# Good governance in Public-Private Partnerships Approaches and applications

## A South African perspective

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## ABSTRACT

***Policy-makers are continuously seeking ways to improve service delivery and the management of facilities. Many governments are turning to the private sector to design, build, finance and operate infrastructure facilities which the public sector is normally responsible for providing. Creating a*** *partnership* ***with the private sector creates the opportunity to avoid the often negative effects of either exclusive public ownership and delivery of services on the one hand, or outright privatisation on the other. The application of good governance in Public-Private Partnerships will be a key component towards the improved service delivery and thus the improvement of quality of life for all citizens.***

## INTRODUCTION

The public sector plays a large role in society and in most economies; public expenditure forms a significant part of a country's gross domestic product (GDP), and public sector entities are substantial employers and major capital market participants. The public sector determines – usually through a political process – the outcomes it wants to achieve and the different types of intervention it will use. These include enacting legislation or regulations, delivering goods and services, redistributing income through mechanisms such as taxation or social security payments, and the ownership of assets or entities such as state-owned enterprises. Governments also play a role in promoting fairness, peace and order, and sound international relations.

In the public sector, good governance refers to effective arrangements to ensure that the intended outcomes for stakeholders are defined and achieved, such as political, economic, social, environmental, administrative, legal and other arrangements. Effective governance

promotes better decision-making and efficient use of resources, and it strengthens accountability for the stewardship of those resources.

The purpose of this approach is the transfer the risk from the public to the private sector, or to share it, and to ensure that the necessary skills and knowledge are available for service delivery. By contrast, a public-private partnership (PPP) combines the best of both worlds: the private sector contributes resources, management skills and technology, and the public sector implements the necessary regulatory actions and protects the public interest. Such a balanced approach is especially welcome in the delivery of public services in South Africa, so policy-makers increasingly use PPPs to increase investment in infrastructure services to improve service delivery.

The aim of this article is to provide a perspective on good governance in respect of PPPs, considering various approaches and two examples of an application, and focusing on affordability, value-for-money solutions, financial relationships and risk-sharing. This article concludes with recommendations on how PPPs can benefit from good governance, with specific reference to establishing good governance structures that empower PPPs for public sector reform.

## CONTEXTUALISATION OF PUBLIC PRIVATE PARTNERSHIPS

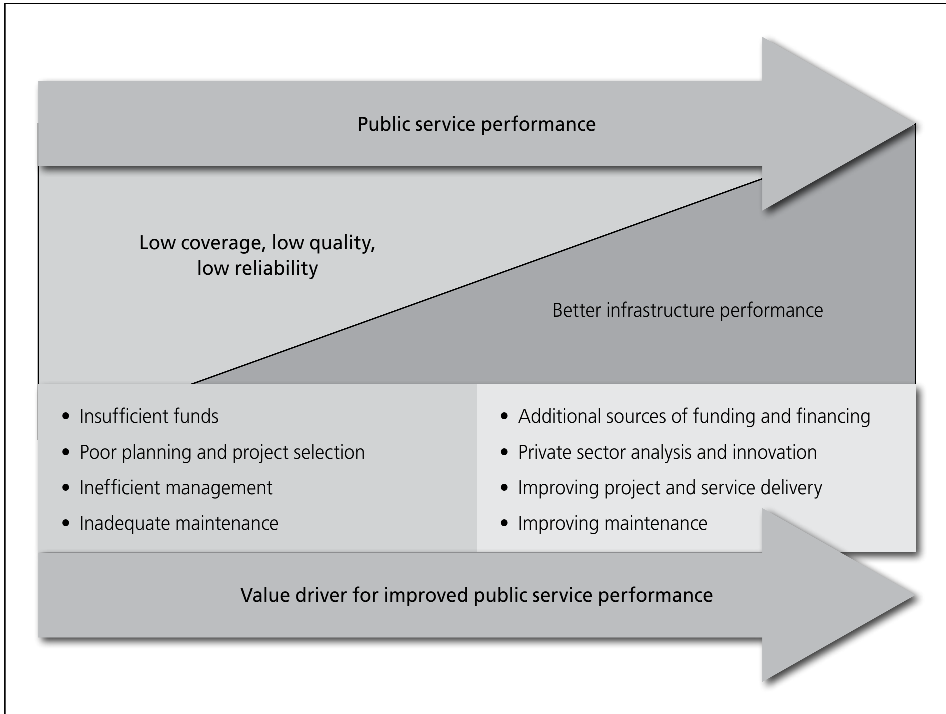
Infrastructure services are often inadequate to meet demand, resulting in congestion or service rationing. The services that are provided are also often unreliable and/or of a low quality, and many areas may not be served at all. The South African government has realised that its limited tax base alone cannot fund the large demand and need for infrastructure, particularly because in South Africa there is an acute need to rehabilitate and upgrade existing infrastructure, much of which was built decades ago (Farlam 2005:2).

