

**A Strategic Framework for  
Delivering Public Services  
through  
Public-Private Partnerships**



# **A Strategic Framework for Delivering Public Services through Public-Private Partnerships**

**Department of Finance**

**Republic of South Africa**

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## **PREFACE**

South Africa's growth strategy includes substantial restructuring of state assets and extended involvement of the private sector in public service delivery. Government's objectives are two-fold – to improve economic efficiency and to extend services to more people.

Government alone cannot meet South Africa's development challenge. To generate economic growth, provide infrastructure and deliver services, Government and the private sector must combine their different strengths – providing a supportive policy and regulatory environment on the one hand, and entrepreneurial innovation and specialist skills on the other.

In many areas of public sector responsibility, the private sector is better able to deliver effective services, often because of the dynamics of competition, or because it generally has advanced technical or risk management capacity. By bringing private capital and expertise into state enterprises, we gain access to technology and skills transfer, as well as to the capital needed for expansion and organisational renewal.

This document is the outcome of a process began in 1997, when Cabinet approved the appointment of an Interdepartmental Task Team on public-private partnerships (PPPs). The team explored ways of improving the performance of various government functions through PPPs.

The *Strategic Framework* addresses the key constraints to the successful implementation of PPPs, and identifies the legislative, regulatory and institutional reforms required to strengthen the enabling environment.

In several areas – upgrading and management of toll roads, municipal services and construction of prisons, for example – Government has already embarked on substantial partnership projects. The formation of a PPP Unit in the national Treasury and the publication of this strategy and the accompanying PPP *Guidelines* are further steps on this challenging journey.

**Trevor Manuel**

**Minister of Finance**

## **ABBREVIATIONS**

APOPS	Asset procurement and operating systems
BOT	build-operate-transfer
DPLG	Department of Provincial and Local Government
IDTT	interdepartmental task team
MIIU	Municipal Infrastructure Investment Unit
MTEF	Medium Term Economic Framework
NRA	National Roads Agency
PPP	public-private partnership
SATRA	South African Telecommunications Regulatory Agency

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# Introduction

## Overview

This paper proposes a strategic framework for making public-private partnerships (PPPs) a more viable service delivery option for government departments. The framework aims to support national and provincial government departments in identifying, procuring and implementing PPPs. It provides a parallel framework to that of the *Municipal Service Partnerships Policy*, which supports service partnerships in the local government sphere.

South Africa faces daunting challenges in the delivery of public services and infrastructure. Although the government has implemented a range of infrastructure delivery programmes that have significantly increased access to services, large backlogs remain.

Addressing backlogs in essential public services while maintaining sound fiscal policies requires greater efficiency in the delivery of public services. This will enhance the scope for increasing access to services and for providing services of a higher quality.

All options for achieving greater efficiency in the delivery of public services need to be explored. In April 1997, the Cabinet approved the establishment of an interdepartmental task team (IDTT), chaired by the Department of Finance, to 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 intergovernmental policy, and legislative and regulatory reform.

## What are public-private partnerships?

A PPP is a contractual arrangement whereby a private party performs part of a 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:

- entirely from service tariffs or user charges
- entirely from a departmental or other budget
- a combination of the above.

The essential aspects of a PPP arrangement, as distinct from the direct delivery of a public service by a department, are:

- a focus on the services to be provided, not the assets to be employed
- a shift of the risks and responsibilities to a private provider for the activities associated with the provision of services.

The simplest form of a PPP is a service contract. In such contracts, a department typically awards a private party the right and obligation to perform a specific service, within well-defined specifications for a period of perhaps one to three years. The government retains ownership and control of all facilities and capital assets and properties. A key feature of more complex PPP arrangements, such as concessions and build-operate-transfer (BOT) schemes, is the mobilisation of private finance on a limited recourse basis. In the former, the concessionaire's responsibilities are expected to include maintenance, rehabilitation, upgrading and enhancement of the facility,

which may involve substantial capital investment. In the latter, the private party undertakes the financing and construction of a given infrastructure facility, as well as its operation and maintenance, for a specified period of time. Given the often substantial capital investment by the private sector under such arrangements, the contracts tend to be of long duration (25 years).

