CHAPTER 3

GOVERNMENT OUTSOURCING POLICY: PUBLIC PRIVATE PARTNERSHIPS

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In May 1996, the then South African president, Nelson Mandela, announced that privatisation was a "fundamental policy" of the African National Congress (ANC) which would be implemented as "government policy".[57] Indeed, since the mid 1990s the South African government has committed itself to privatise state assets. Large chunks of state owned enterprises, such as the iron and steel producer Iscor, the arms manufacturer Denel, several South African Broadcasting Corporation (SABC) radio stations, the Airport Company South Africa (ACSA), state commercial forests and local services have been sold to private investors.[58] This trend is likely to continue, albeit at a slow and erratic pace.

This monograph explores the role a limited form of 'privatisation' can play in increasing private sector (including the not-for-profit sector) participation in the delivery of criminal justice services. Public Private Partnership (PPP) is the term the South African government uses to refer to outsourcing the delivery of public services by private parties. PPPs are relatively new in South Africa, and support for service delivery through PPPs varies across government departments. Indeed, the "role of the state in the provision of public services in South Africa continues to be an ongoing and healthy source of debate".[59] Even pro-PPP advocates concede that the outsourcing of state services needs to be supported by sound regulatory practices which promote key public policy objectives, such as curbing monopolistic practices and promoting universal service access.

In April 1997 the South African cabinet approved the establishment of an Inter-Departmental Task Team (IDTT), chaired by the Department of Finance, to initiate the development of a regulatory framework for PPPs, and explore how PPPs could improve infrastructure and service delivery efficiency. The IDTT was mandated to develop a national Public Private Partnership programme, the key objectives of which were to identify the major constraints to the successful implementation of PPPs, and to develop a package of cross-sectoral and inter-governmental policy, and legislative and regulatory reform.[60] In December 1999, cabinet endorsed the resulting strategic framework for PPPs. In April

2000, Treasury regulations were published in terms of the Public Finance Management Act to govern their implementation.[61] Shortly thereafter, in early 2001, the *Treasury Manual on Public Private Partnerships* was published.[62]

Describing PPPs

A PPP is a contractual arrangement whereby a private party performs part of a government department's service delivery or administrative functions and assumes the associated risks. In return, the private party receives a fee according to predefined performance criteria, which may be from service tariffs or user charges (as is the case with toll roads), and/or from a departmental or other state budget.[63]

The essential aspects of a PPP arrangement, as distinct from the direct delivery of a public service by a government department, are a focus on the services to be provided, and a shift of the risks and responsibilities to a private provider for the activities associated with the provision of services.

A simple form of PPP is a service contract. In a service contract a department typically awards a private party the right to perform a specific service, within well-defined specifications for a relatively short period of time (usually one to three years). In a service contract the government retains ownership and control of all facilities and capital assets and properties.

A more complex form of PPP is a concession, where the concessionaire's responsibilities usually include maintenance, rehabilitation, upgrading and enhancement of the facility in question. A concession may involve a substantial capital investment by the concessionaire. Another complex PPP arrangement are Build-Operate-Transfer (BOT) schemes. In a BOT the private party undertakes the financing and construction of a given infrastructure facility, as well as its operation and maintenance, for a specified time period. Given the often substantial capital investment by the private sector under such arrangements, the contracts tend to be of long duration (usually 25 years).

According to the *Treasury Manual on Public Private Partnerships*, service delivery through a PPP changes the means of delivering services but does not change a government department's accountability for ensuring that the services are delivered. The department's focus shifts from managing the inputs to managing the outputs – the department becomes a contract manager rather than a resource manager.[64] In terms of draft *Standardised PPP Provisions,* pub-

lished for public sector input at the time of writing, a government department has contractual remedies if the private PPP partner defaults. These remedies include financial claims covered by some security, penalties and, in certain instances, an ability for the government department to step into the PPP project. In some circumstances, defaults may entitle the government department to terminate the PPP agreement.[65]

PPP Manual

The *Treasury Manual on Public Private Partnerships* contains guiding tools designed to assist national and provincial government departments to structure successful deals with private partners for improved public service delivery. Writing the preface to the manual, finance minister, Trevor Manuel, argues that PPPs can play a crucial role to satisfy public demand for effective government services. Moreover, to be successful, government departments need to skilfully negotiate and effectively implement PPPs that promise to add value to public service delivery:[66]