Poor infrastructure performance in South Africa reflects three ubiquitous challenges facing the government. *Firstly*, the government is not spending enough to provide all the necessary infrastructure. *Secondly*, poor planning and coordination, weak analysis underpinning project selection, pursuit of political gain and corruption often result in limited resources' being spent on the wrong projects. Moreover, infrastructure assets and services are frequently not available in time, and service delivery is weak. *Finally,* in many areas, infrastructure assets are poorly maintained, increasing costs and reducing benefits.

Figure 1 illustrates how PPPs can add value to help overcome some of these pervasive challenges. PPPs can mobilise additional sources of funding and financing for infrastructure, and can help improve project selection by subjecting assumptions to the market test of attracting private finance (OECD 2012:4).

In August 2004, ten years after South Africa's first democratic elections, Mr Trevor Manuel, then the South African Minister of Finance, stated: "This is what PPPs are about. The public gets better, more cost-effective services; the private sector gets new business opportunities. Both are in the interests of the nation." The mechanisms by which PPPs can help improve infrastructure delivery are often summarised as *value drivers*, thus the ways in which using PPPs to provide infrastructure can achieve value for money. According to the *National Treasury Public-Private Partnership Manual,* these value drivers, as described in Figure 1, are often integrated into PPP policies (National Treasury 2004a:2).

