildings, which could generate several millions of dollars in liquidity, and the sale of its low-generating income portfolio at a discount, even on a recourse basis. After assessing its financial capabilities, ENFG must determine the best and least expensive way to finance a project. ENFG should work on fostering long-term lending by guaranteeing the later maturity segment of interest sensitive loans.

ENFG Market Approach

ENFG's management must become more pro-active in approaching the market. Its new structure must not derail planning. Regardless of private participation, ENFG needs to impose on itself a strict discipline and a razor sharp focus on determining its objectives. Coherence must not be abandoned in favor of fads.

Three-year program strategy

The governing countries of the ENFG need to define and execute a strategy for determining the organization's industry and country exposure. This exercise should be done with a three-year horizon. At the end of each year, management should reassess the strategy for the next two years.

From this overall strategy, credit ceilings should be allocated to the two operating arms—ERIB and ERDF. Both units must work together in areas such as water projects and to develop blended products based on ENFG's funding capabilities. The two units have been created to enable the development of and access to a broader range of instruments. Transparency and coordination are mandatory to the success of the ENFG.

The three-year program strategy should take into account ENFG's size and capability, and should address the questions and issues listed in Exhibit 1. From this master plan, ERIB and ERDF must develop their own plans based on the premises of maximum return for the shortest time spent by the staff in conceptualizing, developing, and implementing a project. At that level, the following types of questions should be raised:

- What is best for ENFG's profitability and visibility?
- Should it act as a quasi-investor with redeemable preferred shares? Or should it be a mezzanine or a long-term lender?
- How will the project affect job creation and tax revenue for the host government?
- Should it optimize project efficiency by adding a co-generation component to it?

Exhibit 1. Questions and Issues to be addressed by a Three-year Program Strategy

1. What can we do on our own to foster domestic and then foreign private investment?
 2. Can we create a pool of funds using ECOWAS structures?
 3. Should we develop with the local banking system a guarantee fund guaranteeing the later maturities of an 8–10-year loan to private companies?
 4. Should we develop an ECOWAS short-term export program for agricultural products and light industry exports?
 5. Should we issue 3–5-year certificates of deposits through the network of our affiliate ECOBANK or through all regional commercial banks?
 6. How do we demonstrate to the commercial banks that we are not competing with them?
 7. Should we promote energy conservation rather than participate in multimillion-dollar power projects? Alternatively, how can we do both?
 8. Should we act as a catalyst to attract, rather than replace, the private sector in such projects?
 9. Should we issue enhanced equipment trust certificates or promote sophisticated leveraged leases?
 10. Should ENFG be promoted as a project developer? Alternatively, should it limit itself on facilitating the permitting process?
 11. Should we structure local emerging funds using Overseas Private Investment Corporation's (OPIC's) models to promote and tap long-term domestic savings?
 12. Should we work with foreign pension funds and insurance companies in developing a secondary market in each of the member countries or at a regional level?
 13. Could facilitating a project from a permitting standpoint save millions of dollars in tariffs to the consumer by curtailing construction delays?
 14. Should we develop industrial parks in cooperation with worldwide trading companies?
 15. How can we use bilateral and multilateral assistance to leverage member countries to respect their financial commitments with the ENFG? Could they include such commitments in their negative covenants; in their cross default clause of financial agreements?
 16. What kind/level of critical mass must we have to attract bilateral and multilateral assistance?
 17. How can we leverage the assistance of the multilateral financial donor bodies?
 18. How can we improve the group leverage by using correspondent banking facilities and issuing and syndicating guarantee facilities rather than loans? What operating arm should be responsible for such a program?
-

Fundamental Requirements for the New Structure

Under the new structure the three units should operate as profit centers, the support groups should merge at the holding level, new liquidity should be generated for the holding, specialty niches should be developed, and an array of financial instruments offered.

OPERATE THREE UNITS AS PROFIT CENTERS AND MERGE SUPPORT GROUPS AT THE HOLDING LEVEL

To ensure *total transparency*, it is *strongly recommended* that all support services, data processing, information systems, and personnel be handled by the holding body of the organization. This arrangement should provide the holding with complete control of its affiliates while giving it a critical mass to market its services outside the group and to generate revenues.

Also, the holding should set up a credit department that would serve the needs of the group and be the base from which a credit-rating agency could evolve. The head of the credit department should have veto power over any lending decision being considered at operational level.

GENERATE NEW LIQUIDITY FOR THE HOLDING

The holding unit must consider generating liquidity by entering into debt/equity swaps with countries in arrears for their equity contribution or for nonperforming loans. Under this concept, member countries would issue shares of municipal services that are being privatized in exchange for canceling the debt owed to ENFG. On receipt of the shares, ENFG would designate one of its operating units as the developer of the privatization project. The latter would have total control over the choice of a private partner. With ECOWAS as the project developer, foreign investors would be encouraged to join.

FIND SPECIALTY NICHEs

Because of the small capitalization of the two operating arms of the group, it is recommended that any projects that can be financed through commercial channels not be undertaken. This works against the development of the private sector in the region.

After setting portfolio limits for each sector they intend to finance, the two operating arms should together look for market niches for their professional talents and lending abilities. Examples include the following:

- **Road systems.** Finance container-transfer facilities with insurance companies that are eager to reduce millions of dollars in claims due to losses and pilferage now occurring in such facilities.

- ***Industrial parks and refrigeration facilities.*** Finance industrial parks and refrigeration facilities in port facilities in cooperation with an international trading company.
- ***Co-generation facilities and energy conservation programs.*** With local power companies, finance co-generation facilities and energy conservation programs.
- ***Global Environmental Fund projects.*** Participate with the Global Environmental Fund (GEF) in fast-track multimillion dollar projects fully funded by GEF. Several subregional member countries are behind in their commitments to the GEF. ENFG could work on the financial package of such projects using the GEF's 14-week fast-track decision process. This would enable the fund to generate management fees and put rapidly and fully funded projects on its books.
- ***Agro-industrial facilities.*** Develop small agro-industrial facilities following the advice of local non-governmental organizations.
- ***Mari culture projects.*** Work toward the development of Mari culture projects using long-term take-or-pay contracts issued by trading companies importing the product to back up the project.
- ***Existing foreign investments.*** Work with successful foreign investments already in the region and help them to expand their operations.
- ***BOO/BOT development.*** Act as a BOO/BOT developer using a minimum of ENFG resources or by tapping into community funding.
- ***Municipal projects.*** Provide an IDA/commercial blended rate for municipal projects to reduce future tariffs.

OFFER AN ARRAY OF FINANCIAL INSTRUMENTS

As its experience grows over the medium to long term, the ENFG could consider more complex financial support by offering the financial instruments described in the following paragraphs. Documentation relative to these instruments and other sophisticated financial packages can be obtained by participating in syndication or by hiring international legal counsels. Another way is to access the U.S. Library of Congress or the New York City Business Library's web site.

Mezzanine Finance

Mezzanine finance involves using financial instruments that fall between the risk-return parameters of equity (high risk, high return) and senior debt (low risk, low return). It enables senior debt to take less risk. Mezzanine finance lies between these two types of debt (thus the term "mezzanine") and has a medium risk–medium return profile. It is good to project finance because with intermediate risk-return parameters, it is more attractive and thus can attain a more attractive price from buyers whose preferences match this type of risk and return. It can also raise the total level of project financing, all other things being equal. Types of mezzanine finance include subordinated debt, convertible subordinated debt, preferred equity, and equity warrants.

Subordinated Debt

Subordinated debt is debt with a claim on cash flow (and assets, in the event of liquidation) that is second to senior debt. However, subordinated debt is senior to equity in its claims. In return for this lower credit quality, it receives a higher interest rate than senior debt.

Convertible Debt

Convertible debt gives its owner the right to exchange debt for a predetermined amount of equity at a fixed price and by a certain time. Until conversion, convertible debt carries the right to the stipulated interest payments, the repayment of principal on maturity, and a claim to cash flow and assets ahead of equity. The convertible debt holder benefits from interest rate payments (which are almost always higher than dividends from equity) before conversion, while maintaining the ability to benefit from the “upside” of appreciation in the price of equity if the project is successful.

Preferred Equity

Preferred equity is a special class of equity that has priority rights over common equity in receiving dividends. It is thus senior to common equity.

Equity Warrants

Equity warrants are long-term options that give the holder the right, but not the obligation, to purchase common equity at an established price within a specified period of time. This enables the holder to benefit from the “upside” potential of a successful project. They are often given to the holders of subordinated debt, which can lower the interest rate that would otherwise have to be paid.

Puts and Calls

Put and call options can be used to increase the attractiveness of a financial position in project finance. Puts are sometimes used with institutional investors for bond financing in the PPP project. The put option gives the holder the right, but not the obligation, to sell the bond (or other financial instrument) at a stipulated price at a stipulated time. It is thus a convenient exit mechanism from a project. Calls involve the right but not the obligation to buy a financial instrument. In this respect, they work in similar ways to the embedded call option in convertible debt. They are more commonly used on the equity side of finance to provide additional upside potential.

Escrow Account

An escrow account is a means to give greater assurance to lenders that interest and principle will be repaid. Project agreements will frequently stipulate that all revenues generated from a project will be deposited directly into an escrow account, which is usually offshore. The escrow account is then a form of security for lenders to ensure that project revenues will be used to service debt.

Long-term Policy Vectors

VECTOR 1. REASSESS CORE ACTIVITIES

ENFG needs to re-assess its investment core activities in the global and African contexts. Africa's economic evolution and restructuring, combined with the pace and surge of global financial capital flows, has already started to transform and split the definition of additionality requirements for ENFG's core activities into

- Additionality and collateral requirements related to lending, and
- Additionality related to member countries' domestic infrastructure (see Vector 2).

Additionality and Collateral Requirements Related to Lending

ENFG's lending policy has not been adjusted to meet the structural changes imposed by SAP. ENFG still requires government guarantees as prerequisites to lending to local governments and semiprivate entities.

Defining Security and Collateral Parameters

ENFG must be concerned primarily with the good performance of an infrastructure project before drawing on the guarantees offered by the project sponsors. ENFG's lending authority should be based solely on projected cash flows and balance-sheet strength.

The shares of the special-purpose company created from a PPP should be pledged to ENFG, especially in countries where enforcement of security over assets is difficult or slow. The pledge of the shares facilitates taking over a project if the sponsors refuse to inject new funds in case of difficulty. ENFG must be able to control and direct restructuring without legal delays in obtaining shares. The share pledge is not a substitute for an asset-based security.

If shares are pledged, and default occurs, ENFG may choose between taking the shares if it seeks to restore the business as a going-concern and taking the assets if it intends to pursue liquidation.

There are limitations to the pledge of shares:

- Some investment funds have charters that prohibit them from granting a pledge. This pledge can be replaced by a put agreement.
- It is impossible to obtain a pledge on the widely dispersed holdings of listed companies. A power of attorney to sell the project unit may be obtained from the board of directors.
- In an existing company that is being restructured, bondholders or lenders may prevent the pledge of shares. In this case, bridge financing may be used to remove bondholders before final restructuring.

- Political risk insurers such as OPIC will insure equity only if they can assign the shares representing the insured investment. ENFG may have a similar program to offer. Private political insurance may be a substitute.
- Environmental or fiscal liabilities could be incurred if the bank takes over the shares of a company that is not a limited liability company.

Convertibility and transferability issues occur for a foreign currency denominated loan, and they should be addressed with a comfort letter from the central bank that provides availability and transferability of currency. In the case of domestic currency denominated loans, the problem does not occur if ENFG intends to remain an active lender in the local market. Cost-of-living indexation of the loan becomes the issue.

VECTOR 2. DEFINE LOCAL OR FOREIGN CURRENCY INVESTMENT DENOMINATION ISSUE

ENFG's lending policy has not been adjusted to the growth of international money flows. The ratio of net private flows to total money flows increased from minus 5 percent in 1987 to 15 percent in 1999. This means that \$1 in \$6.66 floating around the world is earmarked for private direct investment. International trade in goods and services represents a minor fraction of total money flows.

The surge and globalization of non-trade-related flows have led to the creation of all sorts of debt and equity instruments and emerging investment funds. While some of those funds are for the purpose of strategic investment, most are targeting the highest-yield, safest-country risk and regulatory environment possible. This trend will continue with the maturity and emergence of industrialized populations.

We can assume, therefore, that in a regulatory and politically safe environment, a financially sound, well-packaged, properly rated, and well-priced offering will easily find hard-currency long-term lenders and investors at increasingly competitive borrowing rates.

Additionality Related to Member Countries' Domestic Infrastructure

ENFG should focus on regulatory issues and prompt issuance of permits to foster third parties' hard-currency investments and lending. This approach would include advising member countries to organize, facilitate, and comfort foreign investors and lenders.

This effort must be measured to and must correspond to domestic funding and real hard currency needs.

Even if foreign investments are anchored to strategic investments, the volatility of other speculative international flows underscores how vulnerable debt servicing of host country municipal projects is to local political upheavals. Situations in Indonesia and India exemplify inappropriately corresponding currency funding. In Indonesia, as a result of the change in government, the hard-currency debt service applied to projects that generate exclusively domestic revenues has increased astronomically. This increase has led to unsustainable tariff adjustments that lead to further civil unrest. And in India, projected foreign exchange reserves may be insufficient to handle future hard-currency debt service requirements for what could have been domestically procured and funded infrastructure investments that generate exclusively domestic revenue.

Given these situations, multilateral financial institutions should revisit fundamental aspects of their domestic lending policies. As such, ENFG should consider the domestic and foreign procurement and debt service component of a project to determine which currency option it will take, as suggested by the following considerations:

- International finance institutions have not fully explored satisfactory mechanisms to meet their statutory requirements of maintaining their asset value when lending in local currencies, although domestic loans could be indexed to the real cost of municipal services.
- Long-term domestic needs have skyrocketed. Before independence, colonial powers developed, maintained, and financed urban and civil infrastructure. Because of budgetary shortfalls, new independent governments decided that in view of the relatively well-maintained state of their urban infrastructure, budgets—which should have been allocated to urban infrastructure—could be redirected towards other requirements.¹
- Most urban infrastructure needs must be domestically funded because tariffs are paid in local currencies.

VECTOR 3. IMPROVE AFRICA'S REGULATORY FRAMEWORKS TO FOSTER OFFSHORE INVESTMENTS

While ENFG should concentrate on improving member countries' regulatory framework to attract foreign currency denominated investments, it must review and revise its domestic lending policy.

With local pension funds and insurance companies, ENFG should be proactive in creating bonded industrial parks in each member country. Created with the full support of local government authorities, these parks would be delegated the authority to do the following:

- Issue through a one-stop permitting window all licenses and environmental permits in compliance with the GEF and ENFG environmental covenants.
- Provide custom clearance through a bonded forwarding agent.
- Provide local tax advice and auditing facilities.
- Have a three-member local mediation panel to mitigate local litigation, contract enforcement, small claims, and labor issues. This mitigation would be handled through members of local legal firms under the supervision of a major international firm and the member countries' ministries of justice. Their rulings would have force of law and would be supported by the member countries' ministries of justice.
- Negotiate with donor countries new programs that could be linked to ENFG's programs for partnerships and that would maximize donors' exports.

¹ A case in point is Nigeria's water and electricity grids, which are in total disrepair and meet the needs of only a fraction of urban and rural populations. Today such grids require total rehabilitation and expansion. They must meet the needs of a population of 110 million and a huge demand from industrialization. At the same time, local governments must prepare for an additional nine million people born each year.

VECTOR 4. DOMESTIC CURRENCY LENDING AUTHORITY

ENFG must complement or supplement existing financing possibilities. For instance, ENFG should provide long-term lending facilities if the prevailing domestic market provides short-term facilities only. If a long-term market does exist, ENFG should enter it only if it is shallow or if local banks lack project finance experience on a limited recourse basis. In addition, ENFG must

- Not compete with commercial banks or other financial institutions that are multilateral, although it would be prudent to leverage resources using co-financing; and
- Take advantage of its preferred creditor status to mitigate political and foreign exchange risks in terms of its own financing.

The presence of ENFG in a project will command a lower price for the sponsor. Therefore, ENFG may wish to take an equity participation in a PPP to avoid a crowding of the private market and because equity participation is not subject to additionality requirements. This can be accomplished by the combination of facilities, such as preferred redeemable shares for projects and the introduction of enhanced equipment notes and cross-border leverage leases to finance heavy equipment and transportation equipment or bulk commodity handling facilities.

The ENFG's operating units should be authorized to lend to concessionary projects or PPPs according to project credit strength rather than government guarantee.

ENFG's mandate is to assist and foster member country development. ENFG, therefore, has to maintain some local currency holdings in each member country. Once a domestic currency loan is repaid, there is no need to swap it into other currencies, as it will be lent immediately to local borrowers. ENFG's target is to maintain the value of its local currency holdings close to inflation. This is achieved by an interest rate charged to the client and by using an indexation mechanism of the principal invested. Citibank and ING lend in domestic currencies; profitability of their investment activities affects the growth of their retained earnings more than the currency translation back into hard currency.

