

THE CONTRIBUTION OF PUBLIC PRIVATE PARTNERSHIPS TO ECONOMIC GROWTH AND HUMAN CAPITAL DEVELOPMENT: A SOUTH AFRICAN EXPERIENCE

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ABSTRACT

Service delivery is the primary function of government and in this process the government has a responsibility to ensure that citizens have access to their fundamental rights as enshrined in the Constitution. Due to the limitation of financial resources at its disposal the state has been compelled to find alternative service delivery mechanisms in order to fulfil its mandate of ensuring that services meet the expectations of the people. In this regard Public Private Partnerships has been identified as an instrument in addressing the massive infrastructure and service delivery backlogs. Attention will be devoted to the establishment and examples of PPPs and the effect of PPPs on the process of budgeting. Finally the challenges regarding the utilisation of PPPs in service delivery will be highlighted.

INTRODUCTION

Following the first democratic elections in 1994, the main priority for the South African government was the effective transformation of service delivery. Various pieces of legislation and policies outlined the vision and procedures for fundamentally transforming service delivery. The challenge to the public sector was to deliver services to all citizens in a swift, efficient, effective, simplified and seamless manner as required by the *Public Finance Management Act, 1999* (Act 1 of 1999).

In order to address the backlog and to achieve the set goals the South African Government had to find alternative service delivery mechanisms. One such mechanism was the utilisation of Public Private Partnerships (PPPs). Although PPPs must be subjected to strong, accountable and transparent guidelines, South Africa has made great strides in

creating an accountable framework based on strong contractual agreements, which are realised in the public arena. If transparent guidelines are not applied or enforced, this will invariably result in a loss of accountability and ultimately a loss of control.

SERVICE DELIVERY

The delivery of services is the primary function of a government. In this regard Stacey (1997:10) highlights the fact that the provision of infrastructure and service delivery was the domain of the state and this idea was uncontested.

In terms of service delivery the services can be categorized into the following (Gildenhuys, 1997: 32-33 and Pauw *et al.*, 2002: 21-22):

- Collective services where governments are obliged and even compelled to ensure that its citizens have access to basic services and continues the argument by classifying these services as collective of nature since these services would usually not be delivered by the private sector since they are more affordable if delivered on a large scale due to their collective nature. Every citizen of the country has the right to equitable access to these services irrespective of his/her ability to pay for the services
- Particular services where these services can be divided into individual units and be priced according to that apportionment and these services have strong elements of exclusivity that if you do not pay, you do not obtain access to such services.
- Quasi-collective services where the services contain elements of collective and particular services. In this case it is referred to as subsidised services as the public bears part of the cost and the consumer pays part of the cost.

During the first part of the ten-year of democracy the Reconstruction and Development Programme shaped the policy framework for service delivery in South Africa. The Reconstruction and Development Programme (RDP, 1994) instituted by the African National Congress (ANC) provided guidance to the current government. Levin (2004: 28) states that the RDP focused on meeting particular key issues. Included amongst these were satisfying the fundamental needs, human resource development, economic development and democratising the state and society.

Section 1.1.1 of the RDP outlines the programme as an integrated, coherent, socio-economic policy framework that seeks to mobilise all the people and the resources of the country towards the building of a democratic, non-racial and non-sexist future for all. In order to achieve the goals the RDP is based on six principles (ANC, 1994: 4-7). The RDP as a policy document was generally regarded as a developmental instrument that was meant to achieve stated goals within the context of the South African environment. The global realities forced the South African Government to reassess particular policy directives (Levin (2004:28). The result of this reassessment was the adoption of the Growth, Employment and Redistribution (GEAR, 1998) policy framework. The vision of GEAR is to facilitate:

- a competitive fast growing economy which creates enough jobs for all work seekers;
- a redistribution of income and opportunities in favour of the poor;
- a society in which sound health, education and other services are available to all; and

- an environment in which homes are secure and places of work are productive.

Adopting this policy framework was seen as an acknowledgement that the market became the chief determinant for resource allocation. It was also viewed as a signal that the formal economy would become the tool to determine growth and development. GEAR is thus acknowledged as having brought about macro economic stability, however the consequence of the switch was that the development agenda of the State was retarded (Levin, 2004: 28).

