THE 2001 CAPE TOWN CONVENTION
ON INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT

RAIL WORKING GROUP

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Consultation between Civil Society Organisations and Members of the OECD's Working Party on Export Credits and Credit Guarantees (ECG)

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Effective and Fair ECA support for the Railways in Africa

Written Submission from
the
Rail Working Group

R1034

Summary

- Africa has ambitious goals to revitalise and expand its rail sector to create a continental transportation system for high-volume movement of people and goods in a way that is both environmentally and financially sustainable.

- This will require heavy investment in rail infrastructure and rolling stock, in turn creating important business opportunities for OECD-based suppliers and manufacturers of rolling stock.

- But investment will be constrained by a lack of resources and high debt costs.

- ECA support is essential, but it remains expensive for debtors in low- and middle-income countries, restricting the amount of investment in rolling stock because of the high premium rates, which reflect perceived country risk.

- The Luxembourg Rail Protocol to the Cape Town Convention will enter into force in early 2024. It will reduce financial risk by creating a new system of rights for creditors financing all types of railway rolling stock, and by introducing a common global system for identifying and marking rolling stock, also covering cross-border operation of rolling stock.

- The Luxembourg Rail Protocol applies when the debtor is in a contracting state, and this should be reflected in the premium rates offered by ECAs.

- Various African states have already either adopted the Protocol or are in the process of doing so. In the Zanzibar Declaration of 15 September 2023, African transport ministers urged African Union member states to complete the ratification process for the Luxembourg Rail Protocol on railway rolling stock.

- The extension of the OECD Climate Change Sector Understanding to most railway rolling stock is welcome, but this applies independent of the operation of the Luxembourg Rail Protocol and is not reflective of any incremental change to the credit status of the debtor or of country risk.

- The OECD Aircraft Sector Understanding specifically recognises the risk mitigation resulting from the adoption of the parallel Aircraft Protocol to the Cape Town Convention by allowing ECAs to grant a 10% "Cape Town Discount" on their risk premiums.

- This submission argues that, taking into account the significant environmental, social and economic benefits of investment in the African rail sector, the existing treatment by ECAs of aircraft financings, and the risk mitigation effect of the

Luxembourg Rail Protocol, ECAs should make *at least* the same discount available on their risk premiums, and preferably offer a higher discount, in relation to the financing of railway rolling stock when the Luxembourg Rail Protocol applies.

About the Rail Working Group

The Rail Working Group is a Swiss-based not-for-profit association focused on the adoption and implementation of the Luxembourg Rail Protocol. It has over 80 direct members and hundreds of rail stakeholders represented indirectly by various industry organisations that belong to, and support, the objectives of the RWG.

About the Luxembourg Rail Protocol

The Luxembourg Rail Protocol to the Cape Town Convention on International Interests in Mobile Equipment is a new global treaty under the auspices of UNIDROIT, the International Institute for the Unification of Private Law. The Protocol will make it much easier and cheaper for the private sector to finance railway rolling stock. It sets up a new system for recognition, priorities and enforcement of creditor and lessor rights, which will be registered in an international registry based in Luxembourg, accessible to everyone over the internet 24/7.

The Protocol is expected to enter into force in contracting states in early 2024. The European Union (in respect of its competences), Luxembourg, Sweden, Spain and Gabon have ratified the Protocol, and South Africa and Paraguay are about to adopt it. France, Germany, Switzerland, Mozambique, Italy, and the UK have already signed the Protocol, and many other African states, including Kenya, Eswatini, Namibia, Senegal, Zimbabwe, Zambia, Uganda, Ethiopia, and Mauritius, are currently looking at adoption of the Protocol.

The Protocol is endorsed by many international rail organisations (including OTIF, the Intergovernmental Organisation for International Carriage by Rail, and the UIC, the Union of International Railways) and is actively supported by the African Union, the European Union, the UN Economic Commission for Africa, the UN Economic Commission for Europe, and UNIDROIT.