While service delivery through a PPP changes the means of delivering services, it does not change a department's accountability for ensuring that the services are delivered. The department's focus shifts from managing the inputs to managing the outcomes, i.e. becoming a contract manager rather than a resource manager.

## **Why use public-private partnerships?**

The simplest forms of PPPs have been part of South Africa's procurement landscape for some time. More complex arrangements, in particular long-duration contracts that entail private finance, represent new ground. Limited experience with more complex PPPs to date has produced mixed results. Correctly structured, however, such partnerships are a useful service delivery option from both an operational and a strategic perspective.

*Operationally*, the benefits of PPPs include efficiency gains; output focus; economies generated from integrating the design, building, financing and operation of assets; innovative use of assets; managerial expertise; and better project identification. These benefits can result in some combination of better and more services for the same price, and savings, which can be used for other services or for more investment elsewhere.

*Strategically*, partnership contracts enhance accountability by clarifying responsibilities and focusing on the key deliverables of a service. A department's managerial efficiency can benefit significantly as existing departmental financial, human and management resources can be refocused on strategic functions.

The benefits of PPPs can accrue to all stakeholders. Therefore:

- *For departments:* PPPs must be an accessible, relevant, viable and beneficial service delivery option.
- *For the users of services:* PPPs must result in accessible, affordable and safe services that meet acceptable quality standards.
- *For society:* PPPs must promote goals such as social equity, economic empowerment, efficient utilisation of scarce resources, and protection of the environment.
- *For private parties:* PPPs must be sufficiently rewarding in relation to the investment required and the risks undertaken.

## **Overview of the Strategic Framework**

The risks and potential rewards of PPPs tend to increase from one end of the PPP continuum to the other, i.e. from simple service and management contracts through to concessions and BOTs. As the more complex arrangements become more widespread, the creation of a suitable enabling environment becomes increasingly relevant.

This *Strategic Framework* presents a package of integrated reforms to strengthen the enabling environment in support of PPPs by:

- *establishing* a clearer policy framework to ensure that PPPs are a coherent option for departments
- *refining* legislation through a targeted programme to remove unnecessary obstacles to cost-effective PPP arrangements
- *enhancing* the capacity of departments to use PPPs in sound and effective projects

- *providing* a simple yet effective institutional framework to ensure that PPPs achieve value for money and facilitate capacity enhancement activities.

The elements of the *Strategic Framework* are detailed in Section 3 below. This is preceded by an overview of the current enabling environment.



# The current enabling environment for public-private partnerships

## Introduction

While there are no general impediments to the use of PPPs, various uncertainties, inconsistencies and ambiguities create unnecessary risks for the government and private service providers.

## Policy dimensions

Delivering public services through PPPs is relatively new in South Africa. Making this a viable and robust option for service provision requires greater coherence and consistency in government policy.

Support for service delivery through PPPs varies across government departments. In transport, for example, the establishment of the National Roads Agency (NRA) as an arm's-length institution for managing major projects with the private sector has streamlined the tendering process for procuring private services and has fostered an investor-orientated focus. The Department of Public Works, despite some teething problems with its Asset procurement and operating systems (APOPS) programme, has moved to expand the use of PPPs.

The Department of Water Affairs has been more cautious, contending that the public interest and the monopolistic nature of water services provision require that public sector service delivery be viewed as the preferred option. The health sector is currently reviewing and refining its position for delivering core public health services through PPPs.

In some respects, the different approaches reflect a broader debate concerning the role of the government in the provision of public services. Is the state seen primarily as a provider of services or as a regulator of service provision? South Africa, like many other countries, recognises that a range of approaches is required to cater for various needs and circumstances.

The telecommunications sector is an example of the "state as regulator" approach. The partial privatisation of telecommunications, the fostering of effective competition in the provision of mobile telecommunications, and a general concern for universal access to service prompted the establishment of the South African Telecommunications Regulatory Agency (Satra) in 1997. In contrast, other sectors have taken a more measured approach in view of concerns about the capacity of PPPs to deliver on broader social goals.

