The Use of Sovereign Guarantees as a Risk Management Tool in Public-Private Partnerships

Dr. George Nwangwu
Research Fellow, African Procurement Law Unit, Department of Mercantile Law, Stellenbosch University.

ABSTRACT
In recent times, most developing countries have adopted the use of Public Private Partnerships (PPPs) to finance infrastructure projects. However, due to the high perception of risks in these countries, private investors have often demanded for sovereign guarantees from their host governments as a means of managing project risks. These guarantees are typically used to backstop the obligations of government or to assure an investor of a minimum return on its investment. The major problem with sovereign guarantees is that contrary to the perception of some governments that they are free, they can have serious fiscal consequences for countries if the risks they cover eventuates. This paper evaluates the use of sovereign guarantees as a risk management device in public private partnerships and suggests ways of mitigating its impact, especially on developing countries.

Keywords: Sovereign Guarantees, Risk Management, Public-Private Partnerships, Infrastructure

INTRODUCTION
The use of Public-Private Partnerships (PPPs) to fund infrastructure is now a common feature across the world. A number of countries have used it as a means of attracting additional funding to build roads, ports, power plants, prisons, schools and all other different types of public infrastructure.1 However, due to the fact that privately financed infrastructure projects are typically high risk intensive, parties look to manage perceived risks as much as possible. The perception of project risks is certainly higher in developing countries than developed ones due to the fact, for instance, the greater likelihood of adverse political action by the governments in these countries and the obvious fact that most developing countries have fragile economies, with citizens having weaker purchasing power than citizens of developed countries.2 It is principally for these reasons that private sector investors look towards governments in developing countries for additional comfort in the form of sovereign guarantees before investing in these countries.3

---

1 According to the World Bank, during the past 25 years, more than 5000 infrastructure projects in 121 low and middle income economies were delivered through PPPs, representing investment commitments of USD1.5 trillion. See World Bank Group ‘Benchmarking Public-Private Partnerships Procurement: Assessing Government Capability to Prepare, Procure and Manage PPPs’ 2017 Pg. 14
2 See for instance, Sachs Tillman et al. ‘Analysis of Political Risks and Opportunities in Public-Private Partnership (PPP) in China and Selected Asian Countries: Survey Results’ Chinese Management Studies, Vol.1 Issue: 2 pp. 126-148. Also, according to OECD the region benefitting most from guarantees was Africa, followed by Asia and Eastern Europe, which are all developing countries. See Raundi Halvorson-Quevedo and Mariana Mirabile ‘External Financing for Development’ March 2014 found online at: http://www.oecd.org/dac/stats/guaranteesfordevelopment.htm
3 This is not to say that guarantees are not in use for financing infrastructure in developed economies. However, the point that is made is that the use is more rampant in developing countries.
The use of guarantees to finance public infrastructure is not new, governments around the world have been offering guarantees for this purpose since the 19th century. It is instructive that the use of sovereign guarantees originated in developed economies as some of the early guarantees used to finance public infrastructure were used in Europe and North America. For example, the bridge of Boudreaux, the US Canal and the railways were all developed using guarantees. However, in recent history, the use of guarantees as a financing instrument really became prominent in the 1980s when a number of Latin American countries adopted the wide use of guarantees to finance their transport infrastructure with differing outcomes.

With the new wave of Chinese investments in developing countries, particularly in Africa, there has been increased demand for the use of sovereign guarantees, especially to manage loan default risk. In recent times, there has been heightened fear across the continent that these investments might lead to the ‘new colonization’ of a host of the countries that have been beneficiaries of Chinese investments. An analysis of most of the projects under scrutiny reveal that one of the most obvious ways such fears might materialize is if the sovereign guarantees backstopping the host government’s obligations are called by the Chinese government and the guarantor host countries are unable to meet their obligations. This is because whilst these sort of guarantees can be useful in facilitating and stimulating private sector investments and even making PPP projects cheaper, they also create liabilities on the the host countries. Where guarantees are not properly managed, they have been known to wreck havoc to the economies of a number of countries, especially during periods of economic slowdowns.