For more on the Luxembourg Rail Protocol and the Rail Working Group see [www.railworkinggroup.org.](http://www.railworkinggroup.org)

Africa's growing need for rolling stock

The African Continental Free Trade Area (AfCFTA) is one of the flagship projects of "Agenda 2063: The Africa We Want". It is a visionary trade agreement covering critical areas of the continent's economy. By eliminating barriers to trade in Africa, the AfCFTA creates a single market for goods and services across the continent of Africa and will significantly boost intra-Africa trade across all sectors of Africa's economy. It was launched at the 12th Extraordinary Session of the African Union Assembly of Heads of State and Government in Niamey, Niger, in July 2019, and entered into force on 1 January 2021. As of October 2023, it had been signed by 54 African states and ratified by 47 states.

With intra-African trade currently standing at about 15%, compared with 48% in North America, 58% in Asia, and 67% in Europe,[1] the AfCFTA will dramatically improve trade within Africa, in turn creating significant economic benefits, estimated at USD 450 billion by 2035.[2]

But these objectives will not be achieved if the goods cannot be physically transported within Africa. At the moment, approximately 80% of all goods – and 90% of all passengers – transported within Africa, travel by road.[3] Trucks are a significant source of air and noise pollution that tear up African roads and are a major source of accidents. Further, they will not be able to provide sufficient capacity to carry the goods taking advantage of the new free trade area.

It will be the railways that, quite literally, deliver the goods. One freight train can transport the same number of containers as 100 trucks. Indeed, railways are roughly four times more fuel efficient than trucks[4] and will effectively be the only environmentally and economically sustainable way of moving goods across Africa. But this will require huge investment in rehabilitating and expanding existing rail networks, as well as building new ones.

Under the auspices of the African Union, African states have agreed a comprehensive plan for an African integrated rail network to be operating by 2063. The present-value cost of such a system will be significantly higher than USD 100 billion, and the reality is that African governments will struggle to find the resources to fund this.

Moreover, this does not take into account the cost of procuring the rolling stock needed to run on the African rail networks. The UN Economic Commission for Africa has estimated that, as part of the programme for the implementation of the AfCFTA, the

[1] Economic Development in Africa Report 2019: Made in Africa: Rules of origin for enhanced intra-African trade, United Nations Conference on Trade and Development, 2019.
[2] "African Continental Free Trade Area: Economic and Distributional Effects," World Bank Group, 2020.
[3] "Tracking Africa's Progress in Figures: Infrastructure Development," African Development Bank, page 50.
[4] https://tcwr.net/new-to-tcw/why-railroad/

African rail system will need 170,000 more freight wagons by 2030 at an estimated cost of USD 36 billion.[5] This in turn will require thousands more locomotives, conservatively adding another USD 20 billion to the cost.

The railways also have a significant future role in the urban and inter-urban transportation of people. The population of Africa is rapidly moving from the land to the cities. In fact, over the next 40 years, Africa will be home to the fastest growing cities in the world.[6] In 1960, less than 20% of the African population lived in cities. Today on average, at least 40% of the population is urban, and in many African states significantly above this. Since 1990, the number of African cities has doubled from 3,300 to 7,600.[7] More than 11 urban areas across the continent are home to over 5 million inhabitants, and counting.[8] By 2050, over 60% of the African population will be living in cities, representing a population of almost 1.5 billion urban dwellers.[9] By the end of this century, Africa may be home to 13 of the world's 20 biggest urban areas.[10] As a result, almost all large cities in Africa currently suffer from major traffic congestion – as well as terrible pollution – and this will only get worse. The obvious solution is rail transportation into and within urban agglomerations.

Cities such as Dakar and Addis Ababa have built light rail systems that have been so successful that they need to expand. Other cities, such as Nairobi, struggle to create any type of urban rail system to alleviate their terrible traffic problems.[11] Many other urban centres, such as Lagos, Dar es Salaam and Accra, will need light rail or metro systems in the coming years, or they will literally grind to a halt. But the costs of building such infrastructure will be immense.

