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The Committee Manager
Public Accounts Committee
Parliament House
Macquarie Street
Sydney NSW 2000

14 October 2005

Dear Ms Buchback,

Re: Inquiry into Public Private Partnerships

I refer to the current Public Accounts Committee Inquiry into Public Private Partnerships and to your call for submissions. Unfortunately, I am travelling internationally at present and am consequently unable to develop a formal submission to the Inquiry. However, I commend to you the work of the Victorian Public Accounts and Estimates Committee on the topic of private investment into public infrastructure and note that a wide range of governance, public finance, commercial and risk related issues are relevant to the Inquiry.

My overall view of PPPs is that whilst they do appear to produce public infrastructure quicker for governments currently in power, they are insufficiently well governed and exposed to too little independent scrutiny given the nature of these cross-generational, billion dollar projects. I liken the PPP mechanism to government now having access to a 'mega-credit card'. And whilst this is not necessarily a bad thing of itself, the two way business-government deals resulting do in my opinion need far more careful scrutiny and assessment than they usually get. Government political incentives and business commercial incentives both appear to motivate against this. There are many interrelated issues to be considered in your Inquiry. Included with this letter are some aspects of past work which you may find relevant;

1. 'Who Steers the State When Governments Sign Public-Private Partnerships', (a journal paper published in the Journal of Contemporary Issues in Business and Government vol 8, no.1, 2002),
2. 'The trouble with public-private partnerships' (an Opinion piece published in The Age (19 July 2004) titled)
3. 'Governing with Accountability: Has Parliament Abdicated in the Age of Public-Private Partnerships', (a conference paper presented to *Integrated Governance Conference*, Prato, 25-26 October, 2004), and
4. 'Public-Private Partnerships: the Australasian Experience' (a chapter drawn from a forthcoming book, *The Challenge of Public-Private Partnerships: Learning from International Experience*, edited by Carsten Greve and I, and being published Oct/Nov 2005 through Edward Elgar in the UK.

I hope that these publications assist with your Inquiry. Thank you very much for this opportunity to participate.

Yours sincerely,

Graeme Hodge

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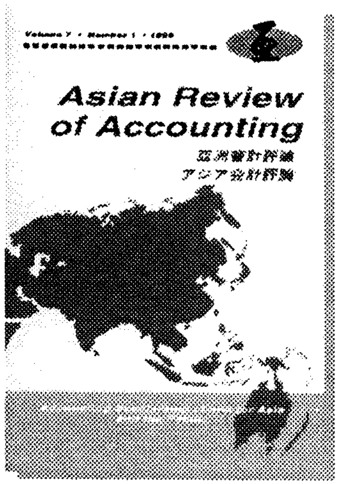

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Who Steers the State When Governments Sign Public-Private Partnerships?

Graeme Hodge*

Abstract

Governments are increasingly entering into long term business relationships with private partners under sophisticated and far-reaching contracts. In delivering new infrastructure, for instance, public-private partnerships promise better efficiency, improved services and strengthened monitoring and accountability, along with stronger business and investor confidence. Internationally, there is some evidence that these promises are being met. There also appears to have been a trade-off made, however, with contracts of up to 54 years, revenue guarantees and compensation for future policy changes by governments. Importantly, the risk that governments may have reduced the capacity and flexibility of the crown to make future decisions in the public interest has seen little independent analysis to date.

This paper looks at the philosophy of public-private partnerships, and analyses the empirical evidence on governance and operational outcomes for Melbourne's City Link road infrastructure project. This case study, one of Australia's largest infrastructure projects to date, is used to illustrate the achievements of the project against the promises made. Governance issues around partnership projects are discussed, along with the extent to which these differ from traditional construction and management arrangements. The paper analyses the effects such governance arrangements have had on accountability and public administration to date, with a particular focus on the interests and rights of citizens and the community. Evidence as to the operational outcomes experienced to date is then presented in terms of relative project cost, risk management and strengthened monitoring and accountability.