The role of the state in the provision of public services in South Africa continues to be an ongoing and healthy source of debate. However, as international and recent South African experience has shown, the private sector option needs to be supported by sound regulatory practices. Such regulation should promote key public policy objectives, for example curbing monopolistic practices, alleviating poverty, promoting universal service access and fostering empowerment.

Although a clearer consensus may emerge on the role of the private sector and the need to develop complementary regulatory initiatives, sectoral differences are likely to remain. However, with the

evolution of appropriate regulatory institutions, departments and other government agencies will in due course be able to approach private partnership options with more confidence.

## **Legislative framework**

The potential viability of PPP arrangements in South Africa is illustrated by examples such as the Dolphin Coast Water Concession, the N3 Toll Road and the APOPS Prison Contracts. However, the development and implementation of these projects have highlighted significant gaps and constraints in the legislative framework. This has been reinforced by the findings of an initial legal scan, which has been undertaken as part of the IDTT's work programme.

This finding is not totally surprising, however, if one considers that much of South Africa's legislation was drafted before PPPs were recognised as a real option for service delivery and infrastructure provision. Nevertheless, these constraints create uncertainties and impose risks on departments and potential private service providers. As such uncertainties and risks are often difficult to allocate in a contract, PPPs are currently less cost-effective as service delivery options.

An indicative list of the legislative and regulatory framework that may constrain the effectiveness and potential benefits of PPPs is presented below. In reviewing the list, it is important to note that legislative review and reform will necessarily be an ongoing process, and that the set of examples presented below is likely to expand as more legislation is encountered in relation to PPPs.

- The present legal framework does not clearly define the *legal capacity* of the various spheres of government (or the relevant officials) to create binding commitments on behalf of the government.
- Existing *procurement legislation* and regulations are geared to conventional procurement activities, such as civil works construction, and for the purchase of equipment and services. Existing procedures are neither designed to address the complexities of PPPs nor provide a basis for ensuring that the key dimensions (e.g. affordability, value for money and efficient risk allocation) are appropriately evaluated.
- Minimum cross-sectoral *contractual provisions* for PPP arrangements have not been adopted. As PPPs can take many forms with different allocations of risk, there is limited practical scope for utilising a standardised approach to contract preparation. However, international experience has shown that PPP contracts should include a number of common provisions. At present, there is no legislative or regulatory requirement for this.
- Current legislation does not specify the extent, timing and scope of mandatory *consultative processes* with labour regarding matters such as workplace reorganisation. This will create uncertainty for all stakeholders and investors until a body of case law has been established.
- In a number of countries, existing stocks of state-owned infrastructure often do not comply with *environmental legislation*. This creates problems where such infrastructure is transferred to PPP arrangements, and where the private sector is required to comply with legislation and to bear all the costs of compliance. South Africa is likely to face similar problems to varying degrees across different sectors.

## **Public financial management**

While PPPs can achieve greater efficiency in the use of public resources, they can also negatively affect public financial management if they are not properly conceived, structured, implemented and monitored. The absence of a formal policy and regulatory framework for the financial management of PPPs needs to be addressed urgently, in order to limit possible adverse budgetary implications. Examples include:

- *Unaffordable public-private partnerships:* The lack of effective regulatory mechanisms creates the potential for departments to embark on PPPs that are not affordable. A framework is needed to balance priorities between sectors and to maintain prudent control over government's financial commitments. Such a framework should require departments to ensure that PPPs provide value for money, present an appropriate allocation of risks between the contracting parties, and are affordable in terms of current and projected budget provisions.
- *Unmandated guarantees:* Many projects, particularly local government and provincial ones that involve the collection of tariffs from the public, are accompanied by requests from private investors for guarantees or performance undertakings. National government has indicated that it will not underwrite provincial and local government guarantees. However, a belief persists in the market that the economic and political costs of not supporting subnational institutions that default on their obligations would be too high for the government to ignore.

## **Institutional framework**

Currently, individual line departments develop PPPs in an institutional vacuum. The roles and responsibilities of the Treasury, the Tender Board and the Department of Public Works have not been clarified, and the position and accountability of technical advisers are uncertain.