Financing service delivery can only occur via one of the following avenues (Lund, 2004: 70):

- government taxes;
- concessions; and
- user-pay principle.

The government has a responsibility to ensure that citizens have their fundamental rights honoured as enshrined in the *Constitution of the Republic South Africa*, 1996 but the financial resources at its disposal are limited (Pauw *et al.*, 2002: 54). It is furthermore a common phenomenon that there is tension between needs and the ability to satisfy those needs due to budget constraints. This tension is clearly highlighted in Soobramoney vs. the Minister of Health, KwaZulu Natal (Constitutional Court case: CCT32/97) where the President of the Constitutional Court made it clear that the Constitution prescribes the access to basic services is dependant on the availability of resources and the corresponding rights themselves are limited by a lack of resources. The limitation of the resources and the demands put on them to meet the demand would not presently be capable of being fulfilled.

The State has been compelled to find alternative service delivery mechanisms in order to fulfil its mandate of ensuring that services meet the expectation of the people. In this regard Stacey (1997: 11) argues that the search for alternative service delivery mechanisms is a result of factors such as low productivity, poor financial management, inadequate risk management, and soft budget constraints. In terms of the *White Paper on Local Government* (1998: 93-94) there are specific principles to be considered in terms of decision-making on service delivery e.g.:

- accessibility of service;
- affordability of service;
- quality of products and service;
- accountability of service;
- intergraded development of service;
- sustainability of service; and
- value-for-money.

It is within the aforementioned framework that government has been considering options such as privatisation, outsourcing, public private partnerships, service level agreements and joint ventures as means to augment traditional service delivery options.

PUBLIC PRIVATE PARTNERSHIPS IN THE SOUTH AFRICAN CONTEXT

Since the 1994 elections, the main priority of the South African government was the transformation of service delivery. Various pieces of legislation and policies outlined the new vision and the actions for fundamentally transformed service delivery. In this case the challenge was to deliver services efficiently, effectively and to simplify it into a seamless manner.

With the purpose to address the backlogs, alternative service delivery mechanisms had to be found. Public Private Partnerships in South Africa were introduced in 2000. The then Department of Finance (now National Treasury) released a strategic framework for Public Private Partnerships (Department of Finance: 2000). This framework ushered in new legislation and policies to give effect to an enabling environment for Public Private Partnerships in the endeavour to achieve the objectives in service delivery set out by government.

In the South African environment the value of PPPs as a model for addressing massive infrastructural and service delivery backlogs show an upward trend and more than R120-billion is invested in PPP projects (Sukazi, 2004:5). From the aforementioned amount, the health sector has currently R8-billion invested in PPP projects alone. The partnership also forms an integral part of government's service improvement strategy within the spirit of the key decisions taken during June 2003 at the Growth and Development Summit Agreement (Gaster and Squires, 2003:155).

The following examples of PPPs are to be found in South Africa:

South African National Roads Agency who manages and toll the national roads;
prisons which operate in Bloemfontein, Free State Province and Makado, Limpopo Province with a total construction cost of R573m (PPP Quarterly, December: 2002;
Pelonomi Hospital in Bloemfontein, Free State with a total cost of R81m (PPP Quarterly, March: 2006); and
a water service delivery project in Nelspruit, Mpumalanga Province.

A number of sources define PPPs. They are all more or less similar in context. Lund (2004:6) for example defines a PPP as:

" a contract between government institution and private party, where a private party performs an institutional function and/or uses state property in terms of output specifications, where a substantial project risk (financial, technical, operational) is transferred to the private party and where a private party benefits through unitary payments from government budget and/or user fees".

The above definition specifies the boundaries in which the finance agreements between parties are negotiated and it also provides the framework in which relationships are negotiated (Fourie, 2006: 926-927). From the definition it is evident that the private entity assumes all risk, while government becomes the monitor and regulator of service delivery, but steps down as the administrator of the service (Parliamentary Monitoring

Group, 2003). It should also be noted that there are arguments against the reasoning that all risks should be transferred to the private sector. Rodrigues (2002:2) states that e.g.:

... the idea is to establish an appropriate balance, that is not to transfer all risk on to the private sector, but rather an appropriate risk to ensure that all stakeholders benefit, including government, users of services, society and private parties...