**Figure 1** Public service performance problems

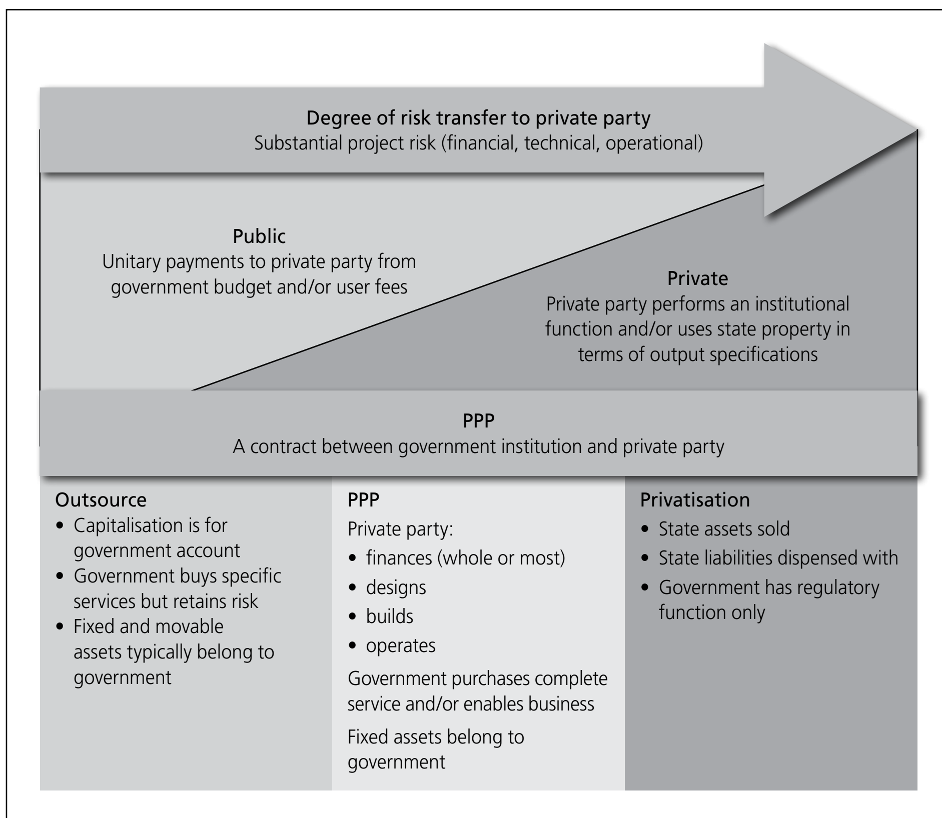



**Source** Adapted from World Bank (2012:12)

According to the World Bank's (2012:11) *Public-Private Partnerships Reference Guide*, there is no single, internationally accepted definition of a PPP and therefore suggests a broad description of a PPP, as a "long-term contract between a private party and a government agency, for providing a public asset or service, in which the private party bears significant risk and management responsibility". This definition covers PPPs that provide new assets and services, and ones that work with existing assets and services. It can include PPPs in which a private party is paid entirely by service users, and ones in which a government agency makes some or all of the payments. The definition encompasses contracts in many sectors and for many services, provided that there is public interest in the provision of the service, and that significant risk and management responsibility have been transferred to a private party.

Yescombe (2007:5) explains that PPPs aim at financing, designing, implementing and operating public sector facilities and services. Their key characteristics include long-term service provision, the transfer of risk to the private sector, and different forms of long-term contracts drawn up between legal entities and public authorities. PPPs refer to innovative methods used by the public sector to contract with the private sector, which contributes its capital and its ability to deliver projects on time and to budget, while the public sector retains the responsibility to provide these services to the public in a way that benefits the public and delivers economic development and improves quality of life. Figure 2 is an illustration of the concept of PPPs. The figure highlights risk transfer, and the shift from pure public initiatives to complete privatisation as the diametric opposite to pure public initiatives. PPPs are positioned in the middle, as a contract between government institutions and private parties.

**Figure 2** The PPP concept




**Source** Adapted from World Bank (2012:25)

PPPs are not equal to privatisation – the public sector remains accountable for the delivery of the public service, whereas under privatisation, the accountability is transferred to the private sector (the public sector may retain some regulatory price control). Under PPPs, there is no transfer of ownership, and the public sector remains accountable. PPPs enable the public sector to harness the expertise and efficiencies that the private sector can bring to the delivery of certain facilities and services which are traditionally procured and delivered by the public sector. A PPP is structured so that the public sector body that wishes to make a capital investment does not incur any borrowing. Rather, the PPP borrowing is incurred by the private sector vehicle that implements the project. Therefore, from the public sector's perspective, a PPP is an *off-balance sheet* method of financing the delivery of new or refurbished public sector assets (World Bank 2012:25).

PPPs are formal commercial contracts between government institutions and private companies, where the private partner assumes substantial financial, technical and operational risk in designing, financing, building and operating a project in return for specified benefits. There are two legally defined types of PPP – where a private company performs a government function, and where a private partner is given rights to use state property for commercial purposes, under specified conditions (Farlam 2005:12).

The implementation of partnerships between the public sector, the private sector, communities and civil society in South Africa has grown steadily since the late 1990s. A

legislative framework to guide the implementation of partnerships involving the public sector has been developed for the national, provincial and municipal spheres. It is noticeable that very little South African literature has emerged on the subject since 2005, which suggests strongly that the development of such partnerships is slowing down, as cumbersome legislation and capacity issues take their toll. In the last ten years, stakeholders have learnt more about the constraints, the keys to success, and the techniques to manage the legislative framework more effectively – in short, what works and what does not work (OECD 2012:13).

