



**New Zealand Aid Programme**

**Public Private Partnerships Research Project**

Synthesis Report

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Public Private Partnerships Research Project: Synthesis Report



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The views expressed in this report are those of the author(s) and do not necessarily reflect the position of the New Zealand Government, the New Zealand Ministry of Foreign Affairs and Trade or any other party.

# 1. Introduction

## 1.1 Project Objectives

The New Zealand Ministry of Foreign Affairs and Trade commissioned IMC Worldwide to provide technical and research support in response to the need to increase the level of engagement of the private sector in the New Zealand Aid Programme. This support was required to assist the Aid Programme in identifying ways in which it may be able to encourage greater levels of engagement through innovative methods. The research was in two phases. In Phase 1, the key research question was: “Should the New Zealand Aid Programme form, and/or help partners to form, PPPs? If so, under what circumstances?” In Phase 2, the key research question was: “How and under what circumstances should the Aid Programme engage in PPPs?”

## 1.2 Research Approach

The research summarised in this report was completed via a mix of internet research, key stakeholder interviews, development of case studies, and discussions with other donor organisations. The emphasis of the research was to understand the perspectives of a range of groups, particularly with respect to the application of the principles of PPPs within the context of the New Zealand Aid Programme. Whilst the research covers all aspects of the Aid Programme, the conclusions are focussed on the Pacific Island countries, as these are the focus of much of the programme, and are where New Zealand is seen as having a competitive advantage over other donors.

## 1.3 This Report

This report analyses the central findings of the studies undertaken, providing a summary of the key conclusions and options for MFAT to increase the involvement of the private sector in the delivery of the Aid Programme.

## 2. Understanding PPPs, in general, in the Pacific, and within MFAT (Phase 1)

### 2.1 Key Findings

#### **MFAT's current engagement framework**

MFAT works with the private sector in a range of ways. These include providing partnership funding through the Partnerships Fund for International Development, support for specific activities within Aid Programme projects, developing partnerships to deliver projects, particularly in the agricultural sector, and by procuring paid consultancy. Examples of these include the involvement of Olivado Ltd and Plant and Food Research in an avocado industry support project in Kenya and Fonterra's partnership in the Myanmar Dairy Excellence Project. Examples of projects involving international private sector organisations include MFAT's involvement in the Clinton Health Access Initiative project in Rwanda and Ethiopia alongside an international consortium of investors.

Each of these partnerships plays an important role in delivering the Aid Programme. However, all of this is being done in the absence of a clear private sector engagement strategy. This means that there is no consistent approach to involving private sector organisations, with consequent repetition and delay. Further, the engagement is not always guided by best practice and lacks the integration of lesson learning from past engagements.

To date, MFAT's involvement in public private partnership projects has primarily been limited to providing funding as part of a consortium of donor organisations, or providing support on regulatory or institutional changes in recipient countries.

#### **Key aspects of PPP projects**

In spite of the popularity that PPPs have gained in recent years, there is no single, internationally accepted definition of a PPP. The New Zealand Treasury defines a PPP as 20-30 year contract between the public and private sector where the private sector will finance, design, construct and operate a facility until it is ultimately transferred back to the government at the end of the contract. The World Bank defines a PPP as simply "A long-term contract between a private party and a government agency, for providing a public asset or service, in which the private party bears significant risk and management responsibility". This definition encompasses PPPs for new assets and services, and those for existing assets and services. However, most definitions would say that a contract for the management of an existing facility that does not require any major new capital investment or upgrading is not a PPP – similarly with Franchises and Lease Contracts.

There is largely agreement that a PPP has the following key characteristics:

- A long-term contract between a public-sector and a private-party;
- Includes the design, construction, financing, and/or operation of public infrastructure by the private sector;
- Involves payments over the life of the PPP contract to the private-sector party for the use of the facility, made either by the public sector party or by the general public as users of the facility; and

- The facility being subject to regulation, remaining in public sector ownership or reverting to public sector ownership at the end of the PPP contract.

Engaging in PPPs can present several challenges and potential problems for governments. Special attention must be paid to the areas of competition levels, risk levels and allocation, and budget balance sheets.