As a result, departmental initiatives are fragmented and, in some instances, mutually contradictory. Consequently, policy coherence on fundamental issues such as regulation and risk allocation may have suffered. An effective and supportive institutional framework is necessary to catalyse the implementation of the PPP framework.

A coordinating point with appropriate technical capacity is clearly needed. However, the creation of a support structure for PPPs raises important questions. For example, how can the Treasury's support to departments on financial management issues be reconciled with the accountability of departments? Is it necessary to separate the function of compliance with regulatory requirements from the provision of technical assistance? What models are appropriate to support good PPP deals?

In the municipal sphere, the Municipal Infrastructure Investment Unit (MIIU) provides technical assistance and support to municipal councils involved in PPPs. It promotes PPPs and fosters capacity enhancement through its work with municipalities. The question is whether the institutional arrangements in the local government sphere are relevant to national and provincial PPPs.

## **Capacity needs**

Ensuring effective service delivery through PPP arrangements typically requires additional functional capacity in financial, technical and managerial areas that are not normally associated with the operations of a government department. Moreover, while it could be argued that government officials have developed skills as contract managers for simpler forms of PPP arrangements, such as service and basic management contracts, this is not true for more complex PPP contracts. The requisite skills for long-duration contracts that entail significant risks are still in relatively short supply in the public sector and will have to be developed over time. A balanced approach is therefore required both to build the required capacity and to reduce the demand on capacity by adopting, for example, measures that reduce the complexity of PPP arrangements.

Functional capacity for engaging in partnerships has been strengthened at the local government level. The Department of Provincial and Local Government (DPLG) is coordinating several technical assistance projects to provide appropriate training and related capacity enhancement activities for local government officials. The DPLG is also issuing various best practice guidelines

on key aspects of the partnership project life cycle and assisting councils in promoting the partnership concept among municipal residents. At present, there are no corresponding national or provincial government initiatives for capacity enhancement in PPP projects.

# Strategy to support public-private partnerships

## Introduction

On opening Parliament in June 1999, the President set a platform for accelerated service delivery and identified a greater role for PPPs in particular. To translate this into a functional reality, the *Strategic Framework* addresses the main areas of concern raised in Section 2, and identifies a package of integrated reforms that will be required to strengthen the enabling environment in support of PPPs. It is important to note, however, that the elements of the reform package cannot all be introduced at the same time and that it will be necessary to pursue a phased approach. The formation of a PPP support unit is a critical short-term goal. Legislative reform and a programme of sustained capacity building are, of necessity, more long-term objectives.

## Policy dimensions

PPPs are an integral component of the state's overall strategy for the provision of public services and public infrastructure across all sectors. This does not imply that PPPs are the preferred option for improving the efficiency of services delivery, but rather that they enjoy equal status among a range of possible service delivery options available to departments in all spheres of government.

Giving practical effect to the *Strategic Framework* entails the following components:

- A process for achieving consistency in sector-specific legislation
- The promulgation of *Treasury Regulations* in terms of the Public Finance Management Act, 1999, that apply to national and provincial government departments for the development, procurement and management of PPP projects
- A strategy and programme for enhancing the capacity of departments to engage in PPP arrangements
- The provision of suitable institutional arrangements to support and monitor PPP arrangements

Jointly, this approach should confirm and reinforce the government's commitment to make PPPs a viable option for delivering public services.

## Legislative framework

The adverse implications of the current legislative framework for PPP arrangements need to be mitigated. Possible measures include selective reform of relevant laws, regulations to clarify the interpretation of the legislation, or administrative guidelines. Legislative amendment has already been necessary in the context of the APOPS Prison PPPs, where the Correctional Services Act had to be changed in order to permit private parties to manage and operate prison services in the country. Interventions to deal with the areas of the legal framework set out in Section 2.2 may also be required. The following could be proposed:

- Clarifying the *legal capacity and jurisdiction* of the spheres of government and relevant officials to create binding commitments on the state. This should also include appropriate

penalties for those institutions and individuals that, in the absence of express legal authority to do so, purport to have a right to bind the state in a transaction.