In each case, Africa currently does not have the capacity to build the rolling stock at such scale, particularly because standard gauge rolling stock is often required[12]. As a result, much of the railway equipment will need to be imported. Moreover, neither the governments nor the railway operators, focusing limited resources on the building of infrastructure, will have the capital needed to pay for this new rolling stock. The only answer will be private capital secured on the rolling stock.

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[5] Implications of the African Continental Free Trade Area for demand of Transport Infrastructure and Services, Fifth Africa Business Forum 2022, United Nations Economic Commission for Africa.
[6] https://www.brookings.edu/articles/figure-of-the-week-africa-is-home-to-fastest-growing-cities-in-the-world/
[7] https://www.afdb.org/en/documents/africas-urbanisation-dynamics-2022-economic-power-africas-cities#:~:text=Since%201990%2C%20the%20number%20of,and%20they%20are%20changing%20fast.
[8] https://africapolis.org/en/about/beyond-large-cities
[9] Development Challenges in Africa Towards 2050, Chapter 6, page 102.
[10] https://www.washingtonpost.com/world/interactive/2021/africa-cities/
[11] A recent study suggests that not only pollution, but a considerable loss of revenue results from Nairobi's congestion, concluding that the reduced productivity due to inadequate transport solutions costs the city about USD 400 million in lost revenue per day: https://ieakenya.or.ke/blog/are-matatus-the-main-cause-of-traffic-congestion-in-kenya/
[12] And is stipulated by the African Union in various instruments and declarations as the preferred gauge for new rail infrastructure projects

Reducing the cost of credit

In this context, export credit agencies (ECAs) will have a significant role to play, underwriting credit provided by the private sector to finance the rolling stock that Africa so urgently needs. Moreover, the level of the underwriting costs will directly impact the economic viability of new rail projects.

In July 2023, a revised arrangement on officially supported export credits under the auspices of the OECD was introduced (the Revised Arrangement) [13]. This applies to ten export credit agencies in OECD states and the export credit agencies of the 27 Member States of the European Union. The Revised Arrangement reflects the policy of encouraging the use of export credits to support the procurement of environmentally sustainable assets. The abolition of the Rail Sector Understanding and the transfer of zero or low emission rolling stock into the Climate Change Sector Understanding (CCSU), resulting in a significant lengthening of the maximum repayment term is welcome, even though the definition of rolling stock covered in Appendix 1 to the CCSU is not optimal[14]. The move goes *some* way to redress the flaw in the Rail Sector Understanding, as it applies to railway rolling stock, where the maximum financing term was 14 years, with an average term of 10 years, whilst the expected useful life of rolling stock is between 30 and 35 years on average, with some rolling stock lasting much longer.

Without question this will help financings of rolling stock within the parameters of the Revised Arrangement. Nonetheless, even if it is spread over a longer period, the risk premium must, best case (i.e. assuming a perfect buyer risk), reflect the country risk[15]. The country risk is set out in the OECD's "Country Risk Classifications of the Participants to the Arrangement on Officially Supported Export Credits", which is revised on a regular basis. Herein lies the difficulty.

Under the operation of the Revised Arrangement, the greater the country risk, the higher the minimum risk premium that must be charged. Some 50% of all 55 African states are currently allocated the worst risk weighting (7) under the OECD Country Risk Classification, and only four African states: Botswana, Mauritius, Morocco and South Africa, have a credit rating better than 5. It is regrettable therefore, that, given that railways are an important tool to combat climate change, states that urgently need investment in the railways to improve their economic position are constrained by a lack

[13] TAD/PG(2023)7
[14] For example, are trams and other urban transport vehicles included in the term "trains"? They should be. By way of comparison, see the more extensive definition of railway rolling stock in the Luxembourg Rail Protocol (article I.2 (e)) and the detailed guidance given under the 2023 UN Model Rules on the Permanent Identification of Railway Rolling Stock [https://unece.org/sites/default/files/2023-06/2304934_E_pdf_web_0.pdf]. The Rail Working Group stands ready to assist export credit agencies to improve the definition.
[15] With very limited exceptions set out in Annex X to the revised arrangement.