Keywords

PPP, Public-Private Partnerships, governance, accountability, risk management, infrastructure.

Introduction

Governments have contracted with the private sector for centuries. Indeed, the modern day focus on matters related to public versus private provision of public sector services is not a recent phenomenon at all. At the big picture level, the relationship between the public sphere and the private can be traced back to the beginnings of civilisation. There has always been a tension between what is held to be public and that held to be private (Parsons, 1995:3). Over the past three centuries, the mercantile role of government, in which it had an involvement in all trade transactions, was replaced by Adam Smith's laissez-faire society. The primary message of Adam Smith was that the state should only be responsible for defence, a system of laws and providing public goods – otherwise government should not interfere with economic life (Hughes, 1997:99). The pursuit of free markets, however, saw undesirable impacts as well as wealth increases to some. Child labour, poor public health and inadequate housing were some of these. The state was gradually seen to be responsible for its citizens' welfare, and electoral advantage was also bolstered by the economic stabilisation ideas of Keynes. The rise of the welfare state brought increased living standards, and saw the growth of major public enterprises, often in place of failed embryonic private markets. Even up until the mid 1970s, nationalisations were still being witnessed in the United Kingdom in order for the government to take the 'commanding heights' of the economy. Such action, it was deemed, was necessary to ensure that the public good was not left to the vagaries of the market, which experience through depressions had shown was a rather unstable and flawed system. Increasing financing pressures and a declining political support base saw the more recent period of economic rationalism evolve. These notions, along with policies tied to individual rationality and a

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An earlier version of this paper was paper presented to the International Research Symposium on Public Management, Edinburgh, April, 2002.

maximum role for market mechanisms, also implied a minimum role for government.

How might such broad historical observations inform us today? First, we might recognise the continuing and inevitable tensions between the public and private domains. The depressions of both the 1890s and 1929 as well as other times in our history led to vociferous debates around the inherent benefits or otherwise of private ownership versus government intervention in the economy. These important debates continue today. We might also reflect on the history of contracting in the public sphere, which, for many western countries, is not new at all[1]. Mathew the private tax collector from the Bible, the cleaning of street lamps in 18th century England, or the railways of the 19th century all testify to this. Again, the arguments for and against the use of private contractors for public sector services can be traced back over a century and half. Importantly, the great debates around cost advantages, quality and accountability, for example, were all well rehearsed at the turn of the last century in Australia, for one, and led to a swing away from the use of private contractors towards the use of government supplied labour for construction work[2]. Furthermore, repeated swings of this private/ public pendulum occurred over subsequent decades in the light of evolving experience and political demands. Such trends and swings are likely to have been the case in other western countries as well.

Privatisation over the past quarter century has seen a renewal of interest. Whether it is the global avalanche of asset sales that followed Thatcher's groundbreaking program in the United Kingdom, the rhetorical war around privatisation and contracting-out government services, or the recent surge towards public-private partnerships (PPPs) as a central tenet of 'third way' governments, the desire to adopt private capacities for government purposes continues. What is also new today is the elevation of such policies to first order issues on the public policy agenda, and the implicit proposition that they themselves are solutions to public policy problems.

Significant commitments are being made by governments such as the Blair government in the UK, where NAO (2001) reports that some £100 billion has been committed by the UK government for 400 PFI contracts currently in force. Across all Australian states, over AUD$20 billion of private finance may be channelled into public assets over the coming five years according to Gray (2002). Likewise, the Bracks Labor Government in Victoria recently announced its 'Partnerships Victoria' policy establishing partnerships for public infrastructure projects worth AUD$4 billion over the coming four years. Clearly, PPPs are, to these governments, a centre piece of good public administration. If privatisation is a story about delivering government services over the past few centuries, PPPs appear to be the latest chapter in the book. Or perhaps, as Daniels and Trebilcock (1996) aptly describe it, the private provision of public infrastructure is "the next privatisation frontier".