VECTOR 5. USING MEMBER COUNTRIES' EQUITY CONTRIBUTIONS TO SUPPORT LOCAL CURRENCY LENDING

ENFG should consider using member countries' local currency contributions to ENFG equity to back up standby guarantees in favor of intermediation by local commercial banks and insurance companies. As a member's equity contribution in local currency depreciates in line with its own market, the pegging of ENFG's local currency funding to the member's local contribution should not affect asset conservation as the member's contribution to the bank's equity depreciates at the same pace.

Consistent with debt/equity swaps of the past, ENFG should consider a mechanism to swap members' delinquent loans for local currency for lending to local infrastructure projects. These swaps could call for a portion of the delinquent loans in local currencies and redeemable preference shares in urban infrastructure projects. ENFG's equity presence in these projects would call for a lower interest rate on the debt side of the financing.

ENFG should borrow from banks on a revolving basis and recycle those funds in longer maturities. It could also issue to the public one- to two-year debt instruments, the principal of which

would be pegged to the production cost of utilities (not tariffs) at an interest rate much lower than those offered by local banks. The proceeds of these notes would be recycled into long-term funds. A similar debt instrument could also be offered to pension funds and insurance companies.

Action Plan to Implement Strategy

REGULATORY AND INSTITUTIONAL FRAMEWORK

Short Term

In the short term, ENFG must do the following:

- Foster the resource mobilization of offshore hard-currency (debt and semi-equity) investment by being an intermediary between the subregion's regulatory bodies of municipal services and foreign investors.
- Develop training programs with member countries toward this goal.
- Create bonded industrial and regulatory parks.
- Develop a credit-rating agency for infrastructure PPP projects.
- Develop a Municipal Bank Insurance Association (MBIA) credit enhancement mechanism in favor of municipal projects.
- Develop a channel to facilitate ADR or GDR issuance in New York or London as part of the creation of an exit channel for the bank.

Medium and Long Terms

In the medium and long term, ENFG should do the following:

- Explore the possibility of using its member countries' shareholders' domestic currency denominated equity contributions to develop a medium- and long-term domestic funding capability decoupled from the present unit of account reference system.
- Explore the possibility of debt equity swaps to turn hard-currency nonperforming loans into long-term funding sources in local currency. Part of the debt swap would be turned into shares in municipal projects being privatized. ENFG's presence would facilitate the structuring of the special purpose companies. ENFG would exit its equity role when the project reaches economic viability. This could be done by selling its shares to insurance companies, converting equity into debt at a put price, or issuing ADRs.
- In conjunction with insurance companies, work on the issuance of 3–5-year debt instruments indexed to the unit production of power and water, for instance.
- Work on the creation of member countries' regional pool of funds using the community levy mechanism. *This work is required.*

- With private institutional investors, create guarantee funds for small and medium-sized enterprises in member countries.
- Develop a domestic equity PPP fund similar to OPIC's emerging fund but denominated in local currency (close-end venture fund with insurance companies).
- Work with member countries to create revolving omnibus facilities, added value tax, and export-proceed pooling funds.
- Work on the development of tailored programs for specialized sector projects (e.g., work on charter school models as in South Africa and private hospital financing).

OPERATIONAL CYCLE, CREDIT PROCESS, AND TRAINING—SHORT AND IMMEDIATE TERMS

In the short and immediate terms, ENFG should do the following:

- Create a three-year country strategy paper.
- Focus on a rapid project management and syndication capability (*ENFG's operational cycle is far too long to be attractive to private investors*).
- Create a credit department to convey the confidence required for a syndication lead manager and agent role in a project.
- Work on a standardized collateral and security package to be required by ENFG from special purpose infrastructure companies to replace the government guarantee now required.
- Structure a standard syndication mechanism to enable foreign investors to provide commercial construction and performance guarantees in favor of lenders, as for Korean construction companies in the Arab Gulf. This would enable foreign firms to expand their role in PPP management.

FUNDING, CREDIT, AND GUARANTEE FACILITIES

In the short term, ENFG must recognize that:

- International money flows have sufficient depth to provide all funding required by well-priced and -structured transactions, but that the subregion's permitting and regulatory environments deter such money flows.
- ENFG foreign currency lending can no longer be considered the required additionality offered to the international private community.
- The only additionality that ENFG can provide in the 15 ENFG countries is regulatory comfort or long-term domestic funding to infrastructure loans. ENFG has relatively small lending limits (one third of that of an average-sized U.S. regional commercial bank).
- The introduction of sector portfolio limits will further decrease ENFG's market share in foreign currency lending.

- Blending ENFG rates with commercial rates through syndicated facilities with commercial banks will bring ENFG's rate very close to that of commercial banks—further marginalizing the economic advantage of ENFG's rate—unless they take the later part of long-term maturities.

In the short term, ENFG should do the following:

- Take redeemable preferred equity participation in projects to provide “multilateral credibility endorsement and safety” to PPP projects.
- Promote the extension of the blended country concept to sector activities (water), mixing ERIB and ERDF funding in the same project. This would enable a drastic tariff reduction.
- Investigate ways of leveraging FRDC concessional funding.
- Analyze all leverage options for its own facilities and seek trust funds from the future nonregional donors.
- Take the lead with foreign banks that operate in a country to syndicate a short-term, hard-currency bridge-financing import facility when a single commodity-producing country is hit by the drop in commodity exports. This would be used to bridge-finance outward FX remittances underlined by import of equipment spare parts.
 - ? Consider providing local currency discounts to commodity exporters who encounter delays on the part of the central bank to remit the proceeds of commodity exports. This type of financing would be ENFG's responsibility as the ultimate obligor is a private exporter and could be financed following the same banker's acceptance mechanisms.
- Define an index mechanism to maintain the purchasing power of its domestic -funding revolving facilities. More and more investors in projects generating local denominated currency revenues will seek long-term local funding sources.
- Provide BOO/BOTs with intermediated domestic facilities funneled through local banks.

ASSET PORTFOLIO BUILDUP

To build a project portfolio rapidly, ENFG should offer existing BOO/BOTs—such as the Societe d'Exploitation des Eaux de Cote D'Ivoire (Sodeci)—financing to start a new expansion phase as may be stipulated by their BOO/BOT program. This offer would enable ERIB to gain experience in PPP projects that have proven track records.

Training in Project Finance for Public–Private Partnerships

ACTION PLAN FOR BOT TRAINING

Immediate and Short Terms

In the immediate and short terms, the following tasks are appropriate:

- **Task 1.** Build capacity in ENFG staff to understand principles, characteristics, conditions, and lessons of the experiences of PPPs in various sectors.
 - ? 1.1. Execute two-week training for ENFG staff and a one-day program for the ENFG Board of Directors on PPP principles, options, mechanisms, and best practices.
 - ? 1.2. Execute six one-week training programs for ENFG staff on particular applications and structuring of PPP arrangements. Technical skills in the following areas must be developed: credit analysis, project valuation, privatization, sectoral unbundling, project development, securitization, and loan syndication.
- **Task 2.** Begin to build member country capacity for PPPs through six in-country training programs for “starter” or “latecomer” member countries in 2002.
 - ? 2.1. Decide on the most appropriate six member countries for training in view of ENFG’s strategy.
 - ? 2.2. Visit member countries to explain ENFG strategy and plan training programs. Do brief initial assessment of countries for PPPs.
 - ? 2.3. Implement training programs. Use training sessions and case studies to identify possible PPPs in countries.
- **Task 3.** According to reactions of the six member countries, select the one or two that appear to be the most interested in and capable of working with the ENFG in undertaking demonstration projects and creating a legal and regulatory framework for PPPs in water and/or solid waste. (Other sectors could be considered if a case were compelling.)
- **Task 4.** Hire a full-time consultant for one year to do the following:
 - ? 4.1. Manage the six in-country training programs in the member countries.
 - ? 4.2. Manage the short-term consultants who will work in the select regional member countries (RMCs).

- ? 4.3. Work with the ENFG on conceptualizing and incorporating PPP options into ENFG projects, operations, and development.
- ? 4.4. Work with the ENFG on developing a menu of options for providing financial support to PPPs.
- **Task 5.** Send a consulting team to the first selected country to search for technical assistance.
 - ? 5.1. Define a one-year program to develop two demonstration projects—one in water, and one in solid waste.
 - ? 5.2. Define a program to develop or amend the legal and regulatory framework as required.
 - ? 5.3. Identify skill composition of team and scopes of work.
- **Task 6.** Mobilize a team to work in a selected country and make trips in coordination with ENFG to that country as required to complete tasks.

Medium Term (Years 2 and 3)

In the medium term (years 2 and 3), the following tasks are appropriate:

- **Task 7.** Once projects are complete, analyze and disseminate the lessons learned. Make them available to member countries.
- **Task 8.** Select a third project and a fourth project in the same country as in year 1 and a second country for new projects. Repeat steps identified and tried in year 1.
- **Task 9.** After a country has done a second project, it can either be “graduated” or receive diminishing assistance from the ENFG. The ENFG continues to add new countries and projects based on success.
- **Task 10.** During this time, as the ENFG acquires institutional experience in promoting PPPs, the process of identifying PPP potential in traditional public sector projects grows and is able to provide assistance to member countries to develop the project or components of it as PPPs.

FUNDING SOURCES FOR BOT AND TECHNICAL TRAINING

The training program encompasses capacity building at the level of ENFG and of host member countries. From a regulatory standpoint, this training also affects the whole community of West African states. Consequently, the training budget should be funded as follow—one third from ENFG’s own budget, one third from host member countries that benefit from the program, and one third from ECOWAS community levies. Once all parties have agreed to fund the program, according to an irrevocable timetable backed by letters of credit, the ENFG should seek bilateral and multilateral assistance for a further contribution. The possibility of joint training programs with other regional institutions should be explored.

Introduction of New Financial Vehicles and Lending Concepts

GUARANTEE FUNDS

With ENFG, sub-Saharan countries should consider establishing a local and hard-currency guarantee fund on a regional basis. Countries wishing to participate would contribute through a revolving currency fund. They would deposit one half of one percent of their export proceeds and one percent of their commercial banks' reserve requirements deposited with their central banks into the fund. Such deposits would then be invested for the same tenure in AAA foreign securities or, in the case of local currencies funding, with local commercial banks or insurance companies. At maturity, the principal amount would be returned to the participating countries, and the interest earnings would become part of the regional fund's equity.

The regional fund could have the following three roles:

- To park nonbankable hard-currency loan maturities (maturities in excess of 10 years) that would be funded by banks at time of loan disbursement (as there is no difference between long-term and short-term maturities at time of disbursement). While funded by the banks, the commercial and political risks on the later maturities could be sold to the regional fund on a "reput" basis as the series of maturities would be repaid, year 11 being repurchased when year 1 has been repaid.
- To provide a window where banks could refinance over a 10-year period the aggregate total of four years of hard-currency maturities in case of devaluation or default of the borrowing countries.
- To provide an MBIA type of credit enhancement that enables institutional lenders, such as insurance lenders, to meet state regulators' requirements and enables domestic players to participate in a secondary underwriting market. The regional fund could reinsure itself in the international market.

ECOWAS Community Levy as Funding Mechanism to Raise Equity for a Regional Guarantee Fund

Article 72 of the ECOWAS Treaty deals with the financing mechanism of its institutions by establishing a community levy equal to 0.50 percent of the CIF value of imports originating from countries outside of the region. This levy, collected by the custom authorities of each member country, is credited within a month from the date of collection to an account in the name of the executive secretariat kept on the books of the central bank of each member country. The proceeds collected are used to

- Fund the operating budgets of the Community,
- Offset excise duties lost from the duty-free interregional trade,
- Finance development programs,
- To be allocated as decided by the ECOWAS Council of Ministers, and
- Increase the ECOWAS Fund's equity.

Based on 1998 import data, the total aggregate raised by the community levy amounted to some \$95.71 million, corresponding to an average of \$1.84 million weekly.

Setting Up a Revolving Pool of Funds

Using the analogy of a hydraulic dam, weekly remittances of community levy could transit for 20 weeks through an account, called thereafter the "Pool of Funds." After a single 20-week buildup period, the flow of weekly remittances would resume and would not be felt by the state central banks. During that period, a float of some \$37 million would be aggregated and remain constant at will. The pool of funds would increase with the pace of worldwide inflation.

The funds would not actually leave the central bank, but would be transferred to an account opened in the name of "ECOWAS Pool of Community Levy" with the mention "Subaccount: Name of the Country Contribution" on the central bank ledgers. Each week, all 15 countries would notify the ECOWAS Fund of the amounts simultaneously credited to and debited from the pool account.

All 15 transfer notifications (representing one transaction per country) would be commingled into a batch for 20 weeks. Out of the \$37 million float, the equivalent of one week of outgoing funds would be earmarked to meet the fund debt service. Also, two week's worth would be earmarked as a fluctuation buffer and invested in a seven-day certificate of deposit with a central bank of the region. This would leave the \$31.5 MM available at all times for investments.

The same mechanism could be used with the value-added tax (VAT) collected in the region. If member states were to apply for 13 weeks 6 percent of VAT collected each week to the pool of funds, the combined aggregate float in the pool A/C would amount to \$180.4 million (with community levy).

Starting with the Community Levy

The \$31.5 MM invested in treasury bonds would be used as the ECOWAS equity share in a guarantee fund set up jointly with private institutional investors, local commercial banks which could invest half of that amount or \$15.6 million or a total of \$47.20 MM.

Purpose and Structure of the Fund

The purpose of the fund would be to guarantee the second half of 10–12-year local currency bank loans to the private sector or to PPPs. The fund would receive a 2-percent guarantee fee each year during the life of the loan. The fund in case of default of the borrower would substitute itself to the obligor. That is, the banks could not accelerate the loan and be paid in one single installment.

It is anticipated that the fund at cruise speed could reach an 8.5 time leverage or approximately \$400 million. The fund would have country limits apportioned to the member country contribution in levies and private participations. As the fund would be called only when the loan maturities fall due, the loan once fully leveraged would grow at a pace of \$40 million per year for five years reaching some \$600 million, assuming a 10-percent yield on investment and 2-percent guarantee fee. Assuming a casualty rate of 15 percent per annum (the average loss rate in mature economies being 6.5 percent p. a.), the fund's disbursements would amount to \$12 million in year 5 and level at \$ 60 million in year 10, at which time the fund would have reached \$960 million in total footing, growing at a pace of \$36 million each year net of casualties.

The fund would have a favorable impact on each member country because it would create a substantial number of jobs, generate government revenues, and improve municipal services. Tapping 6 percent of VAT weekly revenues would increase the total footing of the fund to *\$5.5 billion* by year 10.

SHORT-TERM REGIONAL EXPORT FACILITY PROGRAM

It is striking that few or none of the sub-Saharan countries have a program to finance the export of agricultural commodities and light industry output. (ERDF and ECOWAS Commercial Funding in conjunction with a regional revolving funding mechanism are described elsewhere in this paper.)

As part of the PPP program, ECOWAS should consider creating a short-term local currency denominated refinancing mechanism with member countries' national and private banks. Although exports are denominated in hard currency, exporters of agricultural products need local currencies while financing such exports.

REGIONALIZATION OF AGRO-INDUSTRIES—EXPANDING ON THE UMEOA'S EXAMPLE IN THE SUGAR INDUSTRY

Because of the small size of most plantations and high cost of labor, African production remains expensive. It has difficulty competing with Cuba, Brazil, and Australia where irrigation and plantations are on a large industrial scale.

The privatization/PPP of the Bacita and Numan plantations owned by the Nigerian Sugar Company is aimed at doubling its output to meet 4 percent of the Nigerian sugar consumption.

In Ivory Coast, the privatization in 1997 of Sodesucre by Sucrivoir and SUCAF has increased the actual production area while improving the overall output yield. Sodesucre was in fact only cultivating 75 percent of area capacity. Irrigation has improved the yield per hectare by 15–20 percent.

Improvement shows at two levels: (1) by providing half of domestic market requirements (import substitution) and (2) by increasing the Ivory Coast's quotas in cartel production and regional trade associations, UMEOA. This improvement was made possible by a 20-percent import duty on sugar originating from outside the UMEOA trade zone. UMEOA members want to be recognized as a trade bloc and deal with the World Trade Organization (WTO) on a regional basis rather than on an individual producer basis.

URBAN SERVICES AND THE ADB'S BLENDED COUNTRY CONCEPT

The average urban water-delivered cost is \$0.45/cubic meter, whereas tariffs are \$0.30. This leads to a permanent and recurrent 33-percent subsidy. Combining funding by ERDF with ECOWAS Commercial Funding would practically eliminate this. The water sector—whether rural or urban—should have a special status in ECOWAS. It should qualify for regional development funding during at least the construction period of a facility and be relayed by commercial funding thereafter. For very poor countries, later maturities could be extended and funded with concessionary loans.

The Concept

Under the African Development Bank's "blended country concept" countries with strong foreign exchange earnings and major poverty areas have access to ADB and African Development Fund (ADF) facilities. Similar economic dislocations and earnings distributions can be found in urban areas (e.g., shantytowns that surround rich districts cannot pay the same utility rates as those districts). Thus the ADB's concept could be extended to urban utility sectors that could become "urban blended sectors." The difference? Countries have access to hard currency whereas the revenue of urban public utilities is entirely denominated in domestic currency.