Guarantees appear to be a necessary evil, and it is these reasons that raise the need to re-evaluate the use of guarantees for the financing of infrastructure, especially by developing economies which are definitely more fragile than developed ones. This paper first of all looks at whether these guarantees are absolutely necessary for managing risks in PPPs, since guarantees themselves are very risky instruments. In other words, whether it is wise to replace one risk with another? Secondly, where the answer to the first question is in the affirmative, whether there can be a framework for determining when and how to use guarantees and finally, how to mitigate its effect when the risks it backstops eventuates.

**What are Sovereign Guarantees?**

A guarantee contract assures the holder of a debt or other obligation the timely payment of the debt when it becomes due or if the guaranteed event should materialise. If there is a default of the debt service obligation by the primary beneficiary, the guarantor pays the amount due under the guarantee contract. This is done through a simple guarantee call procedure agreed by the guarantor and the holder of the debt or obligation. A guarantee may be used to insure the consequences of an uncertain event or backstop a negative pledge, where the guarantor guarantees a certain type of conduct. For purposes of this paper, a sovereign guarantee may be defined as a formal undertaking by a host government to private sector asset providers that the government will take or refrain from taking

---

4 For a detailed history of the use of guarantees for the financing of infrastructure projects, see: Irwin Timothy C. ‘Government Guarantees: Allocating and Valuing Risks in Privately Financed Infrastructure Projects: The World Bank, Washington DC pg 1;
5 Irwin ibid
6 While Argentina suffered economic collapse, Chile for instance benefitted greatly from the use of guarantees.
8 During periods of recessions or economic slowdowns there is usually an upward pressure on interest rates, decrease in availability of credit, lower demand for goods and services therefore negatively affecting project cash flows and exchange rate volatility. See the International Monetary Fund Working Paper WP/09/144 ‘The Effects of the Financial Crisis on Public-Private Partnerships’ Prepared by Burger Philippe etal, IMF 2009
certain actions regarding the project, where the guaranteed event or events occur. In essence sovereign guarantees are used by the government to assume some of the downside risks in the project.

Sovereign guarantees may be deceptive because they do not demand immediate cash outlays from the government towards the financing of the project but rather the government assumes certain contingent liabilities, which often have potentially significant fiscal consequences. It is therefore usually advised that countries should be especially careful in the use of guarantees for several reasons: For instance it may be dubiously used by governments to bypass imposed fiscal constraints, also, due to its discretionary nature, it may be used to undermine good governance and finally, may lead to the creation of a guarantee culture where the private sector seeks guarantees as its preferred alternative to properly managing project risks.

For the purposes of the discussions that follow in subsequent paragraphs of this paper, three different types of guarantees are identified as commonly used in the financing of PPP projects, these are: loan guarantees, termination payment guarantees and project risk guarantees.

**Loan Guarantees:** These are guarantees offered by host governments to project lenders to cover the obligations of the private sector investors to repay the project loans. These are used usually where the investors are unable to repay the project loan due to certain factors, like where the revenue from the project is insufficient to meet the obligations of the investors to the lenders. Loan guarantees may also come in the form of a sovereign obligation to assume responsibility for the refinancing of existing project loans.

Most of the sovereign guarantees that are offered to Chinese investors across Africa are loan guarantees. Typically, a Chinese corporation would approach a public authority in a developing country through unsolicited bids, offering to construct some form of infrastructure in the host country. These types of infrastructure are usually procured either through conventional EPC procurements or through PPPs. The Chinese corporation then obtains the project loans through any of the Chinese state owned financing institutions with the condition that the loans be secured with a sovereign guarantee from the host government. Under this scenario, the ultimate responsibility to repay the loan is not the project, like in most non recourse financing deals, but the host government. These types of loan guarantees have become an issue because in a number of developing countries there are usually no thorough analysis of the country’s ability to repay these types of loans. The worry is therefore that it would lead to devastating consequences for beneficiary countries where the guarantee crystallises. The discussions that follow in the later sections of this paper are particularly helpful for developing countries in managing these types of transactions.