of private credit when there is no ECA support, and the relatively high cost of credit when there is.[16]

We argue that, just as the Revised Arrangement now creates a more benign financing regime for environmentally sustainable assets, an equally important social goal is to support the development of low-income countries by improving the financing terms for equipment that will play a direct role in the economic development of those states, *as long as the equipment being financed is environmentally sustainable*. Rolling stock comes within that category, and we propose that export credit agencies should have some flexibility to provide more favourable finance conditions compared to those resulting from the strict application of the relevant country risk coefficient. ECAs also have a responsibility to help poorer countries out of the debt trap they are now in.

In addition, we have serious questions regarding the reliance on country risk classifications in relation to mobile equipment that operates between different jurisdictions with different risk classifications. For example, if rolling stock regularly moves between South Africa and Mozambique, which have country risk classifications of 4 and 7 respectively, it seems arbitrary, in terms of risk assessment, to apply different rates depending on where the debtor has its principal place of business. Indeed, under such rigid rules, there is substantial potential for abuse.

However, even disregarding our arguments set out above, and assuming that ECAs wish, and in some cases are obliged, to apply strict commercial criteria to the pricing of the credit support they provide, the Revised Arrangement, when applied to railway rolling stock, gives no benefit to the debtor arising from the enhanced security provided by the Luxembourg Rail Protocol to the Cape Town Convention. This enhanced security arises from six separate advantages delivered by the Protocol, namely:

(i) It introduces into the local law of contracting states a clear legal framework guaranteeing the rights of creditors that are collateralised by railway rolling stock, either through leases or secured loans, and specifically making it easier, cheaper and faster for such creditors to enforce their rights on debtor default or insolvency.[17]

[16] In their "Nairobi Declaration", adopted at the African Climate Summit on 6 September 2023, African Heads of State from 54 countries noted that "the scale of financing required to unlock Africa's climate positive growth is beyond the borrowing capacity of national balance sheets, or at the risk premium that Africa is currently paying for private capital."

[17] The "ability to make and enforce contracts and resolve disputes is fundamental if markets are to function properly. Good enforcement procedures enhance predictability in commercial relationships and reduce uncertainty by assuring investors that their contractual rights will be upheld promptly by local courts" OECD Policy Framework for Investment at https://www.oecd.org/investment/toolkit/policyareas/investmentpolicy/contractenforcementanddisputeresolution.htm

(ii) This framework is effectively guaranteed by virtue of the Protocol having the status of an international treaty[18].

(iii) It will be a common framework operating in neighbouring countries, thereby providing more security when rolling stock crosses jurisdictional boundaries.

(iv) The unique rail vehicle identification system (URVIS) introduced by the Protocol, introduces for the first time a common global system for uniquely identifying rolling stock, making it easier for creditors to track, in real time, and, if necessary, repossess financed railway equipment.

(v) The new UN Model Rules on Permanent Identification of Railway Rolling Stock[19] create a global minimum standard for physically marking railway rolling stock with the URVIS number.

(vi) The international registry created under the Protocol for the first time provides a public registry where parties providing securing credit for rolling stock can register their security in a public registry searchable 24/7 through the internet.

ECAs must take into account this additional security when pricing their risk premiums, and this should be regarded as a country risk mitigation under Annex X of the Revised Arrangement, empowering ECAs to reduce the premiums to a level below the rate that would be applicable on the country risk.

Creating a level playing field

In fact, ECAs *have* accepted for at least 12 years the principle that the legal regime introduced by a protocol to the Cape Town Convention protects creditors, enhances creditor security, improves the commercial position of ECAs, and therefore justifies a lower risk premium. The Aircraft Sector Understanding (ASU) to the Revised Arrangement[20] permits a discount of 10% of the minimum premium rate when the Aircraft Protocol to the Cape Town Convention applies to the credit being provided[21]. This is known as the "Cape Town Discount".