Utility projects are very sensitive to inflation and construction delays, delays which affect debt service and development in general (see sidebar). Using an ADB/ADF blended funding approach, financial charges—whether or not the project has been delayed—would amount to 4.08 percent of the project. The total cost of the project after repayment would amount to 1.46 times its original procurement cost.

The Advantages

This approach to development has the great advantage of being easy to monitor, especially in countries where foreign assistance proceeds tend to vanish without results. It also addresses the following:

- ***Water is key for industrialization.*** Rural populations are migrating toward cities, and if one accepts the concept of concessionary loans and grants for rural areas, the concept should also be adjusted to mitigate urban dislocations arising from rural migrations.
- ***Urban water investment requirements amount to \$3 billion per year in Africa.*** Investments for rural areas amount to \$1 billion annually. African governments have been able to provide 30 percent of these financial requirements. Most of these investments are in dilapidated grids

Development Issue—Debt Service and Utility Projects

Utility projects are extremely sensitive to inflation and construction delays. Because of interest buildup and inflation, a project delayed by permitting issues during construction has to charge higher tariffs throughout its economic life. The problem is then compounded by currency devaluation that forces the utility to increase tariffs to meet its external debt service.

Accrued interest of 10 percent per annum on a project built on time, over a five-year period, costs 31.2 percent of the project. After a grace period and interest payments during a 15-year repayment period, the total project costs 2.39 times its initial procurement cost. The same project delayed during construction by two years will cost in accrued interest during construction some 54 percent of the project, and the total project would cost 2.52 times its original procurement cost.

that deliver only 40 percent of their designed throughput capacity. The average urban water-delivered cost is \$0.45/cubic meter whereas tariffs are \$0.30. This leads to a permanent and recurrent 33-percent subsidy. Combining ERDF and ECOWAS Commercial Funding would practically eliminate this subsidy. The water sector should have special status with ENFG. It should qualify for concessionary IDA/Commercial-combined funding to enable affordable tariffs.

A Substitute for Cross-subsidy Programs

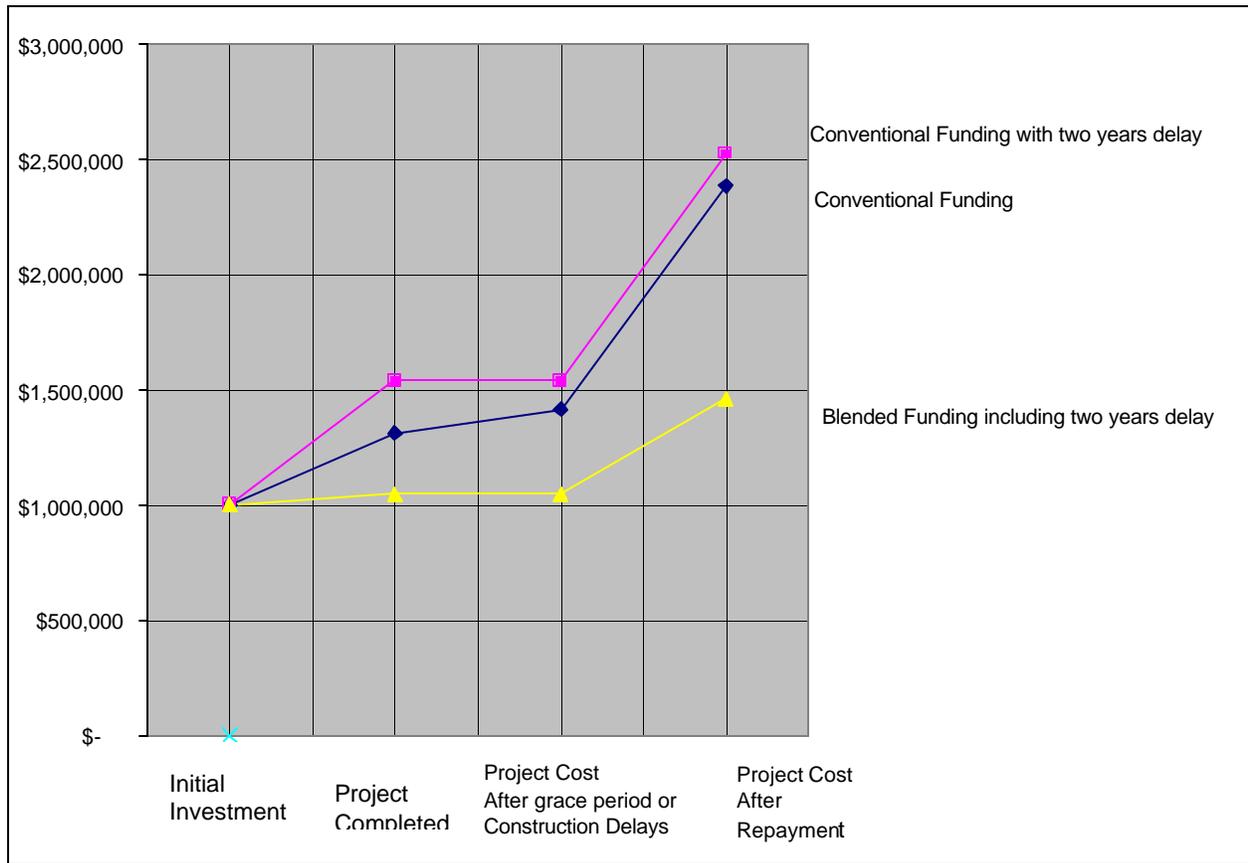
The blended sector concept could be a substitute for cross-subsidy programs, which often affect industrial productivity and competition. Project phases and maturities would benefit from a funding mix between IDA and commercial facilities allowing a decrease of tariffs to the end users. This structure would also take into account country ratings to determine the term and funding mechanism of later maturities. The process of ENFG would be handled in three phases:

- Construction and grace period (if any).
- Commercial-funding period from the end of the grace period to year 15.
- Concession-funding period for poor countries, in years 15–25.

The construction would be funded by IDA (concessionary rates if any) so that permitting delays, for instance, would not affect the debt service of the project. The commercial period would be funded by commercial funding for up to 10 years. The concessionary period would begin during year 15 and would extend for another 5–10 years depending on the country's poverty level.

See Figure 1 for an interest expense comparison for a \$1 million expenditure in the water sector.

Figure 1. Interest Expense Comparison for \$1 Million Expenditure in the Water Sector



Appendix A

ECOWAS FINANCIAL DATA

Table 1. Profit and Loss Account for the Year ended 12/31/2000

	Notes N°	12/31/2000	12/31/1999
Interests and commissions	4	3,139,916	2,966,691
Expenses on revenue	5	<182,996>	<268,018>
Net income		2,956,920	2,698,673
Other income	6	1,558,601	1,240,312
Total net income		4,515,521	3,938,985
Expenses			
Salaries and staff cost	7	<1,976,895>	<1,825,144>
Other administrative expenses	8	<787,857>	<694,355>
Official mission	8.1	46,178	61,509
Conference expenses	8.2	125,181	68,967
Vehicle maintenance	8.3	17,727	14,999
Printing and office stationary	8.4	15,364	14,891
Post and telecommunication	8.5	89,931	68,710
Publicity and advertisement	8.6	24,498	48,890
HQ repairs and maintenance	8.7	308,542	299,368
Studies and project evaluation	8.8	92,564	59,609
General expenses	8.9	27,872	17,412
External audit fees	8.1	40,000	40,000
Other operating expenses	9	<578,187>	<392,808>
Depreciations	10	<247,765>	<244,759>
Operating gain		924,817	781,918

Table 2. Balance Sheet as of 31 December 2000—Assets

Asset	2000 Unit of Accounts	Total (UA) 2000	1999 Unit of Accounts	Total (UA) 1999
Cash and bank balances				
Petty cash	40		1,675	
Due from banks	386,038		65,061	
		386,078		66,736
Investments				
Time deposits	14,116,193		15,920,970	
Call deposit	162,450		40,430	
		14,278,643		15,961,400
Accounts receivable				
Construction of HQS	3,521,632		3,590,418	
Accrued income on loans and investments				
	734,084		530,141	
Other accounts receivable	1,263,613		1,097,557	
		5,519,329		5,218,116
Inter-institutional A/Cs				
Executive Secretariat	11,249,881		11,248,563	
Community Computer Center	68,225		69,247	
Provident Fund	159,722		171,462	
		11,477,828		11,489,272
Loans to member states				
Loans signed	80,752,427		74,558,169	
Less undisbursed amount	<22,778,032>		<21,301,902>	
	57,974,395		53,256,267	
Less repayments	<29,122,808>		<26,304,954>	
	28,851,587		26,951,313	
Less provision for doubtful debts	<2,954,709>		<2,954,709>	
		25,896,878		23,996,604
Equity participation at cost				
Ecobank Transnational Inc.	4,995,121	4,995,121	4,995,121	4,995,121
Other assets				
Fixed assets	9,073,038		9,259,608	
Deposits and guarantees	8,463		8,463	
Assets on order	128,919		0	
		9,210,420		9,268,071
		71,764,297		70,995,320
Provident fund	1,133,697		1,221,270	
Assets of special funds	13,324,061		12,987,256	
		14,457,758		14,208,526
Total assets		86,222,055		85,203,846

Table 3. Balance Sheet as of 31 December 2000—Liabilities Reserve and Capital

	UA, 2000	Total UA, 2000	UA, 1999	Total UA, 1999
Liabilities Reserve and Capital				
Accounts payable				
Creditors	445,171	445,171	447,621	447,621
Inter-institutional accounts				
Special fund for telecommunication	45,267		154,053	
Compensation fund	4,713		4,479	
		49,980		158,532
Borrowings	9,492,731	9,492,731	11,111,518	11,111,518
Capital				
Call up capital	81,923,434		81,923,434	
Less calls in arrears	<13,095,299>		<14,650,132>	
		68,828,135		67,273,302
HQ construction account	6,213,401	6,213,401	6,213,401	6,213,401
Reserves				
General reserve	<3,125,404>		<3,926,438>	
Net Loss/Profit for the year	924,817		781,918	
Currency Translation reserve	<11,064,534>		<11,064,534>	
		<13,265,121>		<14,209,054>
		71,764,297		70,995,320
Provident Fund	1,133,697		1,221,270	
Special Funds	13,324,061		12,987,256	
		14,457,758		14,208,526
Total liabilities, capital and reserves		86,222,055		85,203,846

Table 4. Rates in Converting to Units of Accounts 2000

Currency	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
US\$	1.37936	1.35241	1.32625	1.30865
GBP	0.8456	0.84222	0.86614	0.88587
CAN \$	2.03183	1.96599	1.96381	1.93674
EURO	1.3295	1.37144	1.42229	1.4467
FF	8.71676	8.99693	9.32759	9.48756
FRANC CFA	871.67623	899.69272	932.75898	948.75603
NAIRA	121.66668	129.80874	134.782	138.2603
CEDIS	4,414.41	5,158.13	6,323.85	8,475.69

Table 5. ECOWAS Proposed New Structure, in millions

Items	ERIB		ERDF		EBID	
	UA	\$	UA	\$	UA	\$
Authorized Capital	384	500	384	500	603	750
Paid Up Capital	96	125	96	125	180,9	225
To be Paid by Member States: 120.6						
Of Which:						
ECOWAS Net Asset Value					96,27	119,37
Cash Contributions					24,33	30,17
To be Paid By Partners					60,3	74,77
Member Country Arrears					16,5	20,46
EBID equity	49		86,4			
Total EBID Investment					135,4	167,85
Investment by Outside Shareholders	47,04	61,25	9,60	12,5		
EBID Investment to be Financed by:						
Loan Portfolio			25,9	33,72		
Telecom Special Fund			6,45	8,399		
Investment in Ecobank			18,00	23,44		
Transformation Budgets	0,75	0,98	0,58	0,755		
Other Net Assets EBID	0,13	0,17	0,88	1,146		
Cash	48,08	62,60	34,6	45,04		
Cash Remaining In EBID					18,46	22,89

Source: ENFG's Planning Group

** Some payments were done with UA= \$1.30 and some with UA = \$1.24. This is because transactions took place in a two year time frame.

Table 6. Financial Resources

	Actual in \$	% of original authorized capital	Less Arrears or buildings	Remaining Balance
ECOWAS Fund				
Authorized Capital	\$ 500 000 000	100,00%		
Called Capital	\$ 100 000 000	20,00%	Arrears on capital contributions	
Paid up	\$ 85 000 000	17,00%	\$ (20 510 000)	\$ 64 490 000
				less
			Lome and Abudja offices	\$14 784 000
			Equity available >>	\$49 706 000
Special Telecommunication Fund				
	\$MM			
Authorized capital	\$ 8 500 000			
Called capital	\$ 8 500 000			
Paid up	\$ 8 500 000			
ECOWAS Borrowings				
African Development Bank		\$ 9 461 536		
European Investment Bank		\$ 15 085 750		
African Development Fund		\$ 26 872 613		
CCF			\$ 7 500 000	
Total borrowings from overseas			\$ 58 919 899	
				\$ 108 625 899

**Table 7. Balance as of 12/31/2000
(1UA =\$1.40)**

	Commitments			Disbursement	
	UA	\$		UA	\$
Commitments	UA 80 464 942	\$ 112 650 919	100%	57 279 731	\$ 80 191 623
Telecom		35 327 328	31,4%		\$ 25 148 093
Roads		33 265 816	29,5%		\$ 23 680 586
Rural development		24 895 853	22,1%		\$ 17 722 349
S & M Enterprise		19 161 921	17,0%		\$ 13 640 595
Funded by					
Fund's equity and own liquidity				11 649 000	\$16 308 600,00
Borrowings					\$63 883 023,40
Concessionary borrowing requirement for 2001-2002					\$ 45 000 000
Fund resources for 2001-2002					\$ 30 000 000

Appendix B

THE BOO/BOT CONCEPT

The Build Own and Operate and Build Own and Transfer concept

The BOO/BOT concept is not new and has been commonly used in the water distribution sector in Europe since the nineteenth century. Recently lawyers on Madison Avenue gave it a face- lift and packaged it into a new fade.

A BOO/BOT is a contract between a private sector sponsor and the government or a municipality that calling for the private sector to build or upgrade a facility. Contractually the contractor agrees to operate it while assuming the associated risks for 15o 20 years before transferring it to his host government. In return, the private sector receives a fee (in the form of a tariff or user charge) according to certain standards of service and other criteria as specified in the contract. An independent regulatory commission often replaces the government's role. This commission is focused on regulating and monitoring the performance of the private sponsor.

Worldwide experience shows that BOO/BOTs, if properly structured, can indeed be beneficial, though should be used as only one of multiple instruments for project finance, and cannot mitigate poor policy or laws. Globally, the interest in BOO/BOTs has expanded dramatically during the last decade not because it is a new concept but because governments no longer subsidizing projects and promoting self- sufficiency.

WHAT ARE THE BENEFITS OF BOO/ BOTS?

Globally, the benefits of BOO/ BOTs that can be achieved include access to private sector finance, managerial expertise, access to new markets, new technology, better project design and implementation, and more efficient use of resources.

PPP contracts improve accountability by clarifying responsibilities and focusing on the key deliverables of a service. The benefits of BOO/BOTs can accrue to all stakeholders, provided they are competitively tendered and an adequate legal and regulatory framework exists. For government, it eliminates the burden of providing numerous services, and lets them focus on setting the regulatory and monitoring framework. For consumers, access to affordable services previously unavailable, becomes an option. For the private sector, opportunities to grow as new sectors are opened to BOO/BOT become available, increasing employment and creating economic growth. For the economy, scare resources are used more efficiently, and the economies as a whole work better once infrastructure is in place. This can also lead to improved social equity and increasing economic opportunities.

These examples point to the promise and challenge of BOO/BOTs: solid gains have been made, yet in view of the total number of emerging market countries, the number of BOO/BOTs “leaders” and “starters” is relatively small.

In Africa, the number of "leader" or "starter" countries is no more than six to eight, implying that at least 47 countries are "latecomers." This points to a large number of potential clients for a new approach to meeting basic needs in economic and social infrastructure.

If the potential benefits of BOO/BOTs are large, why have so few countries used them? Each country, of course, has a unique set of circumstances. The following section examines the record of African countries in BOO/BOTs, where many of these globally observed constraints have occurred, in addition to ones that are unique for Africa.

