Success Factors for Private Engagement in FCS

Full Description

- Robust institutional, legal and regulatory framework applicable to privately financed infrastructure
- Competitive and transparent procurement processes
- Protection of investors and lenders
- Including the private sector in the reform dialogue
- Including competent transaction advisors
- Government support
- Support from Development Finance Institutions (DFIs)
- Affordability of tariffs for local users
- Access to skilled labor
- Access to land
- Building a track record of successful small PPP projects
- Scaling up access to energy and other basic infrastructure services

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The diversity of situations in FCS countries does not allow for generalizations on the proper path for infrastructure delivery. Improving legislation, building capacity, and fostering a good investment climate may not be enough. Conversely, in some cases, PPPs can survive very difficult conflict situations - as in Cote d'Ivoire where the PPP utility company continued to deliver electricity to its customers during its civil war. And PPP projects may be successful when the investment climate for private sector participation is sufficiently enhanced, as in the Pamir Private Power Project in Tajikistan shows.

Common success factors in attracting the private sector are described in more detail below:

Robust institutional, legal and regulatory framework applicable to privately financed infrastructure

Economic and financial conditions, business environment, and rule of law are usually weaker in FCS, raising private sector investment's risk in infrastructure projects. A sound PPP institutional, legal, and regulatory framework that is applicable to privately financed infrastructure projects is therefore one crucial factor for attracting private investment for infrastructure projects. This includes sectoral laws that govern privately financed infrastructure, such as energy laws. A robust PPP framework shows good governance, signals to the private sector a government's commitment to sustainable and affordable long-term infrastructure investment while providing a clear legal basis for PPP projects that eliminates the risk of conflicting laws and legislation. When benchmarked against good practices, the quality of the legal and regulatory frameworks for preparation, procurement, management of USPs, and management of contracts in FCS countries is still lower than the regional averages in non-FCS. However, according to PPP Procurement Benchmarking: Benchmarking Infrastructure Development 2020, several FCS countries have undertaken significant reforms regarding their PPP frameworks during the past years, have passed new PPP policies and legislation, and established PPP units. See also PPP Policies, Laws and Regulations in FCS.

Competitive and transparent procurement processes

The lack of a robust PPP framework, capacity and experience with PPP projects, as well as the urge of covering immediate and competing needs fosters a conducive environment for less competitive and non-transparent bidding processes. Correspondingly, the share of contracts awarded through direct negotiations was much higher among FCS than in non-FCS countries according to the World Bank report The State of Infrastructure Public-Private Partnerships in Countries Affected by Fragility, Conflict or Weak Institutions (World Bank Group April 2018). However, projects originated through USPs had the same frequency in both groups.

While directly negotiated arrangements may be necessary for large and complex PPP projects in untested and fragile markets, the lack of competition can lead to overpriced projects and may increase corruption and nepotism. To protect public interests and to ensure a fair market price in the case of unsolicited proposals or negotiated deals in FCS countries, there need to be structures in place that enhance transparency and accountability and introduce some level of competition. For more information see Policy Guidelines for Managing Unsolicited Proposals in Infrastructure Projects.

Protection of investors and lenders

To facilitate private investment in infrastructure a robust PPP institutional, legal, and regulatory framework is important. However, to attract private investment in infrastructure, an enabling legal framework for private investment also requires supportive provisions in other areas of legislation that are necessary to create an investor-friendly business environment in post-conflict countries (see **A favorable investment climate speeds post-conflict recovery**, by Pierre Guislain in: Reconstruction PPPs, Handshake No. 9, IFC April 2013).

One area of concern for private investors and lenders is the degree of protection afforded to investment in the host country, e.g., **protection from expropriation or removal of concession rights without legal recourse** and **appropriate compensation**; ability to convert local currency into hard currency; **ability to ringfence and to repatriate profits**, dividends or sums needed to repay loans in connection with the PPP project; ability to import goods and qualified services, if needed without unreasonable restriction; **right to have disputes determined by offshore courts**, especially in case of change in government and/or expropriation of assets or removal of concession rights.

To protect investors and lenders, legislation on promotion and protection of investment can play an important role in connection with PPPs. In addition many countries, including FCS have entered into **bilateral investment treaties (BIT)** that aim at facilitating and protecting the flow of investment between the contracting parties. BIT usually contain provisions concerning the protection from expropriation; transfer of capital between the contracting parties (e.g., repatriation of investment-related funds); or dispute resolution by neutral international arbitration for disputes between governments and private investors.

