The Luxembourg Rail Protocol: Making The Railways Work For Africa

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It’s the perfect storm

Africa’s growth will increasingly come from its cities. However, rapid migration from rural areas to cities across Africa is squeezing local resources. At the same time, congestion in its major cities has never been worse: the roads cannot take the strain, and the cities endure deadly congestion and pollution. Very few African cities are connected with each other by rail transport, limiting the trade potential between cities.

A recent report from the UN Economic Commission for Africa (UNECA) states that intra-African trade stands at 15%, compared with Europe (67%), Asia (58%) and North America (48%). African economies remain predominantly commodities based, so they suffer whenever prices fall. Even getting commodities to market is a struggle: 16 of Africa’s 55 states are landlocked.

All this is against a background of continuing underinvestment in African infrastructure. Indeed, poor infrastructure is estimated to cost Africa up to 2% of GDP annually. The most recent estimate from the African Development Bank is that the continent's infrastructure needs amount to USD130 – USD 170 billion a year, but its financing gap is USD 67.6 – USD 107.5 billion.

State resources are limited, and there's a rise in public debt across Africa. The median debt level Africa is now over 50% of GDP, compared to just 30% of GDP in 2012. This is a high figure, as African states have relatively little tax income (compared to more developed economies), and this debt level could start to strangle economies as interest rates rise in future years.

An alternative solution is needed

With the launch in March 2018 of the African Continental Free Trade Area (AfCFTA), Africa took a major step forward towards achieving the 2030 Agenda for Sustainable Development and Agenda 2063 (The Africa We Want). By boosting intra-regional and international trade, pan-African economic integration will spur development, create wealth, and ensure economic benefits for all citizens. The question now is how to achieve these noble goals.

Connectivity and improved logistics through better rail infrastructure are at the core of this agenda. Economic growth, and environmentally sustainable development in Africa, will depend on having an efficient and expanded rail network. Rail transport is the only cost-effective and safe way to move large volumes of freight while delivering greater energy efficiency and lower greenhouse gas emissions. There are numerous opportunities ahead:

- When AfCFTA comes into full force, large volumes of goods and bulk commodities, including mining outputs, will be generated, creating huge markets for rail transport.
- Africa's vast size and landlocked countries encourage the development of high-speed, high-capacity transport corridors.

The future opportunities are many, but where do we stand today? Existing railway infrastructure and rolling stock in many African countries is sub-optimal. Africa currently has one kilometre of rail track for every 650 square kilometres of land. The comparable figure for Asia is 225, and for Europe 118. And as rail coverage in Africa uses three different gauges (namely 20% standard gauge, 60% cape gauge and 18% metre gauge), with some systems electrified and some operating diesel locomotives, incompatible networks across the continent are hindering free movement, trade and regional integration.

So, the African rail sector clearly requires significant investment in infrastructure, facilities and rolling stock. The costs involved are enormous. For example:

- The recently commissioned 34 km Addis Ababa Light Rail Transit will cost USD 475 million.
- The bill to renovate the Ethiopia to Djibouti line was over USD 4 billion.
- The new high speed rail project in Morocco is estimated to have cost USD 2.4 billion.
- The cost of close to USD 4 billion for the new standard gauge Mombasa to Nairobi line is one of the most expensive rail projects in Africa to date.

Estimates for converting South Africa's over 20,000 km of cape gauge rail track to standard gauge are quoted at over USD 110 billion. It won't happen. But the new plans for a high-speed standard gauge passenger rail and freight network linking key centres in South Africa probably will be realised, at a cost of many billions of dollars.

Some of the costs can be covered through concessional lending, but this is limited. Understandably, African governments are unable or unwilling to take on more debt. So the solution has to be to bring in the private sector to provide innovative financing and expertise.

Infrastructure can be built and financed by governments in partnership with the private sector, with some risks and costs borne by the private sector. But what about operating the railways? All governments build roads, but they don't finance or underwrite the cost of every truck, bus or car that runs on the roads. Why should the railways be different? Operational costs and the necessary rolling stock can be financed by the private sector without recourse to government. Africa must look to adopting this approach.

With rolling stock often accounting for up to a third of the total cost of a new rail project, the attractiveness of funding this via the private sector, rather than taking precious resources from the state, is obvious. The financing is available: in banks, leasing companies, pension funds and private equity funds. But private investors will not invest unless the conditions are right and they have security for their loans. Every perceived risk adds to the cost, and few countries currently have laws in place that provide such security. The public and private sectors need to work together to find a solution.

Such a solution now exists for African governments. Not only is it cost neutral, it also promises to deliver billions of dollars in direct benefits to governments and state-owned enterprises over and above the valuable support it will give to the development of the African rail industry and overall economy.