Types of Public Private Partnership contracts

Type of contract	Duration	What the contractor usually receives	Nature of contractor performance	Examples
Service contract	Short-term (1–3 years)	A fee from the government for performing the service	A definitive, often technical type of service	Facility repairs and maintenance; laundry
Management contract	Medium-term (3–8 years)	A fee from the government for the service and a performance-based incentive	Manage the operation of a government Error! Bookmark not defined. service	Regional water supply management
Lease	Long-term (8–15 years)	All revenues, fees or charges from consumers for the provision of the service; the service provider pays the government rent for the facility	Manage, operate, repair and maintain (and maybe invest in) a municipal service to specified standards and outputs	Existing airport or port facilities
Build-operate-transfer	Long-term (15–25 years)	The government mostly pays the service provider on a unit basis	Construct and operate, to specified standards and outputs, the facilities necessary to provide the service	Building, construction and maintenance of regional schools, prisons or hospitals
Concession	Long-term (15–30 years)	All revenues from consumers for the provision of the service; the service provider pays a concession fee to the government and may assume existing debt	Manage, operate, repair, maintain and invest in public service infrastructure to specified standards and outputs	New airport or seaport facilities, toll road or bridge

EXPERIENCE OF MEMBER COUNTRIES IN BOO/BOTS

No region in the world is in greater need of BOO/BOTs for new investment in, and more efficient operation of, its economic and social infrastructure than the ECOWAS members in West Africa. On average, only 48 percent of households in sub-Saharan Africa have access to electricity compared to 75 percent in Latin America and the Caribbean. In West Africa the percentage is lower still. Only 42 percent have access to safe drinking water compared to 76 percent in Latin America and the Caribbean

What led to privatization in Africa

Privatization and Public Private Partnership experience goes back ten years in Africa. A World Bank survey of some fourteen countries states that most privatized for the following reasons:

- The Structural Adjustment Policy (SAP) imposed by the World Bank and IMF,
 - Central government budgetary constraints and offsetting budget deficits,
 - Creditors' reluctance to lend to state enterprises without guarantees,
 - Need to repay the national indebtedness to the local banking sector (\$3.34 billion in Egypt),
 - Weakness in the domestic private sector to technically manage such projects,
 - Reluctance of potential private local investors to reveal wealth
 - Need for foreign private capital,
 - Need for international investors with track records in similar projects,
 - Need to introduce realistic, even and unbiased cost recovery methods,
 - Need for correcting operational inefficiencies such as billing and collection,
 - Need to build new facilities, expand transmission and distribution grids,
 - Need for upgrading dilapidated facilities,
 - Need to balance economic and social consideration,
- Under SAP, countries had to create:
- A list of companies to be privatized
 - A precise implementation timetable
 - A list of expected objectives and results

WHAT MEMBER COUNTRIES HAVE ACCOMPLISHED IN BOO/BOTS

Against this background of need for better infrastructure, Africa's participation in BOO/BOTs has been limited. Out of 1,161 private infrastructure projects concluded since 1984, ECOWAS Member Countries in sub-Saharan Africa have seen only 80, or about seven percent.

It is important to note that most ECOWAS Member Countries already have some experience with the simpler forms of BOO/BOTs, such as service or management contracts. More complex arrangements, in particular long-term concessions that involve private finance, represent new ground for many Member Countries.

SECTORS IN WHICH BOO/BOTS HAVE TAKEN PLACE

Telecommunications

Most Member Countries decided to use commercialization rather than BOO/BOTs in the early stages of restructuring and reform¹. BOO/BOTs began in the sector with the provision of new and cellular mobile telephone services. South Africa, Tanzania, and Mauritius are examples of countries that have used this approach.

A number of countries, such as Ghana, South Africa, Cote d'Ivoire and Uganda, have acquired strategic investors as part of the restructuring process, contributing to the expansion and improvement of services.

The concession approach has been used in Guinea-Bissau, Botswana, Burundi, Cameroon, Cote d'Ivoire, Democratic Republic of Congo, Eritrea, Gambia, Ghana, Guinea, Kenya and Madagascar.

Despite the increased activity in private participation, it is estimated that between 3 million and 6 million mainlines are needed to meet pent-up demand in Sub-Saharan Africa. According to The African Development Bank most of this investment will have to come through BOO/BOTs. Using wireless technology to provide basic telephone services has great potential in Africa.

Due to global interest, BOO/BOTs in telecommunication have been successful. This success can also be attributed to the possibility for a "phased in takeovers". Most African countries have opted for commercialization rather than divestiture.

In many cases privatization represents the unbundling of the post, telecommunication, and/or broadcasting administrations. The state enterprise was commercialized before becoming a PPP. Nigeria, Kenya, Gambia, and Tanzania were slow in adopting the privatization process. Ghana, Mauritius, and South Africa were among the fastest to establish a framework for private participation.

Apart from an initial management contract, the process has now evolved to open specific segments of the sector to private participation. The second phase is acquisition by a strategic investor. Cellular phone licensing was done separately from urban networks. Local governments are reluctant to accept foreign participation in the basic local grid systems.

Telecom privatization started in December 1996 when Ghana, Ivory Coast, Senegal, and Guinea invited foreign equity participation from Malaysia Telecom and France Telecom. In 1999, Cameroon, Congo, and Kenya followed suit.

In 2000, Algeria, Madagascar, and Zimbabwe entered into negotiation with foreign investors but results have not as yet materialized. In late 2000 Vivendi Universal entered into a PPP agreement with Maroc Telecom and Mauritel of Mauritania. Several countries chose to delay privatization of their fixed networks.

They opted to sell participations to mobile telephone companies with the view to stimulating competition for their traditional networks. This led to the development of satellite based operators handling Internet transmission and the introduction of Africa Online. For the host governments, this

¹ The basic source of information for this and the following sections is the African Development Bank, *Infrastructure in Africa, 1999*, and supplement by additional sources as indicated.

meant substantial capital inflow. The consumer benefited by decreased delays in obtaining telephone lines. By the end of 2000, the number of cell phone lines were equal to those provided by conventional grids; one line per sixty inhabitants.

In an attempt to maximize revenue, some governments divided their countries into several zones and sold operating licenses to different investors. This was and is the case of Tanzania:

There are five zones that cannot correspond with one another as the national grid operator cannot ensure their interconnection. Cameroon has unbundled its telecom operation into three companies; one devoted to infrastructure, one for domestic connections and the third for international traffic. The latter merged with Camtel Mobile and has been privatized.

Privatization of conventional grids has been successful. Senegal's Sonatel increased its number of lines by 200,000 and some 650 villages were connected to the network. Benin has chosen a BOO/BOT formula with Alcatel of France and the U.S. operator Titan. BOO/BOT companies will build a network infrastructure and trunk lines which are necessary for maximal efficiency.

It is imperative first to privatize and upgrade conventional grids in order to allow the superposition of mobile systems.

Power

BOO/BOTs in the power sector started with management contract, and were followed by leases and concessions. Egypt, Uganda, Zimbabwe, Kenya, and Morocco are examples of countries using the concession approach, Cote d'Ivoire and Guinea of countries using leases. The most likely way to promote BOO/BOTs and increase competition, the ADB notes, would be through independent power producers (IPPs), which sell electricity to the national grid.

National power companies are being privatized at the request of the donor community. This has been twenty years in the making. Member Countries are reluctant to privatize as they fear the consequences of tariff increases. They also fear public accusation of feather bedding and mismanagement.

The first power company in Africa to be privatized was in Ivory Coast in 1990. The Compagnie Ivoirienne d'Electricite which showed a \$23MM deficit, showed a \$ 23MM profit one year later. This successful experience was followed by Guinea in 1994, Gabon and Togo in 2000.

The PPP contracts used in these cases were leases also known as "affermage" where the state keeps the ownership of its grid. These contracts have terms of fifteen to twenty years. In most cases, governments have met the terms of these agreements. After a change in government, the new administration of Senegal reneged on the privatization / PPP agreement of the state electricity company. Management contracts without equity privatization are also successful. This has been the case in Tunisia and Mauritania.

The invitation to private or foreign investors to participate in the equity of state companies is due to two reasons; (1) a lack of internally generated cash flows; (2) the indebtedness of the host government to foreign lenders or to its own banking sector.

In most cases only power generation is open to private participation. Notable examples of BOO/BOT in Africa are: Jorf Lasfar in Morocco (a limited recourse financing and largest IPP (30 year BOO/BOT) project in Africa), and Vridi and Azito in Ivory Coast, partially funded by AIG capital.

Major obstacles for BOO/BOTs are (1) the restriction to sell power to wholesalers outside the grid, (2) Recovery of fixed cost authorized only after the sale of a specific volume of electricity generated at a specific tariff.

Year	Name	Country	Investor/Contractor	Contract Type
1990	Compagnie Ivoirienne D'electricite	Ivory Coast	Saur 67.97 percent Privates 25.38 percent	Concession 15 years
1997	Ste d'Energie et d'Eaux du Gabon	Gabon	CGE	Concession 20 years
1998	Ste Nationale d'Electricite	Senegal	Hydro Quebec Elyo (Suez)	Privatization 34 percent Contract voided in Nov 2000
2000	Ste Tchadienne d'electricite et d'eau	Chad	CGE / State	Concession 30 years
2000	Togo Electricite	Togo	Elyo/ Hydroquebec	Concession 20 Years
2001	Energie du Mali	Mali	Saur 65 percent IPS West Africa 35 percent	Concession 20 years

Transport

Cost recovery and willingness to pay is a key concern for BOO/BOTs by concession in roads and highways in Africa. As a result, there has been little PPP activity in this sector, even though the need for rehabilitation and expansion is urgent in many Member Countries. Contracting out for road maintenance is also a promising area for BOO/BOTs, and has been adopted by Kenya, Algeria, and other countries in the 1990s.

BOO/BOTs in ports and airport infrastructure are gaining popularity worldwide and to some extent in Africa. Countries such as Mauritania, Mozambique, Zambia, Cote d'Ivoire, Mali, Senegal and South Africa are using BOO/BOTs such as leases and concessions for port and airports.

Airlines

Airlines have been subject to partial acquisition, such as Kenya Airways by KLM 54 percent.

Ghana Airways has technical support agreements with British Airways. South African Airways entered into a strategic agreement with Swissair. Tunis Air used the stock market for a 35 percent IPO.

The stumbling block to BOO/BOTs is that African airlines tend to be overstaffed. For instance, Air Afrique has five times the amount of employees of other airlines. Despite Air Afrique's requests for expressions of interest, there has been no interest in BOO/BOTs. Air Afrique as it was known before is being wind up to be replaced by a new Air Afrique in which AIR France has 23 percent equity and management control over the new company. Cameroon Airlines employed a staff of 1,100 with only two planes. The arrival of its new president allowed a reduction of 35 percent of the staff.

Infrastructure Conglomerates

Airports are better candidates for privatization. South Africa's Transnet is an example of potential unbundling. With \$4.5 billion in assets, Transnet employs over 100,000. Transnet owns

- 31,400 km of railroad tracks ;
- Seven of South Africa's largest ports, two of which are Durban and Richards Bay;
- Capetown off-loading facility;
- Nine of the largest airports; and
- An urban transport system.

One quarter of airports of South Africa's equity has been acquired by Aeroport di Roma of Italy.

Port and shipping companies

Port facilities and shipping lines have been more successful in PPP arrangements. This may be in part due to the nature and directions of trade requiring specialized vessels, docking rights and bulk commodity handling facilities. Port authorities frequently participate in the equity of other port facilities to secure routes and to create transshipment regional hubs to funnel business in their own direction.

Tema Shipyard and Dry Dock Ghana were acquired at 60 percent by PSC Terna Malaysia.

Port Autonome D'Abidjan was acquired in part by Groupe Bolloré (Delmas Vieljeux).

Office des Ports du Cameroun, CNAN, the Algerian shipping company, Comanav of Morocco, Sotunav of Tunisia and Egyptian Navigation are seeking strategic partners.

River and Waterway and Rail Transportation

Chemin de Fer de Djibouti was privatized. Cie de Transport du Maroc sold 18.5 percent of its equity in the stock market. Regifercam Cameroon was sold in part to Saga France.

Water and Solid Waste

Water is the first cause of mortality in the world. Five million people die each year due to lack of access to water although only half of potentially usable soft water resources are utilized (WHO). A population of 250 million in Africa has no access to water. This number will double by 2025. Three hundred million have no sewage systems.

Forty percent of agricultural production requires irrigation. In rural Africa, 53 percent of the population has no access to water. In Ethiopia, Chad, Sierra Leone, Mauritania, and Angola some 73 percent have no access to drinking water.

The poorest pay up to four times more to haulers than is charged by PPP grid delivery. Tanzania is an example:

Bodies of water comprise 1/5 of the country. Eighty percent of deaths are caused by stale water. Fifty percent of the rural population has access to water; 60 percent in cities. Only 6.3 million hectares are cultivated out of 43 million hectares of arable land; 150,000 hectares are irrigated. Rainfall is adequate as it is in excess of two feet per year. Agriculture represents 50 percent of GDP and 75 percent of exports. Eighty four percent of the population works in agriculture.

For Africa, yearly urban water investment requirements amount to \$3 billion. Investments for rural areas amount to \$1 billion annually. African governments have been able to provide 30 percent of these financial requirements. Most of these investments are in dilapidated grids that deliver only 40 percent of their designed throughput capacity. French operators such as Lyonnaise Suez and Saur International are very active in Africa.

The French Government provides annually FF1.2 billion for water infrastructure. An inter-ministerial unit is being established at the French Ministry of Foreign Affairs to deal specifically with water and wastewater infrastructure assistance programs in emerging countries.

New foreign operators are entering the market mostly from Spain, Britain and Canada. The types of BOO/BOTs tried in water in Member Countries include management contracts, leases and concession. An example of a PPP in water is provided in the case study on Queenstown, South Africa. According to the ADB, the main problem with increasing the number of BOO/BOTs in the water sector is the risk perceived with capital recovery, a reflection of a legal and regulatory framework that needs to be better developed.

There are several success stories in BOO/BOTs in the water sector in Africa. In Abidjan, for example, a contract between the Ivoirian government and the private sector operator of the urban water system, SODECI, has proven successful: “All stakeholders – private users, government officials, international organizations and the private operator – agree, with few reservations, that the arrangement has worked well” (Menard and Clarke, 2000). Providing contractual arrangements, the same authors of a different study note, for urban water supply with the private sector also seems to have worked reasonably well in Guinea.

Africa is showing signs of increasing its use of BOO/BOTs in water. Six major PPP contracts were awarded in 2000, as indicated in the following table. Virtually every transaction to date is a concession. Several upcoming privatizations in countries such as Ghana and Tanzania, however, will be via lease contracts, a model that is more prevalent historically in France and French-colonial regions. Other anticipated BOO/BOTs transactions include contracts in Lagos, Nigeria, Tangiers and Tetouan, Morocco and Mauritania.

Water Concessions

Water purification plants represent the bulk of concessions. Wastewater treatment needs a minimum threshold capacity to be viable. Secondary cities do not qualify as they have improper grids.

Sodeci started operation in Ivory Coast in 1988. Sodeci is 96 percent privately owned—local private investors 49 percent; French investor 47 percent.

Societe d'Exploitation des Eaux de Guinee started in 1989; owned 49 percent government, 25.5 percent Vivendi, 25.5 percent Saur and has a ten year lease.

Societe de Distribution des Eaux en Centre Afrique ; owned 71.79 percent Saur, 25.6 percent government, 2.56 percent Banque Meridienne BIAO.

In Casablanca, Morocco, Suez Lyonnaise has a sub management contract limited to distribution and billing.

The cities of Tetouan & Tangiers have joint efforts in a 25-year concession known as a Regie (association of several cities into one operating company) managed by Vivendi, Hydro Quebec, private Moroccan investors.

Johannesburg has given a 5-year management contract to Suez.

Mali Waters is owned 65 percent by Saur, which has a 20-year concession contract.

PPs in Water in Africa awarded in 2000

<u>Location</u>	<u>Operator</u>	<u>Description</u>
Cameroon supply Percent of	Suez Lyonnaise des Eaux	20 years concession for water and the acquisition of 51 shares in SNEC
Casablanca, Morocco Elyo	Suez Lyonnaise des Eaux	30 year concession for Water supply
Chad	Vivendi	Phased privatization
Nelsprui South Africa South Africa sanitation	Biwater and Sivukile	30-year concession for Investments in water and services
Dolphin Coast, Africa South Africa	Saur International	30-year concession for South water and sanitation services
KwaZulu-Natal, Africa World South Africa Development Source: Water World	Vivendi	Partnership under the South Bank's Business Partners for

LIMITATIONS TO BUILD OWN AND OPERATE AND BUILD OWN AND TRANSFER PROJECT FACILITIES

Private Sponsors' Balance Sheet Limitations

The lack of serious, competent, dedicated, well-capitalized U.S. and European sponsors for urban and environmental infrastructure projects are a serious handicap, according to officials of the International Finance Corporation and others.

There are exceptions, like Saur International, Suez, Vivendi, Waste Management Inc., Brown and Ferris Inc. and Bechtel Corp., but they tend to prove the rule that there are very few companies with the expertise, wealth and inclination to take a leading equity position in infrastructure projects overseas.

This is because of the actual and perceived risk/return characteristics of overseas projects, the innate conservatism of potential sponsors, and the dimensions of domestic business opportunities. World Bank officials note that most sponsors of energy/Private Public Partnerships Projects in developing countries require an annual rate of return on their equity of about of 20 to 25 percent -- this is undoubtedly beyond reasonable expectations for many urban environmental infrastructure projects.

The limited number of strong project sponsors able to provide a corporate guarantee will limit the number of Private Public Partnerships sponsored by a corporation alone. We know of a French company whose bid was rejected by the City of Atlanta, Georgia because of its balance sheet's over exposure in projects located in Category C and D Countries.