[18] Article 27 of the Vienna Convention on the Law of Treaties states that "a party may not invoke the provisions of its internal law as justification for its failure to perform a treaty. This rule is without prejudice to article 46". Article 46 of the Vienna Convention states that "[a]State may not invoke the fact that its consent to be bound by a treaty has been expressed in violation of a provision of its internal law regarding competence to conclude treaties as invalidating its consent unless that violation was manifest and concerned a rule of its internal law of fundamental importance."

[19] see above

[20] Annex III to the Revised Arrangement

[21] see paragraphs 36 - 39 of Appendix 1 to Annex III

The Luxembourg Rail Protocol applies the Cape Town Convention to railway rolling stock but, aside from divergences dictated by the different types of assets, the Protocol is broadly the same as the Aircraft Protocol to the Cape Town Convention.

How can it be that as the Revised Arrangement currently stands, the Cape Town Discount will be available on aircraft financings when the Aircraft Protocol to the Cape Town Convention applies, but not to rolling stock financings when the corresponding Rail Protocol to the same Convention applies? This is arbitrary and inequitable.

Railways are more environmentally sustainable

Moreover, the social and economic benefits of railways, in particular the environmental benefits of lower CO^2 emissions, far exceed those of the aircraft sector. Indeed, electric rail transport, which accounts for over 85% of passenger rail activity and 55% of freight movements, does not emit any direct CO^2 emissions.[22] Furthermore, electric rail, already the most electrified subsector of transport, is uniquely positioned to take advantage of the rise of renewable fuels.[23]

This seems particularly egregious in the light of a clear policy, encapsulated in the Revised Arrangement, demonstrating a (welcome) preference to extend more favourable terms to the financing of environmentally sustainable assets and indeed to withdraw the financing of heavily polluting assets[24].

In the European Union, for example, aviation accounts for over 13% of all transport greenhouse gas emissions, the railways for 0.5%. Per passenger kilometre, aircraft emit more than four times the amount of CO^2 compared to trains; the railways are between three and eight times more fuel efficient than aircraft.[25] In general, "rail transports around 7% of global passenger-km and 6% of tonne-km but accounts for only around 1% of transport emissions."[26] The aviation and rail sectors compete over certain distances for transportation of both people and freight. Indeed, some nations such as France have taken strong regulatory stances to favour rail-based travel on these routes.[27]

In light of the serious threat to the global community from climate change and the commitment of OECD states to lower carbon economies, how can the Revised Arrangement possibly give a competitive advantage to the highly polluting aviation sector compared to the rail sector?

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[22] https://www.iea.org/energy-system/transport/rail
[23] https://www.carbonbrief.org/eight-charts-show-how-aggressive-railway-expansion-could-cut-emissions/
[24] See Chapter 1 paragraph 6 of the Revised Arrangement
[25] Source EEA 2018. For more on this please see the Rail Working Group, "Combating global climate change", September 2020 at https://www.railworkinggroup.org/wp-content/uploads/docs/R0929.pdf
[26] https://www.iea.org/energy-system/transport/rail
[27] https://www.euronews.com/green/2022/12/02/is-france-banning-private-jets-everything-we-know-from-a-week-of-green-transport-proposals

At the very least, a Cape Town Discount of 10% must apply to ECA premiums relating to the financing of railway rolling stock when the Luxembourg Rail Protocol applies the Cape Town Convention to the credit. With the greatest of respect, any other position would expose ECAs as being deeply hypocritical. Moreover, in light of the fact that railways are far more environmentally sustainable than aircraft, as well as the professed support of the Revised Arrangement for procurement of environmentally sustainable assets, the discount should surely be at least equal or potentially higher.

The time to act is now

The Luxembourg Rail Protocol will enter into force in the first quarter of 2024. Although only Gabon has so far ratified the Protocol in Africa, ratification is currently going through the South African Parliament, and we anticipate that South Africa will adopt the Protocol before the end of 2023. South Africa alone represents more than two-fifths of the entire rail network in Africa. We expect a number of African states to quickly follow. Indeed, indications under the Revised Arrangement that credit terms will improve if the Luxembourg Rail Protocol applies will serve as a catalyst for further ratifications, thereby delivering a win-win: more security to ECAs and better financing terms to African rail operators.