**Termination Payments Guarantees:** Due to the fact that PPP projects typically involve the construction of sunk assets, it is usually impracticable for private sector investors to leave with the assets when the PPP contract comes to a premature end. It is for this reason that the government would normally agree to make some termination payments to the private sector party in the event of contract termination. The formula for the calculation of these payments are usually provided for in advance in the contract. However, it is not unusual for this type of obligation by the government to be backstopped with the use of sovereign guarantees to meet the contractual obligation, where premature termination occurs. In recent times, put and call options agreements have also been used to backstop termination payments. In these types

---

10 Sovereign Guarantees may also take the form of comfort letters, indemnity letters and letters of intent. These types of instruments may however not have the same degree of legal consequence as guarantees backed with firm financial commitments.


12 ibid

13 There have been other typologies that have been used to classify guarantees. See for instance the European PPP Expertise Centre (EPEC) classifies guarantees into: finance guarantees, PPP contract provisions and sub-sovereign guarantees. See EPEC ‘State Guarantees in PPPs: A Guide to better evaluation, Design, Implementation and Management’ May 2011.

14 For instance, it is practically impossible for an investor to uproot a power plant and leave with it where the PPP contract is prematurely terminated.

15 Note that the obligation may also extend to commitment to make a payment for the residual value of the asset at the end of the PPP contract.
of agreements, the private sector investor is given an option to “put” the asset to the government if a termination event occurs. The government must then assume the obligation to pay an agreed amount of money to the investor in this case. There is also a corresponding option available to the government to “call” for the asset under some agreed conditions. In this case the investor is also entitled to be paid off in such cases. These options also create contingent liabilities on the government.

Project Risk Guarantees:
These types of guarantees are used to basically manage project risks. They may come in the form of revenue guarantees which are used to manage demand risk and project viability, assuring investors a certain level of revenues from the project. The may also come in the form of exchange rate guarantees basically transferring the risk of exchange rates volatility to the government. Another type of project risk guarantee is the change in law guarantees, where the government agrees that in the event that a change in law materially alters the economic equilibrium of the project that the government would put the investor back to the position it was prior to the change in the domestic law.

A number of multilateral institutions offer different types of project guarantees to developing countries. One of the most popular of these instruments is the political risk guarantees (PRGs). These instruments typically cover losses arising from the breach of host government’s contractual obligations to private sector investors. In summary, it covers risks such as expropriation, breach of contracts, sovereign debt default and currency transfer or controvertibly risk. Some of the providers are Government export credit agencies (e.g. EDC, OPIC), the World Bank (MIGA) and private insurers (Zurich, AIG etc.).

What are Public-Private Partnerships?
The most common of the private sector investment mechanism that enjoys the benefit of sovereign guarantees are PPPs. There is no consensus on the meaning of Public-Private Partnerships (PPPs) but there is however a general level of agreement of what the constituent elements of a PPP should be. The Malaysian PPP Guidelines lists them as:

i. The relationship between the public and private sectors is based on a partnership, which means that risk is shared between both partners optimally as it is allocated to the party who is best able to manage it.

ii. The public sector procures specified outputs and outcomes of a service for the contract period whilst the private sector determines the required inputs to achieve the specified output. The private sector is given the freedom to introduce innovation into their design and development to reduce cost; there is thus an integration of design, construction, finance and maintenance and operation.

iii. Payment for services is based on predetermined standards and performances.

iv. PPP promotes a ‘maintenance culture’ where the private sector will be responsible for the long term maintenance of the assets throughout the operational period agreed upon by the parties.

v. In some instances, there is an option for the transfer of the infrastructure asset back to the public sector at the end of the contract period.

vi. PPP involves a Whole Life Cycle Costing (“WLCC”) whereby PPP projects are usually awarded based on lowest total cost over the contract period compared to lowest construction cost under traditional procurement.17

Taking all these into consideration, a PPP for the benefits of this paper may therefore be defined as a long-term relationship between public sector agencies and private sector entities under which the responsibility for any or all of the combination of designing, financing, construction, management and operation of public infrastructure and utilities that were traditionally undertaken by the public sector are contractually shared and jointly undertaken by both the public and private sector, usually in proportion to the kind of risks each party can best carry.18

