MONEY TALKS

THE PRICE OF EASY MONEY

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"Miracle cure, works in minutes. Guaranteed!" "Eat all you want and still lose weight!" "I shed 43 pounds in two weeks and you can too!" This approach to dieting appeals to everyone, because we all hope for the easy path. We all want the best results for the least effort.

And what requires less effort, some people think, than a PPP deal, where the investor is going to make huge profits? In a simple deal like this, why shouldn't Government share in the pie? Why shouldn't Government get shares in the company?

Here's how the argument for Government equity in PPP projects usually unfolds. A share in projects is desirable:

- to ensure that Government gets a piece of the action. This is a big investment, so why shouldn't Government share in the bounty?
- to maintain Government influence over the project and the sector.
- as a mechanism for accessing company information.

But like any lose-weight-fast or get-rich-quick scheme, nothing is as fast or easy as promised. Here are four reasons that Government equity share may not be the best approach:

1 Equity investment in infrastructure is a difficult function to fulfill well. It is not just a question of funding, but rather the governance, the ability to make critical decisions in times of need, and the provision of technical and commercial support, given the complexity of an infrastructure transaction. Government often does not have this expertise. Investors know this and will make sure that the real governance structure is insulated from any Government equity holding. When they do not insulate the company, the results are usually a disaster (except for the lawyers, who always win!).

2 Equity distributions (profits) are hard to control and harder to forecast. Put another way, "profits are for accountants."

The definition of profits can be adjusted to minimize tax liabilities and achieve other priorities. It is difficult for shareholders to monitor profits, and argue whether more should be made available for distribution to shareholders. In practice, the Government share may be subject to the whim of management.

3. Private partners are likely to limit real Government control over the project as equity holders to mitigate conflict of interest and ensure that decisions are made on a commercial rather than political basis. Imagine a project where Government is not paying fees or performing activities as it is required. If the company wants to sue the Government for breach, will the Government as shareholder support this legal action? Even if the legal action goes forward, the Government as shareholder would have access to information that would prejudice the company's claim.

4. Private partners will inevitably establish a governance structure that isolates sensitive information. In many cases this involves two board meetings: one formal meeting that includes the Government, and another informal meeting of just the private partners, where the real decisions are made.

But here is the most important reason of all: Government equity may not add value to the project. Where Government pays for its equity, then new funding is provided and earning a return for that new value makes sense. But in most cases, Government does not pay full value or indeed provide any real value for the equity share it requires.

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In such cases, the investor is not going to reduce its return in order to provide equity return to the Government. Instead, it will make the project more expensive. Tariffs will increase, costs to Government will increase. The benefit to users/consumers will decrease in order for Government to capture value (effectively an additional tax, but through the mechanism of the company's equity structure).

So, although the goals are sound, equity may not be the answer. Instead, if Government wants to share in the upside, it should require a share of revenues or a fixed lease payment. Revenues are easier to verify and simpler/cheaper for Government administration. A simple, clear mechanism can reduce conflict and disputes significantly.

Government may find it is easier and better to maintain control, gather data, and access information through regulations and regulatory powers. This is a critical function often lost in the PPP process, possibly in the hopes that the Government can avoid the expense and complexity of regulation where a private operator is involved.

> However, just as with Government equity, there is no such thing as free money.

The quest for Government equity is often closely aligned with arguments that local investors should have an equity share. This argument uses similar reasoning, but in particular to ensure that part of the profit of the project stays in the country. Having local investors in a PPP transaction can provide a number of benefits. For example, it ensures that the investor has access to local knowledge and an understanding of how the local market works.

However, just as with Government equity, there is no such thing as free money. If the local investor is not bringing in an appropriate level of investment, technical capacity, or in-kind support, then the benefit to be earned by the local investor is, in effect, a tax on the project that will result in higher costs to users or higher availability payments from the Government—all to the benefit of the local private entity. This is unlikely to be efficient or fair, and is likely to raise concerns of unjust enrichment, corruption, and influence peddling by the local investor.

Government equity in PPP projects, or even mandated local investors, may not result in value for money. It may even undermine the project by complicating the governance of the company and increasing conflict and disputes between the Government and the investor. As we all learn eventually, when something looks too good to be true, it probably is.

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