> Our [the government's] overwhelming priority is to meet the socio-economic needs of all South Africans, and in particular, to alleviate poverty. But we would be wrong to assume that government can meet this challenge alone. The state must complement its budgetary capacity with the wealth of innovative and specialist skills available in the private sector. Furthermore, the availability of state resources for these purposes must be used to leverage much-needed private sector investment in public infrastructure and services…
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> Governments across the world are notoriously shoddy at calculating the risks associated with service delivery. PPPs force us to think differently, and in so doing, calculate the real costs… In a PPP the department is no longer the hands and legs of delivery, but rather its strategist, its monitor, its driver and its public accountant. We need new skills to play these roles, and to ensure that we engage confidently and effectively with business partners in negotiating the terms and conditions of long-term contractual commitments. This manual [the Treasury Manual on Public Private Partnerships] should go a long way to building such essential abilities.

According to the Treasury Manual, PPPs are an integral component of the state's overall strategy for the provision of public services and public infra-

structure. This does not imply that PPPs are the preferred option for improving the efficiency of services delivered, but rather that they enjoy "equal status among a range of possible service delivery options available to departments in all spheres of government".[67]

The manual concedes that complex PPP arrangements – especially long-term contracts involving private finance – have produced mixed results in South Africa. The manual goes on to say, however, that correctly structured PPPs are a useful service delivery option from both an operational and strategic perspective. Operationally, the benefits of PPPs "can result in some combination of better and more services for the same price, and savings, which can be used for other services or more investment elsewhere".[68] Strategically, PPPs can boost a department's managerial efficiency as "existing departmental financial, human and management resources can be refocused on strategic functions".[69]

Treasury Regulations

PPPs that entail payments to private parties from departmental or other state budgets are generally likely to impose more serious risks to the fiscus than those that derive their revenues from service tariff or user charges. The National Treasury's strategic framework for delivering public services through PPPs notes that "all PPPs involve a commitment of public resources, and to this extent, public revenues are almost always involved in PPP arrangements".[70] Long-duration contracts that entail financing arrangements are likely to impose more serious risks on the fiscus than simple service contracts. According to the treasury's strategic framework, "the degree of regulation is likely to increase from one end of the PPP continuum to the other".[71]

In 2002 the finance ministry issued regulations in terms of the Public Finance Management Act of 1999, to regulate the state's use of PPPs.[72] The regulations seek to ensure that the financial consequences of PPP arrangements do not adversely affect the state's coffers. The regulations control all aspects of a PPP life cycle, from project identification through to post-contract management and monitoring. Under certain terms and conditions the National Treasury may exempt a government department from the application of the regulations.[73]

In terms of the Treasury Regulations, the National Treasury maintains firm control over national and provincial government departments wishing to enter into PPP agreements. According to the regulations, a government department

may not proceed with a PPP without the prior written approval of the National Treasury, or the relevant provincial treasury, if the department is a provincial institution and the National Treasury has delegated this function to the provincial treasury.[74] Moreover, the relevant treasury may approve of a PPP agreement only if it is satisfied that the proposed PPP will meet three requirements. Namely, that the PPP will provide value for money; be affordable for the government department; and transfer appropriate technical, operational and financial risks to the private party.[75]

Standardised PPP process

The Treasury Regulations lay down a standardised and specific set of processes which need to be followed before a government department can obtain the necessary treasury approval to enter into a PPP agreement with a private party. These processes are discussed briefly below.

Feasibility study (Treasury approval I)

To determine whether a proposed PPP is in the best interest of a government department, the department must undertake a feasibility study that:[76]

- Explains the strategic and operational benefits of the PPP agreement for the government department in terms of its strategic objectives and government policy.

- Describes in specific terms the nature of the departmental function that is to be subject to the proposed PPP agreement; the extent to which this departmental function, or the use of state property, can be performed by a private party in terms of a PPP agreement; and what other forms of PPP agreement were considered, and how the proposed form was selected.

- Assesses whether the agreement will provide value for money, is affordable for the government department, and transfers appropriate technical, operational and financial risk to the private party. (Operational risk is the risk that operating costs vary from budget, that performance standards slips or that the service cannot be provided.)

- Includes any relevant information and the economic criteria used to justify these assessments.

- Explains the capacity of the government department to effectively enforce the PPP agreement, including to monitor and regulate implementation and performance in terms of the agreement.

Affordability versus value-for-money

Affordability relates to whether the cost of a PPP project, over the whole project life, can be accommodated in the budget of the sponsoring government department, given the department's existing commitments. This is different from 'value-for-money', which simply means that private provision of a government service or function results in a net benefit to government, defined in terms of cost, price, quality, quantity, or risk transfer, or a combination thereof.