Underlying this commitment, however, remain many of the issues that have plagued the public-private debate for decades. Governments nowadays are increasingly beginning to enter into long term business relationships with private partners under more sophisticated and far-reaching contracts than ever before. Given that the public versus private debate has always attracted its share of policy spin and advertising from both sides, it seems reasonable that we devote careful attention to the advantages and disadvantages of PPPs. Policy enthusiasm and the undoubted large potential for adopting private finance, skills and capacities in the provision of public works and services do not in themselves represent a sufficient argument for the extensive application of public resources without deliberation.

This paper begins firstly by looking at the concept of the public-private partnership. From the range of differing definitions and policy rhetoric espoused, it establishes some common ground and notes how partnerships differ from traditional contracting arrangements. Second, the promises being made with PPPs are then compared with the available evidence on partnership performance based on experience to date. Third, the paper discusses how such arrangements differ from the more conservative use of the private sector in public works such as under traditional contracting. Lastly, the paper analyses Melbourne's City Link road infrastructure project in terms of empirical experience on governance and operational outcomes. Through this analysis, the achievements of this PPP project, along with shortfalls, are contrasted against political promises made and growing public expectations. Lessons learned are finally outlined.

The Public-Private Partnership (PPP) Concept

The concept of the public-private partnership appears to be broad. It is now used throughout the world, with a range of different definitions.

Ghere (2001) suggests that:

> **...the term public-private partnership eludes precise definition because it assumes various meanings depending on context, ranging from traditional government procurement to voluntary participation in civic affairs". His use of the term in the United States focuses on "privatisation ventures that involve complexities in financing operations and (often) facility construction/maintenance over lengthy contracts periods. Gerrard (2001) looks from the United Kingdom perspective and argues that "PPPs are generally not 'privatizations' ... [but are] ... a business relationship between the public and private sectors". Furthermore, it is suggested that "for the case of a Private Finance Initiative (PFI) project, "the business is defined by a long term contract in which public services are to be delivered by the PPP - the outputs- are specified in great detail. In its form as an equity joint venture between the public and private sectors, a PPP is a business with certain public sector obligations set out in its constitutional documents or within contracts with the public sector". COPPP (cited in IPPR Summary, 2001) goes further in its definition, explaining that PPPs "are a risk sharing relationship based upon an agreed aspiration between the public and private (including voluntary) sectors to bring about a desired public policy outcome. More often than not this takes the form of a long term and flexible relationship, usually underpinned by contract, for the delivery of a publicly funded service.**

Collin and Hansson (2000) cite earlier work by Haider (1986) in defining a PPP as "an arrangement between a municipality and one or more private firms, where all parties involved share risks, profit, utilities and investments through a joint ownership of an organisation."

Cowdery (2000), on the other hand, suggests that:

> **...'privatisation' and public-private partnerships are synonymous, stating that "privatisation, also referred to as public-private partnerships, may be defined as an arrangement under which private firms become involved in financing, designing, constructing, owning or operating public facilities or services.**

A PPP in the state of Victoria, which probably leads Australia's efforts along this path, is seen by government in broad terms as "a contract for a private party to deliver public infrastructure based services" (Department of Treasury and Finance, 2001:). Under this local definition, however, PPPs explicitly exclude "outsourcing or other service delivery arrangements where no capital investment is required" (Department of Treasury and Finance, 2001:). In a similar vein, Campbell (2001) suggests simply that "a PPP project generally involves the design, construction, financing and maintenance (and in some cases operation) of public infrastructure or a public facility by the private sector under a long term contract".

There are also many other uses of the PPP concept. Osborne (2001) notes that as well as them being a cornerstone of 'New Labour's' stakeholder society in the UK, they have also become a tool for providing public services and developing a civil society in post-communist regimes such as Hungary, and a mechanism for combating social exclusion and enhancing community development under European Union policy. In the US, PPPs have traditionally been associated with urban renewal and downtown economic development. As Osborne (2001) puts it, PPPs have "been central to national and state-government initiatives to regenerate local urban communities, as well as often arising out of community-led attempts to deal with the crisis of government in American communities".

