

The Role of PPPs and the AfDB in Charter Cities Financing

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Abstract

Many citizens of African countries are migrating to cities for a better life, which has given Africa the fastest urbanisation rate in the world. However, at the global level, the continent has the lowest urbanisation rate (Githira, et al. 2020). By 2050, half of the African population is expected to be living in cities. Africa is going through its era of urbanisation. Rapid urbanisation in Africa has its own shortfalls which include violent crime, lacking infrastructure, diminished economic opportunities, and major informal settlements. These issues are symptoms of Africa's intrinsic and pervasive problems of misgovernance, lack of structural transformation, and economic stagnation. There is no silver bullet to solve all these issues within the existing cities. Rikhotso (2021), writing on charter cities as an alternative to current urbanisation problems, asked "Is there an alternative to conventional urban African cities, and if so, what is it?". Outside-the-box city models, such as charter cities, offer a glimmer of hope to solving Africa's urbanisation problems.

Keywords: Africa, charter cities, urbanisation, public-private partnerships, African Development Bank, development finance, urban development

1. Introduction

Charter cities are new cities created on vacant land within a particular country (host country). They have their own governance and legal jurisdiction despite being located within a host country (Bernard, 2021). The aim of charter cities is to create new rules and governance systems that encourage growth and sustainability in urban areas (Mason, 2019). Bernard (2021) sums up the value of charter cities into three components; that is: firstly, they increase wellbeing and wealth for those who live in the charter cities and around them. Secondly, successful charter cities will serve as paragons of good policies which potentially leads to adoption across the host country. Thirdly, the success of charter cities at local level can also lead to adoption of charter cities at the international level.

There is no doubt that charter cities are the future of Africa's urban sustainable development. However, a critical question remains: How are charter cities in Africa going to be financed? With regards to infrastructure finance, Africa has been structurally excluded from global finance for decades on the premise that it is mostly rural (Cirolia 2020). Therefore, the issue of financing charter cities is critical because if it is not addressed in the formative stages of charter city development, Africa will be left out of this effort. Exploration of ideas on financing charter cities in Africa needs to be embedded in the charter cities discourse at this formative juncture as it is a critical point to the success of charter cities in Africa.

This article will explore two main issues on the financing of charter cities in the African context. The first is the organization of charter cities as public-private partnerships (PPPs). PPPs are at the heart of the conceptualisation of charter cities as they "bring together public and private sector interests in a mutually beneficial way" (Bernard, 2021). PPPs are defined as agreements entered between a government entity and a private business entity aimed at providing basic public goods (Masekesa, 2021). The private party performs the functions that are traditionally

performed by a public institution. It provides technical, financial, and operational championship of the project and an arrangement is made on how the private party will be compensated.

The second issue that this article will explore is the role of the African Development Bank (AfDB) in financing charter cities through PPPs. Huge amounts of capital are needed to finance charter cities and the processes involved are complex. Given the role of the AfDB as one of the leading lenders for infrastructure development in the continent, it is logical to explore its possible role as a financier for charter cities. As a mobiliser of private finance for charter cities in the Africa, AfDB can leverage its Urban and Municipal Development Fund (UMDF) initiatives to offer a technical and policy support to charter cities projects in Africa. This article seeks to contribute to the growing body of knowledge on charter cities, especially from an African perspective. At the end of this treatise, I submit a proposal on how the AfDB can support the creation of charter cities in Africa through a PPP framework.

2. The concept of charter cities and financing through PPPs

When the idea of charter cities was initially floated by Paul Romer in 2009, its conceptualisation was based on cooperation between a host country and a foreign “guarantor” country (CGD, 2010). Romer and Fuller (2010) describe charter cities as a concept where “A host country would provide land; a source country would provide residents; and a guarantor country would provide the assurance that the new city’s charter would be respected and enforced. All three roles would be entirely voluntary.” The Romer model argues for a guarantor concept as a means of boosting investor confidence because the guarantor country will provide security for investors through a neutral legal system.

The idea charter cities has since evolved to a concept that favours arrangements where a “new city developer enters into a public-private partnership with the host country. The developer works with the host country to develop a special jurisdiction, which remains under the sovereignty of the host country” (Mason and Lutter, 2020). This approach eliminates opposition to the establishment of charter cities through a host country and guarantor model, which was perceived by some to be neo-colonialist. This approach instead advocates for organizing charter cities as PPPs, an area which has notable geopolitical and economic implications worth studying in the African context.