Moreover, the African Union has adopted a clear policy urging its member states to adopt the Protocol at the earliest opportunity. On 15 September 2023, African transport ministers meeting in Zanzibar, Tanzania, adopted the Zanzibar Declaration[28], addressed to the 55 AU member states, urging:

> "[a]ll remaining Member States to complete the ratification process for ….. the Luxembourg Protocol on railway rolling stock".

On 20 October 2023, the declaration made at the end of the UIC Africa Rail Finance Forum in Dakar stated the following:

> "some African countries are in the process of adopting the Luxembourg Protocol into their national legislation to secure and finance rolling stock. These ownership efforts are encouraged by the African Union. It is therefore strongly suggested that African countries support the Luxembourg Protocol ratification process."

The Luxembourg Rail Protocol is already a firm component of Africa's overall developmental strategy, with considerable political support at the regional level.

[28] https://www.uneca.org/sites/default/files/Private-Sector-Dev/zanzibar-declaration.pdf

ECAs must support the rail sector

The African Continental Free Trade Area is in the process of creating a single market for goods and services in Africa. It will only succeed if governments and operators in Africa are able to move goods around the continent in an efficient and economically and environmentally sustainable way through a massive investment in railways across Africa.

Plans are already well advanced for implementation over the next 40 years. But the cost will be immense, and governments and state-owned rail operators will not have the resources to pay both for the necessary infrastructure development and the rolling stock.

With the huge speed and scale of urbanisation in Africa, the need for more urban rail networks in African cities only becomes more pressing before road congestion brings them to a complete standstill. The projected demand for new rolling stock in Africa is therefore potentially huge, and there will need to be engagement and delivery from rolling stock manufacturers across OECD states.

Export credit agencies will have an important role to play in supporting private sector finance of rolling stock provided to Africa. But the cost of that support is very high in most cases, due to the relatively poor credit status of most countries across Africa.

The OECD Revised Arrangement on Officially Supported Export Credits, introduced in July 2023, moving most railway rolling stock into the Climate Change Sector Understanding, will undoubtedly improve the financial terms available to debtors based in Africa when underwritten by export credit agencies. But the cost will still be too high and critical opportunities will be missed to fight climate change through investment in the railways and to support economic development and integration across Africa. And to create new business for rolling stock manufacturers in OECD states and in Africa. The opportunities can only be realised if African states and operators can finance rolling stock in the private sector on financially sustainable terms.

The Luxembourg Rail Protocol to the Cape Town Convention, which is due to come into force in Q1 2024. Like many OECD states, African states are committed to the introduction of the Luxembourg Rail Protocol. The Protocol enhances the security for private sector creditors providing collateralised financing, through secured loans or leases, of railway rolling stock to rail operators across Africa. This should be reflected in the risk premiums being charged by ECAs.

However, export credit agencies, under the Revised Arrangement, already may discount their risk premiums by 10% when the equivalent protocol to the Cape Town Convention relating to aircraft applies. It would neither be reasonable nor equitable that, once the Luxembourg Rail Protocol enters into force, the Cape Town Discount would apply to aircraft financings but not to the financing of rolling stock, taking into account the clear policy of the OECD export credit agencies to favour more environmentally friendly assets.

At the very least, the 10% Cape Town Discount should also be available and be applied to ECA risk premiums when they have the benefit of the enhanced security provided by the Luxembourg Rail Protocol. Furthermore, taking into account the undeniably superior social, environmental and developmental benefits of rail transport as compared to aviation, the discount should arguably be somewhat higher.

For ECAs to act otherwise would be in complete contradiction to the well-received policy that they have adopted to focus their support on environmentally sustainable assets, and which is encapsulated in the recent revision of the arrangement applicable in OECD countries to export credits.

Contact us

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