Implementation of the Public Private Partnership in Zambia

Submitted to the

Committee on Economic Affairs, Energy and Labour
Of the
National Assembly of Zambia

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Contents

Preamble

This report is in response to the request made by the Committee on Socio-Economic Affairs, Energy and Labour of the National Assembly of Zambia to the Zambia Institute for Policy Analysis and Research (ZIPAR). The report provides an analysis on the Implementation of the Public Private Partnerships in Zambia. The report highlights and attempts to answer the following questions as requested by the committee:

i. The effectiveness of the PPP framework in Zambia;
ii. The role of Government in implementing the PPP framework;
iii. The role of the private sector in the implementation of the PPP framework;
iv. The role of ZIPAR in fostering the implementation of the PPP framework in Zambia;
v. The coordination mechanism and institutional strategic plan that exists in the implementation of the PPP framework of PPP projects in Zambia;
vi. The challenges faced in the implementation of the PPP framework in Zambia;
vii. The fiscal implication of the PPP framework; and
viii. Suggestions, if any, on how to enhance the PPP framework in Zambia.

1. Introduction

Government faces challenges in infrastructure development and public service delivery which poses constrains to economic growth and development in Zambia. According to the 2010 Africa Infrastructure Country Diagnostic Country Report by the World Bank, Zambia needed to spend US$1.6 billion a year over the decade 2006-2015 to develop its infrastructure to the level found in the rest of the developing world (ZDA, 2014). The limitation of public resources implies that the country's huge deficit in infrastructure cannot be met by the public sector alone. Government recognizes this limitation and thus views Public-Private Partnerships (PPPs) as important instruments to bridge the resource gap in infrastructural development and effective service delivery. It is therefore Government policy to promote PPPs as a means of leveraging public resources and collaborating with private sector resources to close public infrastructure gap and deliver efficient services to citizens.

This demand for new infrastructure and services, rehabilitation and maintenance of existing infrastructure is continuously growing due to rising population in the last few decades. These foregoing challenges have compelled Government to formulate a Public-Private Partnership framework in its continued desire to improve the quality, cost-effectiveness and timely provision of public infrastructure and services in Zambia. PPPs can provide Government with an alternative means of providing new infrastructure as well as rehabilitation of existing infrastructure through involvement of the private sector that will provide requisite finance and expertise for such investments.

Notably, PPPs are not the only remedy for all public infrastructure investment needs and therefore, the PPP framework should be viewed as a complement to and not a substitute for the Government's continued commitment to provide infrastructure. PPPs need to be considered in situations where they are able to provide greater value for money than other fully-private or fully public service delivery options.

Government's aim is to ensure that services from PPPs are cost effective thereby ensuring access and value for money for Zambian citizens. It is also envisaged that PPPs offer an opportunity to develop and strengthen the local capital markets which may stimulate additional local and foreign investment.

1.1 Understanding Public-Private Partnerships

A PPP broadly refers to an agreement, typically medium to long term, between the Government and the private sector, in which the private partners deliver the service in such a manner that the service delivery objectives of the Government are aligned with the profit objectives of the private partners, and where the effectiveness of the alignment depends on the sufficient transfer of risk to private partners. Risk is identified, priced and either retained by the public sector or transferred to the private partner through an appropriate payment mechanism and specific contract terms.

The public sector retains a significant role in the partnership project, either as the main purchaser of the services provided or as the main enabler of the project. It purchases services and specifies the service outputs/outcomes required as well as the performance criteria for payments. The private party commonly provides the design, construction, operation and possibly financing for the partnership project, and is paid according to performance. Ideally, identified risks are allocated to the party that is best suited to bear and manage them at the lowest cost.

1.1.1. The Purpose of Public-Private Partnerships

In order to bridge the infrastructure gap, there is need for Government to mobilise resources especially those related to preparing a project to a level where private investors can be attracted to take risks and invest. PPPs can leverage on the economy's existing strengths and help other sectors of the economy instead of just focusing on infrastructure investments. The last decade has seen Zambia engage in a huge infrastructure development program which has contributed to widening fiscal deficits due to lack of adequate planning and project appraisals before undertaking projects.

A public-private partnership can therefore act as a crucial tool in delivering the much needed infrastructure development especially when it comes to growth and development within the country. In a country like Zambia, PPPs can help present opportunities for personal development of project staff, encourage knowledge and enhance skills. However, in spite of vocational skills empowerment, PPPs serve the public's interests by spurring capacity-building efforts and creating a sound environment for the development of strategic infrastructure. These benefits go hand in hand with the transfer of financial and operational risk between Government and the private sector.