## GOOD GOVERNANCE IN PUBLIC PRIVATE PARTNERSHIPS

PPPs present a severe organisational and institutional challenge for the public sector. They are complex, require different types of skills and new enabling institutions, and lead to changes in the status of public sector jobs. To work well, they require institutions that function well, as well as transparent, efficient procedures, and accountable and competent public and private sectors – thus, good governance.

The concept of governance is not new – it is as old as civilisation. It refers to "the process of decision-making and the process by which decisions are implemented (or not implemented)" (UNESCAP 2007 and Clark 2004:2). The term *governance* should be distinguished from *government* – *governance* is what a *government* does. This may refer to a geo-political government (nation-state), a corporate government (business entity), a socio-political government (e.g. tribe or family), or any number of different kinds of government. Governance is the kinetic exercise of management power and policy, while a government is the instrument (usually, a collective) that exercises this management power and policy. The concept of governance also encompasses two main approaches, one that sees governance as concerned with the rules of conducting public affairs, and another that regards governance as an activity of managing and controlling public affairs (Hyden and Court 2002:14).

According to Bingham, Nabatchi and O'Leary (2005:548), the concept of governance has been explored in many academic fields, including political science, public administration, policy-making, planning, and sociology. The concept of *good governance* gained prominence during the 1980s in the wake of the World Bank and International Monitory Fund (IMF) report (Fourie 2006:435) as a result of the economic crisis confronting Third World countries, and specifically sub-Saharan Africa. The report centred on the democracy-development relationship. The World Bank's statement positioned democracy as a necessary precondition for development. Good governance was seen to be signalled by the presence of a multiparty democracy, rule of law and a free press that keeps political leaders accountable in view of the risky fusion of the domains of politics and administration (Wohlmuth 1999:7).

The concept of governance transcends the conventional boundaries of public administration. According to Carmichael (2002:5), public administration is concerned with the formal institutions of government, whereas governance focuses on wider processes through which public policy is affected. Governance refers to the development and implementation of public policy through a broader range of private and public agencies than those traditionally associated with government. Government is increasingly characterised by diversity, power interdependence and policy networks, whereas governance stresses the complexity of policy-making, implementation and accountability relationships between a

variety of state and societal actors at various levels, globally and regionally, and at national government level, as well as in local administrations. In governance theory, the relationships between state and non-state actors have become less hierarchical and more interactive. Thus, governance denotes a highly fluid institutional and policy matrix in which the powers and responsibilities of different actors and tiers of government are in flux (Wohlmuth 1999:7).

Good governance is a form of governance that embodies eight ideal characteristics (UNESCAP 2007):

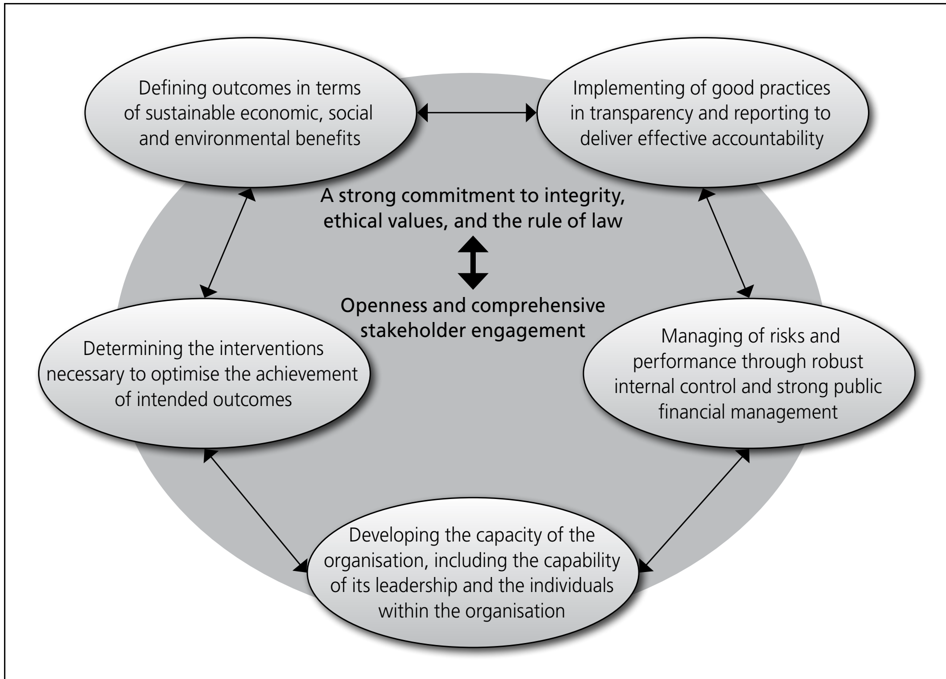
- accountability;
- a consensus orientation,
- effectiveness and efficiency;
- equity and inclusiveness;
- participation;
- responsiveness;
- rule of law; and
- transparency.