Evidently, a huge range of definitions exists. The common ground here appears to be that government has a business relationship, it is long term, with risks and returns being shared, and that private business becomes involved in financing, designing, constructing, owning, or operating public facilities or services.

How do PPPs differ from the more traditional contract arrangements for public works or services? From our cursory review so far, it seems that the long time frames for the PPP contract, the sharing of risks and rewards, and the greater involvement of the private sector particularly in finance arrangements are all relevant. Klijn and Teisman (2001) go further in defining several differences. They see PPPs as involving joint decision making rather than having a principal–agent relationship, with both parties being involved early on in developing effective joint outputs and arrangements rather than government alone defining both the problem and the solution, and then choosing the most cost-efficient private company for production.

We might reflect on the fact that, at least potentially, such partnership arrangements cover quite different territory than the traditional contracting-out of services, with longer term implications, a larger potential role in infrastructure decision making possible, bigger financial flows and greater capacity for risks to be shifted to either side of the partnership. Each of these differences with traditional contract arrangements will no doubt require an appropriate mechanism to ensure accountability by government to citizens. In establishing decision processes and governance arrangements for PPPs, it would appear to be critical that mechanisms are established to ensure the protection of the public interest for the long term and to also ensure that any trade-offs being made for short term political expediency are transparent.

PPP Promises and Performance

What are the promises being made with PPPs? There is no doubt that, like its cousin privatisation, the PPP concept is the subject of policy rhetoric and salesmanship. At the macro-level of policy, common arguments for partnerships have suggested that private financing through PPPs can reduce pressure on government budgets and supply new infrastructure earlier and cheaper than otherwise would have been possible. Against this, Teisman and Klijn (2001) argue that the reduced pressure on public budgets is only for a short time and that experience in Europe shows PPP costs are higher, not lower, than private financing. They add as well that private financing will have no effect whatsoever on the need to reorganise the welfare state, and that delays in infrastructure projects are as much due to concerns around economic, social and political risks as lack of money. Similar arguments have come out of the UK experience with Kelly (2000) noting that "the claim that PPPs offer a useful way of side-stepping public borrowing rules has been convincingly dismissed by the Treasury and others". Individual public agencies might feel that PPPs offer an additional route for obtaining investment, but from the perspective of the public sector as a whole, they cannot result in greater resources being made available for public services. "This is not to say that PPPs are wrong in principle, but simply that "it is naïve to present PPPs as an elixir for all the travails of the public services".

For infrastructure projects, public-private partnerships (PPPs) promise better efficiency and improved services. Department of Treasury and Finance (2001), for instance, suggests that for Victoria, PPPs "can potentially deliver significant benefits in quality of services and the cost of providing them", and looking at the UK experience, quotes a cost savings figure of 17% compared to traditional public sector delivery. Strengthened monitoring and accountability are also claimed and, implicitly, stronger business and investor confidence.

What is the evidence that these promises are being met, based on experience to date?

The surprise, when we look at the evidence here, is its sparsity. For the size of the financial commitments to PPPs being entered by governments around the globe, the evidence on cost and quality gains is thin indeed. The two most famous reports from recent PPP experience remain those from Arthur Anderson and LSE Enterprise (2000) and National Audit Office (c2000). Anderson and LSE Enterprise investigated, at the request of the UK Treasury Task Force for public-private partnerships, twenty-nine business cases from departments and estimated average cost savings of 17% compared with the projected costs under public provision[1]. This report also discussed many of the common arguments against private funding of infrastructure and, in a methodical way, rebutted the logic. The National Audit Office also reported on projects from the UK and reviewed the costs associated with seven specific Private Finance Initiative projects. For these seven projects, cost savings of 10-20% were estimated.

