STREAMLINING POWER PROJECT DEVELOPMENT IN AFRICA *by Promoting Standardized Power Purchase Agreements*

IGD | INITIATIVE *for* GLOBAL DEVELOPMENT

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Dr. Nedelcovych is the President & CEO of the Initiative for Global Development, a nonprofit organization that engages corporate leaders to reduce poverty through business growth and investment in Africa. Prior to joining IGD, Dr. Nedelcovych was the Chairman of Schaffer International, where he led the development of a number of agro-industrial concerns throughout Africa, including the Markala Sugar Project in Mali.

Dr. Nedelcovych served in the Administration of President George Bush from 1989 to 1993 as the U.S. Executive Director to the African Development Bank (AfDB) in Abidjan, Cote d'Ivoire. He was instrumental in formulating the "private sector initiative" at the AfDB, the African Business Roundtable and the African Export-Import Bank.

Dr. Nedelcovych presently sits on the Boards of Schaffer International, International Green Structures, the Partnership to Cut Hunger and Poverty in Africa, Afriland First Bank SA (Cameroon) and is a past Director and President of the CCA and Member of EXIM Bank's Sub-Saharan Africa Advisory Committee.

Power plays an important role in fostering inclusive economic development. While standardizing power purchase agreements (PPAs) will help accelerate negotiations for independent power projects, it's up to all stakeholders involved to create an environment that will ultimately facilitate greater access to power for both urban and rural communities.

Last year 1.2 billion people in the world lived without electricity, half of them in Sub-Saharan Africa. A lack of reliable and accessible power often has debilitating social and economic impacts. Businesses cannot efficiently expand while hospitals and schools are unable to properly function at full capacity. The lack of electricity access is exacerbated by the long process of negotiating and implementing investments in independent power projects. The extended discussions can lead to missed investment opportunities. Overcoming these barriers to much needed investments in power infrastructure will ultimately help transform and shape Africa's future economic growth.

USING POWER TO CLOSE THE EQUALITY GAP

The growing population in Africa will play a driving role in the continent's development narrative. The overall population is expected to double to over 2 billion inhabitants in the next 35 years. More than half will be living in urban areas and be eager for jobs. As such, Africa's urban centers can become hubs for manufacturing and industrialization. To turn this potential into reality, there is a need for access to reliable, competitively priced power. Without it, many African countries may face social unrest and political instability as they are unable to meet the rapidly growing employment demand.

Ethiopia's new Grand Renaissance Dam is an example of one nation's efforts to develop the infrastructure necessary to meet the demand for industrialization. The $5 billion project is funded by the Ethiopian government with support from Chinese banks and will generate around 6,000 megawatts of electricity to meet domestic and regional demand. Once completed and on line, the World Bank estimates Ethiopia could earn $1 billion a year in electricity exports, making it the largest exporter of power on the continent. This project is also expected to drive economic development along the Nile basin in countries such as Sudan and Egypt. Increasing electric power in the region will provide Ethiopia and its neighbors the ability to power homes and businesses, ultimately driving regional economic growth.

These kinds of projects are necessary to make Africa a competitor in the global economy. As China moves up the industrialization ladder, the manufacturing jobs that have driven China's growth will ultimately move. How can Africa compete with Southeast Asia or other regions with low labor costs for those jobs? Access to reliable, competitively priced power is the major pre-requisite. That, along with Africa's abundant natural resources and a large, young and increasingly urban population, should make it an attractive destination for those manufacturing jobs.

The complement to rapid urbanization is a decreased number of farmers feeding the growing population. At present, agriculture is the largest employer and major economic driver in many African economies. For African economies to take advantage of its vast, arable resources, smallholder subsistence farmers must transform to support sustainable productivity. This means expanding the agro-allied industry to include the full complement of services along the farm to fork value chain, including provision of inputs and farm services, offtake of product and aggregation, warehousing, processing, packaging, branding, wholesaling and retailing food products. Very efficient links along the value chain will create higher paying jobs as well as more competitively priced food to the consumer, and will drive sustainable economic growth. But again, these added efficiencies in value addition to raw food products will require reliable and affordable power in rural areas.

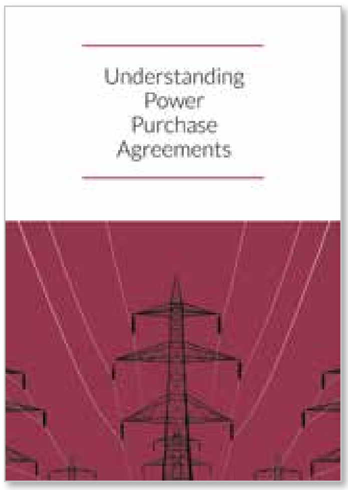
Outside of urban areas, there is little access to power due to poorly designed, inadequate or often missing national grid systems, or simply not sufficient power generation. The central power grid often fails to reach out to those in rural communities, and, in areas where it does reach, many countries lack sufficient generation capacity to provide reliable power year-round. As late comers to industrialization, African countries can take advantage of more recent innovations in technology to incorporate renewable energy and point of use power generation into their power supply mix and bank on off-grid solutions to bring power to rural areas. With the addition of and mini- and off-grid systems to the often frail national grid networks, electricity can reach underserved, hard to reach communities and drive inclusive growth where there has been virtually none.