Upon reflection, then, it seems that good governance is about both performance and conformance. Performance is defined by how (well) an institution uses governance arrangements to contribute to its overall performance and effective delivery of goods and services. Conformance refers to how an institution uses governance arrangements to ensure that it meets the requirements of the law, regulations, published standards and community expectations of probity, accountability and openness. This implies that, on a daily basis, governance is typically about the way in which public servants take decisions and implement policies, and also help governments to play a critical role in the process and involve citizens and other stakeholders (Rowe 2008:2).

Applying the characteristics of good governance to PPPs, one might argue that good governance objectives in PPPs refer to a fair and transparent selection process by which governments develop partnerships, and the assurance that value for money is obtained. It also encompasses the improvement of essential public services, especially for socially disadvantaged members of society, and adequate training for those to be involved in the new partnerships. It supports a commitment to fair incentives for all parties and fair returns for risk-takers, combined with the achievement of commercial success. It implies sensible negotiation of disputes to ensure the continuation of services, and prevents the collapse of projects and consequent public waste. Finally, it provides for enhanced security in the face of possible threats and for a general improvement in the safety of services provided under PPP arrangements.

From an economic perspective, good governance in PPPs supports an effective procurement regime that empowers government institutions to buy goods and services of a higher quality at lower prices. It supports mechanisms that secure well-governed projects that elevate the support of society for PPPs, and give policy-makers the confidence they need to provide the necessary political support for the PPP process. The result of good governance practices is well-planned projects which are based on the full agreement of all the parties involved, which follow proper and on-going consultation, and which have less chance of unravelling, thereby avoiding costly litigation. A public administration that conducts its purchasing in an open manner contributes to increased confidence among

**Figure 3** Relationships between public sector good governance principles




**Source** World Bank (2012:12)

suppliers regarding the reliability of the administration as a business partner. Finally, good governance and efficient institutions are strongly linked to increased competitiveness and higher rates of economic growth and development (North 1990:12).

Based on the above objectives, a principle-based framework that promotes good governance in PPPs is essential. The need for a coherent PPP policy in strong enabling institutions, with a legal framework that emphasises an approach of *fewer, better, simpler* is a critical. The framework must provide for a culture of cooperative risk sharing and mutual support, putting people first, with transparency in the partner section, and aiming at achieving sustainable development (United Nations 2008:14).

Figure 3 illustrates how the various principles for good governance in the public sector are interrelated with a principle-based framework for PPPs.

The core principles for good governance in the public sector set out above are high-level principles which bring together a number of concepts relating to PPP applications. The next section of the article looks at the emergence of PPP policy and legislation in South Africa.

## PUBLIC-PRIVATE PARTNERSHIPS IN SOUTH AFRICA – AN APPLICATION

In April 1997, South Africa's Cabinet approved the appointment of an Inter-Departmental Task Team (IDTT) to develop a regulatory framework for PPPs in South Africa. A Strategic Framework for PPPs was subsequently endorsed by Cabinet in December 1999. In April

2000, Treasury Regulations, notably Regulation 16, for PPPs were first issued in terms of the *Public Finance Management Act,* 1 of 1999 (RSA 1999; National Treasury 2000b).