The specific objectives of PPPs include the following:

- Accelerate delivery of much-needed infrastructure and public services; on time and within budget;
- Increase international and domestic investment;
- Encourage the private sector to provide innovation design, technology; and financing structures;
- Risk sharing by Government with private sector;
- Economic growth and increased and wider employment possibilities;
- Improve operation and maintenance of public infrastructure; and
- Technology transfer and capacity building.

1.3.1. The PPP Policy

The PPP policy was formulated in order to provide the guiding principles for establishing partnerships between the public and the private sector given that they are expected to enter into partnership with different expectations. The policy helps safeguard the interest of Government, private sector and the taxpayer. The policy is therefore structured to encourage the provision of a wide variety of quality and timely public infrastructure and services. This can be achieved through faster project implementation, maximum leveraging of public funds, enhanced accountability and a shift to whole life cycle costing and infrastructure management by the private sector.

The key objectives of the policy are to:

a) Leverage public assets and funds by the private sector resources from local and international markets to accelerate needed investment in infrastructure and services;
b) Encourage and facilitate investment by the private sector by creating an enabling environment for PPPs where value for money for Government can be clearly demonstrated;
c) Increase the availability of public infrastructure and services and improve service quality and efficiency of projects;
d) Ensure attainment of required and acceptable local and international social and environmental standards;
e) Protect the interests of all stakeholders including end users, affected people, Government and the private sector;
f) Set up efficient and transparent institutional arrangements for the identification, structuring and competitive tendering of PPP projects;
g) Provide a framework for developing efficient risk sharing mechanisms; and

h) Encourage and promote indigenous Zambian private sector participation in the delivery of public infrastructure and services.

The PPP Policy's Guiding principles include:

- **Affordability**
  The end user's ability to pay shall be a key consideration for all PPPs projects. The PPP option must demonstrate long term affordability to the public and overall Government budgetary sustainability, forward commitment in relation to public expenditure and the potential for returns on private sector investment, given other priorities and commitments.

- **Value for Money**
  PPPs should give greater value for money than the best realistic public sector project to achieve similar service outputs. Achieving value for money is a key requirement of Government at all stages of a project's development and procurement and is a combination of the service outcome to be delivered by the private sector, together with the degree of risk transfer and financial implications for the Government

- **Appropriate Risk allocation**
  An efficient risk allocation is vital in determining whether the value for money can be achieved in PPP projects. Government's principle with regard to risk allocation should be to optimize rather than maximizing the transfer of project risks to the private party or investor. Risks will therefore be allocated to the party best able to control and manage then in such a manner that the value for money is maximized. This should be able to determine the appropriate method of deciding private sector involvement and allocation of responsibilities which take into account the protection of public interest.

- **Local content and technological transfer**
  PPP projects shall be structured in such a way that they are able encourage the maximum use of local content initiatives and technology transfer from the foreign investors to local Zambians. In this context, PPP arrangements shall facilitate?

The PPP policy further provides the framework for:

- Institutional set-up;
- Regulation;
- Stakeholder consultation;
- Capacity building;
- Monitoring and evaluation; and
- Resource mobilization.

1.3.2. The PPP Act

In Zambia, the PPP Act No. 14 of 2009 defines a PPP as a contractual agreement between a public entity and a private entity, whereby the private entity performs part of a Government's organisation service delivery functions, and assumes the associated risks for a significant period of time. In return, the private entity receives a benefit/financial remuneration according to predefined performance criteria, which may be derived:

i. Entirely from service tariffs or user charges
ii. Entirely from Government budgets
iii. A combination of the above.

The PPP Act sets out the necessary legal and administrative framework for efficient and transparent implementation of PPPs. It also provides an opportunity for establishing a set of general principles and rules for PPP procurement, thereby ensuring consistency across sectors and projects. It also defines the respective roles and responsibility of each stakeholder in the PPP process.