Unless the sponsor obtains a credit guarantee from its export credit agency or syndicates a commercial bank credit guarantee as was done for Korean general contractors in the Arab Gulf, it is unlikely that the same contractor will duplicate such an undertaking often.

Insurance companies' guarantees have their limits unless underwritten by an insurance located and registered in Member Countries' markets. In the case of U.S.- based insurance companies, most of them are registered in the state of Delaware and subject to Delaware regulators unfamiliar with Africa. Ultimately an accumulation of country C or D exposure could become detrimental to their credit rating and their borrowing rates. Direct funding by life insurance companies registered in Member Countries would be possible, as their income and liabilities are denominated in local currencies.

The Limitations of Commercial Banks and Other Private Lenders

- A major problem for the development of urban environmental and energy infrastructure projects is the decline in commercial bank lending for foreign projects, particularly among U.S. banks, due largely to the losses suffered on developing country debt during the balance of payments crises of the 1980's and 1990's.
- Commercial bank lending has never recovered from these problems, except for short term trade lending, and the World Bank has recently stated that only 28 commercial banks are now engaged in project financing in developing countries, worldwide. The International Institute of Finance has estimated an even lower figure—not more than 24 active banks. Most of these are in Europe and Japan.
- Risk is the major concern of commercial banks approached for overseas project financing, but another deterrent is the repayment term required for infrastructure projects, which is at least not without support.
- It is difficult to believe that U.S. or Canadian potential private lenders, such as insurance companies and pension funds, would take such *risks* in view of their lack of regional experience, and in the absence of a credit rating and a strong assurance of repayment.

FOREIGN GOVERNMENTS ASSISTANCE PROGRAM LIMITATIONS : THE CASE OF U.S. AGENCIES

There are several US agencies playing a key role in facilitating and financing urban environmental and energy infrastructure projects, The Export Import Bank (EX-IM), The Overseas Private Investment Corporation (OPIC) , The Trade Development Agency (TDA), and The US Agency for International Development (USAID).

Each agency has its own mandate, including fostering US foreign policy.

Most of the US agencies have difficulties with limited recourse financing. The expertise to successfully operate such a facility is not presently available within these agencies. Only OPIC provides project finance coverage independent of sovereign guarantee requirements, for capital projects in developing countries, or through OPIC Emerging Market Funds mechanisms.

None of the US agencies works closely with the World Bank and other international financial institutions to finance capital projects. The level of budgetary resources allocated to Eximbank, OPIC, AID and TDA is very limited in relation to the total potential need for urban environmental and infrastructure projects. For AID specifically, the tightness of budget resources and competing priorities have produced a steady decline in capital projects over the last ten years. In BOO/BOTH the AID and TDA recent assistance has been almost wholly in the form of non-reimbursable grants which count 100 percent against budgetary allocations and therefore offer no budgetary leverage.

BOO/BOTH Eximbank and SBA have export finance programs oriented to small business exporters, but these programs are not as well known nor as heavily utilized as they might be. Duplication of coverage and unevenness of marketing efforts characterize BOO/BOTH programs, and a major problem for small exporters remains the difficulty they have in arranging bank financing to meet working capital needs.

Other U.S. government agencies with an interest in the export of environmental and energy infrastructure projects have things they might contribute to the key financing agencies including extra funding, project evaluation expertise, delivery of financial programs to the local level, and technical assistance to project sponsors, but to date they have not been effective in these areas. The other agencies include the Department of Energy, Environmental Protection Agency, and Department of Commerce.

U.S State Governments

All of the 50 state governments have established trade and investment promotion offices and addressed export finance issues at some level. About half of the states have established export finance programs which work with the Federal Government typically through EXIM. The explicit goal of these programs is to improve their firms' ability to participate in overseas projects and increase their exports of goods and services. These states help their exporters obtain working capital financing using their own guarantee programs, sometimes enhanced by investment banking syndicates, and help to market and make application for Federal loans, guarantee and insurance programs. One of the main problems the states face is a lack of reserve funds needed to operate their own guarantee programs and a lack of administrative funds to expand their ability to bring Federal financing programs home to local exporters.

ADDITIONAL CONSTRAINTS AFFECTING BOO/BOTS IN MEMBER COUNTRIES

Governments continue to provide economic and social infrastructure the traditional way, even though there are many projects that could be structured as BOO/BOTs. Thus, the supply of BOO/BOTs falls well short of potential.

Most countries and government may be unaware or not fully realize the potential benefits of BOO/BOTs. If they do, they may be stymied by a lack of capacity to undertake them. BOO/BOTs call for skills in finance, economics, engineering, legal, regulatory and procurement, areas in which governments typically have difficulties retaining qualified people.

Bureaucratic realities often get in the way of BOO/BOTs. Line ministries frequently resist the new approach, which is viewed as a threat to power and prestige, including informal perquisites sometimes associated with the traditional tendering process.

Even when these obstacles can be overcome, the process of identifying PPP projects and taking them through the project life cycle to implementation is a long one, and, without benefit of previous experience, they can run into difficulties that can delay or derail a project or program.

In spite of all the obstacles, some projects are tendered as BOO/BOTs. The reactions by the potential private sector sponsors and bankers is often mixed. Perception of high risk that are normally encountered in emerging market countries seem to be unacceptably high by potential sponsors in the "latecomer" Member Countries: country risk, political risk, regulatory risk, market risk, payment risk, inflation risk and foreign exchange

In view of these factors, multilateral institutions and other donors have worked with governments to help them to create a PPP program and to provide support to specific PPP transactions.

In most cases implementation of such program was delayed due to:

- reluctance of governments to allow third party management in state enterprises
- delays in permitting
- fear of public unrest due to:
 - labor redundancy
 - increased tariffs and collection efficiencies
 - uncovering wrongdoing and waste
 - Fear of losing personal gain generated by the company.

WAYS TO OVERCOME CONSTRAINTS

The essence to overcoming the constraints is to begin to create a market--the supply of, and demand for, -- BOO/BOTs.

A good way to begin to develop a market for BOO/BOTs is to provide training and increase awareness among key stakeholders--government, ministries, unions, the local business sector, and consumers.

To increase the supply of projects, governments in Member Countries can reexamine existing projects scheduled for the traditional approach, or old projects that have been subject to a feasibility

study but which have not been implemented owing to inadequate budgets, and see if these projects lend themselves to a PPP approach.

This review of existing projects that have PPP potential can be helped if MEMBER COUNTRIES governments move from an ad-hoc, case-by-case approach to BOO/BOTs, and begin to create a more structured approach to them. They can do this by creating PPP units, which are technical teams with identify PPP candidate projects and take them through the project life cycle, from identification to procurement to award and post award monitoring and supervision. While every project is different, PPP projects share similar features and can benefit from a common approach that can achieve economies of scale and scope in taking projects through the project life cycle.

Member Countries government can also begin to create a demand for BOO/BOTs through the public awareness effort to explain the benefits to citizens of BOO/BOTs. They can create a demand from the local and foreign private sector sponsors and financiers by creating clear policies on BOO/BOTs that explain how it will work as a partner in with the private sector. It will further the demand for BOO/BOTs by establishing a consistent and transparent legal and regulatory framework for BOO/BOTs, covering such areas as tendering, evaluation, negotiations, tariffs, standards of service, and dispute resolutions.

KEY ELEMENTS OF THE ENFG 'S STRATEGY FOR BOO / BOTS IN MEMBER COUNTRIES

How multilaterals and other institutions help BOO/BOTs

The World Bank is limited by its charter to making loans and guarantees to governments backed by a sovereign guarantee. It cannot make direct loans to BOO/BOT projects, which by definition lack sovereign guarantees. However, the World Bank has worked with donors to find creative ways to assist member countries in implementing BOO/BOT projects.

The World Bank plays a key role in enhancing the bankability of PPP projects. In several countries, the bank has channeled loan funds to a Private Sector Infrastructure Development Fund (PSIDF), which make loans to PPP projects. These loans typically constitute 20 to 30 percent of project debt financing, with repayment terms longer than commercial bank loans. This assistance helps projects to structure favorable financing packages and repay commercial bank loans quickly. The result is a reduction in commercial bank risk that lowers interest costs for borrowers and increases banks interest in participating in projects, particularly those with IFC backing.

In Pakistan, for instance, the World Bank helped establish a \$520 million private sector energy development fund for long-term loans of up to 30 percent of the cost of qualifying energy projects, including BOO/BOT projects. The bank also provides assistance for PPP projects by conducting sector studies to determine the feasibility of PPP projects.

The World Bank is also able to provide partial credit and partial risk guarantees to PPP projects to improve their bankability. This enables them to leverage a greater amount of private sector finance. However, to date guarantees have proved time-consuming to use.

The International Finance Corporation (IFC), which is the private sector-lending arm of the World Bank Group, and the private sector window of the Asian Development Bank (ADB), have played a pivotal role in bringing projects to financial closure in less than investment-grade countries, particularly in Asia. As the IFC does, ENFG could make equity and debt investments in PPP

projects, often syndicating loans with commercial banks, known as “B” loans. Interest rates for these loans are lower than typical commercial bank loans because the loans run less risk of rescheduling.

The success of a number of IFC- and Asian Development Bank -assisted projects in Asia has catalyzed the development of project finance in a number of countries where risk is too high to attract purely commercial investment. Once financed and commercially successful, these projects have provided a significant "demonstration" effect, which has increased commercial bank financing for subsequent projects.

A short case study on the Hopewell PPP power project in the Philippines, included in the appendices, illustrates the catalytic role played by the IFC and ADB in providing finance to an early PPP project. Subsequent projects succeeded in attracting private finance in the Philippines, and the Philippines' PPP program went on to become one of the most successful globally.

Like the IFC, the Multilateral Investment Guarantee Agency (MIGA) is part of the World Bank Group. MIGA supports investment by providing political risk insurance to foreign investments, including BOO/BOTs, in emerging markets . It covers four basic types of risk in foreign investment: expropriation, war and civil disturbance, currency inconvertibility, and breach of contract and denial of justice.

The United States Agency for International Development (USAID) has sponsored numerous training and public awareness programs to lay the foundation for the development of PPP programs and units.

USAID has also played a leading role globally in providing technical assistance to create BOO/BOTs in a number of the countries. Three examples can be mentioned. USAID has supported the Philippines in its efforts to develop a PPP program throughout the 1990s.

Their assistance of USAID played an important role in developing the Philippines program. USAID is also facilitating support for South Africa to develop PPP projects, especially for municipal services in former black homeland areas where the supply of water and other vital services was inadequate. In Egypt, USAID has supported PPP activities in the water and wastewater sector, and solid waste collection and disposal. It has worked to create an enabling legal environment and initial transactions to attract the private sector to provide these basic services.

The mission of the Development Bank of South Africa (DBSA) is to “facilitate the provision of infrastructure development finance in order to improve the quality of life of the people of South and southern Africa.” Their mandate include four levels of investment: municipal and household infrastructure serving basic needs; economic infrastructure facilitating regional and national linkages; institutional infrastructure; and social infrastructure, including health, education and recreation.

The DBSA has broadened the scope of its activities to act as a catalyst for BOO/BOTs. The DBSA established the Private Sector Investments in 1996 to develop the Bank’s portfolio of BOO/BOTs. It identifies, appraises and manages PPP projects, and in such projects provides technical assistance to public sector clients, coordinates interaction with private sector developers and financiers and interacts with bilateral and multilateral organizations on co-financing and technical assistance. The DBSA provides a range of financial products to private providers of infrastructure services including loan finance, equity investments, guarantees and refinancing commitments. Financing is supported by technical assistance aimed at enhancing the capacity of the clients to plan, manage and implement BOO/BOTs.

The DBSA has taken a leading role in two of the infrastructure BOO/BOTs underway in South Africa. In the Witbank-Maputo Toll Road, the DBSA is co-arranger of the debt facilities for the project invested approximately R200 million. It provided 20-year loans, a longer maturity than the commercial banking sector. Assistance to Nelspruit water PPP included assisting it with project structuring, undertaking technical and financial investigations, pre-marketing the transaction with the private sector, design of the bidding process, and preparation of bidding documents.

The DBSA also houses South Africa's Municipal Infrastructure Investment Unit, which provides technical assistance and support to municipalities to develop BOO/BOTs to provide local services such as water and wastewater, and solid waste collection and disposal.

Though not institution per se, the South Africa Infrastructure Fund (SAIF) is an interesting example how financing is being mobilized in Africa to support BOO/BOTs, in part because of the AFDB support for it. The South Africa Infrastructure Fund is a private equity fund that seeks to achieve long-term capital appreciation through private sector investment in infrastructure projects within southern Africa. SAIFs capital base is made up of irrevocable capital commitments from 14 South African institutions and the AFDB. South Africa is the primary focus of AFDB.

However, some investments will involve cross-border projects or projects outside South Africa. It is intended that up to 20 percent of AFDB's capital will be allocated and invested in projects in southern Africa outside South Africa. The focus of AFDB is on, among others, investments in the environmental (water, waste, sanitation and sewerage), energy, telecommunications and transport. AFDB concentrates on equity investments in greenfield developments and in expansion, rehabilitation or restructuring of existing infrastructure projects. Investment by AFDB is concentrated on equity opportunities and may, in exceptional cases, be accomplished through quasi-equity, subordinated debt, convertible debt, hybrid securities or a combination.

LESSONS LEARNED FROM THE MULTILATERAL INSTITUTIONS

The basic lessons learned from the experience of the multilaterals is that there is an important, indeed vital, role for them to play in assisting countries in developing BOO/BOTs, especially among the "latecomer" countries. For example, for the many Member Countries that do not have a credit rating, the role of a multilateral is almost essential if some of the more advanced forms of BOO/BOTs, such as concessions, are to take place. The involvement of multilateral and others can be decisive in helping the private sector, especially the foreign private sector, to understand the elements of risk involved in working with BOO/BOTs in a particular country, and to find ways to identify and assign the risk in a PPP.

The specific lessons learned include the following.

- Training and public awareness is a very valuable contribution in "starter" and especially "latecomer" countries in initiating their PPP programs.
- Creative financing techniques devised by the multilateral institutions have proved to be important in bringing initial transactions to closure, and have acted as a catalyst to mobilize subsequent private sector finance. After the period of playing the catalytic role, though, they should not compete with the private sector in providing finance. The private sector has the comparative advantage in financing BOO/BOTs.

- BOO/BOTs can only be financed if there are governments that have the capacity to identify BOO/BOTs and bring them to the attention of the private sector through the tendering process. Perhaps an even more important role for the multilaterals, then, is to help countries to bring BOO/BOTs to the market through a structured PPP program with a PPP unit. This can help to ensure a steady supply of well-designed BOO/BOTs in which the private sector will be interested, rather than an erratic, ad-hoc supply of poorly designed projects.
- With few exceptions, it is important to avoid overly ambitious PPP projects at first, especially in "latecomer" countries. Doing a transaction with a complex PPP is a difficult task in the best of circumstances, and if the project is too big, it may result in delays that will diminish the enthusiasm for the concept and bring on fatigue by the major parties.
- Another important lesson learned from the experience of multilaterals is that helping countries implement BOO/BOTs is a medium to long-term undertaking. With the possible exception of service or management contracts, it is generally difficult to break ground on PPP transactions in the first year of assistance. ENFG and its Board of Directors must understand that it may be difficult to show much success in the short run. If it does have the stamina and patience, however, it can be of great assistance to its client countries in enabling them to undertake PPP projects and programs, and thereby advance economic and social development.

Case Study: Queenstown (South Africa)

The Queenstown water PPP is an interesting case study. Although in several respects the tendering process for the document fell short of best practices, the results of using the private sector seem to make up for any procurement shortcomings.

Queenstown had embarked on some earlier BOO/BOTS and privatizations before the water sector. A vegetable market owned by the municipality was losing money. Queenstown decided to simply give the market away. The private sector improved and upgraded it, and it became a “rateable asset”. The market thus went from being a drain on the municipal budget to providing it with revenue.

An abattoir owned by the city was also running at a loss, as well as failing to meet the standards of hygiene set by the Department of Health. The municipality sold it. The abattoir started to make a profit, and was able to contribute to the city’s budget. Other municipal services privatized included solid waste and cemeteries (perhaps they were run by the same group, enabling them to achieve economies of scale and scope; and with the cemeteries it would be interesting to find out if they ran into stiff opposition to the idea.)

Impressed by these results, and influenced by the United Kingdom’s experience in privatization, the town council decided to tackle a large target: the water sector. They drew up tender documents according to the law or regulations for municipal tenders. The town clerk freely admitted that they made two basic mistakes in the tender document: it didn’t contain any specification--making it difficult to compare “like with like” in the evaluation process, and they didn’t widely market the tendering process. It seems like the municipality was asking the private sector to give them their best ideas for improving water and wastewater services without specifically having any particular PPP technique in mind.

The town clerk mentioned that the process was guided by the principle of working for the best interest of the rate payer. And he said that they spent time with the workers to explain what the concession would mean for them. They stipulated that the affected staff could not be made worse off under the concession. Forty five staff members resigned from the municipality and joined the new company. The workers are provided with ongoing training. According to the Town Clerk, not one wishes to go back.