Including the private sector in the reform dialogue

Including the private sector in a reform dialogue that supports the implementation of transparent, inclusive, and efficient policies and regulatory practices may enhance the investment climate and incentivize private investment. **Cambodia** has regularly convened the Government-Private Sector Forum since 2001. The resulting reforms generated $69.2 million in cost savings to the private sector as of 2015. **The CIPE article on public-private dialogue** provides a methodology for conducting this dialogue (Public-Private Dialogue: The Key to Good Governance and Development, Bettcher et al. CIPE January 2015).

Including competent transaction advisors

FCS also often suffer from capacity deficits in the public and local private sector, making public-private engagement and collaboration challenging. Although investing in the capacity of the public and private sectors should be the long-term goal, governments may use skilled intermediaries and transaction advisors in the short term to compensate for these deficiencies as recommended in the **Brookings paper on multinational engagement to support economic growth** ((How Can Multinationals Engage with Government to Support Economic Development? by Nelson, Jane, Brookings Institution 2014, p. 11).

It may, for example, be difficult to select an appropriate partner and design a good agreement - particularly when some firms are willing to pay bribes or when officials request bribes to influence procurement. In these cases, governments in FCS have benefited from the advice of experienced transaction advisors to design and implement competitive tender processes to attract quality investors. Some countries also find it useful to outsource contract management to an independent party.

Government support

While it may be possible to finance PPP projects in FCS without government support, they do typically rely heavily on government support to be bankable and commercially viable. The role of the central government plays a key part to make projects attractive to the private market and to make them sustainable on the long run. According to The State of Infrastructure Public-Private Partnerships in Countries Affected by Fragility, Conflict or Weak Institutions, (World Bank Group April 2018) the proportion of projects receiving direct government support is typically higher for FCS than for non-FCS, in particular in the form of capital subsidies while the proportion of projects receiving guarantees did not differ between the two groups between 2012 and 2016. However, guarantees for exchange rate, interest rate, and construction cost risks were more frequent in projects in EFCS countries. See also Government Support in Financing PPPs.

Support from Development Finance Institutions (DFIs)

Private financing is typically less significant in FCS countries than in non-FCS countries, due mainly to lower levels of commercial debt. International commercial banks have a significant role only in upper-middle-income FCS countries. A large share of FCS project financing comes from MDBs, and particularly from bilateral banks. The proportion of projects receiving MDB support as well as bilateral support is higher in FCS countries than in non-FCS countries for any type of support, with loans being the most common type of **financial support.** (For more details see The State of Infrastructure Public-Private Partnerships in Countries Affected by Fragility, Conflict or Weak Institution, World Bank Group April 2018).

Political risk insurance can play a particularly important role in economies recovering from conflict. Private sector providers of political risk and export credit insurance typically limit their exposure in such environments. It may therefore be necessary to include multilateral institutions that can provide guarantees and insurance products that reduce the risk for private investors if PPP-like structures are to be used in FCS. See also Guarantee and Risk Insurance Products Provided by IFIs.

Some DFIs also have specialist products and facilities that support project development and are empowered to invest in the equity of project companies in emerging markets, such as IFC's Infraventures initiative. In particular in FCS where market interest may still be low the **involvement of DFIs in equity financing** plays an important role to provide comfort and to unlock additional private investment in the country.

Examples of DFIs that offer such products are:

- **IFC Infraventures** (Infraventures), a global infrastructure project development fund that provides early stage risk capital and experienced project development support (Infraventures 2015)
- **InfraCo,** comprised of (InfraCo Africa) and (InfraCo Asia), project developers in lower-income countries established by the Private Infrastructure Development Group (PIDG)
- **Pacific Region Infrastructure Facility** (PRIF), which supports infrastructure development and maintenance in Pacific Island Countries through investment coordination, research and technical assistance

Affordability of tariffs for local users

For the project to work there should be clear sector regulations regarding tariff. Tariffs must be both affordable and acceptable for local end-users but must also be able to yield reasonable returns to the project company. Where tariffs are not affordable for local end-users, **support by** the **government, donors of DFIs** needs to be put in place to bridge the gap. **Output-based aid (OBA)** provides a way in which DFIs can directly structure its financing to benefit poor people, even when the service provider is a private company. Service delivery is contracted out to a third party - public or private - that receives a subsidy to complement or replace the required user contribution (for more details see The Global Partnership for Results-Based Approaches - GPRBA).