South Africa created the first statutory basis for cooperation between the public and private sectors in 1999 with the *Public Finance Management Act,* 1 of 1999. This legislation was supplemented in 2003 by the *Local Government: Municipal Finance Management Act,* 56 of 2003 (RSA 2003b) and subsequent regulations. A Unit for Public Private Partnerships (the PPP Unit) was established at the National Treasury as a contact and coordination agency, and this Unit has been very active since then. South Africa has become a model for other countries in southern Africa that seek to put in place the legislative and practical framework for formalised partnerships between the public and private sectors.

The PPP Unit still holds a fairly traditional view on PPPs, focusing on infrastructure-driven partnership projects, but South Africa has a sound history of cooperating with the private sector. Some of the most important government contributions towards collaboration and relationship-building with the private sector include the Expanded Public Works Programme, the National Skills Development Strategy and the Jobs Fund. There is increasing recognition amongst the stakeholders that a partnership between public and private actors beyond the traditional PPPs may be conducive to achieving a stable political environment and a prosperous economic one (National Treasury 2004a:1).

The legislation and regulations governing PPPs in South Africa at a national, provincial and local government sphere differ from one another. National and provincial government is subject to the *Public Finance Management Act,* 1 of 1999 (RSA1999) and municipal government is subject to the *Local Government*: *Municipal Systems Act,* 32 of 2000 (RSA 2003a), the *Local Government: Municipal Finance Management Act,* 56 of 2003 (RSA 2003b) and *Regulation 309* as per *Government Gazette*, No. 8200 of 1 April 2005, which was drafted to assist in clarifying the *Municipal Finance Management Act,* 2003 for municipal entities.

The *Public Finance Management Act,* 1999 (RSA 1999) stipulates the appointment of accounting officers, outlining their roles and responsibilities. It addresses matters such as the responsibilities of Ministers and MECs (executive authorities), the general principles on borrowing and issuing, guarantees, as well as financial misconduct and how to regulate these issues. The *Public Finance Management Act,* 1999 (RSA 1999) also defines the areas over which the National Treasury is empowered to issue Treasury regulations and list instructions, and to obligate the appointment and composition of audit committees.

National Treasury *Regulation 16* as per *Government Gazette*, No. 25773 of 28 November 2003 provides precise and detailed instructions for PPPs. An appointed accounting officer must enter into a PPP on behalf of a department and is responsible for registering the PPP with the National Treasury. If required, a project officer must also be elected. The accounting officer must conduct a feasibility analysis that, amongst other things, illustrates that the agreement is affordable to the government institution, offers a value-for-money solution and transfers financial, technical and operational risk to the private party.

Once feasibility has been assured, a procurement procedure must be complied with. Procurement may proceed with the consent of the National Treasury. The procurement procedure ensures that a PPP arrangement is fair, equitable, transparent, competitive and cost-effective, and in line with other legislation, such as Black Economic Empowerment (BEE) legislation. A second report must be compiled, illustrating the preferred bid exhibit; it must include the same criteria as the feasibility report. This second report must be submitted

to the National Treasury for approval. The contracting phase requires a third report to be submitted to the National Treasury for approval. Again, the report must illustrate that the selected party, amongst other things, meets the same criteria set out in the feasibility report. A management plan must also be included. The accounting officer is then responsible for ensuring that the PPP agreement is properly implemented, managed, enforced, monitored and reported on (National Treasury 2004a:12).

The *Municipal Systems Act*, 32 of 2000 (RSA 2003a) regulates PPPs, amongst other conditions. The *Municipal Systems Act,* 2000 applies when a municipality reviews and decides on the appropriate mechanism to provide a municipal service. It outlines the criteria and processes for deciding on mechanisms to provide a municipal service, such as a cost-benefit analysis, a full assessment of the private partner(s) and the impact on municipal employment patterns.