- Prescribing cross-sectoral *minimum contractual provisions* for PPPs to cover, among other things, the following:
  - Duration of the contract
  - Range of services and/or output levels
  - Basis of payment in relation to service and output levels
  - Relationship between the department and the service provider
  - Use and retention of technology by the department
  - Accommodation of a department's changing requirements over the duration of a contract
  - Protection of government intellectual property
  - Allowances for contingencies and termination
- Clarifying the timing, scope and extent of *consultative processes* with labour on changes in workplace practices associated with PPP arrangements.
- Including within *environmental legislation* provisions that deal fairly with the cost implications of making non-compliant infrastructure comply when responsibility for that infrastructure is transferred to the private sector.

The list above is indicative of the types of legislative amendment that may be required. While it would be premature to propose firm recommendations on amendments to existing legislation, it will be necessary to pursue an ongoing process of legislative review and reform, in order to provide more certainty to government departments and potential private sector service providers. Legislative reform is likely to be of two types: that which is sector-specific (such as amendments to the Correctional Services Act), and that which cuts across a range of sectors (such as possible changes to environmental legislation).

## **Public financial management**

The *Treasury Regulations* ensure that the financial consequences of such arrangements do not impose adverse risks on the fiscus. The *Regulations* control all aspects of the PPP life cycle, from project identification through to post-contract management and monitoring. Particularly relevant regulations deal with the following issues:

- *Definition:* The *Treasury Regulations* clearly and precisely define what is, and what is not considered a PPP. The emphasis is on a contractual arrangement whereby a private party takes responsibility for, and assumes the risks associated with, all or part of a department's functions. Financial transactions where risk transfer is not a characteristic will be treated as in-substance borrowing and recorded accordingly.
- *Affordability and value for money:* The *Regulations* also prescribe that affordability and value for money are crucial factors in deciding whether or not a PPP proposal can be executed and made legally binding. Proposals that do not satisfy these tests will not be considered for implementation.
- *Provision of guarantees:* The *Regulations* provide that guarantees or other public support do not constitute an actual or implied sovereign obligation unless explicitly provided for in consultation with the Minister of Finance.
- *Budgeting:* To facilitate better public financial management of PPPs, such arrangements will be incorporated into the MTEF framework to enable departments to plan rationally on a multi-year basis.

It is true that PPPs that entail payments to private parties from departmental or other budgets are generally more likely to impose more serious risks to the fiscus than those that derive their revenues from service tariffs or user charges. It is important to note, however, that all PPPs involve a commitment of public resources, and to this extent, public revenues are almost always involved in PPP arrangements. Thus, regulation of PPPs to ensure that they comply with the requirements of good public financial management will always be necessary, albeit to varying degrees.

Moreover, long-duration contracts that entail private financing arrangements are similarly likely to impose more serious risks on the fiscus than will simple service contracts. While the degree of regulation is likely to increase from one end of the PPP continuum to the other, it will need to be remembered that even management contracts that have no private financing component can have significant budgetary implications. These, too, will need to comply with the *Treasury Regulations*.

## Procurement

A sound procurement process is one that achieves value for money and promotes important societal goals. As noted, existing procurement legislation and regulations are geared to conventional procurement activities where the department *is procuring assets and services (as inputs)* that allow it to deliver services to the public. In a PPP, the department is *procuring an arrangement* under which someone else provides services on its behalf.

As a PPP involves the delegation of a departmental function, the risks to both the department and the service provider are much higher and a correspondingly more sophisticated approach to procurement is required.

Procedures for handling these requirements are prescribed in the *Treasury Regulations*. These *Regulations* provide sufficient checks and balances to permit departments to determine their own procurement outcomes for PPP projects. It will need to be considered, as part of a broader procurement reform process, whether PPP procurement could be done outside of the existing procurement framework, which was not designed to accommodate the complexities underlying PPP arrangements.