16 These are also known as Partial Risk Guarantees.
Managing Risks in Public Private Partnerships with Sovereign Guarantees

As mentioned consistently in the earlier parts of this paper, the major reason for the use of guarantees to finance public infrastructure is to manage risk in PPP projects. A risk itself is defined as any factor, event or influence that could threaten the successful completion of a project in terms of time, cost or quality. It is said to be characterised by a number of components: The risk event; what might happen to the detriment or in favour of the project, the probability of occurrence; the chance of the event occurring and the potential loss or gain; consequence of the event happening. However, the best way to view risk is not just as a threat with negative consequences, but as also capable of leading to a positive outcome in the project. Risk is converted to from a threat to an opportunity, where parties to the project are innovative in the management of the risk. For this reason, the definition by Al-Bahar, that ‘risk is the exposure or chance of occurrence of events adversely or favorably affecting project objectives as a consequence of uncertainty’, is preferred.

One of the major advantages of PPPs over other procurement models is that it enables the better management of project risks. This is achieved through the transfer of risk from the public sector to the private sector. The essence of the “partnership” in PPP is the fact that parties are able to share the risks and rewards so that the party best able to assume a particular risk shoulders it. Consequently, there is a correlation between the proper transfer and management of risk and the improvement of value for money in PPP projects. The reason for this is simply because parties now become more conscious of risks that affect the project and are able to reduce either the probability of the risk occurring or the financial consequences if it does, or both. The management of risk involves the following:

a) risk identification: the process of identifying all the risks relevant to the project;

b) risk assessment: the determination of the degree of likelihood of the risk and the possible consequences if the risk occurs;

c) Risk allocation: assignment of the responsibility of the consequence of the risk to one or more of the contracting parties; and

d) Risk mitigation: the process of controlling the likelihood of occurrence of the risk and or the consequence of the risk.

There are certain rules that guide risk allocation in privately financed projects. It is agreed that risk should only be allocated to a party who:

a) has been made fully aware of the risks they are taking

b) has the greatest capacity to manage risk effectively and efficiently (and charge the lowest risk premium)

c) has the capability and resources to cope with the risk eventuating

d) has the necessary risk appetite to want to take the risk

e) has been given the chance to charge the appropriate premium for taking it.


22 ibid


24 Ng, A, and Loosemore M ‘Risk Allocation in the Private Provision of Public Infrastructure’ Volume 25, Issue 1, January 2007, pp. 66-76
It is important to note that risk transfer does not eliminate the risk; it only reduces their economic cost. The party to whom a risk has been allocated, then has the responsibility to mitigate the risk. In some cases, therefore after risk has been allocated to the parties in a PPP project, the private sector may wish to mitigate the severity of the risk it has assumed by asking the government to issue guarantees to backstop some of probable adverse events or other variables that are likely to affect that risk. This occurs typically where the private sector party is not in control of all the essential elements that may likely affect the particular risk.

Based on the rules articulated above, it is doubtful whether a risk should in the first place be transferred to a party that is not in control of all aspects of the risk. This is because the issuance of sovereign guarantees effectively transfers the risk back to the government thereby distorting the initial risk allocation framework between the parties. The use of guarantees as a risk management device appears to suggest that the rules for proper risk allocation was not followed by the parties. In other words, by demanding guarantees, the private sector party is shown to be incapable of managing the risk it has been allocated and therefore is unwilling to assume it or is only able to assume it at a great premium to the public sector. This is consistent with the position of Ng and Loosemore, who warn that not following the rules concerning the allocation of risks will lead to dire consequences for the project. According to A. Ng and Loosemore:

Not following these simple rules will compromise the success and efficiency of the project since it will produce higher risk premiums than necessary, increase the chance of the risk arising and the consequences if they do arise. Further inefficiencies can arise from confused responsibility for monitoring and responding to risks; resentment for being forced to take them and; denial, conflict and dispute to avoid responsibility when they do arise. In effect, by not following the above rules, the public sector is merely gaining the illusion of risk transfer, since it is likely that the risk will be transferred back to them in the form of higher risks, risk premiums and project problems.