Access to skilled labor

One of the key challenges for governments in post-conflict countries is to create employment opportunities to lift people out of informal employment and poverty. Private sector investment in infrastructure can help to create jobs on different levels of responsibility. This often presupposes technical and vocational education and skills training of locals as well as a review of labor legislation, in particular standards and safeguards as well as incentive schemes. To ensure that a PPP project opens up employment opportunities for locals, foreign investment laws, PPP legislation or PPP contracts may contain specific provisions that ensure training and education of locals and may require that private investors give priority to local labor up to a certain percentage.

The **Civil Aviation Development Investment Program** in Papua New Guinea offers lessons for large-scale development projects that require long-term investments. In this case, a resource gap in experienced and qualified staff in the Civil Aviation Authority was holding back the development of Papua New Guinea's air transport sector. The project implementation unit has also had a difficult time keeping trained people employed. **Incentive programs to retain a skilled workforce** were necessary for long-term maintenance of air transport facilities and services as well as **capacity building**, not only for the project implementation unit but also for the staff of the different aviation agencies (A Flexible Financing Model for Large-Scale Infrastructure Investments, ADB October 16, 2017).

However, experience and qualification develops over time. As some jobs related to the construction and operation of complex infrastructure may need to be filled with foreign workers in FCS for some time, it is also important to review and adjust existing policy and legislation with respect to issuing work permits and residence visas to foreign workers.

Access to land

Land is one of the most important assets for the success and optimal development of infrastructure PPP projects. Normally, the title of ownership of the land will remain in the hands of the public authority which will grant to the private partner the legal right to use the land to build and manage the infrastructure asset (for example, by a lease or concession) and will assure to the project company and its lenders that all relevant public and required private land has been transferred to the project company by financial close.

However, the acquisition or leasing of the necessary land and rights of way for the construction and operation of infrastructure assets can be challenging in FCS countries. Weak and unclear rights and titles over land and a system that is unreliable can discourage investors. Issues related to land, in particular a failure to obtain access to land and rights of way can easily lead to substantial delays or additional costs and complicate a smooth project implementation for everyone involved: lenders, sponsors, contracting authorities, and relevant stakeholders (Infrastructure PPPs in the most challenging developing countries: Closing the gap).

To attract private finance for infrastructure development in challenging business environments it may therefore be necessary to take action to facilitate secure access to land for commercial purposes. This often involves the improvement of land policies and legal arrangements regarding land tenure, land administration, title of ownership of the land, as well as dispute settlement. Read more.

Building a track record of successful small PPP projects

The number and volume of investments in PPPs remains low among FCS countries, and many FCS countries have few or no PPP projects. In order to move from sporadic to a more consistent implementation of PPP projects a **gradual development of PPPs is realistic**, starting with a few small pilot cases with a transparent competitive process with strong support from MDBs. Another approach is to **start with shorter-term PPP arrangements** that are focused on improving capacity. For example, private expertise can be brought in through management contracts, to reinforce domestic utility capacity. Then, once the utility is in a stronger position, a more comprehensive PPP can be considered. The high share of **small renewable energy PPP projects** in FCS during the past years indicates that this sub-sector has characteristics that make it more feasible for PPPs, and may serve as a starting point for PPPs in FCS countries. (For more details see The State of Infrastructure Public-Private Partnerships in Countries Affected by Fragility, Conflict or Weak Institutions, World Bank Group April 2018; **Which post-conflict PPP** by Jeff Delmon in: Reconstruction PPPs, Handshake No. 9, IFC April 2013).

Scaling up access to energy and other basic infrastructure services

One common characteristic of FCS is that natural disasters or years of civil war destroyed or impeded access to basic infrastructure. And even where such infrastructure does still exist, FCS are often not able to maintain and rehabilitate the services. Consequently, they seem to experience more extended and repeated water and power shortages than non-FCS countries (Global Investment Competitiveness Report 2017/2018: Foreign Investor Perspectives and Policy Implications, World Bank Group 2018) while insufficient transport infrastructure limits the connectivity to the rest of the world. The lack of essential infrastructure stalls any type of public or private investment in all sectors and impedes economic growth in general. One priority in FCS should therefore be to promote private investment in essential infrastructure to create economic opportunities to lift people out of poverty, thus overcoming fragility and the "cycle of low investment and low productivity that may contribute to resurgent conflict" (**Partnerships for piece** by Carrie Farley & Andrew Jones in: Reconstruction PPPs, Handshake No. 9, IFC April 2013). Recent developments in the renewable energy sector have shown that expanding access to reliable, sustainable and affordable energy in fragile contexts can be one crucial step to escape fragility. In countries where grid infrastructure is nonexistent or seriously damaged, **distributed off-grid solutions, mini-grids and new renewable energy technologies** hold much potential to increase energy connections.

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