The challenges of funding Sub-Saharan infrastructure

Sub-Saharan Africa: The challenges, misconceptions and financing involved in Infrastructure projects in the region

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Bujagali Hydroelectric Dam, Burundi, Democratic Republic of Congo, DRC, Economic Community of the Great Lakes Countries, Energies des Grand Lacs (EGL), PPP, PPPs, Public Private Partnerships, ruzizi III, Ruzizi III Regional Hydroelectric Project, Rwanda, Uganda, World Bank

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Decades of underinvestment and mismanagement in Africa have resulted in poor performance across many areas, namely the power, rail, and road sectors. Less than 40 per cent of the population across the continent has access to electricity and electrification rates of less than 10 per cent are not uncommon in Sub-Saharan Africa. Approximately 34 per cent of the population has access to improved sanitation facilities, and 35 per cent lack access to clean drinking water.

The infrastructure deficit in Africa is sizable even compared to the deficits of other low income and developing regions. Tremendous opportunities for investment in infrastructure exist in the continent and the governments of many African countries are starting to take the types of actions that are required to turn their countries into desirable investment destinations. In many cases, the electricity sector is one that deservedly receives much of their attention.

It has been clear for some time that scaling up financing from the traditional sources of taxes, government borrowing, and aid will not be adequate to successfully address the infrastructure gap. Public-private partnerships (PPPs), which use private expertise and funding to construct, operate, and maintain infrastructure and deliver public services, are one of the solutions African governments are turning towards to solve this deficit. Yet, such projects need to overcome a range of challenges to ensure that they are well structured, deliver value for money, and transfer operational risk to the private sector.

In the least developed countries, three of the most significant of these challenges are: (i) political instability, (ii) mustering the political will to balance the interests of investors and consumers (and keep them balanced), and (iii) a shortage of skills in structuring and negotiating PPPs in the public sector.

Balancing the interests of investors and consumers

One of the most widespread causes of poor infrastructure is the lack of cost-reflective tariffs. The tariffs paid by consumers for basic services in most African countries are not sufficient to enable the utility or service providers to recover the costs it incurs to provide the service. Across Africa, it is politically difficult for governments to increase tariffs to cost-reflective rates. As a result, many governments have established independent regulatory authorities to de-politicise tariffs.

But taking these steps introduces a new problem–the newly established independent regulator has no proven track record of successfully balancing the interests of investors and consumers. This is particularly difficult to achieve with large, complex projects because it may not be feasible for investors to bid a fixed price.

Uganda has suffered from a shortage of generation capacity for several years and provides a compelling example of a country that has worked to address the problem of balancing investors and consumers demonstrated by the operation of the US$900 million, 250 MW Bujagali Hydroelectric Dam – the largest private sector investment ever undertaken in the region – which achieved commercial operations on August 1 2012, signifying a monumental change for Uganda’s power generation.

Starting in the early 1990’s, the World Bank and other development finance institutions aggressively advocated for structural reforms to the electricity sectors of developing, emerging, and least developed countries. Simply put, they concluded that the process of establishing electricity tariffs had to be de-politicised before utilities would be able to charge cost-effective tariffs. By 2003, it had become clear that independence was not enough, and that a clearly specified regulatory contract must be negotiated by the political authorities for projects to gain public acceptance and retain it for the long term.

In January 2004, the Government of Uganda launched a request for proposals (an RfP) seeking investors to develop the project. The RfP contained a detailed set of formulas that collectively established a detailed tariff methodology that was annexed to the Power Purchase Agreement.

The tariff methodology contained cost openers for the capital cost of the project and for costs associated with the servicing of the project loans. There were many advantages of the RfP that encouraged private sector interest in undertaking the project. Given the tariff’s structure, the bid evaluation criteria included an explicit internal rate of return on the equity invested in the project, a cap on the development costs the sponsors would seek to recover, and a fixed monthly operations and maintenance charge.

The Bujagali Hydroelectric Project has demonstrated that regulation by contract can be successfully applied to independent power projects. Uganda successfully avoided the trap into which many countries with newly established regulators fall. This was possible largely as a result of the willingness of Uganda’s Electricity Regulatory Authority to engage in a dialogue as to the types of tariff structures they felt would be consistent with their obligation to balance the interests of consumers and investors, but to ultimately permit that tariff structure to be embodied in a contract that is subject to international arbitration.

Uganda’s efforts have paid off. It has been identified as one of a select few countries that are at the forefront of reform, and Uganda’s economy is now expected to achieve growth rates of between 7.5 per cent and 10 per cent during the 2012 to 2016 period.

Political Instability

Many of the least developed countries have suffered political instability and conflict at both the national and the regional levels. It is difficult to attract investors and debt financing for projects that are located in such regions, but it is not impossible – there are tools to address these issues.

Take, for example, the Ruzizi III Regional Hydroelectric Project currently being promoted by Energies des Grand Lacs (EGL), a regional organisation that operates under the auspices of the Economic Community of the Great Lakes Countries with a mission to foster regional cooperation in energy projects. The site of the project is on the border between the Democratic Republic of Congo (DRC) and Rwanda. The offtakers include the parastatal utilities of Burundi, the DRC, and Rwanda – three nations with a long history of conflict.

Many projects would simply get derailed in such an environment, but Ruzizi III has benefited tremendously from EGL's cross-border facilitation of the project. The key has been transparency, consultation, and an unwavering focus on the technical, legal, and economic problems that must be overcome.

The project has also benefited tremendously from the support of a broad range of bi-lateral and multi-lateral development finance institutions, which financed the initial steps in the project's development, have signaled interest in lending to the project company, and are likely to offer political risk insurance and guarantees that cover the risk of sovereign defaults under the project agreements.

The Capacity of the Public Sector

Launching a successful PPP requires governments to find the political will to make a number of decisions of critical importance quickly and transparently. This challenge is often compounded by a lack of experience and gaps in understanding at the level of the civil servants who are responsible for advising political decision-makers. These problems can be overcome by quality advisors, but the expense of quality advisors is itself a challenge to many governments. Fortunately, bi-lateral and multi-lateral development finance institutions, and experienced investors alike understand this problem and often step in to fill the gap.

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