THE CASE FOR STANDARDIZED POWER PURCHASE AGREEMENTS

Private investment in the electricity sector in Africa will be fundamental to increasing access in the region. Because any Independent Power Project (IPP) must be based upon a Power Purchase Agreement (PPA) between the IPP and the off-taker, it will be necessary to facilitate the negotiation and finalization of bankable PPAs.

In many African countries, PPA negotiations can take 5-10 years – more than two to three times longer than in other parts of the world. The result? Fewer projects are successful and ones that are completed can be more expensive due to these costly delays. I've been on the four sides of the negotiating table: representing the developer, financier, the government, and now an NGO. One of the major initial challenges hindering power projects is overcoming a lack of trust and understanding for the perspectives of the other stakeholders. The developer wants profits and the government wants cheap power. Without compromise, it can take 2-3 years just to settle on a minimum price for the power even before any further discussions about terms and conditions.

A new PPA handbook, "Understanding Power Purchasing Agreements", was produced by IGD in collaboration with the US Department of Commerce, OPIC, USAID, and the African Development Bank through the African Legal Support Facility. The handbook translates knowledge and best practices on PPAs into an accessible primer on this often complicated and misunderstood legal instrument. It brings more structure to the process by increasing



understanding of important provisions that address risks, obligations, and remedies. Ultimately, it provides the foundation for any conversation about an IPP by framing each of the key issues for the investor, the off-taker, the financing parties and the consumer him or herself.

Creating a standardized document minimizes the confusion for multiple parties within the complex PPA process and narrows the number of issues that must be negotiated between the parties. When the negotiation process begins with a previously agreed document that includes all of the elements necessary for bankability, the parties will increase the likelihood of financing by facilitating the review to be conducted by banks and other financing partners. By introducing a standardized PPA, the intention is that the insights shared will reduce the PPA negotiation time and lower transaction costs significantly – ultimately facilitating IPPs, lowering development costs and offtake pricing requirements, increasing the attractiveness of investments in the power sector, and most importantly increasing the speed of access to power.

INTERSECTION BETWEEN THE DEVELOPERS AND GOVERNMENT AUTHORITIES: SEEKING COMMON GROUND AND ALIGNING INTEREST

Standardized PPAs simplify the development and negotiation process and facilitate private investment in electricity generation assets. But the PPA is only one piece of the power investment puzzle. Investors require a reliable legal and regulatory regime; the off-taker needs a tariff that falls within its budget and accounts for the (often) low price at which it sells electricity. Politicians need a deal they can sell to a skeptical public and developers need to show a rate of return that is sufficiently high to attract investors in a potentially risky project. These pieces must all come together for an investment in the power sector to succeed.

In addition to aligning interests of invested stakeholders, we see the process of developing a standardized PPA as useful to consolidating interest and creating political momentum for increased investments in the sector. Yet due to the significant legal, economic, and policy matters at stake, a government- whether in Africa or elsewhere- must have the political will to pass measures that will increase private sector investment.

A number of measures will be unpopular in the short-run. However addressing these issues such as using transparent procurement processes, adopting cost-reflective tariffs, ending corruption, implementing fiscal transparency, long-term sector planning, and respecting the sanctity of contract are necessary for long term economic growth. When these measures have been adopted in other regions, private investment has increased and where they continue to languish, investment has stalled along with development.

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GOING BEYOND STANDARDIZED PPAS

The “Africa Rising” narrative focuses on the continent’s resources which can alleviate poverty, strengthen inclusive growth, and turn Africa into a major player in the global economy. Access to power will play a fundamental role in realizing this potential. While the development and dissemination of the new handbook will go a long way toward increasing general understanding of the PPA and its role in a power sector investment, IGD has decided to use this document as the starting point for a program focused on developing and adopting standardized PPAs in select countries in Africa. Some of the factors that will be looked at include deal flow, i.e. significant potential for independent power production development in the country, as well as for the appetite for governments to set the right conditions to attract private developers. We will also look at the interest that local and foreign stakeholders expressed in encouraging IPPs. And of course, it is important to also consider the complex issue of navigating the country’s bureaucracy and regulatory system to gain traction for establishing a standardized PPA.

Our goal is to work with governments committed to increased private investment in the sector by crafting a PPA document specific to that country’s unique political and business landscape. It can form the basis of future negotiations with developers and banks. With a more streamlined approach, the hope is to expedite the power project development process to provide greater power access and ultimately help drive economic development on the continent at a faster pace than has been the case to date. ■

“Our main aims are to provide private sector solutions to the challenges of inclusive economic growth in Africa”