Risk sharing should be considered as a pillar of any PPP. According to Fayard (1999:4-5) the tradition of public funding bears witness to the fact that risk analysis is an area that has been neglected for many years. However, risk analysis is actually a fundamental feature of any public-private partnership. PPP agreements should address the following risks:

- *Political and legal risks.* This incorporates possible changes in the political regime, or even government policy, but also inappropriate or unstable legal frameworks and the inability or refusal of government to honour contractual obligations.
- *Force majeure* where such risks are unpredictable and unavoidable and take many forms such as natural disaster, social unrest or acts of war.
- *Technical risks* relating to inception and operation. In this case the risks are associated with not only the construction of the partnership but also the maintenance and operations to execute the agreement.
- *Economic and financial risks* where the risks arise from uncertainty over the growth in economy or inflation.
- *Commercial risks* relating to the tariffs levied by the private sector for services rendered.

Ahwireng-Obeng and Mokgohlwa (2002:36) argue that risk should be equitably shared due to the fact that the lack of political risk cover in South Africa is compounded by the reluctance of government to bear socio-political risks; absence of regulatory framework; lack of clarity in the taxation treatment of PPPs; and limited local government influence in the formulation of legislation in the national sphere of government.

In the South African context the regulatory framework for PPPs is based on the *Constitution of the Republic of South Africa, 1996* which states:

When an organ of the state in the national, provincial and local sphere of government, or any other institution identified in national legislation, contracts for goods or services, it must do so in accordance with a system which is fair, equitable, transparent competitive and cost-effective.

In the collaborative efforts between the public, private and non-profit sectors attempts are made to change both management and financial control by transferring the financing and management of particular aspects of service delivery to the private sector. It should be noted that transferring is not without risks. Whether this is effective and will produce better outcomes in service delivery becomes a core question. Although government purchases the service or facilitates the project they still remain the owner of the service because this responsibility cannot be delegated to the private entity.

The *Public Finance Management Act, 1999*, regulates the financial management within the national and provincial spheres of government and prescribes the duties of responsible persons entrusted with financial management. The PFMA provides the legislative framework in which PPPs are created and developed. The National Treasury Regulations (Section 16 of 2002) issued in terms of the PFMA, 1999 requires that all PPP projects must first obtain approval from National Treasury.

The underlying philosophical base of PPPs is focused on the belief that partnership can improve service quality (Dutz, 2003:4). Gaster and Squires (2003:157) argue that local government does this by emphasising the link between people-centred government and quality services. This argument was emphasised in the address which the Minister of Finance made to the National Assembly when tabling the Medium Term Budget Policy Statement (MTBPS) for 2003 (National Treasury, 2003(a)). National Treasury (2003(a)) views local government as the stepping-stone in delivering infrastructure by utilisation of the consolidated Municipal Infrastructure Grant system. Through this mechanism, government aims to target the removal of backlogs supported by sound fiscal policies (National Treasury, 2001:B5 and B7).

The 2003 Growth and Development Summit Agreement strengthened the call for partnerships between government (public sector), business (private sector) and civil society (NGOs) as part of the strategies tabled in the MTBPS (National Treasury, 2003(a)). By including partnerships as one of the key strategies in the MTBPS and budgeting process it encouraged the formation of PPPs through various types of collaborative networks or partnerships (Reich, 2002:5; National Treasury, 2003(a)).

Reich (2002:3) and Dutz (2003:3) conclude that no single formula exists to construct effective partnerships. This is due to the fact that PPPs continue to diversify and are confronted by unique challenges in managing effective organisational integration along the entire route from the producer to the consumer (Reich, 2002). Each PPP brings with it, its own unique characteristics, different organisational cultures and unique financial resources (Dutz, 2003:3). These differences thus create challenges in the partnership efforts to collaborate effectively for the achievement of their objectives. There are substantial risks and efforts associated with the construction of each partnership. In the development of these partnership agreements and relationships there will be some crossing of the different organisational boundaries. This could lead to a lack of accountability that are supported by effective control systems. It furthermore places the focus on management's ability to operate outside the classic hierarchical, single organisational setting and highlights their proficiency in managing these collaborations (Guffy, 2003:42).