This process took place before the democratization process of 1994. The original concession was for the old, white area of Queenstown which had about 5,000 households. (The contract between Queenstown and WSSA is often referred to as a concession, although it is more of a hybrid. It is largely a management contract, although it has some features of an investment concession because it involves some new investment in expanding the sewage treatment plant.) While the service was not especially bad, they did not know the extent of water losses through leaks because the system was not metered. Old Queenstown also supplied two nearby black townships with water in bulk, though it was not responsible for reticulation (i.e. distribution to households.)

WSSA submitted a proposal which emphasized a concession approach instead of a “cost” proposal. It contained the following items:

- Well defined responsibilities
- Acceptable conditions of transfer and employment of the municipal personnel
- Clearly spelled out rates (per cubic meter of water consumed), allowing easy financial evaluation, showing in particular how much money the town would save
- A real degree of commitment and risk taking by the operating company, WSSA, linked to a good technical understanding of the system
- Financing for part of the project to extend the sewage treatment plant

The initial contract in July 1992 stipulated that WSSA would manage, operate and maintain the entire water and sanitation systems of Queenstown for a period of 25 years. This included:

- Fifty kilometers of raw water supply pipeline and pumping stations
- A 36,000 cubic meters per day water treatment plant
- 120 kilometers of water reticulation including 5,000 connections
- 100 kilometers of sewers

Under the terms of the concession, WSSA is responsible for wages for workers transferred from the municipality to WSSA, the cost of electricity and chemicals, the cost of maintenance and repairs, the replacement of water pipes and meters as needed, replacement of electro-mechanical equipment, and the extension of the sewage treatment plant.

The contract provides for quality standards in terms of delivery of services and pollution control. It also addresses the maintenance and replacement of assets, penalties and liabilities for non-compliance with standards, a series of specific clauses defining conditions of contract termination, conflict resolution and arbitration, and insurance which WSSA must be covered by.

Queenstown employs an independent consultant to check periodically the standards of service--water purity and sewerage discharge. The consultant issues a report to the town council. If there are any problems observed, the town council and WSSA discuss them. The Town Clerk said that they were pleased with their partnership with WSSA. He noted that whenever they had problems come up, they would resolve them among themselves. He believed that these approaches were sufficient for the regulation of WSSA. He was wary of any centralized regulation above and beyond what was already in place.

The payments to WSSA is based on a fixed rate for fixed operational costs such as staff, and a rate per cubic meter of water actually consumed by and users as determined by the meters. WSSA bears the costs for unaccounted for water from leaks and other losses. The concession provides for a pre-agreed escalation formula to permit rises in cost which result from inflation in South Africa.

After the first year of operation, Queenstown was served with water at a 17.9 percent cost reduction.

After democratization, old Queenstown was amalgamated with the township of Mlungisi and Ezibeleni. According to the town clerk, the town council and WSSA amended their concession to include the provision of distribution of water to these two townships. The two townships had 14,000 households with water connections. According to WSSA, by 1995 the services to Mlungisi and Ezibeleni were equalized, including rehabilitation.

Queenstown still collect payment for water and wastewater services from households itself. WSSA would like to assume the responsibility for billing and collecting. They are currently holding

discussions with the town council to introduce customer management, whereby they would improve the current billing and collection system.

WSSA in Queenstown offered some interesting insights into how the private sector can introduce cost efficiencies. They noted that before the concession, the water company maintained a constant level of water in the reservoirs. They pumped water into them whenever the level fell below the stipulated level. WSSA now pumps water into the reservoirs above the former level when the charges for electricity are low--typically before 7:00 am. It stops pumping just before 7:00 am, and resumes at 11:00 am when rates have gone down again. By carefully monitoring the times that it pumps, it has been able to realize considerable costs saving on electricity.

WSSA also monitors its inventories closely. It introduced security around the warehouse that houses the inventory. Before the concession, there was little control and workers were free to help themselves to desired items. WSSA also practices to the extent possible "just-in-time" inventory so that it doesn't have to tie up a lot of cash in inventory before it is needed.

It has also introduced set of tools on the pickup vans that respond to customers' calls so that they can deal on the spot with relatively basic repairs and maintenance. Before, the vans would go out to inspect a problem, then return to headquarters to pick up the tools. This unnecessary driving added to maintenance costs. Also, there was a liberal policy before the concession of allowing workers to use the vans after hours. This policy has stopped after the concession, with considerable savings on maintenance of the fleet.

WSSA now closely monitors calls for repairs and maintenance. If a problem requires urgent attention, they will respond to it after hours or on the weekend. Otherwise, they determine if it can be dealt with during working hours. This way they avoid have to pay overtime for unnecessary work. Before the concession, overtime was reportedly much higher.

Case Study—The Hopewell Project (Philippines)

An example of a BOO/BOT project in the Philippines (one of the earliest BOO/BOT power projects in Asia) is the Hopewell Energy (Philippines) Corporation's 200-megawatt gas turbine plant located at Navotas, in Metro Manila.

The financing arrangements indicate the then "art of the possible" in the Philippines. Under the terms of the BOO/BOT agreement, Hopewell would build, own and operate the Navotas plant for 12 years and then transfer it free of charge to the National Power Corporation (NPC).

The terms included the following provisions:

- All electricity would be purchased by the National Power Corporation.
- NPC will provide the site and all fuel for generation of electricity at no cost to Hopewell.
- NPC will pay Hopewell a capacity fee (monthly) for standby capacity committed to be available plus an energy fee based on electricity actually generated.
- The project was awarded "pioneer" status by the government. This provides certain privileges including "tax holiday" of 5 years and waiver of import duties on equipment.

The IFC and the ADB (through its private sector window) provided US\$ 10 million in loans with a 10-year maturity in US dollars on a floating rate basis. Another US\$ 10 million was obtained on a complementary basis linked to the ADB direct loan, with a 7 year maturity in US\$ on a floating rate basis. This complementary financing was provided by 4 European commercial banks, with the ADB as lender of record, but with commercial banks taking full project risk.

The government of the Philippines guaranteed all performance obligations of the NPC (including payments). The capacity fee and energy fee were paid in U.S. dollars to an offshore bank account to be maintained by Hopewell.

The equity participation by Citibank was in the form of a debt-equity swap. Notable was the absence of local financing, apart from certain "in-kind" contributions from NPC (land, fuel.) Reasons included the unfamiliarity by local financial institutions with BOO/BOT, the lack of suitable term financing, the reluctance of Hopewell to risk crowding out limited local financial resources, and the desire to get the project on stream quickly.

Hopewell indicated that this project, relatively small in scope by BOO/BOT standards, was designed as a demonstration project to determine what could be accomplished on a BOO/BOT basis. The experience gained in the first small project encouraged them to attempt a second, much larger BOO/BOT undertaking, which was successful.

Subsequent power projects in the Philippines succeeded in attracting private finance. The Philippines PPP project expanded its sectors of activities. The Philippines PPP program is regarded as one of the most successful.

The BOO/BOT Concept

The build-own-operate/build-own-transfer (BOO/BOT) concept is not new. It has been used in the water distribution sector in Europe since the nineteenth century. Recently, lawyers on Madison Avenue gave it a face-lift and packaged it into a new fad.

A BOO/BOT is a contract between a private sector sponsor and the government or municipality that calls for the private sector to build or upgrade a facility. In the contract, the contractor agrees to operate it while assuming the associated risks for 15–20 years before transferring it to his host government. In return, the private sector receives a fee (in the form of a tariff or user charge) according to certain standards of service and other criteria specified in the contract. An independent regulatory commission often fills the government's role. This commission would focus on regulating and monitoring the performance of the private sponsor.

Worldwide experience shows that if BOO/BOTs are properly structured, they can be beneficial. But they should be used as only one of several instruments for project finance, and they cannot mitigate poor policy or laws. Interest in BOO/BOTs has grown dramatically in the last ten years because governments no longer subsidize projects but wish to promote self-sufficiency.

WHAT ARE THE BENEFITS OF BOO/BOTS?

Globally, the benefits of BOO/BOTs include access to private sector finance and new markets, managerial expertise, new technology, better project design and implementation, and efficient use of resources.

PPP contracts improve accountability by clarifying responsibilities and focusing on the key deliverables of a service. The benefits of BOO/BOTs can accrue to all stakeholders, if they are competitively tendered, and if an adequate legal and regulatory framework exists. For government, it eliminates the burden of providing numerous services and lets it focus on setting the regulatory and monitoring framework. For consumers, access to services previously unavailable becomes affordable. For the private sector, opportunities to grow arise as new sectors open to BOO/BOT, increasing employment and economic growth. For the economy, scarce resources are used more efficiently, and the economies as a whole work better once infrastructure is in place. This can also lead to better social equity and economic opportunities that increase.

These benefit examples point to the promise and challenge of BOO/BOTs: solid gains have been made, yet in view of the total number of emerging market countries, the number of BOO/BOT “leaders” and “starters” is small.

In Africa, the number of “leader” and “starter” countries is no more than 6–8, implying that at least 47 countries are “latecomers.” This points to a large number of potential clients for a new approach to meeting basic needs in economic and social infrastructure.

If the potential benefits of BOO/BOTs are large, why have so few countries used them? Each country has a unique set of circumstances. The following section examines the record of African

countries in BOO/BOTs, where many of these globally observed constraints have occurred, in addition to ones that are unique to Africa.

Table B-1 shows types of PPP contracts.

Table B-1. Types of PPP Contracts

<i>Type of contract</i>	<i>Duration</i>	<i>What the contractor usually receives</i>	<i>Nature of contractor performance</i>	<i>Examples</i>
Service contract	Short term (1–3 years)	A fee from the government for performing the service.	A definitive, often technical type of service.	Facility repairs and maintenance; laundry.
Management contract	Medium term (3–8 years)	A fee from the government for the service and a performance-based incentive.	Manage the operation of a government service.	Regional water supply management.
Lease	Long term (8–15 years)	All revenues, fees, or charges from consumers for the provision of the service; the service provider pays the government rent for the facility.	Manage, operate, repair, and maintain (and maybe invest in) a municipal service to specified standards and outputs.	Existing airport or other port facilities.
Build-operate-transfer	Long term (15–25 years)	The government mostly pays the service provider on a unit basis.	Construct and operate, to specified standards and outputs, the facilities necessary to provide the service.	Construction and maintenance of regional schools, prisons, or hospitals.
Concession	Long term (15–30 years)	All revenues from consumers for the provision of the service; the service provider pays a concession fee to the government and may assume existing debt.	Manage, operate, repair, maintain, and invest in public service infrastructure to specified standards and outputs.	New airport or seaport facilities, toll road, or bridge.

EXPERIENCE OF MEMBER COUNTRIES

No region in the world is in greater need of BOO/BOTs for new investment in and more efficient operation of economic and social infrastructure than ECOWAS region. On average, only 48 percent of households in sub-Saharan Africa have access to electricity and in West Africa the percentage is lower still. Only 42 percent have access to safe drinking water. In Latin America and the Caribbean, in contrast, 75 percent have access to electricity and 76 percent to safe drinking water.

What Led to Privatization in Africa

Privatization and PPP experience goes back 10 years in Africa. A World Bank survey of 14 countries states that most privatized for the following reasons:

- The SAP imposed by the World Bank and IMF.
- Central government budgetary constraints and offsetting budget deficits.

- Creditors' reluctance to lend to state enterprises without guarantees.
- Need to repay the national indebtedness to the local banking sector (\$3.34 billion in Egypt).
- Weak ability in the domestic private sector to technically manage such projects.
- Reluctance of potential private local investors to reveal wealth.
- Need for
 - Foreign private capital.
 - International investors with track records in similar projects.
 - Realistic, even, and unbiased cost recovery methods.
 - Correct operational inefficiencies such as those in billing and collection.
 - New facilities and expanded transmission and distribution grids.
 - Upgraded dilapidated facilities.
 - Balanced economic and social considerations.

Under SAP, countries had to create the following:

- A list of companies to be privatized.
- A precise implementation timetable.
- A list of expected objectives and results.

WHAT MEMBER COUNTRIES HAVE ACCOMPLISHED IN BOO/BOTS

Against this background of need for better infrastructure, Africa's participation in BOO/BOTs has been limited. ECOWAS members in sub-Saharan Africa have had only 80 private infrastructure projects concluded since 1984 of 1,161 such projects, about seven percent.

Most ECOWAS members already have some experience with the simpler forms of BOO/BOTs, such as service or management contracts. More complex arrangements, in particular long-term concessions that involve private finance, represent new ground for many.

SECTORS IN WHICH BOO/BOTS HAVE TAKEN PLACE

Telecommunications

Most member countries decided to use commercialization rather than BOO/BOTs in the early stages of restructuring and reform.¹ BOO/BOTs began in the sector with the provision of new and cellular mobile telephone services. South Africa, Tanzania, and Mauritius have used this approach.

¹ The basic source of information for this and the following sections is the African Development Bank, *Infrastructure in Africa*, 1999, supplemented by additional sources as indicated.

A number of countries, such as Ghana, South Africa, Cote d'Ivoire, and Uganda, have acquired strategic investors as part of the restructuring process, contributing to the expansion and improvement of services.

The concession approach has been used in Guinea-Bissau, Botswana, Burundi, Cameroon, Cote d'Ivoire, Democratic Republic of Congo, Eritrea, Gambia, Ghana, Guinea, Kenya, and Madagascar.

Despite the increased activity in private participation, it is estimated that 3–6 million mainlines are needed to meet pent-up demand in sub-Saharan Africa. According to the ADB, most of this investment will have to come through BOO/BOTs. Using wireless technology to provide basic telephone services has great potential in Africa.

Due to global interest, BOO/BOTs in telecommunication have been successful. This success can also be attributed to the possibility of “phased-in takeovers.” Most African countries have opted for commercialization rather than divestiture.

In many cases, privatization represents the unbundling of the post, telecommunication, and/or broadcasting administrations. The state enterprise was commercialized before becoming a PPP. Nigeria, Kenya, Gambia, and Tanzania were slow to adopt privatization. Ghana, Mauritius, and South Africa were among the fastest to establish a framework for private participation.

Apart from an initial management contract, the process has now evolved to open specific segments of the sector to private participation. The second phase is acquisition by a strategic investor. Cellular phone licensing was done separately from urban networks. Local governments are reluctant to accept foreign participation in the basic local grid systems.

Telecom privatization started in December 1996, when Ghana, Ivory Coast, Senegal, and Guinea invited foreign equity participation from Malaysia Telecom and France Telecom. In 1999, Cameroon, Congo, and Kenya did too.

In 2000, Algeria, Madagascar, and Zimbabwe negotiated with foreign investors, but results have not yet materialized. In late 2000, Vivendi Universal entered into a PPP agreement with Maroc Telecom and Mauritel of Mauritania. Several countries chose to delay privatization of their fixed networks.

They opted to sell participations to mobile telephone companies to stimulate competition for their traditional networks. This led to the development of satellite-based operators that handled Internet transmission and the introduction of Africa Online. For the host governments, this meant substantial capital inflow. The consumer benefited by fewer delays in obtaining telephone lines. By the end of 2000, the number of cell phone lines was equal to that of those provided by conventional grids: 1 line per 60 inhabitants.

To maximize revenue, some governments divided their countries into several zones and sold operating licenses to different investors. This was and is the case of Tanzania.

There are five zones that cannot correspond with one another as the national grid operator cannot ensure their interconnection. Cameroon has unbundled its telecom operation into three companies: one devoted to infrastructure, one for domestic connections, and the third for international traffic. The latter merged with Camtel Mobile and has been privatized.

Privatization of conventional grids has been successful. Senegal's Sonatel increased its number of lines by 200,000, and some 650 villages were connected to the network. Benin has chosen a BOO/BOT formula with Alcatel of France and the U.S. operator Titan. BOO/BOT companies will build a network infrastructure and trunk lines which are necessary for maximal efficiency.

It is imperative to first privatize and upgrade conventional grids to allow the superposition of mobile systems.

Power

BOO/BOTs in the power sector started with management contracts and were followed by leases and concessions. Egypt, Uganda, Zimbabwe, Kenya, and Morocco are examples of countries using the concession approach. Cote d'Ivoire and Guinea used leases. The most likely way to promote BOO/BOTs and increase competition, the ADB notes, would be through independent power producers (IPPs), which sell electricity to the national grid.

National power companies are being privatized at the request of the donor community. This has been 20 years in the making. Member countries are reluctant to privatize, as they fear the consequences of tariff increases. They also fear public accusation of feather bedding and mismanagement.

The first power company in Africa to be privatized was in Ivory Coast in 1990. The Compagnie Ivoirienne d'Electricite, which showed a \$23 MM deficit, showed a \$23 MM profit one year later. This success was followed by that of Guinea in 1994 and those of Gabon and Togo in 2000.

The PPP contracts used in these cases were leases, also known as "affermage," where the state keeps ownership of its grid. These contracts have terms of 15–20 years. In most cases, governments have met the terms of these agreements. After a change in government, the new administration of Senegal reneged on the privatization/PPP agreement of the state electricity company. Management contracts without equity privatization are also successful. This has been the case in Tunisia and Mauritania.