Specifically, the PPP Act provides for:

- Promotion and facilitation of the implementation of privately financed infrastructure projects and effective delivery of social services by enhancing transparency, fairness and long term sustainability and removing undesirable restrictions on private sector participation in the provision of social sector services and the development and operation of public infrastructure;

- Establishment of a Public-Private Partnership Unit and provide for its functions;

- Establishment of the Public-Private Partnership Council and provide for its functions;

- Public-Private Partnerships for the construction and operation of new infrastructure facilities and systems and the maintenance, rehabilitation, modernisation, expansion and operation of existing infrastructure facilities and systems and the provision of social sector services;

- General principles of transparency, cost effectiveness and fairness in the award of contracts by public authorities through the establishment of specific procedures for the award of infrastructure projects and facilities and provision of social sector services and rules governing public-private inception, procurement, contracting and management of public-private partnerships;

- Implementation of Public-Private Partnership agreements between Contracting Authorities and concessionaires; and provide for matters connected with, or incidental to, the foregoing.

1.3.3. Institutional Set-up

The PPP Act No. 14 of 2009 in section 6.1 stipulates that the PPP unit will be established in Ministry of Finance and National Planning as a dedicated department to coordinate, administer and monitor PPPs in Zambia. This is also in line with international best practice as it stipulates that PPP units are best placed under the ministry of finance due to the need to meet Government objectives of leveraging finance and coordinating implementation of PPP projects.

The positioning of a dedicated unit within the Ministry of Finance provides a direct link to other expenditure and capital investment expertise and decision making processes. It is also widely acknowledged that the location of PPPs in the ministry helps filter fiscally irresponsible projects while maintaining investor confidence in the Government's public-private partnership programme.

However, the recent shift in this policy where the unit has moved to fall under the Office of the President raises concerns about the legitimacy of future negotiation processes as well as public sector's project management strengths. This is also pertinent considering the fragmented nature of public sector functions across a number of Government departments. Furthermore, the other potential drawback for locating the unit within state house is the role which political preferences could play as opposed to the concrete costs and benefits of the project which play a key role when evaluating PPP agreements.

However, having reviewed the framework through the lens of the existing PPP Act of 2009, the Policy and the institutional set-up, we find that the framework is adequate and can assist in formalising PPP contracts but we are unable to state as to how effective it is due to lack of completed projects constructed under the PPP modality thus far.

1.2 The effectiveness of the PPP framework in Zambia

The PPP framework is the combination of policies and laws which define how and when PPPs can be used to deliver public services. It constitutes the PPP policy and the Act and explicitly outlines the institutional set-ups and legal and regulatory framework. The aim of the framework is to promote the use of PPPs where appropriate, that is, for suitable projects and the right reasons. This framework therefore guides the PPP development process and provides certainty to all stakeholders that the Zambian Government is committed to partnering with for the delivery of public infrastructure and services.

PPPs in Zambia can take a wide variety of forms, ranging from short-term contracts involving minimal involvement from the private sector to divestures that demand its huge involvement. For example, service contracts, management contracts and leases are designed to retain many features of public ownership. Concessions such as build-transfer-lease, build-operate-transfer, and build-operate-own have divesture with more benign postures.

However, despite having a sound framework, Zambia is yet to successfully implement any PPP. The concession agreement to redevelop Long Acres Lodge into a five-star hotel with a shopping mall, conference centre and office complex by Thuthuka Group International of South Africa was the first notable PPP initiated after the introduction of the PPP Act of 2009. This $200 million project fell off without much information as to the reasons why.

Notwithstanding the PPP statute, the Authorities have engaged in PPP transactions in the past. These included:

i. A 20-year concessioning of Zambia Railways assets to Railway Systems of Zambia in 2003. This operated for 10 years before the concession was cancelled in 2012 after non-performance of the contract was cited by Government.

ii. The 25-year concessioning of Mpulungu Harbour Corporation to Agro Fuel Zambia in 2000. The concession was terminated two years ago on public concerns about unsatisfactory performance.

iii. The 65-year build-own-transfer contract between Lusaka City Council and an investment company that built Lubama Market in the early 2000s. This concession is in force.

iv. The Kasumbalesa One-Stop-Border Post 25-year build-operate-and-transfer contract with a private investor in July 2009, although it was reversed in 2012 and the reasons have not been disclosed so far.

More recently in 2010, a concession to construct the Toll Gates was entered into by Government and Track Investments Limited. However, this fell off after discovering that the Act at the time did not allow for the private sector to collect fees from toll gates. While this has been rectified, it demonstrates the lack of due diligence and capacity in the public service to undertake PPPs.

