



PUBLIC PRIVATE PARTNERSHIPS (PPPs) IN LARGE INVESTMENT PROJECTS:

Why the EAC Governments Should Tread Cautiously?

Introduction

Private Public Partnerships (PPPs) are a mode of blended finance which is an approach involving a mix of both public and private sector capital in support of development. It is a solution that emerged years ago and has been viewed as an important way to help developing country governments to raise resources to finance the realization of their country's development goals including the Sustainable Development Goals, among others.

The history of PPPs can be rooted in decisions that were made during the first International conference on Financing for Development in Mexico in 2002, in which the business community was for the first time invited to join in the discussions of the Monterrey Consensus, which they actively supported. In this consensus, a chapter was devoted to Foreign Direct Investments (FDI) and other private inflows as international resources for development.

Developing countries as a compromise were given clear responsibilities that they were obligated to fulfill if they were to attract and enhance inflows of productive capital into their countries. The consensus also emphasized the need for these countries to achieve a transparent, stable and predictable investment climate, with proper contract enforcement and respect of property rights, with economic policies that promote and protect investments.

In 2004, PPPs emerged as the new form/ category of blended finance. Due to tighter national budgets owing to numerous fiscal constraints in these countries and changes in the international aid architecture, PPPs are growing at a much faster rate than earlier anticipated. They are now being viewed as potential arrangements for mobilizing private capital to bridge the gap in public sector financing.

This policy brief therefore seeks to explain the inherent dangers of PPPs and kindle a debate on the need for a PPP regime reform towards inclusive PPP investment projects for the sustainable development of the East African Community (EAC) region.

What exactly are PPPs?

PPPs are long-term contractual agreements between the public and private sector for the provision of public services.

Traditionally, governments have been the main providers of public goods and services, but recently, this role has been opened up to the private sector. Consequently, private investments in the health sector, education, transport infrastructure, energy generation and supply services, and water supply services, among other have grown albeit under the PPP arrangement. This change has also been witnessed in the paradigm shift in the policy and practice of international development financial institutions. While development financing institutions previously gave funding to governments to undertake development projects in their countries, the new approach promotes the more active involvement of private actors into the development process. It has resulted in the proliferation of new instruments to catalyze private investments in the pursuit of the SDGs and other global public goods¹.

Notably, within the last decade, the value of PPPs in many developing countries has grown rapidly since 2004. For instance, investments through PPPs increased in 2014 and in 2015 from US\$104 to US\$118 billion, respectively, although falling in 2016 to US\$70 billion and rising again in 2017².

PPPs in the EAC

The EAC is endowed with a wide range of mineral resources. The current trends in the extractive resource industry in East Africa, specifically the discovery of oil reserves in Uganda, Kenya's fortitude to find and exploit her oil reserves and the impressive mineral wealth of

Tanzania should be a source of high expectations for a prosperous future for the region. This mineral wealth coupled with the potential of the region's agriculture sector has increased its prominence as a trade and industrial hub, hence attracting large investments in the infrastructure and energy sector.

Within the region, the EAC partner states' development plans underscore the role of the private sector in financing the country's development. They strongly promote PPPs and put forward a series of strategies to support a conducive environment for doing business. In addition, national legal and institutional frameworks to facilitate greater use of PPPs not only in infrastructure, energy and mineral development, but also in other sectors such as education and health have been developed. In support of these developments, a considerable body of information material has also been made available for these governments on good practice in PPPs, and international institutions such as the World Bank and several donor organizations are providing technical assistance and support to governments in the area of PPP projects.

Remarkably, PPP projects in the EAC region are currently valued at \$618 million in Rwanda, \$2476 million in Kenya, \$1,488 million in Uganda and \$815 million in Tanzania, totaling a sum of 62 projects in the four partner states of the EAC³, with the other two countries i.e. Burundi and South Sudan registering no project under the PPP arrangement.

Why the EAC governments should deal more cautiously in PPP arrangements?