There is a relationship between the group origin (mandated and voluntary) and the task structure (external and internal). The relationships of the forces and their impact on outcomes are critical points in understanding the PPP project life cycle as described in the *Public Private Partnership Manual* for the national and provincial departments (National Treasury, 2001: G4). Furthermore it also determines how agreements are formulated, the sources of funding agreed on and if the solutions and agreements are workable and have a better possibility of success. Managing each type of partnership towards efficient, effective and accountable administration indeed require well-formulated agreements or

contracts as well as defining from the start how the sources of funding are to be shared amongst each party in conducting feasibility studies.

With the introduction of the *Standardisation Document* (National Treasury - PPP Unit, 2004:2), procedures and guidelines are set out to assist public managers in focusing on the appropriate risk profiles of PPPs and to describe the key issues that are likely to arise in PPP projects regulated by the provisions of Regulation 16 of the National Treasury Regulations of 2002. Unfortunately, this document does not identify whether a PPP is suitable from a strategic and operational perspective and if in constructing a PPP project, this is the most suitable mechanism for service delivery. The responsibility of this requirement need to be determined by the accounting officer while the feasibility study is conducted. This is done by demonstrating the affordability of the project and the advantages gained financially from establishing such a service agreement or contract through this partnership over the specified period.

In order to evaluate decision-making processes that go hand-in-hand with operational efficiency for PPPs the accounting officer must consider:

- the regulatory framework for PPPs set out in the *Public Finance Management Act*, 1999 and the Treasury Regulations (Section 16 of Treasury dealing with Public Private Partnerships for national and provincial departments and Schedule 3 public entities) issued in terms of the PFMA;
- the *Standardised Public Private Partnership Provisions* issued by National Treasury in accordance with section 76 (4) (g) of the PFMA of 1999 (National Treasury - PPP Unit, 2004);
- the manual for national and provincial departments towards Public Private Partnerships and the generic PPP project life cycle (National Treasury, 2001);
- the *Municipal Service Partnerships Policy* as set out in the Local Government: *Municipal Finance Management Act*, 2003 (Act 56 of 2003), which supports service partnerships in the local government sphere and the Integrated Development Plans (IDP);
- Tender Board Procedures;
- the *Code of Good Practice for Black Empowerment in Public Private Partnerships* (National Treasury - PPP Unit, 2003(c)); and
- the *Guidelines for Implementing the New Economic Reporting Format* (National Treasury, 2003(d)) provides for uniform expenditure reporting (annual budget) and increases the quality of compliance with the PFMA.

EFFECT OF PPPS ON THE PROCESS OF BUDGETING

National Treasury (2003 (d): 6 and 7) notes the difference in approach between the traditional payment mechanisms and the current PPP payment system. By comparing the traditional payment mechanism against the current PPP payment system a systematic analysis was done, highlighting the differences in approach and how this leads to advantages and benefits for the use of PPPs. The analysis makes use of the building and operation of a hospital and PPP prison in the provincial sphere and clinics in the local sphere of government (Monama, 2002; Parliamentary Monitoring Group, 2003).

The examples used in the analysis of PPP projects and payment systems are all involved with the construction of buildings and infrastructure. The management of PPP projects in service delivery show a substantial change in the options available especially in the delivery of municipal services where different financial regulations shape decision-making.

Pauw, *et al.*, (2002:88) indicate that poor budgeting directly results in an inability to continue with service delivery. An important part of the budgeting is the ability to combine the working capital management with the *Medium Term Expenditure Framework* (MTEF) (National Treasury, 2001: J3). The working capital or available cash allows for the day-to-day operations of an organisation (Pauw, *et al.*, 2002:205).

Various forms and options in the use of PPPs exist. The form and option used has a significant impact on the budget planning, which include a mix of *Balance sheet* and *project finance type structures* and determine how PPP agreements are constructed. The PPP Unit (National Treasury - PPP Unit 2003(b): 13) emphasises that before any PPP agreements or contracts are negotiated, financial agreements depend on strong credit ratings such as a contractually stable income stream and proper allocation of risk. Significant weaknesses include high leverage and the single-asset nature of projects. Therefore, it is important that a contracting department should investigate the various forms and types of PPP used and what the financial implications of each option will be for public expenditure.