Arguments for PPPs	Arguments against PPPs
<ul style="list-style-type: none"> <li>• Minimise whole-of-life cost</li> <li>• Encourage innovation</li> <li>• Maximise asset utilisation</li> <li>• Minimise public borrowing</li> <li>• Risk transfer</li> <li>• Strengthen skills and competition in local economy</li> </ul>	<ul style="list-style-type: none"> <li>• Challenge of risk allocation</li> <li>• Contingent liabilities/risks end up on government balance sheet</li> <li>• Difficult for governments to design project to standard</li> <li>• Difficult for governments to conduct transaction</li> <li>• High transaction costs</li> </ul>

IMC recommends that it is most appropriate for MFAT to adopt a broad definition of a PPP, recognising the particular circumstances in many of the countries within which it operates. However, it is still important to establish what a PPP is not. While there is some debate around the issue, the following examples are generally accepted to be outside of the scope of a PPP:

- **Privatisation** – government assets being acquired by the private sector.
- **Management contracts** – can include similar output driven indicators and requirements to PPPs but operate on a short term basis.
- **Operations and Maintenance (O&M)** and performance-based maintenance contracts may also fall outside the scope of a PPP if they are short-term contracts.
- **Design-build** – or ‘turnkey’ contracts are often too short-term and lack the same long-term performance incentives or responsibilities as PPPs.
- **Finance/lease contract** – is a long-term contract for providing public assets or equipment, but has a much lower risk profile than a PPP.

It is essential for MFAT to consider how to emphasise value creation in a developing country context when designing a PPP programme. This may partially be achieved through the inclusion of non-traditional actors such as NGOs and bringing local communities into projects as co-implementers, whilst another aspect may be adapting structures to be flexible and fit for purpose while remaining bankable to lenders and investors. The proposed definition is based on four pillars that exemplify these principles.

**Proposed working Public-Private Partnership definition for MFAT:**



Our review of numerous case studies provided a range of tested **success criteria** that should form part of the review process when developing a PPP. While all were in some way important, there were seven critical areas that appeared in each case:

1. Legal/regulatory – A clear legal framework that establishes rules governing PPP procurement and implementation.
2. Commercial viability – Rigorous financial and economic due diligence to determine bankability and any required public support.
3. Appropriate risk transfer – That the project appropriately transfers risks to the private sector that they can actually manage.
4. Public/donor support – In countries with nascent PPP sector, donor involvement can be key to ensuring best practice and effective project structuring.
5. Preparation/procurement – Due diligence is conducted across all important parts of the project before implementation.
6. Ownership/capacity – The line ministry responsible has ownership over the project.
7. Safeguard protection – All projects must fully consider the impacts that will be had on communities and the environment. If social or environmental impacts are ignored, the results can be very difficult and costly to rectify after the fact and may also discredit the project all together.

### **Innovative PPP models**

The use of PPPs in developing countries has led experts to question the appropriateness of standard PPP contract models that are often applied in advanced economies. This has led to modifications of project structures in order to address political challenges (perception of privatising excessive profits from public projects) or low levels of income (affordability) in a specific area. Affordability on the part of both users and government still poses a significant challenge to the viability of PPP projects in low income countries or regions. These issues are particularly relevant when working in lower income countries, and where the size of investments is relatively small, such as in the Pacific.

Alternative models that have been deployed often aim to reduce the cost to the public by: (i) modifying the financing structure; (ii) involving NGOs to help communities negotiate better terms and to play a mediation role; and (iii) partnering with the community itself as a co-implementer with the private sector. It is considered that these are areas where MFAT can provide additional value, working with communities and not-for-profit organisations to build PPPs that are relevant, affordable and sustainable.

### **Other donors' activities**

PPPs are a key focus for many donors, as a means by which to provide additional funding for infrastructure and other investments, to improve the delivery of infrastructure and services, and to engage private sector discipline in scheme design and implementation. Donor activities include providing support funding for specific investments, funding the provision of technical and other advice during project development, and supporting statutory and institutional changes. In some cases this is done through regional centres of excellence (e.g. ADB, SPC), in others it is through a mix of in-house staff and consultants (e.g. IFC).

MFAT should not attempt to duplicate these activities, but should rather identify ways in which it can supplement other activities. These may include working to build partnerships between international and domestic private sectors, supporting transaction costs associated with smaller, or marginal schemes that otherwise may not be delivered, and providing capital funding support towards priority schemes.