The invitation to private or foreign investors to participate in the equity of state companies is due to two reasons: (1) a lack of internally generated cash flows; (2) the indebtedness of the host government to foreign lenders or to its own banking sector.

In most cases, only power generation is open to private participation. Notable examples of BOO/BOTs in Africa are Jorf Lasfar in Morocco (a limited recourse financing and largest IPP [30-year BOO/BOT] project in Africa) and Vridi and Azito in Ivory Coast, partially funded by AIG capital.

Major obstacles for BOO/BOTs are (1) the restriction to sell power to wholesalers outside of the grid and (2) the authorization to recover fixed cost only after the sale of a specific volume of electricity generated at a specific tariff.

Table B-2 shows energy organizations, countries, investors or contractors, and contract types.

Table B-2. Energy Organizations, Countries, Investors and Contractors, and Contract Types

<i>Year</i>	<i>Energy Organization</i>	<i>Country</i>	<i>Investor/Contractor</i>	<i>Contract Type</i>
1990	Compagnie Ivoirienne D'electricite	Ivory Coast	Saur 67.97 percent Privates 25.38 percent	Concession 15 years
1997	Ste d'Energie et d'Eaux du Gabon	Gabon	CGE	Concession 20 years
1998	Ste Nationale d'Electricite	Senegal	Hydro Quebec Elyo (Suez)	Privatization 34 percent Contract voided in Nov. 2000
2000	Ste Tchadienne d'electricite et d'eau	Chad	CGE/State	Concession 30 years
2000	Togo Electricite	Togo	Elyo/Hydroquebec	Concession 20 years
2001	Energie du Mali	Mali	Saur 65 percent IPS West Africa 35 percent	Concession 20 years

Transport

Cost recovery and willingness to pay are a key concern for BOO/BOTs by concession in roads and highways in Africa. As a result, there has been little PPP activity in this sector, even though the need for rehabilitation and expansion is urgent in many member countries. The contracting out for road maintenance is also a promising area for BOO/BOTs and was adopted by Kenya, Algeria, and other countries in the 1990s.

BOO/BOTs in ports and airport infrastructure are gaining popularity worldwide and to some extent in Africa. Countries such as Mauritania, Mozambique, Zambia, Cote d'Ivoire, Mali, Senegal, and South Africa are using BOO/BOTs such as leases and concessions for port and airports.

Airlines

Airlines have been subject to partial acquisition, as with Kenya Airways by KLM at 54 percent.

Ghana Airways has technical support agreements with British Airways. South African Airways entered into a strategic agreement with Swissair. Tunis Air used the stock market for a 35-percent IPO.

The stumbling block against BOO/BOTs is that African airlines tend to be overstaffed. For instance, Air Afrique has five times the amount of employees of other airlines. Despite Air Afrique's requests for expressions of interest, there has been no interest in BOO/BOTs. Air Afrique—as it was known before—is being wound up to be replaced by a new Air Afrique in which AIR France has 23-percent equity and management control over the new company. Cameroon Airlines employed a staff of 1,100 with only two planes. The arrival of its new president allowed a reduction of 35 percent of the staff.

Infrastructure Conglomerates

South Africa's Transnet illustrates potential unbundling. With \$4.5 billion in assets, Transnet employs over 100,000 and owns the following:

- 31,400 km of railroad tracks.
- Seven of South Africa's largest ports, two of which are Durban and Richards Bay.
- Capetown off-loading facility.
- Nine of the largest airports.
- An urban transport system.

One quarter of airports of South Africa's equity has been acquired by Aeroport di Roma of Italy.

Port and Shipping Companies

Port facilities and shipping lines have been more successful in PPP arrangements. This success may be in part due to the nature and directions of trade that requires special vessels, docking rights, and bulk commodity handling facilities. Port authorities frequently participate in the equity of other port facilities to secure routes and to create transshipment regional hubs to funnel business in their own direction.

Tema Shipyard and Dry Dock Ghana were acquired at 60 percent by PSC Terna Malaysia.

Port Autonome D'Abidjan was acquired in part by Groupe Bolloré (Delmas Vieljeux).

Office des Ports du Cameroun, CNAN, the Algerian shipping company, Comanav of Morocco, Sotunav of Tunisia, and Egyptian Navigation are seeking strategic partners.

River, Waterway, and Rail Transportation

Chemin de Fer de Djibouti was privatized. Cie de Transport du Maroc sold 18.5 percent of its equity in the stock market. Regifercam Cameroon was sold in part to Saga France.

Water and Solid Waste

Water is the first cause of mortality in the world. Each year, 5 million people die because of lack of access to water, although only half of potentially usable soft water resources are utilized (WHO). A population of 250 million in Africa has no access to water. This number will double by 2025. Also, 300 million have no sewage systems.

Of agricultural production, 40 percent require irrigation. In rural Africa, 53 percent of the population have no access to water. In Ethiopia, Chad, Sierra Leone, Mauritania, and Angola, about 73 percent have no access to drinking water.

The poorest pay up to four times more to haulers than is charged by PPP grid delivery. Tanzania is an example.

Bodies of water comprise 1/5 of the country. Stale water causes 80 percent of deaths. Of the rural population, 50 percent have access to water; in cities, 60 percent have access. Only 6.3 million hectares are cultivated out of 43 million hectares of arable land; 150,000 hectares are irrigated. Rainfall is adequate as it is in excess of two feet per year. Agriculture represents 50 percent of GDP and 75 percent of exports. Of the population, 84 percent work in agriculture.

For Africa, yearly urban water investment requirements amount to \$3 billion. Investments for rural areas amount to \$1 billion annually. African governments have been able to provide 30 percent of these financial requirements. Most of these investments are in dilapidated grids that deliver only

40 percent of their designed throughput capacity. French operators such as Lyonnaise Suez and Saur International are very active in Africa.

The French government provides annually FF1.2 billion for water infrastructure. An inter-ministerial unit is being established at the French Ministry of Foreign Affairs to deal specifically with water and wastewater infrastructure assistance programs in emerging countries.

New foreign operators are entering the market mostly from Spain, Britain, and Canada. The types of BOO/BOTs in water tried in member countries include management contracts, leases, and concession. An example of a PPP in water is provided in the case study on Queenstown, South Africa, near the end of this appendix. According to the ADB, the main problem with increasing the number of BOO/BOTs in the water sector is the risk perceived with capital recovery, a reflection of a legal and regulatory framework that needs to be better developed.

There are several success stories in BOO/BOTs in the water sector in Africa. In Abidjan, for example, a contract between the Ivoirian government and the private sector operator of the urban water system, SODECI, has proven to be successful. “All stakeholders—private users, government officials, international organizations and the private operator—agree, with few reservations, that the arrangement has worked well” (Menard and Clarke, 2000). Providing contractual arrangements—the same authors of a different study note—for urban water supply with the private sector also seems to have worked reasonably well in Guinea.

Africa is showing signs of increasing its use of BOO/BOTs in water. In 2000, six major PPP contracts were awarded, as indicated in Table B-3. Virtually every transaction to date is a concession. Several upcoming privatizations in countries such as Ghana and Tanzania, however, will be via lease contracts, a model that is more prevalent historically in France and French-colonial regions. Other anticipated BOO/BOT transactions include contracts in Lagos, Nigeria, Tangiers, and Tetouan, Morocco, and Mauritania.

Table B-3. PPP Contracts in Water in Africa Awarded in 2000

<i>Location</i>	<i>Operator</i>	<i>Description</i>
Cameroon	Suez Lyonnaise des Eaux	20-year concession for water supply and the acquisition of 51 percent of shares in SNEC
Casablanca	Suez Lyonnaise des Eaux	30-year concession for Morocco Elyo water supply
Chad	Vivendi	Phased privatization
Nelsprui, South Africa	Biwater and Sivukile	30-year concession for South Africa Investments in water and sanitation services
Dolphin Coast, South Africa	Saur International	30-year concession for South Africa water and sanitation services
KwaZulu-Natal, South Africa	Vivendi	Partnership under the South Africa World Bank's Business Partners for Development

SOURCE: *Water World*.

Water Concessions

Water purification plants represent the bulk of concessions. Wastewater treatment needs a minimum threshold capacity to be viable. Secondary cities do not qualify as they have improper grids.

Sodeci started operation in Ivory Coast in 1988. Sodeci is 96-percent privately owned; local private investors represent 49 percent; French investor represents 47 percent.

Societe d'Exploitation des Eaux de Guinee started in 1989; it was owned at 49 percent by the government, at 25.5 percent by Vivendi, and at 25.5 percent by Saur; and it has a 10-year lease.

Societe de Distribution des Eaux en Centre Afrique is owned at 71.79 percent by Saur, at 25.6 percent by the government, at 2.56 percent by Banque Meridienne BIAO.

In Casablanca, Morocco, the organization Suez Lyonnaise has a submanagement contract limited to distribution and billing.

The cities of Tetouan and Tangiers have joint efforts in a 25-year concession known as a Regie (association of several cities into one operating company) managed by Vivendi, Hydro Quebec, private Moroccan investors.

Johannesburg has given a 5-year management contract to Suez.

Mali Waters is owned at 65 percent by Saur, which has a 20-year concession contract.

LIMITATIONS ON BOO/BOT PROJECT FACILITIES

Private Sponsors' Balance Sheet Limitations

The lack of serious, competent, dedicated, well-capitalized U.S. and European sponsors for urban and environmental infrastructure projects is a serious handicap, according to officials of the International Finance Corporation (IFC) and others.

There are exceptions, like Saur International, Suez, Vivendi, Waste Management Inc., Brown and Ferris Inc., and Bechtel Corp., but they tend to prove the rule that there are very few companies with the expertise, wealth, and inclination to take a leading equity position in infrastructure projects overseas.

This is because of the actual and perceived risk/return characteristics of overseas projects, the innate conservatism of potential sponsors, and the dimensions of domestic business opportunities. World Bank officials note that most sponsors of energy/PPP projects in developing countries require an annual rate of return on their equity of about of 20–25 percent; this is undoubtedly beyond reasonable expectations for many urban environmental infrastructure projects.

The limited number of strong project sponsors able to provide a corporate guarantee will limit the number of PPPs sponsored by a corporation alone. We know of a French company whose bid was rejected by the City of Atlanta, Georgia, because of its balance sheet's over exposure in projects located in category C and D countries.

Unless the sponsor obtains a credit guarantee from its export credit agency or syndicates a commercial bank credit guarantee as was done for Korean general contractors in the Arab Gulf, it is unlikely that the same contractor will duplicate such an undertaking often.

Insurance companies' guarantees have their limits unless underwritten by an insurance company located and registered in member country markets. In the case of U.S.-based insurance companies, most of them are registered in the state of Delaware and subject to Delaware regulators unfamiliar with Africa. Ultimately an accumulation of country C or D exposure could become detrimental to their credit rating and their borrowing rates. Direct funding by life insurance companies registered in

member countries would be possible, as their income and liabilities are denominated in local currencies.

Limitations of Commercial Banks and Other Private Lenders

A major problem for the development of urban environmental and energy infrastructure projects is the decline in commercial bank lending for foreign projects, particularly among U.S. banks, due largely to the losses suffered on developing country debt during the balance of payments crises of the 1980s and 1990s.

Commercial bank lending has never recovered from these problems, except for short-term trade lending, and the World Bank has recently stated that only 28 commercial banks are now engaged in project financing in developing countries worldwide. The International Institute of Finance has estimated an even lower figure: not more than 24 active banks. Most of these are in Europe and Japan.

Risk is the major concern of commercial banks approached for overseas project financing, but another deterrent is the repayment term required for infrastructure projects, which is at least not without support.

It is difficult to believe that U.S. or Canadian potential private lenders, such as insurance companies and pension funds, would take such risks in view of their lack of regional experience and in the absence of a credit rating and a strong assurance of repayment.

Foreign Government Assistance Program Limitations^{3/4} The Case of U.S. Agencies

There are several U.S. agencies playing a key role in facilitating and financing urban environmental and energy infrastructure projects. They are the Export Import Bank (EX-IM), OPIC, the Trade Development Agency (TDA), and the U.S. Agency for International Development (USAID).

Each agency has its own mandate, including the fostering of U.S. foreign policy.

Most of the U.S. agencies have difficulties with limited recourse financing. The expertise to successfully operate such a facility is not presently available in these agencies. Only OPIC provides project finance coverage independent of sovereign guarantee requirements, for capital projects in developing countries, or through OPIC emerging market funds mechanisms.

None of the U.S. agencies works closely with the World Bank and other international financial institutions to finance capital projects. The level of budgetary resources allocated to Eximbank, OPIC, AID, and TDA is very limited in relation to the total potential need for urban environmental and infrastructure projects. For AID specifically, the tightness of budget resources and competing priorities has produced a steady decline in capital projects over the last 10 years. In BOO/BOTs, the AID and TDA recent assistance has been almost wholly in the form of nonreimbursable grants which count 100 percent against budgetary allocations and therefore offer no budgetary leverage.

BOO/BOTs Eximbank and SBA have export finance programs oriented to small business exporters, but these programs are neither as well known nor as heavily utilized as they might be. Duplication of coverage and unevenness of marketing efforts characterize BOO/BOT programs, and a major problem for small exporters remains the difficulty they have in arranging bank financing to meet working capital needs.

Other U.S. government agencies with an interest in the export of environmental and energy infrastructure projects have things they might contribute to the key financing agencies, including extra funding, project evaluation expertise, delivery of financial programs to the local level, and technical assistance to project sponsors. But to date, they have not been effective in these areas. The other agencies include the Department of Energy, Environmental Protection Agency, and Department of Commerce.

U.S. State Governments

All of the 50 state governments have established trade and investment promotion offices and addressed export finance issues at some level. About half of the states have established export finance programs that work with the federal government typically through EX-IM. The explicit goal of these programs is to improve their firms' ability to participate in overseas projects and increase their exports of goods and services. These states help their exporters obtain working capital financing using their own guarantee programs, sometimes enhanced by investment banking syndicates and help to market and make application for federal loans and guarantee and insurance programs. One of the main problems the states face is a lack of reserve funds needed to operate their own guarantee programs and a lack of administrative funds to expand their ability to bring federal financing programs home to local exporters.

Additional Constraints Affecting BOO/BOTs in Member Countries

Governments continue to provide economic and social infrastructure in the traditional way, even though there are many projects that could be structured as BOO/BOTs. Thus, the supply of BOO/BOTs falls well short of potential.

Most countries and governments may be unaware or may not fully realize the potential benefits of BOO/BOTs. If they do, they may be stymied by a lack of capacity to undertake them. BOO/BOTs call for skills in finance, economics, engineering, legal, regulatory, and procurement areas, areas in which governments typically have difficulties retaining qualified people.

Bureaucratic realities often get in the way of BOO/BOTs. Line ministries frequently resist the new approach, which is viewed as a threat to power and prestige, including informal perquisites sometimes associated with the traditional tendering process.

Even when these obstacles can be overcome, the process of identifying PPP projects and taking them through the project life cycle to implementation is a long one, and without benefit of previous experience, they can run into difficulties that can delay or derail a project or program.

In spite of all the obstacles, some projects are tendered as BOO/BOTs. The reception by the potential private sector sponsors and bankers is often mixed. The risk that is normally encountered in emerging market countries seems to be considered unacceptably high by potential sponsors in the "latecomer" member countries. It seems to include country, political, regulatory, market, payment, inflation, and foreign exchange risks.

In view of these factors, multilateral institutions and other donors have worked with governments to help them to create PPP programs and to provide support to specific PPP transactions.

In most cases, implementation of such program was delayed because of the following:

- Reluctance of governments to allow third-party management in state enterprises.
- Delays in permitting.
- Fear of public unrest due to the following:
 - ? Labor redundancy.
 - ? Increased tariffs and collection efficiencies.
 - ? The uncovering of wrongdoing and waste.
 - ? Fear of losing personal gain generated by the company.

Ways to Overcome Constraints

The essence to overcoming the constraints is to begin to create a market: the supply of and demand for BOO/BOTs.

A good way to begin to develop a market for BOO/BOTs is to provide training and increase awareness among key stakeholders: government, ministries, unions, the local business sector, and consumers.

To increase the supply of projects, governments in member countries can reexamine existing projects scheduled for the traditional approach or old projects that have been subject to a feasibility study but which have not been implemented because of inadequate budgets. Thereby, the governments can see if such projects lend themselves to a PPP approach.

The review of existing projects that have PPP potential can be helped if member country governments move from an ad-hoc, case-by-case approach to BOO/BOTs and begin to create a more structured approach to them. They can do this by creating PPP units, which are technical teams that identify PPP candidate projects and take them through the project life cycle, from identification to procurement to award and postaward monitoring and supervision. While every project is different, PPP projects share features and can benefit from a common approach that can achieve economies of scale and scope in taking projects through the project life cycle.

MC governments can also begin to create a demand for BOO/BOTs through the public awareness effort, to explain the benefits to citizens of BOO/BOTs. They can create a demand from the local and foreign private sector sponsors and financiers by creating clear policies on BOO/BOTs that explain how one would work as a partner in or with the private sector. They would increase the demand for BOO/BOTs by establishing a consistent and transparent legal and regulatory framework for them, covering such areas as tendering, evaluation, negotiations, tariffs, standards of service, and dispute resolutions.