The policy outlined in the *Municipal Finance Management Act,* 2003 (RSA 2003b) is in essence consistent with the *Public Finance Management Act,* 1999 (RSA 1999) with regard to PPPs. The main approaches to PPPs, namely affordability, risk transfer and value-for-money, are consistent with those of the national Act (RSA 1999). However, the *Public Finance Management Act,* 1999 (RSA 1999) and the *Municipal Finance Management Act,* 2000 (RSA 2003b) differ in respect of the institutional systems they relate to and the decision-making processes involved. The *Municipal Finance Management Act,* 2003 (RSA 2003b) prescribes that PPPs must be affordable to the government institution, offer a value-for-money solution and transfer financial, technical and operational risk to the private party. The *Municipal Finance Management Act,* 2003 (RSA 2003b) regarding PPPs also requires a regulatory framework to be developed and prescribed by the National Treasury. With the assistance of the National Treasury, a feasibility study similar to that described by *Regulation 16* as per *Government Gazette*, No. 25773 of 28 November 2003 must be carried out. Once the feasibility study has been completed, the municipality's accounting officer must formally solicit the views and recommendations of the National Treasury (and other relevant departments). The local community must be informed and given an opportunity to comment and give input.

## CRITICAL SUCCESS FACTORS FOR PUBLIC-PRIVATE PARTNERSHIPS

A PPP is a legally binding contract between the government and a private sector organisation for the provision of assets and/or the delivery of services that allocates responsibilities and divides business risks among the various partners. As mentioned above, PPPs can be viewed, broadly speaking, as covering most interactions between the private and the public sectors, and more narrowly, as focusing on particular sets of risk-sharing and financial relationships. If PPPs are used correctly, they can deliver value for money, but they can also pose a risk to fiscal sustainability because of their complexity in respect of risk-sharing, costing, contract negotiation, affordability, budget and accounting application (OECD 2012:23).

The underlying principle behind PPPs is that, although it may be necessary for the public sector to be responsible for delivering a specific service, the public sector does not have to be responsible for actually providing the service, or for undertaking the investment itself.

Involving the private sector enables all the actors in a PPP to focus on doing what they are likely to do best (their core business). The main challenges facing public sector organisations in the foreseeable future are ensuring that PPPs are vested in strong and competent public institutions, are affordable, represent value for money and are transparently treated in the national budget process. A public governance principle-based framework for PPPs should be set and monitored at the highest political level, so that the entire applicable government approach ensures affordability, transparency and value for money (World Bank 2012:41).

A successful partnership is only possible if there is a strong commitment from the highest organisational authority. The most senior public officials must be willing to be actively involved in supporting the concept of PPPs and playing a leading role in the development of each contractual partnership. A committed and well-informed political leader can play a critical role in minimising misperceptions about the value to the public of an effectively developed partnership. This situation requires a well-established statutory framework as the foundation for the implementation of each partnership, and the creation of a performance platform for service delivery (World Bank 2012:41).

Once a partnership has been established, the public sector must remain actively involved in the project or programme. Openness and comprehensive stakeholder engagement is a critical requirement. On-going monitoring of the performance of the partnership is important in assuring its success. This monitoring must be done continuously, with the emphasis on output specifications and related milestones towards completion (United Nations 2008:23).

More people are affected by a PPP than just the public officials and the private-sector partner(s). Affected employees, the portions of the public receiving the service, the press, appropriate labour unions and relevant interest groups all have a stake and their own opinions, and frequently significant misconceptions arise about a partnership and its value to the public and other stakeholders. It is important to communicate openly and candidly with these stakeholders to minimise potential resistance to establishing a partnership (OECD 2012:22).

A well-prepared project charter and a carefully developed project plan increase the likelihood of a successful partnership substantially. This plan usually takes the form of an extensive, detailed contract, clearly describing the roles and responsibilities of both the public and private partners. Aside from attempting to foresee areas of respective responsibilities, an effective plan or contract includes a clearly defined dispute resolution mechanism, and a formal, entrenched governance arrangement (OECD 2012:22).