Having made the point above, it is important to note that there are however several other acceptable policy reasons why guarantees are useful in financing infrastructure. The first is that guarantees allow governments defer their spending obligations to a future date since they do not immediately commit upfront cash to projects. In essence government effectively borrows from the private sector to finance infrastructure knowing that it would have the obligation to repay back the loan when the guarantees are called in future. Where a government adopts this policy towards the use of guarantees, it suggests that the government is aware of the likelihood of the guarantees being called but is willing to meet this obligation at a future date. In determining whether guarantees provide value for money under this policy framework, the concern of the government would be that the repayments under the guarantee must not exceed the principal and interest payment if the country had taken a loan from other available sources to finance the project.

Secondly, sovereign guarantees may be employed to fast track projects. This is particularly useful in PPP projects which take longer delivery lead times compared to other conventionally procured projects. The usual reasons for the delay in delivering PPP projects is the lengthy due-diligence processes required to make projects bankable. Governments may utilise sovereign guarantees to shorten the delivery timeframe by effectively signalling to the private sector party that it is prepared to assume the risks that would have been investigated through a lengthy due diligence. In this case the government is effectively insuring the investor against the occurrence of certain risks. The problem in using this policy approach is that proper feasibility studies and due diligence is jettisoned, thereby increasing the risk of project failure. In determining whether guarantees would provide value for


26 A. Ng and Loosemore M. supra
money under this policy approach, the concern of the government should be whether the guarantees would be cheaper than available insurance premiums covering the guaranteed risks. Sovereign guarantees may also be employed as credit enhancing instruments. This is premised on the assumption that sovereigns can borrow at a much cheaper rate than the private sector. The use of guarantees in this case improves the credit rating of the project by substituting the credit rating of the project with that of the sovereign. In other words, where countries guarantee the viability of the project, it lowers the risk profile of the project, thereby making the project cheaper. This should normally translate into lower tariffs and user fees to the user public. Under this policy thrust, the government would be effectively subsidizing the project and must therefore ensure that such subsidies are transferred to its citizens and not creamed off by the private sector operators of the assets. The evaluation of value for money should centre around whether the total cost of the guarantee, including the probability of the guaranteed risk eventuating, would translate to an equivalent or increased subsidy on services delivered to the citizens. Guarantees may also be used as a strategy for encouraging the private sector to invest in sectors in which private sector investors would normally not have invested in but for the offered guarantee. In other words, guarantees may be used to generate confidence and stimulate investment in a sector in which the government has found difficult to attract private financing. It may also be the case that the reason for stimulating private sector investment in a particular sector is that the government wishes to tap into the expertise or technology of the private sector in the area.  

The Issue of Contingent Liabilities

As stated above, one of the major issues surrounding the use of guarantees for financing PPP projects is that it creates contingent liabilities. However, it is important to note that all public infrastructure projects irrespective of how they are procured, managed and financed are likely to generate future liabilities. Some of these, such as the cost of repaying domestic project loans or the costs of operating and maintaining an asset are direct and predictable with a relatively high level of certainty. These types of liabilities are obvious liabilities. Others, such as the cost of managing the consequences of an environmental incident related to an asset, addressing the effects of technological obsolescence and the consequences of the crystallization of a sovereign guarantee, are subject to a high degree of uncertainty both as to when and if they will arise and as to the level of financial exposure involved. The liabilities that originate in this manner are referred to as contingent liabilities. A contingent liability is a ‘future’ obligation that may or may not arise. It depends on the outcome of an uncertain future event such as the eventuation of a risk, a court judgment, credit default, contractual warranty or contract default. Two types of contingent liabilities are generally recognized: Explicit liabilities are usually based on contractual agreements between the government and another party, for example a Power Purchase Agreement (PPA) or a contract to guarantee project design etc. Implicit liabilities are based on a moral or political obligation of the government to give financial support when needed since government is the ultimate guarantor of infrastructure services. For example, where the government invokes its step in rights.