### **Areas where MFAT could do better**

MFAT has been active in working with the private sector on a range of schemes. However, because of a lack of a consistent approach to engagement, some schemes have not been as successful as they could have been. The aim of this research and the development of a private sector engagement strategy is to establish processes and experience that would help avoid previous difficulties. Examples of projects and initiatives that we believe could have been more successful include:

- The Partnerships Fund, which has been unable to attract applications from the private sector, beyond NGOs;
- The Olivado project in Kenya, which in its first year suffered from lack of both a development and a results focus; and
- The PNG Fresh project, the design for which initially failed to reflect the difficulties of engaging with a range of private sector organisations with differing objectives and capacity.

## 2.2 Recommendations for MFAT

### Focus sectors

The New Zealand Aid Programme Sector Priorities 2012-15 distinguishes between Drivers and Enablers of growth. The drivers of growth identified include: agriculture, fisheries and tourism. The enablers of growth include: renewable energy, transport and communication infrastructure, private sector development, education and training, health, water supply and sanitation, and safe and secure communities. The combination of focus on both the drivers and enablers of growth can be seen in the programme activities for New Zealand partner countries in the Pacific.

Based upon recent experience, ongoing MFAT activities and the above distinctions, Phase 1 of the research project concluded that MFAT was able to demonstrate an existing advantage in private sector engagement in a small number of sectors: Agriculture, ICT, and Renewable Energy. Phase 2 of this research therefore focussed on these sectors, particularly with respect to identifying a range of potential opportunities for MFAT in each sector.

### MFAT role in PPP projects

The arguments for pursuing PPPs are strong, although not in all circumstances or environments. There is a clear set of benefits that would accrue from a well-established PPP programme, promoted by MFAT. These include the opportunity to increase the availability of development finance, the benefits of engaging the private sector in scoping and delivering the project or service, the chance to remove maintenance from the uncertainty created by short term budget decisions, and the ability to transfer appropriate risks to a private sector better able to deal with them.

MFAT involvement in PPPs can help fill some of the gaps that exist in terms of skills. This is in part due to the fact that stakeholders must remain on the same page through the sometimes lengthy process of project structuring, procurement and operation. Each step of the implementation process presents different challenges that governments, the private sector and communities must reach agreement on if the project is to move forward successfully.



## 3. Sector and Value Chain Analysis, Decision Support Tool, and Next Steps (Phase 2)

Phase 2 of the research, focussed more specifically on investigating three sectors in which the New Zealand Aid Programme is already heavily involved; namely ICT, Renewable Energy and Agriculture. Following Phase 1, while reviewing initial conclusions concerning the type of PPPs that MFAT should pursue, MFAT and IMC sought to establish sectors that may hold opportunities for MFAT supported PPP investments. While infrastructure globally has the greatest number of PPPs, PPPs are not restricted to infrastructure and can be applied across sectors as a method of sharing risk between government, NGOs, the private sector and communities. This is important given the broad range of activities MFAT is involved in through the Aid Programme that would not generally be classified as being in the infrastructure sector.

The sectors were analysed through their representative value chains, which also served to identify options and opportunities for PPP involvement. In line with the focus of the New Zealand Aid Programme, it was decided the sector analysis should have a Pacific focus, as circumstances in different countries could vastly impact and skew potential opportunities.

### 3.1 Sector Strategies

#### ICT

There has been significant progress in the last decade in terms of ICT service penetration in the Pacific. An improved level of service to communities in the region has gone hand in hand with sector reforms and the introduction of competition into various markets. Many of the countries that have allowed private firms into the market have seen a significant fall in the cost of their telecoms services, and more affordable services have driven an increase in demand. However, donors consider inadequate domestic infrastructure as the biggest threat to slowing the progress towards universal access in the Pacific Islands.

MFAT has only recently embarked on developing a work stream focused on addressing issues within the ICT sector. While the programme is nascent, given the challenges in the region there is a significant need for support along different links within the value chain. MFAT's current involvement in the sector is mostly programmatic and not strongly linked to addressing deficiencies in network infrastructure or other services requiring high up-front capital investment. With MFAT investing more resources into setting up its own approach to supporting the sector in its partner countries, there will be a need to address a wider set of issues currently being faced in the region that go beyond educational aspects, including aspects such as policy and access.

Within ICT, the scope for PPPs in the more traditional sense is greater with the opportunities that require investing in network expansion infrastructure. However, this does not mean projects that incorporate ICT into other sectors cannot be implemented as PPPs. We have identified several ways in which the private sector and governments in the region have developed innovative means of working together to expand access to ICT services (e.g. reforming telecommunications in Samoa, and increasing market competition in PNG).

