# The necessity of a strong regional regulatory oversight on infrastructure projects in Africa

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1. The quality of infrastructures and collective services available and accessible in each country has a significant impact in improving populations' living conditions and fostering economic growth[1]. Delmon held that investing in infrastructures is not only a good investment, but is even a moral and economic imperative[2]. This is perhaps why, since the end of the Second World War, the development of infrastructures and public services rested on states which still today deliver a substantial part of the financing needed for such a development[3].

2. Nowadays however, public funding is not sufficient to close the gap between infrastructure needs and available funds due mainly to an ever increasing demand in such financing and also often to a lack of technical and managerial capabilities of the public sector. Moreover, public budgets have also become insufficient – and even almost totally inexistent in some African countries – to finance all productive and collective investments. This helps explain the increased participation of the private sector as well as the systematic use of competitive mechanisms in the economics of public assets[4].

3. As a matter of fact, states and public entities are increasingly relying, in their economic development policies, on processes and schemes that favor the assistance and the intervention of the private sector. Associating the public and the private sectors appears as a reliable and inescapable alternative for financing public services needs and most notably collective infrastructures and, particularly in Africa, even some industries.

4. Besides traditional means of financing development with public funds (including borrowings) or with public guarantees therefore, innovative methods[5] generally

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[1] Even though some authors claim that there is no direct causation between an increase in infrastructure spending and economic growth compared to an increase in spending related to healthcare or education for example, it has been proved that the quality of physical infrastructure has an impact on productivity, competitiveness on foreign markets as well as on the ability of a country to attract foreign investments. See e.g. B. Akitoby, R. Hemming and G. Schawrtz, Investissement public et partenariats public-privé, Washington D.C., FMI (FMI-Dossiers économiques), 2007, p. iv; *adde* for further studies showing the impact of infrastructures and collective services on the economic growth: J. L. Guasch, *Granting and renegotiating infrastructure concessions – Doing it right*, Washington DC, World Bank Institute, 2004, p. 2 and all the references cited by this author; J. L. Guasch, J.-J. Laffont, S. Straub, Renegotiation of concession contracts in Latin America, USC Center for Law, Economics & Organization, Research paper n° C02-22, available on: http://papers.ssrn.com/abstract_id=340580, p. 2 ; J. Delmon, *Public-Private Partnership projects in infrastructure – An essential guide for policy makers*, Cambridge, Cambridge University Press, 2011 (paperback), p. 1.

[2] J. Delmon, *Private sector investment in infrastructure – Project finance, PPP projects and risk*, The Netherlands, Wolters Kluwer, 2nd edition, 2009, p. 1.

[3] See about the leading role of the public sector in the financing of infrastructures: J. Delmon, Public-Private Partnership projects in infrastructure – An essential guide for policy makers, op. cit., p. 2.

[4] Public assets in this context refer to physical goods as well as services which production require the intervention of a public authority or have to be carried out by the latter since the market would not adequately satisfy that production.

[5] According to some scholars, "The public customer would weigh the tradeoffs with respect to quality, cost, and schedule. The gap between a public customer's objectives and available resources would determine the financing approach. If the resources are limited, then an innovative project delivery and financing method is needed": A. M. Algarni, D. Arditi, G. Polat,

inspired by project finance[6] – i.e. basically the ability of a project to generate revenues – are increasingly used to reach the goal of optimal financing of collective needs. Those innovative processes and methods are now referred to as public-private partnerships (here after "PPP")[7].

5. A PPP has the advantage of both offering new alternatives of private financing and managing of public projects while allowing states or public entities to retain the strategic control and direction of public projects as well as on the ownership of facilities which stem from those schemes[8]. The Build, Operate and Transfer ("BOT") option is for example one of the PPP's modalities[9].

6. However, the implementation of a PPP structure in Africa is not without problems. In fact, a successful PPP involves, among other, legal reforms, innovative approaches to risk mitigation and mobilizing private investment, implementing good practice procurement processes and deepening local financial markets and local private sector. While PPP projects may help mobilize competition to drive down project cost and improve innovation, it is also recognized that: "They are not panaceas and they require clear goals and objectives, good public leadership, and a strong government institutional capacities for effective implementation"[10].