2. The role of Government in implementing the PPP framework

The key role for the Zambian Government in the PPP implementation framework is to provide and facilitate a credible and conducive legal and regulatory framework which should guide PPP processes in the country. In this regard, Government is expected to deploy a range of instruments which support project preparation and financial viability of all PPP projects. Government through the PPP unit is also required to ensure that all projects are appraised and assessed for value for money and that all other statutory feasibility studies are conducted.

Government is further expected to provide incentives to encourage the private sector to deliver projects on time and within budget. In order to facilitate this process, Government has a role to lead the PPP process of developing and implementing each project from inception to completion.

3. The role of the private sector in the implementation of the PPP framework

In order for Government to effectively deliver on PPP projects, there are specific roles and responsibilities required from the private sector. It is important for Government to have clear policies and procedures with respect to how the private sector complies with such policies and regulations. One of the key roles for the private sector in the PPP process is to provide additional sources of funding and financing in order to bridge Government's financing gap in infrastructure development. This assists Government in reducing its infrastructure deficit. By allowing the private sector to invest their resources in the development of public infrastructure facilities through PPPs, Government can have access to private capital and speed up the delivery of public infrastructure.

The private sector also plays a critical role in providing design, capabilities and expertise. By so doing, the private sector are able to determine how best to achieve the output as specified in the contract and also participate in setting appropriate cost recovery or profitable tariffs and user charges.

Therefore, the role of the private sector is critical in identification and implementation of PPP projects which includes the design, construction, operation and maintenance and if desired, the financing of the infrastructure required. In addition, the private partners would play a role to leverage research and development and provide innovations at all phases of a contract in line with the changing environment

The private sector can also help strengthen the governance and management framework of PPPs through the provision of expertise and disciplines in all fields relating to PPP processes. By so doing, they add a compelling voice with the introduction of new perspectives and thinking and by additional publicity and credibility for PPPs mission or actions.

4. The role of ZIPAR in fostering the implementation of the PPP framework in Zambia

The Government's focus going forward on infrastructure development is set to focus on PPPs and joint ventures and this will require advisors who are able to provide the requisite expertise and experience in research and policy analysis and therefore provide evidence-based knowledge. ZIPAR is expected to play a pivotal advisory role in formulating economic and social policy that is conducive to the successful structuring of PPPs.

Specifically ZIPAR can research and analyse potential PPPs to ensure that: Government's objectives and rationale are well researched and articulated; the provisions of the PPP transaction agreement and target are well defined according to the stipulated policies; risks are identified and analysed; and Government is advised to avoid making costly mistakes.

5. The coordination mechanism and the PPP framework

The PPP framework defines the coordinating mechanism which is anchored around the PPP unit that oversees the link between the public and private sector. This role further extends to supporting and managing all PPP individual projects which may fall under the control of central Government but also at provincial level. The unit also plays a pivotal role in the coordinating mechanism by pooling expertise from both the private and public sectors as well as standardising the procurement procedures. In addition, the unit is also responsible for pooling resources on behalf of Government for all PPP projects.

Corporate Governance is critical in the coordinating mechanism for the successful implementation of PPP projects by the unit. This process should operate in a transparent and independent manner and free from political interference on how programs are coordinated.

5.1. The challenges faced in the implementation of the PPP framework in Zambia

Lack of Institutional and Regulatory Framework: Though the country has the legal and policy framework for implementing PPPs, there is no adequate institutional framework to spearhead project identification, appraisal and implementation. The PPP unit is still limited in terms of staffing (perhaps until recently) and technical expertise. Further, the current organisational arrangements where the PPP unit in directly located under State House presents potential reputational risks to investors that may perceive it as a political special purpose vehicle.

Lack of skills capacity to undertake PPP functions: The implementation of PPP initiative present a paradigm shift in implementing infrastructure and service provision which entail the need to build capacity in the central PPP Unit and in the sector implementing Ministries. Therefore, the complex nature of the PPP processes require a combination of a special skills set in financial analysis and modelling, transaction structuring, commercial legal expertise and sector specific knowledge. The shortage of manpower possessing these special skills is a big challenge for the PPP implementation.

Lack of financial resources dedicated to PPP projects
One key aspect of PPP contract negotiations which has been absence from the contract negotiations which Zambia has engaged in so far has been the lack of undertaking the feasibility study which analyses the cost-benefit of the project. This diminishes the project attractiveness to both Government and the private sector and has often led to the public questioning the transparency and viability of the project. This weakens Government's position during negotiations and leads to a weak concessional agreement.