MFAT could have the greatest impact in this sector by facilitating and investing in projects that increase the use of existing or future connectivity provided by others. These include improving the delivery of public services by improving ICT technology; supporting the provision of domestic and other infrastructure in remote areas, and supporting training and education programmes which aim to increase computer literacy.

Findings of sector analysis	Opportunities (in increasing order of complexity)
<ul style="list-style-type: none"> <li>• Large development impact potential</li> <li>• Traditionally a private sector driven sector</li> <li>• Capable private firms</li> </ul>	<ul style="list-style-type: none"> <li>• Market studies</li> <li>• Community training centres</li> <li>• Expanding access and usage in remote areas</li> <li>• Satellite connectivity</li> <li>• Submarine cables</li> </ul>

### Renewable Energy

The majority of the Pacific Islands rely heavily on imported non-renewable fuels such as petrol and diesel to meet their energy needs. Approximately 15% of Pacific Island countries' GDP is represented by fossil fuel imports, with the Cook Islands exceeding 28%. Complex fuel delivery logistics, costly supply chains and limited capacity to store fuel, make the Pacific Islands extremely vulnerable to the high cost of imported fuel.

To date, MFAT has supported a range of activities guided by two prioritised energy development outcomes: (i) sustainable energy and reduced reliance on imported fuels; and (ii) increased number of people with access to clean, reliable and affordable energy services. Over the past three years (2012/13 to 2014/15), estimated expenditure on renewable energy activities was \$109 million. MFAT expects to maintain this level of investment over the next three years (2015/16 to 2017/18).

Growth in the renewable energy industry is contingent on long-term capital investments and technical expertise, and this requires stable, long-term policies and financial incentives. Currently inadequate or non-existent legislation relating to renewable energy integration as well as a lack of technical knowledge is hindering the private sector from delivering services that traditionally have been provided by the public sector. Accordingly, assistance is needed to address these shortcomings. Activities that MFAT could support include design and establishment of Power Purchase Agreements, Independent Power Producer regulations as well as Feed in Tariffs; and high quality training centres in partnership with private operators that provide training in building, operating and maintaining renewable energy infrastructure.

MFAT also has the potential to address issues related to financial uncertainty of small and large renewable energy projects by addressing high up-front costs, dis-economies of scale, or low energy demand due to competition from conventional technologies. This could potentially take the shape of MFAT offering investment guarantees, soft/concessional loans and/or subsidies to the private concessioner.

A long-term opportunity for MFAT is the development of hydro-electro PPPs in the Solomon Islands, Vanuatu and Samoa.



Findings of sector analysis	Opportunities (in increasing order of complexity)
<ul style="list-style-type: none"> <li>• Large development impact potential</li> <li>• International and local firms with capability</li> <li>• MFAT has track record</li> </ul>	<ul style="list-style-type: none"> <li>• Training in building, operating and maintaining infrastructure</li> <li>• Regulatory framework</li> <li>• Provision of guarantees and/or subsidies</li> <li>• Project development</li> <li>• Transaction advisory</li> </ul>

## Agriculture

For the Pacific Island countries, agriculture is still a significant backbone of the economy, both nationally and for individual households. FAO data from 2006 shows that, in most Pacific countries, approximately 30% of the labour force was employed in agriculture; this figure is considerably higher in PNG and Solomon Islands.

The demand for agricultural infrastructure, skills and knowledge transfer that can be gained from partnering with the private sector continues to grow. There is, however, a persistent challenge around the types of PPP that can add value for market-oriented agricultural development. An added level of complexity arises from how subsidies, when available, fit into the design of the project. PPPs in the agriculture sector can vary greatly in size and scope, from match-making programmes to larger infrastructure undertakings. The size of the programme will naturally impact the level of risk, and level of investments required. Over the past three years (2012/13 to 2014/15), estimated expenditure on agriculture and fisheries was \$162 million. MFAT expects an increase in this level of investment over the next three years (2015/16 to 2017/18).

The need for rural communities to approach development from a wider perspective has created a greater focus on a broad range of development goals, rather than merely creating incentives for agricultural or resource based businesses. Training, entrepreneurship, physical infrastructure, and social infrastructure all play an important role in developing rural areas. What has emerged is a growing understanding of cross-sector collaboration away from traditional PPP models and donor funded projects, as exemplified by the World Economic Forum initiative<sup>1</sup>. In some cases, the scope of traditional PPPs has been widened to incorporate NGOs in what some describe as Public-Private-Not-for Profit Partnerships (PPNP) or work directly with communities through Public-Private-Community Partnerships (PPCP). These alternative models run the risk of not being sufficiently standardised and exposing communities to exploitation if the process is left unmonitored or unmanaged by the government. A standardised approach is needed to bring objectives of the various stakeholders together.