## Institutional framework

The institutional framework to support and streamline PPPs must be guided by a set of institutional principles. Key among these are:

- The institutional arrangements should streamline project processes and not add administrative or procedural burdens.
- Any new arrangements must comply with the general fiscal approach, with a particular emphasis on greater fiscal accountability.
- The arrangements need to cut across line departments, yet respect the latter's spheres of accountability.
- Conflicts of interest must be avoided, both in terms of different roles and functions, such as enforcing affordability and value for money on the one hand and providing technical assistance on the other, and with regard to the interests of the government as whole, individual departments and private parties.

Following from these principles, it is proposed that the primary responsibility for identifying, procuring and implementing PPPs must rest with government departments. The *Treasury Regulations* limit the Treasury's role to ensuring sound expenditure control and the prudent use of the State's assets, and not to "second guess" or "micromanage" the decisions of departments.

## **Departmental capacity needs**

Capacity building is critically important to a sound PPP programme. Appropriate functional capacity will have to be developed by:

- preparing advisory guidelines to assist departments in following suitable practices to implement their PPP programmes.
- seeking complementary donor funding and assistance to support training and related capacity enhancement activities.
- actively encouraging rotation of staff skilled in PPPs between departments and spheres of government.

## **Public-Private Partnership Unit**

It is proposed that a dedicated Public-Private Partnership Unit be established to promote PPPs effectively in conformity with the institutional principles highlighted above. This will be a critical but temporary intervention to spearhead innovative infrastructure and services delivery through PPPs, aiming to implement successful projects and develop best practice templates in key infrastructure and service delivery sectors.

Options such as self-regulation, where each department assumes full and unassisted responsibility to commit the national budget, could prove to be destabilising. Self-regulation could also increase management costs as the lack of formal institutional development assistance, project coordination and information sharing places operational burdens on departments and agencies. This could also result in severe delays in the programme and duplication of efforts.

The key objective of the Unit will be to address constraints in the enabling environment and facilitate successful implementation of affordable PPPs that represent value for money to all stakeholders.

The core functions required to meet this objective entail technical assistance and support, monitoring and enforcement, and policy and legislative review, and include the following:

- Communicating the government's PPP strategy to departments, potential private investors and other stakeholders
- Assisting departments in preparing cost-effective and affordable PPP projects, with support throughout 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 partnerships are implemented in conformity with the requirements of the Public Finance Management Act, as set out in the *Treasury Regulations*
- Reviewing existing policies and legislation to identify potential constraints to successful implementation of PPP arrangements, and recommending additional reforms and refinements as required

The Unit will not eliminate the need for departments to develop their own capacity and use their own expert advisers. Rather, it will assist in building such capacities and developing a wider pool of expertise, within and outside the government, to bolster the implementation of PPPs in the long run.

It is proposed that the Unit be established within the structures of the public service. In line with its monitoring and enforcement responsibilities under the *Treasury Regulations*, the Unit will logically be located in the national Treasury. However, in order to attract appropriately skilled personnel – with considerable expertise in project finance, contract law and economics – it will

probably contract in scarce disciplines from the private sector in an advisory capacity. The Unit will be managed by a full-time managing director with senior management skills and experience in project finance.

To ensure ongoing strategic links with departments, and especially to facilitate ongoing policy review and development, the IDTT on PPPs will continue to function, specifically mandated to work in close liaison with the Unit. Members of the Unit will work closely with departmental project teams throughout the project cycle, thereby fostering operational links.

A dedicated Unit, located in the Treasury, seems the most appropriate for South Africa, as PPPs are still in their relative infancy and potentially threaten responsible public financial management. The Unit provides an opportunity to concentrate key resources on a few priority projects for a specific time. It allows quicker identification and dissemination of the capacity, implementation and enforcement issues in the South African context.

After five years, and as a consequence of experience gained with PPPs, other options could be considered. These include a voluntary technical assistance facility or an entirely self-regulatory framework.



## Conclusion

The *Strategic Framework* aims to create an environment for PPPs, which requires a consistent policy message from the government, supporting legislative reform, capacity enhancement and institutional mechanisms to enforce the *Treasury Regulations* and promote such partnerships.