7. Private sector involvement is not indeed a panacea and the notion that the private sector is more efficient than the state can only be supported in situations of vigorous competition and free market principle that tends to be conspicuously absent in the case of public infrastructure projects[11]. Moreover, the pursuit of efficiency can have perverse results, hence the need for states to ensure for example that operating cost are not reduced to the detriment of project's quality of service, or its long-term interests. Intensive and effective monitoring from a regulatory body is therefore needed.

8. In advocating for a regional regulatory regime governing this infrastructure finance/delivery technique in Africa, this paper takes a critical look at the PPP structure by examining its various negative potential impact upon African countries.

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Build-Operate-Transfer in infrastructure projects in the United States, in Journal of Construction Engineering and Management, vol. 133, n° 10, 2007, p. 729 with the reference to Sweeney quoted by the authors.

[6] See e.g. for a detailed study of this technique: G. Vinter, G. Price and D. Lee, Project Finance, 4th edition, London, Sweet & Maxwell, 2013; *adde* for a recent study in French: N.R. Tafotie Youmsi, Introduction au Project Finance, Bruxelles, Larcier, June 2015.

[7] See e.g. for a multidimensional analysis of PPP: N. A. Andersen, *Partnerships – Machines of possibility*, Bristol, The Policy Press, University of Bristol, 2008; D. Grimsey and Mervyn K. Lewis (Eds), *The economics of Public Private Partnerships*, Cheltenham/Northampton, Edward Elgar Publishing Limited, 2005; J.-Y. Perrot and G. Chatelus (Eds), *Financing of major infrastructure and public service projects – Public-Private Partnerships (Lessons from French experience throughout the world)*, Paris, Presses de l'Ecole nationale des ponts et chaussées, 2002.

[8] See E. Engel, R. Fischer and A. Galetovic, The economics of infrastructure finance: Public-private partnerships *versus* public provision, in EIB Papers, Vol. 15, n° 1, 2010, p. 6; *adde*: J. Delmon, *Private sector investment in infrastructure – Project finance, PPP projects and risk*, 2nd edition, 2009, op. cit., p. 4.

[9] For an in-depth analysis of the BOT option see N. R. Tafotie Youmsi, *Build, Operate and Transfer: Modalité de partenariat public-privé – Approche Law and Economics*, Bruxelles, Larcier, 2013.

[10] J. Delmon, *Private sector investment in infrastructure – Project finance, PPP projects and risk*, 2nd edition, 2009, op. cit., p. 4. Delmon adds that experience has demonstrated that the best way to attract more private capital into infrastructure is to provide a sustainable and credible policy and regulatory framework.

[11] See M. M. Kumaraswamy and X. Q. Zhang, Governmental role in BOT-led infrastructure development, International Journal of Project Management, 19 (2001), p. 200.

9. Presently, international PPP agreements lack sufficient regulatory oversight, especially in Africa. Although PPP project developers might be accountable to the taxing and corporate authorities of their home country in matters such as public financial disclosure and shareholder protection, these regulatory voices do not represent the intended beneficiaries of the PPP projects i.e. the inhabitants of the African countries for which the infrastructure is built. The latter are often the missing voice, because their interests are safeguarded only by national law system of the host country where the PPP project is located. But, many African countries are often ill-equipped to oversee and regulate complex PPP structures that involve multiple partners and multilayered financial engineering, and are even sometimes cross-regional projects[12]. Most of these countries quite often suffer from governmental corruption, political instability, and a still-developing legal system that may not be consistent with international norms or otherwise may not sufficiently address the complexity of large-scaled and multi-layered infrastructure projects.

10. For illustrative purpose, a typical PPP arrangement by private interests from developed countries can be full of room for self-dealing, conflicts of interest, and related party transactions[13]. This is mainly because equity sharing in some PPP projects is deemed to secure the needed long-term partnership among the technical/financial players[14]. Also, the degree of specialization in the market and the competitiveness of potential suppliers ultimately shape the mode of provision.

11. More fundamentally, because technical players from developed countries often seek to build their integrated presence and collaboration with host countries in a particular region and across different sectors, often the same players are seen in various parts of the African continent, forming long-term partnerships with both host governments and other multinational corporations due to their leading technical capabilities and dominant market share[15]. Hence, as stated by Mrs. Duong for example, "there is also a danger that global infrastructure or economic development projects have become a growing, *de facto* state of monopoly in which syndicated players and multinationals occupy the scenery of both the financing as well as the technology markets. This alliance or monopoly may impede the growth of a true "free enterprise", or economic growth for the private sector in the host country, where local businesses can develop and prosper"[16].