A particular PPP may thus be unaffordable, even though it provides value for money. According to the Treasury Manual, if a project is unaffordable, it undermines the government's ability to deliver other services and should not be pursued, even if there is a possibility that it may meet value-for-money criteria.[77]

Finance minister, Trevor Manuel, argues that "affordability is both about budgetary considerations and about wider human, social or environmental considerations… and affordability is also about avoiding the unnecessary exclusion from public goods or services of those who could be accommodated without cost or inconvenience to others, but who lack the means to pay".[78]

A government department may not proceed with the procurement phase of a PPP without written treasury approval for the feasibility study on aspects relating to affordability, value for money and appropriate technical, operational and financial risk transfer.

Procurement (Treasury approval II)

Prior to the issuing of procurement documentation to any prospective bidders, the government department must obtain approval from the relevant treasury for the procurement documents. The approval must include at least the main terms of the proposed PPP agreement, the aspects of affordability,

value for money and risk transfer.[79] The procurement procedure must include an open and transparent pre-qualification process; a competitive bidding process; and criteria for the evaluation of bids to identify the bid that represents the best value for money.[80]

After the evaluation of the bids, but prior to entering into negotiations with any of the bidders, the government department must submit a report for approval by the relevant treasury, demonstrating the means by which affordability, quantification of value for money, appropriate technical, operational and financial risk transfer can be established.[81]

According to the regulations, the procurement procedure "may include" a preference for categories of bidders, such as previously disadvantaged persons, provided that this "does not compromise the value for money requirements".[82] The procurement procedure may also include incentives for recognising and rewarding innovators in the case of unsolicited proposals.

Contracting PPP agreements (Treasury approval III)

After the procurement procedure has been concluded, but before the government department enters into a PPP agreement, the department must obtain approval from the relevant treasury:[83]

- that the PPP agreement contains the affordability, value for money and appropriate risk transfer; and
- a management plan that explains the capacity of the government department to effectively enforce the agreement including, to monitor and regulate implementation of, and performance in, terms of the agreement.

Management of PPP agreements

Once a PPP agreement has been approved by the treasury and entered into by a government department, the Treasury Regulations place certain responsibilities on the contracting government department to ensure that the PPP agreement is properly enforced. The regulations hold that a PPP agreement does not divest a government department "of the responsibility for ensuring that the relevant institutional function is effectively and efficiently performed in the public interest".[84] Specifically, to meet its responsibilities in terms of a

PPP agreement, a government department must establish mechanisms and procedures for:[85]

- monitoring and regulating the implementation and performance in terms of the PPP agreement;
- liaising with the private party;
- resolving disputes and differences with the private party;
- generally overseeing the day-to-day management of the PPP agreement; and
- reporting on the management of the agreement in the government department's annual report.

Government Commitment

In May 2003, the National Treasury released the draft *Standardised PPP Provisions*. The 340-page document describes the key issues that are likely to arise in PPP projects regulated by the Treasury Regulations discussed above. The objectives of the Standardised Provisions include the promotion of a common understanding of the technical, operational and financial risks that are typically encountered in PPP projects, and a common understanding of how such risks must be transferred or shared among the parties involved in the delivery of PPP projects. Moreover, the Standardised Provisions seek to promote a consistent approach to risk transfer and sharing value for money across PPP projects falling within the same sector, and a reduction of the time and cost of negotiation of the parties involved in a PPP project.[86]

Government commitment to developing high and predictable standards in respect of PPPs was underlined by finance minister, Trevor Manuel's comments at the occasion of the launch of the Standardised Provisions:[87]

> Too often, in too many countries, in too many projects, weakly specified contracts have led promising partnerships into conflict, contestation, failed services, unmet targets, unpaid bills and court proceedings… We will not go down that route. Those who think that service delivery contracts can be signed off on the basis of casual disregard for procurement procedures… do not belong on our government side

> negotiating teams. And those businesses who think that government contracts are a licence to overcharge for shoddy services or to offer system designs that meander from one mediocre consultant's report to the next incontinent permutation, should know that they also do not belong in this partnership.