The Luxembourg Rail Protocol to the Cape Town Convention on International Interests in Mobile Equipment is a new international treaty due to enter into force in late 2019, which will protect private investment in the rail sector. It creates a new worldwide legal framework to recognise and regulate the security interests of lenders secured by, and lessors of, railway rolling stock, and it will allow creditors to repossess financed assets on the default or insolvency of the debtor, subject to public interest safeguards.

The new Rail Protocol applies to all railway vehicles on tracks or guideways, from high speed train sets to conventional freight or passenger locomotives and wagons, as well as to metro trains, trams, and even cable cars. Not only will it give governments a ready-made legal solution to attract private investors, it will also create a common African legal regime that secures private creditors financing railway equipment. It thus makes investment much more attractive and understandable for external private investors, and provides previously unavailable protection for owners and financiers, and indeed operators, as trains move across national borders within Africa.

A further benefit of the Protocol is that for the first time, it will create unique global identifiers for rolling stock, with an international public registry established in Luxembourg that will allow financiers to register their interests, and prospective creditors and purchasers to check any rival claims to the equipment being financed. Thanks to the internet, the registry will be available for searches 24/7. The international public registry also means that states will not have to set up their own registries of rolling stock, with all the costs and administration involved. The unique numbering system will make it easier to track the physical location of rolling stock in real time, facilitate customised maintenance programmes, and support governments as they set up regulatory structures for monitoring increasing cross-border operation and interoperability of railway equipment.

And there's more. By reducing risk for rail equipment financiers, the Protocol will:

- Attract more private sector lenders and lessors into the market, resulting in cheaper finance for non-state-guaranteed operators, as the risks for private sector funders and export credit agencies decrease and more funders come into the market.
- Create choice for operators in relation to the cost and types of funding, and open the way for governments to deleverage the state operators' portfolio of rolling stock by refinancing it with private capital.

- Facilitate the provision of finance to customers where up to now, their poor credit and/or lack of a legal infrastructure has discouraged creditors.
- Attract capital investment, which will in turn promote and support the expansion of African rolling stock manufacturing.
- Facilitate short-term operating leases of rolling stock, not just into railways operators from financiers, but also between operators, ensuring more efficient use of rolling stock.

In recent studies for the Rail Working Group (an international non-profit working on implementation of the Luxembourg Rail Protocol), independent economists Oxera calculated the direct micro-economic benefits of the Protocol in 20 states across Europe at EUR 19.4 billion, and in relation to South Africa alone, EUR 1.3 billion. The additional macro-economic benefits will also be considerable.

We can also expect lower barriers to entry into the industry for private sector operators, more efficient and competitive existing operators, and as a result, a more dynamic industry. State and private operators will no longer need to request state funding or guarantees (which are often not available). Governments can focus their resources on financing infrastructure, not rolling stock.

By underwriting secured financing without state guarantees, not only will the Protocol ensure more attractive financing rates, it will also allow public and private operators to invest in rolling stock when the need arises, not when the funds are available. By underwriting operating leasing, the Protocol will:

- Open the way for sharing risk between the public and private sectors.
- Create an economic driver towards the standardisation of equipment and economies of scale.
- Provide a mechanism for operators in different countries to share capacity, as it will be less risky for private financiers to permit rolling stock to move across borders.

The Luxembourg Rail Protocol will cost governments nothing - except the time involved for the process of adopting the Protocol. The opportunities, the investment, and the cost savings the Protocol will bring to Africa will be immense. This is a valuable and practical new tool to support free trade and sustainable development in Africa through building a common system for African railways. The UN Economic Commission for Africa and the Rail Working Group are working to assist countries both to ratify the protocol and to structure deals to maximize its benefits.

The Luxembourg Rail Protocol is not yet in force but is expected to begin to operate in late 2019. As of writing:

- The Protocol has been ratified by: the European Union (in respect of its competences), Luxembourg, Sweden and Gabon.
- France, Germany, Switzerland, Mozambique, Italy and the UK have signed the Protocol and are proceeding to ratification.
- Malta, Finland, Ukraine, Mauritius and South Africa are actively focused on adoption of the Protocol.
- Kenya, Senegal and Burkina Faso, with the support of UNECA, are working to ratify.
- China, Spain and Hungary have launched studies into its adoption.

The African Continental Free Trade Area will significantly improve the lives of tens of millions across Africa. But it will be the railways, quite literally, that deliver the goods – as long as Africa can mobilise the resources to (re-)build and operate them. The Luxembourg Rail Protocol is an important part of the solution to do this, so that railways can transport goods and people in an environmentally and financially sustainable way across Africa, moving the AfCFTA from dream to reality.