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[12] See for example the current West African rail loop project aiming to connect, through more than 2500 Km of railways, the cities of Abidjan (Ivory Coast), Ouagadougou (Burkina Faso) Niamey (Niger) and Cotonou (Benin).

[13] See also W.N. Duong, Revisiting the BOT structure in Direct Foreign Investment Transactions, Legal research paper series, University of Denver Sturm College of Law, p. 3. Electronic copy available at: http://ssrn.com/abstract=1697976

[14] In some authors opinion: "the equity holdings that the contractor and the operator have in the project company provide them with an incentive to be efficient by making them residual claimants whose profits depend on how well the project facility is built and operated": R. A. Brealy, Ian A. Cooper and M. A. Habib, Using project finance to fund infrastructure investments, Journal of Applied Corporate Finance, Vol. 9, n° 3, 1996, p. 31.

[15] Private sector firms that produce final goods and services are rarely fully integrated. Thus, many intermediate inputs, the resources that are needed for final production, are supplied by outside contractors. The optimal level of integration of productive activity becomes a key issue, hence the need for strong regulation in Africa if local private sector is to be developed and fostered.

[16] W.N. Duong, Revisiting the BOT structure in Direct Foreign Investment Transactions, op. cit. p. 4.

12. In addition, stabilization clauses may be used in some PPP projects. But, as convincingly demonstrated elsewhere[17], far from fostering foreign direct investment in the host country or protecting the foreign investors, stabilization clauses have the potential, on the one hand, to impede the still-developing legal systems of African countries and, on the other hand, to create moral hazard for the foreign investors which mainly leads to opportunistic behavior from the latters. This is particularly so since when a project does not in its own merit achieve bankability or financial viability, it may necessitate more government support than would be required in more developed countries. But, if government support is a necessary component of privately financed infrastructure projects in striking trade-offs between risks and return, when governments put in place good policies, investors are willing to invest without special government support.

13. Therefore, if PPP provides an opportunity to implement good governance into every aspect of project implementation, and thereby reduce the opportunities for corrupt practices, it is only on the condition of equal treatment and open competition. As Delmon rightly mentioned: "One of the means of reducing the risk, both to investors and to the state, in PPP projects is ensuring that PPP projects are prepared properly, with appropriate attention to fiscal risk management and that they tie in well with national and regional priorities. (…) The amount of risk acceptable to sponsors and lenders is stimulated by competition"[18].

14. With these potential negative outcomes, PPP structures as currently implemented may not have safeguarded the interest of the African populations, although they are supposed to be the intended beneficiaries of infrastructure and economic development. In reality, these beneficiaries are not often represented in the structuring of PPPs or at the PPP negotiating table, because their governments either are not their true representative, or otherwise are not technically equipped to protect their interests. Yet, when PPP projects fail, these supposed beneficiaries must eventually labor under extreme economic austerity in order to pay the international debts of their countries.

15. The solutions for these potential negative outcomes of PPP structures must therefore lie, beside well-drafted projects contracts, in well-crafted, effective and efficient African regional regulatory oversight system, with clear roles and lines of command, that is able to protect against ills such as self-dealings and anti-competitive alliances or monopolies. Within that regulatory body, a number of tasks will need to be allocated to well resourced and expert personnel to ensure proper implementation of PPP transactions in Africa. One of these tasks can be the monitoring of the tendering process against corruption[19].

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[17] See R. Tafotie, Stabilization clauses in international investment contracts : *requiem* for an inconsistent and inefficient practice, Revue de droit international et de droit comparé, Bruxelles, Bryulant, 2014, n° 4, pp. 429 ff.

[18] J. Delmon, *Private sector investment in infrastructure – Project finance, PPP projects and risk*, 2nd edition, 2009, op. cit., p. 21.

[19] For example, the Hong Kong Government have developed a well-structured competitive tender selection process for BOT projects, and as stated by some authors:"The whole process is also monitored by the Independent Commission Against Corruption (ICAC), which has played a major role over many years in minimizing corruption levels in Hong Kong": M. M. Kumaraswamy and X. Q. Zhang, Governmental role in BOT-led infrastructure development, op. cit., p. 202.

16. In conclusion, PPP is not and should no be a way for African states to exit a sector or to reduce the attention they need to give to that sector.