NATIONAL ENERGY REGULATOR OF SOUTH AFRICA

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IS THE PUBLIC PRIVATE PARTINERSHIP MODEL THE RIGHT VEHICLE FOR PUBLIC INFRASTRUCTURE DELIVERY IN DEVELOPING COUNTRIES: AN ANALYSIS OF INTERNATIONAL EXPERIENCE?

Two types of PPPs

- **Traditional PPP-**
  - All activities including financing are the responsibility of the private sector partner.
    - Private sector carries most of the risks,
    - Public sector has less control over project governance

- **Hybrid PPP-**
  - The government agency raises funds through issuing government bonds or raise debt from financial markets.
    - Public sector carries all market and financial risks
    - Public sector partner has more control over the project governance

Two schools of thoughts about PPPs

- **Arguments for**
  - PPPs enable government to deliver needed infrastructure even if it does not have the budget
  - PPPs deliver infrastructure at lower cost,

- **Arguments against**
  - PPPs are equal to privatisation,
  - are more costly than traditional procurement,
  - are a way for government to avoid reporting debt,
  - are weak in accountability and transparency,
  - lead to public-sector jobs losses,
  - Sacrifice quality for the sake of profits,

Economics of PPPs

- **Benefits of contracting out**
  - **Ex-ante competition**: high-powered incentives, optimal risk allocation and economies of scale,
  - **High incentives and optimal Risk Allocation:**
    - The incentive to reduce costs comes from the fact that the private sector is a profit maximising agent,
    - Private sector is believed to deliver more innovative products more speedily, with more flexibility and at a lower cost.

Delegating Design and/or Operation to the Private Firm

- Combining design, construction and operation lead to low operation cost

- Bidders are forced to focus on the whole life costs of the project and
    - Produce durable asset
    - As those responsible for building the asset would also be responsible for the long-term maintenance and operation

Arguments for and against PPPs

- **Do PPPs minimise on-budget govrnt expenditure?**
  - **Argument:** to eliminate upfront capital expenditure and provide budget stability
  - **Problem:** hide the exact government expenditure - lack of accountability and transparency
  - **Solution:** reflect all government expenditure on the balance sheet

Do PPPs provide services at lower cost?

- Because of economies of scale, scope or learning
- Private sector's superior incentives to minimise costs,
- Bundling up the various components of a project reduced costs
- **Experience:** studies that looked at competitive tendering and contracting (CTC) concluded that CTC leads to a substantial reduction in service costs.
- **Opponents** of PPP argue that the observed cost savings are a result of decreased service quality,
- **Existing evidence** on this issue is ambiguous or contradictory

Does the Public Sector Borrow at lower Costs than the Private Sector?

- Public sector borrowing is backed by tax revenue and is considered to be risk free,
- When a project is funded by the private sector, investors carry the risk of default and are rewarded accordingly,
- However, when funded by the public, taxpayers carry the risk but are not compensated for doing so,
- The public underwrites for government loans and receives nothing in return.

Optimal capital structure

- In a hybrid PPP cost savings are possible because:
- the SPV achieves optimal capital structure in that:
- if the cost of capital is lower for public entity (all things equal) and the outlays on building the infrastructure are lower when the construction is done by a private company, it is possible to reach the lowest total cost
- This is because mixed capital structure enables internalization of both the costs of capital advantage of the public sector and the knowledge advantage of the private sector.

Other questions that you may ask are:

- Do Private Firms Sacrifice Quality for Profits in a PPP?
- Does the PPP Model manage risks better than the traditional procurement model?
- Do PPPs hinder accountability?
- Do PPPs make it politically feasible to impose user fees?

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HAVE PPPs REALLY BENEFITED THE PUBLIC?

- the UK government claims that 76 percent of PFI projects are completed on time compared with only 30 percent of traditionally procured projects (Hall, 2015),

- European Investment Bank (EIB) came to the same conclusion that, PPP projects were largely completed on time, on specification and on budget (Hall, 2015),

- This may not be the case in developing countries where lack of appropriate skills is one of the many constraints.

Selected S A infrastructure Projects cost overruns

Project	Initial budget(R bil)	Final cost(R bil)	Cost over-run (%)	Finance/procurement method
Gautrain	25.1	30.5	21	PPP
Kusile power station	90	121	34	Corporate finance with government guarantee
Medupi power station	33.6	105	213	Corporate finance with government guarantee
Gauteng toll roads	6.3	90	1329	PPP
New multi-product pipeline	11.1	23.4	111	Corporate and public finance
ORT international airport	5.2	8.5	64	Public finance
De Hoop dam	7.9	20	153	Public finance
Soccer world cup stadia	8.1	18.4	126	Public finance
N4 toll road	2	3	50	PPP
Standard bank building	1.1	2	82	Private sector financing

IPP Average Bid Prices, 2011 values (SA cents/kW)

Technology	Round 1	Round 2	Round 3
Wind	114.3	89.7	65.6
Reduction from previous round		-21.5%	-26.9%
Total reduction from round 1			**-42.6%**
Solar	275.8	164.5	88.1
Reduction from previous round		-40.4%	-46.4%
Total reduction from round 1			**-68.1%**
Concentrated Solar power	268.6	251.2	146.0
Reduction from previous round		-6.5%	-41.9%
Total reduction from round 1			**-45.6%**

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Conclusion

- To evaluate whether PPPs are more efficient than the traditional procurement is not an easy task,
- The EIB (2005) attempted to do this comparison and concluded that, such an evaluation/comparison is difficult to make because it needs identification of two projects of similar specification, constructed and operated in the same legal, financial and fiscal framework and subject to the same market conditions,
- Difficulty in accessing PPP information.

Recommendations

- improve transparency as well as information availability and accessibility on PPP agreements,

- improve the public sector accountability on services delivered through PPP
  - by prompting reviews of standards and service specifications;
  - (b) by introducing rigorous performance monitoring; and
  - (c) by setting up mechanisms for redress in cases individuals or organisations have suffered loss or damage;

Recommendations-cont.

- always strive for optimal risk sharing between the PPP firm and avoid risk shifting and strive for optimal capital structure

- introduce competition in the PPP market,

- build in-house PPPs expertise.