<sup>1</sup> In 2011, twelve global companies banded together with the Vietnam Government to launch a public-private task force with the goal of advancing sustainable agricultural growth and practices. The partnership was created under the World Economic Forum’s “New Vision for Agriculture”. The programme is working in six agricultural subsectors; coffee, tea, vegetables, fisheries, common commodities and finance. In Vietnam, agriculture accounts for 18% of GDP, and an increase in efficiency and productivity could therefore have a tremendous development impact.

Findings of sector analysis	Opportunities (in increasing order of complexity)
<ul style="list-style-type: none"> <li>• Private sector opportunity for niche international firms to work with local communities</li> <li>• MFAT existing track record</li> <li>• Existing private sector capability</li> </ul>	<ul style="list-style-type: none"> <li>• Not for profit PPP</li> <li>• Matchmaking</li> <li>• Organic and Fairtrade certification</li> <li>• Plantation rehabilitation</li> <li>• Irrigation</li> </ul>

### 3.2 Institutional Requirements

#### Development of MFAT’s capacity

Because of the overall size of the New Zealand Aid Programme and the likely number of PPP projects, it is unlikely that MFAT would develop a dedicated PPP Unit, as others have. The costs of doing this would be prohibitive. However, PPPs are likely to become a more important aspect of the Aid Programme. It is therefore expected that MFAT will need to continue to expand its capability relating to PPP projects.

If MFAT were to adopt a programme management role, whilst also offering financial support to projects, the main capabilities required would include the procurement and management of transaction advisory consultants. In such a role, MFAT would provide ongoing technical and policy support to national organisations, particularly with respect to the development and management of a PPP pipeline. This could include the provision of transaction advisory consultants that would be in place to provide technical, financial and legal support to a specific project, acting as the client Government’s agent. MFAT’s support would include producing terms of reference, quality assurance of outputs and managing consultancy budgets. Many of these skills already exist within MFAT.

In order to fulfil a project investment role, MFAT would also need a range of skills related to project planning and engineering, environmental and social analysis, financial and economic appraisal, and legal review. As part of its internal due diligence processes, MFAT would need to be able to satisfy itself and the New Zealand Treasury that a project is viable and robust, meets international safeguarding standards, is in line with national development strategies, is being contracted in an appropriate manner, and properly accounts for climate change and disaster risks. These due diligence studies could be undertaken by a mixture of internal and external teams, and would rely on the work of any MFAT appointed transaction advisor. It is likely that some of these skills already exist within MFAT, although some would need to be developed further.

### 3.3 MFAT’s Decision Making

#### Project development process

MFAT already has a robust decision making process in place for planning and implementing development activities. This ‘Activity Cycle’ guides the project development process within MFAT, enabling informed decision making at each stage. It is important that the assessment of the



suitability and viability of a PPP approach is assessed alongside wider considerations within this cycle.

Given the relative lack of experience in MFAT of PPPs, identifying projects with potential for PPP implementation and identifying appropriate structures for those projects has been a challenge. To assist MFAT decision making, particularly with respect to identifying opportunities which may be best delivered under a PPP mode, IMC developed a 'Decision Support Tool' as part of this research. This spreadsheet based tool is structured as a series of increasingly detailed questions that are designed to guide future project development activities.

### 3.4 Next Steps

Based upon the analysis and research undertaken as part of this work, we have reached the following key conclusions:

- MFAT should establish a working group to develop a private sector development [or engagement] framework that incorporates the principles of PPPs as an anchor;
- MFAT should continue to include PPPs within the Aid Programme. This should include both traditional PPP models for larger infrastructure projects, but also more innovative structures. As part of the Aid Programme, MFAT should identify innovative PPP models that are suitable for smaller scale infrastructure and service provision PPPs, particularly in a Pacific context;
- MFAT should further engage with New Zealand's private sector, particularly in the core sectors of agriculture, ICT and renewable energy; and
- Areas where New Zealand, or the Aid Programme, has a unique selling point or a comparative advantage should be identified and prioritised as PPP opportunities for consideration.