To support government departments wishing to enter into PPP agreements, the National Treasury established a dedicated PPP Unit in 2001. A key objective of the Unit is to spearhead innovative infrastructure and service delivery through PPPs, and to implement successful projects and develop best practice templates in key infrastructure and service delivery sectors. Moreover, the Unit seeks to address constraints and facilitate successful implementation of affordable PPPs. The core functions of the Unit include:[88]

- communicating the government's PPP strategy to departments and potential private investors;
- assisting departments in preparing cost-effective and affordable PPP projects, with support through the project implementation cycle, from project inception through to financial closure;
- supporting capacity enhancement activities by initiating, managing and, where appropriate, offering technical assistance and training activities;
- serving as a resource centre for South African best practice in PPPs;
- ensuring that all PPPs are implemented in conformity with the Treasury regulations; and
- reviewing existing policies and legislation to identify potential constraints to successful implementation of PPP arrangements, and recommending additional reforms as required.

The Unit does not eliminate the need for government departments to develop their own capacity and use their own expert advisers. Rather, the Unit is tasked with assisting in building such capacities and developing a wider pool of expertise, within and outside of government, to bolster the implementation of PPPs in the long run. In order to attract appropriately skilled personnel – with the necessary experience in project finance, contract law and economics – the Unit contracts in private sector specialists in an advisory capacity.

In the municipal sphere, the Municipal Infrastructure Investment Unit (MIIU) was established in 1998 to provide technical assistance and support to municipal councils involved in PPPs or Municipal Service Partnerships (MSPs). It promotes PPPs and fosters capacity enhancement through its work with municipalities.

The MIIU was conceived as a five-year intervention to develop a market for technical assistance for project preparation in the sphere of municipal infrastructure and services. However, in August 2002, the MIIU's lifespan was extended to 2006. The MIIU's scope of activities include:[89]

- provide grant funding to local authorities on a cost sharing basis, to hire private sector expertise for assistance with PPP project preparation;

- assist local authorities in the process of hiring private sector consultants; and

- assist local authorities with the management of PPP contracts.

The MIIU undertakes its activities with local authorities that are developing project proposals involving private sector investment. The investments can take a broad range of forms, including:

- private sector financing of municipal debt;

- contracting out, or outsourcing, the management of ongoing services;

- concessions to operate the local authority's assets over a defined period;

- contracts requiring the private sector to Design, Build, Finance and Operate assets to deliver services for the local authority; and

- privatisation of assets and services.

The Department of Provincial and Local Government has also coordinated several technical assistance projects to provide appropriate training and related capacity enhancement activities for local government officials. The department has also issued various best practice guidelines on key aspects of the PPP project life cycle, and has assisted municipalities in promoting the PPP concept among municipal residents.[90]

Conclusion

At the private sector launch of the *Standardised PPP Provisions*, finance minister Manuel stressed that, properly conceptualised and negotiated, PPPs should enhance the standards and quality of public service delivery. Minister Manuel listed some of the benefits or strengths of PPPs, over traditional public service delivery mechanisms, provided the PPP process is adequately regulated and managed:[91]

- public private partnerships require outputs and service level standards to be specified clearly and transparently, together with identification of costs and risks;
- efficiencies arise from the integration of the design, building, financing and operation of assets that is intrinsic to a well-structured PPP;
- the private sector tends to bring [a] higher level of innovation to planning and project delivery, and has a sharper and more timely engagement with technology, with significant spin-offs for skill transfer in the public sector;
- the introduction of enhanced management skill into public service delivery through the PPP process is of considerable benefit in service quality and effectiveness; and
- the contractual assurances of specified service standards and affordability of PPP agreements bring about a stricter and more effective management of risk.

PPPs are a relatively new concept in South Africa. It consequently does not come as a surprise that the number of completed PPP agreements number only a few dozen at the time of writing. With the publication of the Treasury Regulations, and the refinement of the Treasury's *Manual on Public Private Partnerships*, a significant increase in the number and value of PPPs can be expected in the years to come.

The government – the National Treasury in particular – has adopted a regulated and top-down approach in the implementation of PPPs throughout the country. As a result of limited government capacity –especially at provincial and municipal level – and some poorly negotiated (from the government's point of view) PPP contracts in the mid-1990s, the Treasury appears committed to

retaining strong control over the PPP process. This may change as both government departments and private sector investors become more comfortable with the partnership approach, and PPPs become an established fixture in the country's investment and business environment. Indeed, both the Treasury's PPP Unit and the Municipal Infrastructure Investment Unit are temporary institutions, designed to assist in the initial development of rules and operating procedures around PPPs.

In the interim, during the initial 'teething' period of the PPP concept, the government appears to have embraced the PPP concept as a vehicle for expanding the delivery and provision of public services to a needy populace. Government commitment to making PPPs work appears to be sincere and strong. Too strong, some would argue, given government's persistent temptation to err on the side of over-regulation, as the detailed and verbose policy documents, regulations and statutes on PPPs tend to indicate.