---

27 For instance, where the technology that is to be used in delivering the service is covered by a patent to a particular party.
28 Government’s step in right allows the government step-in and takeover the provision of PPP services where the private sector fails to meet its obligations for any of the several reasons that would lead to the termination of the PPP contract. For a comprehensive discussion on contingent liabilities see: Nwangwu George ‘Managing Contingent Liabilities
Contingent liabilities for government are even more of an issue in the case off PPPs where guarantee instruments are offered by the government as a risk mitigating strategy. This is because it may likely blunt the incentive of the private sector to innovate, reduce cost and try to make the project profitable since it can rely on the government to cover its losses. Also the possibility that the public sector may fail to identify, track or manage the effects of the guarantees increases the possibility of contingent liabilities crystallizing. Finally, the fact under PPPs the government has an implicit obligation to step in and provide contracted services where the private sector fails, increase the likelihood of contingent liabilities eventuating. This responsibility reduces the likelihood that governments would default on their guarantees. Therefore, where governments decide to finance PPP projects through the use of sovereign guarantees, such a decision must be accompanied with a clear framework for the management of contingent liabilities which arise as a result of the use of such guarantee instruments.

Simple Framework for Using Guarantees to Finance PPP Projects

Since it has been concluded from the analysis above that the use of sovereign guarantees may sometimes be essential to the provision of infrastructure through PPPs, it is important to devise a number of simple rules that public sector authorities may follow to reduce the impact of these guarantees and also the severity of contingent liabilities if the risks which the guarantees cover eventuate.

The first step for a country intending to run a PPP programme that would be supported with sovereign guarantees is to draw up a formal policy document dealing with how such guarantees will be issued and managed. This policy must at the minimum cover issues like the nature and types of projects that are eligible for guarantees, the terms that should be covered by the guarantees and how the projects enjoying such guarantees should be tracked and monitored. The policy must also articulate the institutional framework for providing and managing the guarantees. In other words, the policy should clearly state which institutions are responsible and how the different institution involved in the process coordinate with one another. Another key provision of such a policy is the requirement for a value for money assessment before the guarantees are issued. Guarantees should be targeted at a particular problem or priority sector. it must not be the policy of the government to issue blanket, indiscriminate guarantees covering all sorts of projects. The best approach would be for countries to determine upfront, in financial terms, the amount of guarantees that it would like to provide to a particular sector and what the desired objectives for issuing such guarantees are. Once the articulated objectives have been met, the government must then stop issuing the guarantees so that subsequent investors in the sector then assume those once guaranteed risks. For instance, a government may propose that it would like to procure 10,000MW of electricity urgently, and then offer sovereign guarantees to investors that come forward until the target is met. Subsequent investors that offer additional megawatts not included in the guaranteed 10,000 would no longer be entitled to such guarantees. This strategy would allow countries value their obligations better and also ensure that there is a long term plan to allow for proper risk management in the future.

Guarantees must not become a substitute for proper risk management. Where guarantees are excessively used it defeats the essence of PPPs which is to ensure that the private sector party shares the risks and rewards in projects and manages the risk that it can best handle for optimal project results. The correlation between the proper use of guarantees and obtaining value for money in projects cannot be overemphasized. Therefore, sovereign guarantees must only be issued in exceptional situations where project risk transfer and mitigation would lead to the private sector charging an absolutely ridiculous premium to assume a particular risk. Sovereign guarantees should be viewed as a risk management instrument and governments must use it only when their use is advantageous to the country.

One of the obvious reasons why a sovereign guarantee might be called is because the revenues or tolls from the project are insufficient to meet expected thresholds. This is usually because either the services are being subsidized by government or improper revenue studies have been conducted on the

---

29 Note the obligation to step in as provider of last resort for social services arise even where there is no explicit contractual commitment to do so.
project. It is recommended that where there is insufficient funds to subsidize projects, governments should charge cost reflective user charges for the contracted services as much as possible. In addition, the government may also look at the option of setting up a dedicated fund for financing the contingent liabilities that might arise as a result of the guaranteed risk eventuating. Another reason why sovereign guarantees have caused a lot of issues is that they create a false sense of being free, since contingent liabilities only arise in future. However, they are far from being free as at best they act as an insurance policy on the project and at worse, merely delaying the date of payment for the infrastructure. There is therefore a need for the proper valuation of guarantees and effective budgeting for the likely eventuation of guarantees. As a corollary to this, there is a need for the proper accounting treatment of guarantees. Due to the desire of countries to treat PPPs as a form of balance sheet financing, there has always been a tendency not to account for contingent liabilities. Where countries have adopted a cash basis accounting policy, it is more likely to hide the financial implication of guarantees as opposed to the accrual basis currently being championed by IPSAS which is more likely to encourage the recognition of some of these obligations. There is therefore need for a system that allows for the identification, mitigation, tracking and monitoring of contingent liabilities arising from project inception and throughout the life of the project.