Whereas PPP deals come with a number of development promises, they are a new form of investment treaties which investors are using to secure greater protection from their host states. It is therefore important that the EAC partner states are conscious of the following:

¹ <http://investmentpolicyhub.unctad.org/Blog/Index/63> accessed on 12th June 2018

² <http://investmentpolicyhub.unctad.org/Blog/Index/63> accessed on 12th June 2018

³ World Bank (US), PPP Knowledge Lab <https://pppknowledgelab.org/countries/>

a) PPPs could risk a country more fiscal distress

Under PPP arrangements, projects often cost the host countries almost twice⁴ the amount they would have otherwise had to pay if the investment contract was directly awarded to the public sector works and not to a private entity. While they are viewed as more efficient, this financing and investment model risks causing these countries fiscal distress in the future.

The costs that are often associated with PPP funded projects include costs of capital, profit expectations by the private partners and transaction costs associated given that PPPs involve the negotiation of complex contracts. The reason for these high costs include the fact that unlike the private sector, national governments can borrow money at lower interest rates, because lending to private companies is normally riskier than lending to governments, given that they are less likely to default.

b) PPPs are associated with indirect-contingent liabilities

The costs of PPPs do not only result from the direct liabilities as stated in the contractual arrangements, but also from the indirect-contingent liabilities. These could include financial obligations whose timing and magnitude depends on the occurrence of some uncertain future events outside the control of the partnering government. Events such as a fall in the exchange rate of the host state's currency, or if the demand for the requested service or facility falls below a specified level, or during economic crises which could result into a reduction in the demand for a certain service or product being supplied by the PPP project. In view of these varying cases, many governments have been lured into guaranteeing such projects in order to attract private investors. In such cases, substantial guarantees including loan repayments, guaranteed rates of return, minimum income streams, guaranteed currency exchange rates and guaranteed compensation, should new

legislation affect an investment's profitability, are offered to firms to make the PPPs look bankable.

These costs are closely similar to the compensation costs provided for in national investment policies, laws and in Bilateral Investment Treaties (BITs) i.e. under the provision on "Expropriation and compensation" for indirect expropriation. Such provisions have been contested over the years in BITs and other International Investment Agreements (IIAs). At the moment, a number of countries such as Ecuador, South Africa, India and most recently, Uganda and Tanzania have embarked on processes to reform some of their BIT regimes. These reforms have also been driven by provisions that facilitate Investor-State Dispute Settlement (ISDS) mechanisms, which subject a country to legal suits by private investors. This provision, which is also being slipped into PPP Contracts has proven to be very problematic under BIT/ IIA between states because it allows for investors to directly sue their host states in international courts of arbitration in case of breach of a contract or an agreement. According to the OECD, such cases cost on average US\$ 8 million. It is also for this reason that countries like Tanzania in 2018 opted to amend its PPP Act to remove this provision.

c) Limited transparency and public scrutiny

PPPs also often suffer from a lack of transparency and limited public scrutiny, which can lead to poor decision-making resulting from less oversight and accountability, and can increase opportunities for corrupt behavior.

Generally, there are often higher costs associated with poor transparency including in accounting for PPPs throughout the project cycle, often reinforced by confidentiality clauses. This is unlike the BIT regime in which the negotiation processes for some countries often allow for a wider consultation with the public and key stakeholders such as civil society, and scrutiny by the parliament before ratification. While this is not stated to support the BIT regime whose credibility in fostering increased FDI inflows and their attendant benefits into a host country is still under

⁴ In the case of the United Kingdom (UK), a 2015 review by the UK's National Audit Office (NAO) found 'that the effective interest rate of all private finance deals (7%-8%) is double that of all government borrowing (3%-4%)'.¹⁴ In other words, the costs of financing of PPP-

operated services or infrastructure facilities were twice as high for the UK public purse as if the government had borrowed from private banks or issued bonds directly.