KEY ELEMENTS OF THE ENFG'S STRATEGY FOR BOO/BOTS IN MEMBER COUNTRIES

How Multilateral and Other Institutions Help BOO/BOTs

The World Bank is limited by its charter to making loans and guarantees to governments backed by a sovereign guarantee. It cannot make direct loans to BOO/BOT projects, which by definition lack

sovereign guarantees. However, the World Bank has worked with donors to find creative ways to assist member countries in implementing BOO/BOT projects.

The World Bank plays a key role in enhancing the bankability of PPP projects. In several countries, the bank has channeled loan funds to private sector infrastructure development funds (PSIDFs), which make loans to PPP projects. These loans typically constitute 20–30 percent of project debt financing, with repayment terms longer than commercial bank loans. This assistance helps projects to structure favorable financing packages and repay commercial bank loans quickly. The result is a reduction in commercial bank risk that lowers interest costs for borrowers and increases banks interest in participating in projects, particularly those with IFC backing.

In Pakistan, for instance, the World Bank helped establish a \$520 million private sector energy development fund for long-term loans of up to 30 percent of the cost of qualifying energy projects, including BOO/BOT projects. The bank also provides assistance for PPP projects by conducting sector studies to determine the feasibility of PPP projects.

The World Bank is also able to provide partial credit and partial risk guarantees to PPP projects to improve their bankability. This enables them to leverage a greater amount of private sector finance. However, to date, guarantees have proved time-consuming to use.

The IFC, which is the private sector–lending arm of the World Bank Group, and the private sector window of the Asian Development Bank (AsDB), have played a pivotal role in bringing projects to financial closure in less than investment-grade countries, particularly in Asia. As the IFC does, ENFG could make equity and debt investments in PPP projects, often syndicating loans with commercial banks, known as “B” loans. Interest rates for these loans are lower than those of typical commercial bank loans because the loans run less risk of rescheduling.

The success of a number of IFC- and AsDB-assisted projects in Asia has catalyzed the development of project finance in a number of countries where risk is too high to attract purely commercial investment. Once financed and commercially successful, these projects have provided a significant “demonstration” effect, which has increased commercial bank financing for subsequent projects.

A short case study on the Hopewell PPP power project in the Philippines, near the end of this appendix, illustrates the catalytic role played by the IFC and ADB in providing finance to an early PPP project. Subsequent projects succeeded in attracting private finance in the Philippines, and the Philippines’ PPP program went on to become one of the most successful globally.

Like the IFC, the Multilateral Investment Guarantee Agency (MIGA) is part of the World Bank Group. MIGA supports investment by providing political risk insurance to foreign investments, including BOO/BOTs, in emerging markets. It covers four basic types of risk in foreign investment: risks of expropriation, war and civil disturbance, currency inconvertibility, and breach of contract and denial of justice.

USAID has sponsored numerous training and public awareness programs to lay the foundation for the development of PPP programs and units.

USAID has also played a leading role globally in providing technical assistance to create BOO/BOTs in a number of the countries. Three examples can be mentioned. USAID supported the Philippines in its efforts to develop a PPP program throughout the 1990s.

Their assistance of USAID played an important role in developing the Philippines program. USAID is also facilitating support for South Africa to develop PPP projects, especially for municipal

services in former black homeland areas where the supply of water and other vital services was inadequate. In Egypt, USAID has supported PPP activities in the water and wastewater sector and solid waste collection and disposal. It has worked to create an enabling legal environment and initial transactions to attract the private sector to provide these basic services.

The mission of the Development Bank of South Africa (DBSA) is to “facilitate the provision of infrastructure development finance in order to improve the quality of life of the people of South and southern Africa.” Their mandate includes four levels of investment: municipal and household infrastructure serving basic needs; economic infrastructure facilitating regional and national linkages; institutional infrastructure; and social infrastructure, including health, education, and recreation.

The DBSA has broadened the scope of its activities to act as a catalyst for BOO/BOTs. The DBSA established the Private Sector Investments in 1996 to develop the bank’s portfolio of BOO/BOTs. It identifies, appraises, and manages PPP projects, and in such projects it provides technical assistance to public sector clients, coordinates interaction with private sector developers and financiers, and interacts with bilateral and multilateral organizations on co-financing and technical assistance. The DBSA provides a range of financial products to private providers of infrastructure services including loan finance, equity investments, guarantees, and refinancing commitments. Financing is supported by technical assistance aimed at enhancing the capacity of the clients to plan, manage, and implement BOO/BOTs.

The DBSA has taken a leading role in two of the infrastructure BOO/BOTs underway in South Africa. In the Witbank-Maputo Toll Road, the DBSA is co-arranger of the debt facilities for the project and invested approximately R200 million. It provided 20-year loans, with a longer maturity than the commercial banking sector’s. Assistance to Nelspruit water PPP included assisting it with project structuring, undertaking technical and financial investigations, premarketing the transaction with the private sector, design of the bidding process, and preparation of bidding documents.

The DBSA also houses South Africa’s Municipal Infrastructure Investment Unit, which provides technical assistance and support to municipalities to develop BOO/BOTs to provide local services such as water and wastewater and solid waste collection and disposal.

Though not an institution *per se*, the South Africa Infrastructure Fund (SAIF) is an interesting example of how financing is being mobilized in Africa to support BOO/BOTs, in part because of the AFDB support for it. SAIF is a private equity fund that seeks to achieve long-term capital appreciation through private sector investment in infrastructure projects in southern Africa. SAIF’s capital base is made up of irrevocable capital commitments from 14 South African institutions and the AFDB. South Africa is the primary focus of AFDB.

However, some investments will involve cross-border projects or projects outside South Africa. It is intended that up to 20 percent of AFDB’s capital will be allocated and invested in projects in southern Africa outside South Africa. The focus of AFDB is on, among others, investments in the environmental (water, waste, sanitation, and sewerage), energy, telecommunications, and transport. AFDB concentrates on equity investments in green-field developments and in expansion, rehabilitation or restructuring of existing infrastructure projects. Investment by AFDB is concentrated on equity opportunities and may, in exceptional cases, be accomplished through quasi-equity, subordinated debt, convertible debt, hybrid securities, or a combination thereof.

Lessons Learned from the Multilateral Institutions

The basic lessons learned from the experience of the multilateral institutions is that there is an important—indeed vital—role for them to play in assisting countries in developing BOO/BOTs, especially among the “latecomer” countries. For example, for the many member countries that do not have a credit rating, the role of a multilateral institution is almost essential if some of the more advanced forms of BOO/BOTs, such as concessions, are to take place. The involvement of multilateral institutions and others can be decisive in helping the private sector, especially the foreign private sector, to understand the elements of risk involved in working with BOO/BOTs in a particular country and to find ways to identify and assign the risk in a PPP.

The specific lessons learned include the following:

- Training and public awareness is a very valuable contribution in “starter” countries and especially “latecomer” countries in initiating their PPP programs.
- Creative financing techniques devised by the multilateral institutions have proved to be important in bringing initial transactions to closure and have acted as a catalyst to mobilize subsequent private sector finance. After the period of playing the catalytic role, though, they should not compete with the private sector in providing finance. The private sector has the comparative advantage in financing BOO/BOTs.
- BOO/BOTs can only be financed if there are governments that have the capacity to identify BOO/BOTs and bring them to the attention of the private sector through the tendering process. Perhaps an even more important role for the multilateral institutions then, is to help countries to bring BOO/BOTs to the market through a structured PPP program with a PPP unit. This can help to ensure a steady supply of well-designed BOO/BOTs in which the private sector will be interested, rather than an erratic ad-hoc supply of poorly designed projects.
- With few exceptions, it is important to avoid overly ambitious PPP projects at first, especially in “latecomer” countries. Doing a transaction with a complex PPP is a difficult task in the best of circumstances, and if the project is too big, it may result in delays that will diminish the enthusiasm for the concept and bring on fatigue by the major parties.
- Another important lesson learned from the experience of multilateral institutions is that helping countries implement BOO/BOTs is a medium- to long-term undertaking. With the possible exception of service or management contracts, it is generally difficult to break ground on PPP transactions in the first year of assistance. ENFG and its board of directors must understand that it may be difficult to show much success in the short run. If it does have the stamina and patience, however, it can be of great assistance to its client countries in enabling them to undertake PPP projects and programs and thereby advance economic and social development.

CASE STUDY^{3/4} QUEENSTOWN (SOUTH AFRICA)

The Queenstown water PPP is an interesting case study. Although in several respects, the tendering process for the document fell short of best practices, the results of using the private sector seem to make up for any procurement shortcomings.

Queenstown had embarked on some earlier BOO/BOTs and privatizations before the water sector. A vegetable market owned by the municipality was losing money. Queenstown decided to simply give the market away. The private sector improved and upgraded it, and it became a “ratable asset.” The market thus went from being a drain on the municipal budget to providing it with revenue.

An abattoir owned by the city was also running at a loss and failing to meet the standards of hygiene set by the department of health. The municipality sold it. The abattoir started to make a profit and was able to contribute to the city’s budget. Other municipal services privatized included solid waste and cemeteries. (Perhaps they were run by the same group, enabling them to achieve economies of scale and scope. With the cemeteries, it would be interesting to find out if they ran into stiff opposition to the idea.)

Impressed by these results and influenced by the United Kingdom’s experience in privatization, the town council decided to tackle a large target: the water sector. They drew up tender documents according to the law or regulations for municipal tenders. The town clerk freely admitted that they made two basic mistakes in the tender document: it didn’t contain any specification, making it difficult to compare “like with like” in the evaluation process; and they didn’t widely market the tendering process. It seems that the municipality was asking the private sector to give them their best ideas for improving water and wastewater services without specifically having any particular PPP technique in mind.

The town clerk mentioned that the process was guided by the principle of working for the best interest of the rate payer. And he said that they spent time with the workers to explain what the concession would mean for them. They stipulated that the affected staff could not be made worse off under the concession. Of the staff members, 45 resigned from the municipality and joined the new company. The workers are provided with ongoing training. According to the town clerk, not one wishes to go back.

This process took place before the democratization process of 1994. The original concession was for the old, white area of Queenstown, which had about 5,000 households. (The contract between Queenstown and WSSA is often referred to as a concession, although it is more of a hybrid. It is largely a management contract, although it has some features of an investment concession because it involves some new investment in expanding the sewage treatment plant.) While the service was not especially bad, they did not know the extent of water losses through leaks because the system was not metered. Old Queenstown also supplied two nearby black townships with water in bulk, though it was not responsible for reticulation (i.e., distribution to households).

WSSA submitted a proposal that emphasized a concession approach instead of a “cost” proposal. It contained the following items:

- Well-defined responsibilities.
- Acceptable conditions of transfer and employment of the municipal personnel.

- Clearly spelled out rates (per cubic meter of water consumed), allowing easy financial evaluation, showing in particular how much money the town would save.
- A real degree of commitment and risk by the operating company, WSSA, linked to a good technical understanding of the system.
- Financing for part of the project to extend the sewage treatment plant.

The initial contract in July 1992 stipulated that WSSA would manage, operate, and maintain the entire water and sanitation systems of Queenstown for a period of 25 years. This included the following:

- Of raw water supply pipeline and pumping stations, 50 kilometers.
- A 36,000–cubic-meters-per-day water treatment plant.
- Of water reticulation including 5,000 connections, 120 kilometers.
- Of sewers, 100 kilometers.

Under the terms of the concession, WSSA is responsible for wages for workers transferred from the municipality to WSSA, the cost of electricity and chemicals, the cost of maintenance and repairs, the replacement of water pipes and meters as needed, the replacement of electro-mechanical equipment, and the extension of the sewage treatment plant.

The contract provides for quality standards in terms of delivery of services and pollution control. It also addresses the maintenance and replacement of assets; penalties and liabilities for noncompliance with standards; a series of specific clauses defining conditions of contract termination, conflict resolution, and arbitration; and insurance that WSSA must be covered by.

Queenstown employs an independent consultant to check periodically the standards of service, water purity, and sewerage discharge. The consultant issues a report to the town council. If any problems are observed, the town council and WSSA discuss them. The town clerk said that they were pleased with their partnership with WSSA. He noted that whenever problems came up, they would resolve them among themselves. He believed that these approaches were sufficient for the regulation of WSSA. He was wary of any centralized regulation above and beyond what was already in place.

The payments to WSSA are based on a fixed rate for fixed operational costs such as staff and a rate per cubic meter of water actually consumed by users as determined by the meters. WSSA bears the costs for water unaccounted for from leaks and other losses. The concession provides for a pre-agreed escalation formula to permit rises in cost which result from inflation in South Africa.

After the first year of operation, Queenstown was served with water at a 17.9-percent cost reduction.

After democratization, old Queenstown was amalgamated with the townships of Mlungisi and Ezibeleni. According to the town clerk, the town council and WSSA amended their concession to include the provision of distribution of water to these two townships. The two townships had 14,000 households with water connections. According to WSSA, by 1995 the services to Mlungisi and Ezibeleni were equalized, including rehabilitation.

Queenstown still collects payments for water and wastewater services from households itself. WSSA would like to assume the responsibility for billing and collecting. They are currently holding

discussions with the town council to introduce customer management, whereby they would improve the current billing and collection system.

WSSA in Queenstown offered some interesting insights into how the private sector can introduce cost efficiencies. They noted that before the concession, the water company maintained a constant level of water in the reservoirs. They pumped water into them whenever the level fell below the stipulated level. WSSA now pumps water into the reservoirs above the former level when the charges for electricity are low, typically before 7:00 a.m. It stops pumping just before 7:00 a.m. and resumes at 11:00 a.m. when rates have gone down again. By carefully monitoring the times that it pumps, it has been able to realize considerable saving of costs on electricity.

WSSA also monitors its inventories closely. It introduced security around the warehouse that houses the inventory. Before the concession, there was little control, and workers were free to help themselves to desired items. WSSA also practices to the extent possible “just-in-time” inventory so that it doesn’t have to tie up a lot of cash in inventory before it is needed.

It has also introduced a set of tools on the pickup vans that respond to customers’ calls so that they can deal on the spot with relatively basic repairs and maintenance. Before, the vans would go out to inspect a problem, then return to headquarters to pick up the tools. This unnecessary driving added to maintenance costs. Also, there was a liberal policy before the concession of allowing workers to use the vans after hours. After the concession, this policy stopped, with considerable savings on maintenance of the fleet.

WSSA now closely monitors calls for repairs and maintenance. If a problem requires urgent attention, WSSA will respond to it after hours or on the weekend. Otherwise, they determine if it can be dealt with during working hours. In this way, they avoid having to pay overtime for unnecessary work. Before the concession, overtime was reportedly much higher.

CASE STUDY—THE HOPEWELL PROJECT (PHILIPPINES)

An example of a BOO/BOT project in the Philippines (one of the earliest BOO/BOT power projects in Asia) is the Hopewell Energy (Philippines) Corporation’s 200 megawatt gas turbine plant located at Navotas, Metro Manila.

The financing arrangements indicate the “art of the possible” that was then in the Philippines. Under the terms of the BOO/BOT agreement, Hopewell would build, own, and operate the Navotas plant for 12 years and then transfer it free of charge to the National Power Corporation (NPC).

The terms included the following provisions:

- All electricity would be purchased by the NPC.
- NPC will provide the site and all fuel for generation of electricity at no cost to Hopewell.
- NPC will pay Hopewell a capacity fee (monthly) for standby capacity committed to be available plus an energy fee based on electricity actually generated.
- The project was awarded “pioneer” status by the government. This status provides certain privileges including a “tax holiday” of 5 years and a waiver of import duties on equipment.

The IFC and the ADB (through its private sector window) provided US\$10 million in loans with a 10-year maturity in U.S. dollars on a floating rate basis. Another US\$10 million was obtained on a

complementary basis linked to the ADB direct loan, with a 7-year maturity in US\$ on a floating rate basis. This complementary financing was provided by four European commercial banks, with the ADB as lender of record but with commercial banks taking full project risk.

The government of the Philippines guaranteed all performance obligations of the NPC (including payments). The capacity fee and energy fee were paid in U.S. dollars to an offshore bank account to be maintained by Hopewell.

The equity participation by Citibank was in the form of a debt-equity swap. Notable was the absence of local financing, apart from certain “in-kind” contributions from NPC (land and fuel). Reasons included the unfamiliarity by local financial institutions with BOO/BOT, the lack of suitable term financing, the reluctance of Hopewell to risk the crowding out of limited local financial resources, and the desire to get the project on stream quickly.

Hopewell indicated that this project, relatively small in scope by BOO/BOT standards, was designed as a demonstration project to determine what could be accomplished on a BOO/BOT basis. The experience gained in the first small project encouraged them to attempt a second, much larger BOO/BOT undertaking, which was successful.

Subsequent power projects in the Philippines succeeded in attracting private finance. The Philippines PPP project expanded its sectors of activities. The Philippines PPP program is regarded as one of the most successful.