CONCLUSION
This paper considered whether sovereign guarantees are absolutely necessary for the delivery of PPP projects in developing countries. In the main, it was agreed that despite the fact that most developing countries are desperate for private sector investment in their infrastructure, care must be taken to ensure that they do not issue sovereign guarantees indiscriminately since these guarantees are likely to generate future contingent liabilities. Governments must therefore consider the policy objectives for utilizing guarantees and ensure that proper value for money evaluations are carried out to ensure that the use of guarantees meet the desired objectives. It was also suggested that where a country decides to provide sovereign guarantees as part of its PPP programme, such guarantee must be provided with absolute caution because if it is misused, the public sector may be inadvertently creating a guarantee culture where the private sector seeks guarantees as an alternative to managing the risk itself. The misuse of guarantees may lead to a situation where the risk that was previously assumed by the private sector reverts back to the public sector, therefore distorting the originally agreed risk allocation framework. There is also the possibility that the cost and risk of such guarantees are neither transparent nor well understood by the PPP stakeholders. It is also good practice to ensure that where these guarantees are used, provision should be made for the use of claw-back provisions in the contracts. These contractual clauses ensure that the private sector gets only the additional subsidies that are require to make the project work and ensures that excess benefits are creamed off and given back to the tax payers. The reasoning behind this is simply the notion that if risks are to be shared, then benefits should also be shared. Before the government commences a sovereign guarantee programme, it must devise a plan on how to manage the risks that arise as a result of the use of the guarantees. This plan should cover periods from project conceptualization to the operational phase of the project. At project conceptualization stage, the plan must amongst other things, emphasize the priority sectors that are eligible for sovereign guarantees and also the nature which such guarantees should take. At the operational phase of the project, the public sector authority must also put in place a risk monitoring and reporting

---

30 See for Instance Indonesia and Columbia. Note that this also helps reassure investors that government will meet its obligations when they arise.
31 See also Irwin Supra @ Pg. 122
32 United Nations Guide Book Supra
34 Ibid
This system not only ensures that the services are delivered to the public according to the contracted performance specifications but also that the service provider is doing enough to ensure that the risk of sovereign guarantees being called are minimal. In granting sovereign guarantees, extreme care ought to be taken as experience from other countries has demonstrated that the scale of total contingent liabilities can build up quickly if a successful PPP programme is established and that economic downturns or financial crises can result in fiscal liabilities from many projects crystallizing together within a short period of time. This has the potential to undermine national macroeconomic policies and to cause significant economic harm to the government. There is therefore a need for a proper upfront valuation and tracking of the likely contingent liabilities arising from sovereign guarantees and ensuring that the country can afford them. Finally, it is important that developing countries build sustainable institutions, regulations and also pursue greater transparency in their PPP programmes. It is a fact that country risk perception depends a lot on the institutional and regulatory environment existing within the particular country. It therefore follows logically that once there exists more conducive institutional and regulatory environments within countries, investors would limit their demand for sovereign guarantees from those countries.

REFERENCES
Ng, A, and Loosemore M ‘Risk Allocation in the Private Provision of Public Infrastructure’ Volume 25, Issue 1, January 2007
Raundi Halvorson-Quevedo and Mariana Mirabile ‘External Financing for Development’ March 2014 found online at: http://www.oecd.org/dac/stats/guaranteesfordevelopment.htm
Sachs Tillman etal, ‘Analysis of Political Risks and Opportunities in Public-Private Partnership (PPP) in China and Selected Asian Countries: Survey Results’ Chinese Management Studies, Vol.1 Issue: 2