The private partner may provide the initial funding for capital improvements, so there must be clearly defined ways to repay this investment over the partnership term. The income stream can be generated by a variety of sources, and/or a combination of sources, such as fees, tolls, tax increment financing, or a wide range of additional options, but this income must be assured for the duration of the partnership (Yescombe 2007:12).

PPPs are complex instruments, and they require the presence of a number of capacities in government. These include setting up a robust system to assess value for money and financial performance management, using a prudent public sector mechanism, and transparent and consistent guidelines regarding non-quantifiable elements in the value-for-money judgement. It also involves being able to classify, measure and allocate risk to the party best able to manage that risk, and it requires sound accounting and budgeting practices (National Treasury 2004a:12).

Governments have to be able to assess whether or not a project represents value for money. Value for money is a relative measure or concept. In the parameters of economy, efficiency and effectiveness, the lowest bid is not always the best choice for selecting a partner. The best value in a partner is critical in a long-term relationship, which is central to a successful partnership. A candidate's experience in the specific area of the partnerships under consideration is an important factor. An outcomes-based focus requires careful consideration of a potential partner's ability to deliver at the right time, and according to mutually accepted specifications (World Bank 2012:33).

A critical challenge that undermines the effective implementation of PPPs is the lack of institutional capacity to manage and maximise the potential of a partnership arrangement. By definition, a partnership is premised on an arrangement between two or more entities to cooperate. It is often difficult to match the capacity of the entities involved. By virtue of their market-related definition, it is generally the private partner that has the capacity, and the public partner that is limited in this regard (World Bank 2012:34).

Monitoring is an essential feature of best practice in all circumstances. In the context of PPPs, monitoring serves two functions: *firstly*, it ensures that partners are doing what they are supposed to be doing; and *secondly*, it provides an important opportunity for review that almost always results in the enhancement of delivery in all aspects, including technical and financial aspects (United Nations 2008:43).

The contractual arrangement that underpins any PPP has the potential to enhance the impact of a relationship, and to ensure the best basis for the success of the delivery, or it can provide only a weak foundation and thus be a recipe for failure. A PPP contract has to be well structured, optimising the respective skills sets and capacity of the partners concerned. Any lack of clarity regarding the various roles and responsibilities within the contractual arrangement can slow down the delivery process, or lead to the disintegration of relationships between the partners (OECD 2012:22).

PPPs are highly sensitive to programme and project management issues, such as life cycle management and integrating various knowledge areas. It is essential that there be institutional responses to the effective management of the PPP in order to ensure that all parties are part of the decision-making process, and are called to account regarding implementation. There are a number of ways in which these partnerships can be managed at an operational level, and the method selected needs to be determined by the specifics of the task at hand (OECD 2012:24).

## CONCLUSION

PPPs are becoming an increasingly important tool for public service reform and the delivery of public services. Good governance requires good government, and effective public service institutions that are productive, transparent and responsive.

The concept of PPPs is related to the financing, designing, implementing and operating of public sector facilities and services. PPPs provide for effective long-term service provision and the transfer of risk to the private sector. The result is ideally a skilful and innovative application of management practices and contractual commitments between the public sector and private sector in respect of financial management, project delivery and accountability.

Governance is the exercise of public authority with reference to the establishment of structures and institutions for policy-making and implementation. It transcends the conventional boundaries of public administration. Governance refers to the development and implementation of public policy through a broader range of private and public agencies, characterised by power interdependence, policy networks and accountability relationships between a variety of state and societal actors at various levels. Good governance also includes improved essential public services, especially for the socially disadvantaged.

A principle-based PPP enables improved public sector reform initiatives by allowing both sectors to do what they do best. Empowered PPPs permit a government to make the best use of all the available resources and engage successfully in the quest to use public resources efficiently and effectively for public sector reform programmes, in order to meet the needs of the community in an equitable manner. The desired and expected outcome is high-performing public sector organisations, which are results-driven, and have a culture of continuously improving performance. Public sector organisations can then be responsive to change, encourage innovation by seeking a balance between risk and opportunity, have a strong customer focus, and be highly transparent about their performance to all stakeholders.

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