question, it is important to note that the contracts to which our governments are increasingly committing to under PPPs are marred with secrecy. Yet the lack of transparency frequently leads to less informed fiscal policy decisions and encourages governments to go ahead with projects even when they can create fiscal problems in the future. To further cover this up, governments have adopted accounting practices which allow them to keep the costs and liabilities of PPPs off-balance sheets to avoid such costs being reflected as budgetary constraints. However, shifting public debt to government-guaranteed debt does not reduce governmental debt liabilities. Rather, it disguises accountability and hinders scrutiny by parliamentarians and the public.

d) Limited democratic accountability

Conversely, the lack of transparency decreases democratic accountability and inclusiveness; and curtails the participation of citizens and parliaments to hold the actors in PPP projects responsible regarding who will pay what, to whom, and when, as well as hold them accountable to human rights and environment protection obligations, which are often left out during the contractual process. The high level of secrecy which not only undermines government's capacity to undertake due diligence on a potential private sector partner and to effectively monitor the project's implementation, also undermines the communities' involvement in the project. This is despite the fact that a public project just like any other project established within a community also relies on social legitimacy, trust and credibility for its success.

A study done by Oxfam in 2014⁵ on PPPs in growth corridor initiatives in the agriculture sector in Ghana, Tanzania, Mozambique and Malawi revealed that "the poorest people are all too often likely to lose out or be bypassed". The study notes that mega-PPPs are inherently risky in sub-Saharan African countries, where governments have low levels of government effectiveness, have challenges in regulating markets and difficulties with including the voices of the poor in policy-making. Many African states continue to register poorly when it comes to following up on issues

raised in Environment and Social Impact Assessments. Consequently, even the mitigation measures often highlighted in Environment Impact Assessments (EIA) reports to address the adverse impacts of a proposed project are often not implemented by the investors. Hence, under the PPP framework, it is often difficult to ascertain who should be held accountable in cases of adverse impacts.

e) Problematic Investor State Dispute Settlement (ISDS) included in PPP contracts

It is apparent that many countries do not have the capacity to properly implement PPPs⁶, and that not all proposed PPPs are rigorously evaluated or that not all of them have been designed in line with the appropriate structure. Furthermore, the financialization of infrastructure investments as an asset class, involving hedge funds and institutional investors, further complicate the relationship between the state, other stakeholders, and PPP investors and the ability of the state to participate in and/or effectively regulate infrastructure investments⁷. What remains evident is the fact that private partners in PPPs do not necessarily have the same priorities or interests as their government partners or the beneficiaries of the investments. As such, most private parties often demand that disputes arising during the partnership must be settled through international arbitration mechanisms. This, however, comes with its own challenges including the high costs that could be required during such processes. To avoid disputes, a lot of governments step aside and do not regulate the investments made under PPP arrangements. This is despite the fact that in order for PPPs to function, the government must play a central and effective regulatory role. This is especially given the long-term and public nature of infrastructure investments which necessitates the need to ensure that the benefits, protection and power related to the investment flow in a balance towards the private party on the one hand and communities, the environment, and taxpayers on the other.

⁵ <http://policy-practice.oxfam.org.uk/publications/moral-hazard-mega-public-private-partnerships-in-african-agriculture-325221>

f) Limited domestic private sector involvement in PPP projects

What remains challenging however, is that there is very little support available to the domestic private sector for their participation in their countries' PPP projects. As a result of this, it has remained very difficult for local businesses to benefit from these PPP projects as implementation contracts are generally awarded to large, multinational corporations. Thus the local private sector, though benefiting from the improved infrastructure that results from such projects, are unable to gain any additional business directly and hence an opportunity for indigenous economic growth is lost⁸.

Conclusions and Recommendations

In conclusion, PPPs are indeed a contemporary project development financing/ investment model being promoted world over. While PPPs provide an avenue through which developing states like the EAC partner states, can individually but also as a regional bloc, realize large investment projects, the nature and process of designing a number of PPP contracts should be undertaken consciously to ensure that they do not undermine inclusive development. *Because what is development without the people or sustainable development without communities?*

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⁸ East Africa Chamber of Commerce, Industry and Agriculture <http://www.eastafricanchamber.org/index.php/ppps-in-the-eac-the-project>