The context of financing charter cities through PPPs cannot be divorced from the entire context of infrastructure financing in Africa. By 2025, Africa’s infrastructure spending needs will amount to US\$125 billion, with an annual financial gap of US\$100 billion every year (ICA, 2018). This growing infrastructure gap in Africa has necessitated the interest in PPPs and they have been endorsed by multilateral bodies such as the African Union (AU), the UN Economic Commission for Africa (UNECA), and the African Development Bank (AfDB) (Loxley, 2013)

As a testament to this, in 2020, the Nigerian government and its private partners signed a US\$430m deal with the AfDB to develop the Enyimba Economic Zone (Orimsian, 2019). Despite the growing infrastructure gap in the recent years, there has been an increase in African infrastructure financing. In 2018, the Infrastructure Consortium for Africa’s (ICA) annual

report stated that infrastructure financing in Africa rose to more than US\$100 billion for the first time (ICA 2018).

While the public sector and international aid are some of the leading financiers of infrastructure development in Africa, there is a growing concern about their failure to meet the infrastructure deficit. To meet this deficit, there is a need to rally the private sector to finance infrastructure development. PPPs have grown in prominence in recent years throughout the continent. In 2018, it was estimated that more than 30 countries have developed PPP laws and others were in the process of drafting and adopting such policies (Vallée, 2018). It is also estimated that only 10 countries may not yet to establish a PPP framework. However, it has also been noted that despite having PPP framework, most PPPs in Africa are undertaken outside the established PPP framework.

PPPs come in different types and can be divided into two groups. The first, which largely see “functions transferred to the private sector,” includes Design-Build-Finance-Operate-Maintain, Design-Build-Finance-Operate, and Design-Construct-Manage-Finance agreements. In the second grouping of PPPs, each agreement “captures legal ownership and control of the project assets. Under a BOT project, the private company owns the project assets until they are transferred at the end of the contract.” This group includes Build-Operate-Transfer (BOT), Build-Own-Operate-Transfer (BOOT), and Build-Transfer-Operate (BTO) agreements (World Bank, 2012).

PPPs can take on any of the above forms depending on stakeholders involved and the type of project. For example, the Bujagali Hydropower Plant in Uganda, which is one of the first independent power projects and one of the largest in sub-Saharan Africa, was built through a BOOT PPP. The project was started in 1994 through an unsolicited bid which resulted in a memorandum of agreement being signed between a US power developer, AES Corporation, and the government of Uganda (GoU). However, in 2003, AES pulled out because its parent company (Enron) went bankrupt and GoU was forced to go through the PPP route to continue the project with new partners (Yescombe, 2017).

Through a competitive process in 2004-2005, the Aga Khan Fund for Economic Development (AKFED) and Sithe Global Energy (Sithe), under a project company called Bujagali Energy Ltd (BEL), won the bid for the project. BEL was responsible for the design, construction, finance, and operation of the project. Investors in the project included AKFED (US\$65m), Sithe (US\$115m) and GoU (US\$20 million, in the form of land). At the end of the PPP, GoU would buy the plant at \$1. Project stakeholders also included multilateral finance institutions (International Finance Corp, European Investment Bank, and AfDB) which collectively provided US\$374m in loans. Bilateral development finance institutions including Proparco (French), FMO (the Netherlands), and DEG/KfW (Germany) contributed an additional US\$213m in loans. Commercial banks involved in the project included Standard Chartered and ABSA (Barclays Africa Group), which invested US\$115m, with their risk covered by the International Development Association. In total, US\$920 million was raised to complete the project, which was launched in 2007 and completed in 2012 (Yescombe, 2017).

There are some important lessons from this project which are important for all PPPs, and for charter cities. First, the project was approved in the Ugandan parliament in the face of political opposition over site selection. Second, the World Bank pulled out of the project twice in response to objections from NGOs and allegations of corruption. Lastly, Sithe wanted to make an investment of more than US\$100m on a short-term basis while AKFED was keen to remaining involved long-term. This presented a problem for the project in that the largest shareholder would sell their shares before the concession had come to an end. To resolve these issues, AKFED was granted a controlling interest of shares while Sithe would agree to only sell its shares three years after the project has become operational. This is a small glimpse into the challenges faced by large PPPs, but also that these challenges are not insurmountable.