It is imperative that the financial implications of PPPs on the budget strategies be managed properly as Treasury Regulations require departments to ensure that proposed PPPs are affordable and financial commitments must be available within the departmental budgets (National Treasury, 2001:J5). The choice of a particular PPP option is tightly interwoven with the type of contract, the form of relationships and coordination arrangements and how administrative processes are developed to enhance the structure and execution of the PPP throughout the project life cycle.

It is evident that most PPP projects are unlikely to have a high investment grading. As indicated by National Treasury PPP Unit (2003(b):14) and National Treasury (2001:E14) these are due to innovative and complex construction undertaken; overly demanding services; the high reliance on third parties; complex performance related mechanisms; or proportionally low debt service coverage ratio. These may lead to non-investment grade ratings. To obtain sound ratings on projects, especially those that are concerned with building of highly capitalised infrastructure and have long and intense construction periods, it is necessary to wait until the construction has been completed and revenue commence that the project becomes less risky. Such PPP projects have to take into consideration that the ratepayers who benefit from the operation of the asset throughout the project's life cycle are equally involved in repaying the principal (National Treasury, 2001:E14).

CHALLENGES REGARDING PUBLIC PRIVATE PARTNERSHIPS

In the process to achieve the goals regarding service delivery with the utilisation of PPPs it is important that it is subjected to strong, accountable and transparent guidelines. If the aforementioned prerequisites are not present Farazmands's (2002: 368) argument

that there will be a virtual loss of accountability to the public is valid since without transparency control can be forfeited. The South African system has done much to create an accountable framework, and as such should vigilantly ensure that these are compelled with. It should be noted that PPP must be based on contractual agreements, which must be constructed in the public arena with all the stakeholders involved. Participations and stakeholder involvement are critical. In the South African examples there was little emphasis in respect of the participation of other stakeholders. It is important that the affected communities should be involved in such initiatives and should participate in the decision-making process that will affect them.

A major shortcoming of PPPs in South Africa is that there has not been effective monitoring and evaluation of the partnerships to assess the benefits of their sustainability. A continuous examination for the improvement of existing PPPs is required as well as prerequisites before entering into future ones. A need on quantitative and qualitative information on whether the PPP has provided a better alternative at lower cost is of critical importance and should be made known to all the stakeholders.

The issues and difficulties regarding contract management cannot be over-emphasised. Normally the PPP contract management difficulties arise from:

- lack of clearly specified public goods and service requirements;
- difficulty of maintaining technical competence in public administration to manage contracts properly; and
- the potential that is introduced through corruptive political and administrative influences.

A major constraint in, for example the PPP Prison construction project the difference in itemising and application of terminology between Bloemfontein and Makado prison's annual budgets. Benchmarking and comparing services through the creation of effective PSC Models were impossible due to the use of different classification systems (National Treasury, 2003(e): 29-30: Parliamentary Monitoring Group, 2003). These impacts negatively on accountability and value-for money decisions.

The challenges are not insuperable. Even through identifying them, there are already obvious solutions to overcome them, such as an effective and efficient administration enabling the management of the contracts, monitoring systems, acquiring of relevant skills and the application of technology. Public Private Partnerships are powerful tools to address the ever-increasing social needs, and this tool should not be undermined.

CONCLUSION

Public Private Partnerships consist of a complexity of agreements and it should ensure that public benefits should not be limited at the cost of private benefits. The government should be responsible when it comes to limiting control of assets to private concerns. A balance between the public-private concerns is of essential importance. It is therefore important to ensure that the state succeeds in attracting private interests to provide public services by creating an environment that is conducive to these

private entities. Once it is secured, the state needs to ensure that it does not allow the private sector's drive for profits to endanger service delivery.

It should be noted that PPPs are not miracles for service delivery ills, it is a tool and if utilised properly it can assist in the attainment of service delivery challenges. If PPPs are used ineffectively it will be useless or can inflict untold damage, but if utilised effectively it can contribute towards service delivery.

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