Inadequate Public Awareness and Stakeholder Consultation*:* The success of PPP programs requires support from all stakeholders. To date, there is still a lack of awareness on the need for PPP ventures which has resulted in some stakeholders opposing the implementation of PPP projects without understanding the associated benefits attached to such ventures.

Lack of Project Implementation framework: For the partnerships to yield intended results to all stakeholders, namely Government, Private sector investors and the public, there is need for a comprehensive and regular review of projects at both development and operation. This is the core responsibility of structures managing the development of PPPs, coordinated by the PPP unit. Most projects were implemented without putting in place project implementation and monitoring mechanisms, resulting in poor implementation and failure to achieve the intended goals for Government.

Insufficient private sector expertise: Since the PPP initiatives are relatively new in Zambia, the country has insufficient private sector capacity to structure and implement PPP projects. This capacity insufficiency is normally in terms of management skills to realise improved service delivery and efficiency gains, experience in pricing life cycle costs in the infrastructure development and management field as well as insufficient numbers of potential private sector bidders to allow for an effective competition.

Political Interference*:* Government unfortunately still adopts practices of patronage and favouritism over capability and competence in its selection process. Several projects have in the past failed at the initial stage due to the lack of clear defined selection criteria which are often hijacked by political interference.

5.2. The fiscal implication of the PPP framework

PPPs can at times be a very contentious fiscal subject for Government. On the one hand, they allow Governments to take advantage of possible private-sector efficiencies and thus get public services more cheaply than otherwise. While on the other hand, the motivation for using PPPs often seems to hide Government debt, at the risk of increasing the Government's costs in the long run.

Thus far, the main fiscal effect of using a PPP instead of public finance is to defer Government spending. This effect usually dwarfs any effect of the PPP on the Government's net worth which is the present value of revenues less than present values of the expenses on the project. This deferring effect can make the PPPs seems cheaper than public finances when in actual fact, there are more expensive.

In addition, most fiscal implications for PPPs also arise from the administrative costs associated with project development and procurement as well as other liabilities which are linked to the project.

Government also needs to develop the political will of having to let go of control in areas where the private sector has the expertise and capabilities of running PPPs effectively.

6. Conclusion

6.1. Opportunities

Despite not having successfully implemented any PPP to date, Zambia still has many untapped opportunities for PPPs that will allow Government to leverage both public and private funds for the delivery of socio-economic goods and services in various sectors. These include: Health infrastructure to meet the growing demand for health services; education (tertiary and lower forms), transport (roads, airlines, railway), tourism (conference facilities, hotels), border facilities (border posts, cold rooms).

6.2. Recommendations

The Public-Private Partnership framework is relatively a newcomer in the efforts to addressing the infrastructure gaps in the Zambian setup. Thus far, all evidence suggests that the use of PPPs will and can start to complement

Government's infrastructure development agenda. However, concerns about the effectiveness of how the framework has been implemented in Zambia seem not to be misplaced. It's against this background that we recommend the following:

Strengthening of institutional and regulatory framework

Government needs to strengthen the institutional framework and have clear defined responsibilities which are transparent. This should include reversing the decision of placing the PPP unit under state house so as to stimulate and motivate investor confidence. The unit should also undertake rigorous information dissemination and guidance functions and provide the advisory role to all Government and private sector PPP programs.

Build technical capacity

Government needs to build technical capacity across all levels of Government institutions to develop a required skills set and expertise in finance management, procurement and legal. This is to facilitate for PPP contracts which are often broader and cuts across a wider range of ministries that require more human capital resources.

Political will to drive the PPP development agenda

PPP framework will require the political leadership to drive the infrastructure development agenda through PPP contracts. Global evidence shows that PPP projects can only be implemented with a strong political desire. This is necessary in order to marshal the support of stakeholder in the implementation of PPP projects.

Mobilisation of financial resources under a fund for PPP projects

Government needs to institute a PPP project development fund to cater for transaction costs which accrue to Government in the preparation and bidding process for PPP programs. The fund can also cover the cost of Government commitments under PPP contracts

Investment framework

The current investment framework is not clear on how sectors can incorporate PPPs. Therefore, there is need for Government to present a clear investment plan for sectors and show how supporting industries will be developed using PPPs. That is to say, in an instance where an investor is considering bidding to construct a road, Government's investment framework should already consist of a plan for the same road to be constructed.