3. The role of the AfDB in playing a major in financing Charter Cities

The AfDB is at the forefront of advocating for the PPP financing model for infrastructure development in Africa (van Noorloos and Kloosterboer, 2018). The AfDB's prominent role as an infrastructure financier throughout the continent has been well proven. What has yet to be explored is its potential role in finance and capacity building for the creation of charter cities. As mentioned previously, Africa has a growing infrastructure finance gap which must be closed. However, the gap is not necessarily attributable to a lack of funds, but instead to a lack of projects deemed bankable by investors (ICA, 2017). If countries adopted and presented effective institutional arrangements, it is possible that more projects would become bankable and have access to AfD financing. There are several key points which suggest charter cities are in fact a bankable project in the eyes of the AfDB.

Firstly, there are risks that are associated with charter cities and PPPs. There is a risk that the government may expropriate the charter city. Expropriation "could entail a sudden change in the concessions granted to the charter city, or, in a more extreme form, a direct takeover of key infrastructure or of the city itself" (Charter Cities Institute, 2020). The private sector is wary of such risks, particularly in emerging markets.

Through the African Development Fund (ADF) Partial Risk Guarantee instrument, the AfDB can insulate private sector lenders from failure to honour commitments by the borrower country or entity. This instrument protects against "political force majeure, currency inconvertibility, regulatory risks (adverse changes in law), and various forms of breach of contract" (AfDB, 2021). The aim of the instrument is to encourage the private sector and other co-financiers to invest in ADF countries, and to encourage countries to undertake the necessary reforms to mitigate performance-related risks. Thus, this instrument can be used to encourage PPPs for charter cities in Africa. Charter cities are not different from other infrastructure development projects and thus there are no separate provisions needed for guarantees under this instrument.

One of the key tools that can be deployed to facilitate the financing and support of charter cities by the AfDB is the Urban and Municipal Development Fund (UMDF). The UMDF is an AfDB mechanism for supporting the development and transformation of cities in Africa. The

fund is designed for all cities and municipalities in Africa as well as other entities like urban development agencies. According to UMDf guidelines, beneficiary cities and municipalities are identified by the UMDf in consultation with AfDB's regional departments and country offices. The fund provides grants for research to beneficiary cities and municipalities. The main aim thereof is to boost the capacity of cities and municipalities to operate in a more results-based and sustainable manner.

Charter cities are research-intensive projects and would benefit greatly from UMDf research and technical support. Since its launch in 2020, the UMDf has already commissioned city diagnostics in five cities: Antananarivo, Bizerte, Dodoma, Conakry, and Libreville. In Addis Ababa, the UMDf has begun the Sheger River Infrastructure and Investment Plan. The plan aims to prepare a roadmap on the infrastructure required along the riverside, the capital investments required, and the financial sustainability of the project" (ARS Progetti, 2021). Charter cities will need such feasibility studies, especially at this early moment where greater buy-in for the idea is needed.

Assistance from the AfDB in the form of loan guarantees and from the UMDf in the form of investment research support would help build the case for charter cities as bankable projects in the eyes of investors.

4. Ideal charter city process using PPPs

In sum of the above discussion, charter cities in Africa can be established through a BOOT PPP in the manner of the Bujagali project. A host country can initiate the charter city and provide land as a contribution for a stake in the governance of the charter city and its profits. In the initial stages of the charter city, the UMDf can provide technical support in terms planning and coordination. Through a competitive process, a private investor will be appointed by the host country with the support of the AfDB. A consortium must be formed with the host country, investors, and other stakeholders as owners of the charter city. They will also form part of the governance structure of the charter city. In terms of financing, the AfDB will mobilise the financing through loan guarantees for the consortium. The consortium will then hire developers who will build the city and the consortium will own and operate the city.

Operation of the city will require public services like courts and emergency services, among others. Returns must be generated for the investors including, the host country. It is prudent to follow the example of conventional cities and use taxes to fund these services. Following a proper BOOT PPP procedure, the city will after a number of years be transferred from the governing consortium to an autonomous governing structure. The host country and other stakeholders, including the local community, may then have representatives in the governing body.

5. Conclusion

Charter cities are novel idea that African countries must seize as a matter of urgency to solve their current but also future urbanisation problems. The use of PPPs in the financing, building

and owning charter cities in Africa is important as PPPs are already a popular concept in infrastructure development in the continent. For the success of charter cities, it is important to use the various financing mechanisms and support that the AfDB has in place especially because of its reputation as a supporter infrastructure development in the continent.

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