Hall (1998) in his earlier careful analysis also noted that value for money in PFI schemes depends on any gains in efficiency through private sector involvement more than compensating for higher finance costs and that it it is difficult to obtain clear evidence on this in the absence of an accurate and uncontroversial public sector comparator. He presented the initial evidence on PFI deals in the UK as achieving significant savings overall for roads projects (despite two of the four projects apparently providing better value for money under traditional procurement methods), and two prison contracts generating around 10% savings compared to publicly financed prisons (but with all of these savings coming from one prison). Added to this was the National Insurance Recording System (NIRS2) contract providing some 60% cost savings compared to an equivalent public sector development. These estimates, however, were provided within the general context of the initial UK contracts being subject to considerable uncertainty, and being qualified to the extent that managers may have aimed to deliver cost saving successes for political reasons and knowing that outcomes for long term contracts are always uncertain[4]. Overall, Hall's judgement regarding the initial evidence on value-for-money in using private finance was important. Despite its sparsity and qualifications, Hall saw the evidence on performance as nevertheless providing "some grounds for optimism"(Hall, 1998).

Aside from this, infrastructure based PPP projects appear to have only limited rigorous and independent analysis. Walker and Walker (2000) is one local exception in Australia, looking at privatisation activities throughout Australia. Their analysis, however, is not complimentary. They liken off-balance sheet infrastructure financing deals being undertaken through PPPs as similar to the misleading accounting trickery of Australia's failed and jailed entrepreneur Alan Bond in his Bond Corporation through the 1980s. To Walker and Walker, PPPs generally represented an erosion of accountability to parliament and to the public. In support, they cite the Sydney Airlink BOOT project where the private project consortium was expecting to achieve a real rate of return of around 21%–25%, compared to the return to the public via government of 2%, for the proposed rail link between metropolitan Sydney and Mascot Airport (Walker and Walker, 2000: 204). They also report a pre-tax return of 24.4% for Sydney's M2 Motorway according to the NSW Auditor General. At the same time, however, these authors nevertheless make the concession that "there can be situations where BOOT schemes are good deals for both government and private sector" (Walker and Walker, 2000).

Other international case studies also reveal assessments that are often not kind. Bloomfield, Westerling and Carey (1998) for instance reviewed a Massachusetts correctional facility constructed as a PPP and found that the lease-purchasing financing arrangement used was some "7.4% more expensive than conventional general obligation financing" for the $72.7 million facility in Plymouth County. As a consequence, this arrangement was deemed by Bloomfield et al (1998) as "wasteful and risky", with the added comment that the "inflated sales pitches for such proposals can camouflage the real costs and risks to the public".

On the other side of this debate over empirical experience, Department of Transport (2002) remarks that the London Underground (under public ownership) "has had a history of completing investment projects over budget and late". Experiences here included the recent line upgrade for the Jubilee Line which was six years late and 30% over budget, and an analysis of some 250 projects by LU between 1997 to 2000 that revealed cost over-runs averaging 20%. Likewise, National Audit Office (2001) in the UK indicates that for their survey of PFI projects let prior to 2000, some 81% of authorities viewed the value-for-money from PPPs as excellent (6%), good (46%) or satisfactory (29%), whilst 19% saw PPPs as being of marginal (15%) or poor (4%) value[5].

Looking at the claims and counter claims made in the PPP debate, many appear remarkably similar to those put forward by both sides of the broader privatisation debate. So perhaps it is not surprising that we see trenchant criticism of PPPs on one side and glowing praise on the other[6]. According to Bowman(2001), PPPs have been seen by some in the UK as "yet again screwing the taxpayer" with private project sponsors being caricatured as "evil bandits running away with all the loot", and with London Underground issues now being labelled as "Son of Fat Cat". Similar attitudes have even resulted in PPPs in Canada as being coined in terms of the unfortunately memorable phrase "Problem, Problem, Problem" (Bowman). On the other side of the rhetoric, PPPs have been dubbed as a "marriage made in heaven" by some commentators, and an arrangement which, drawing on the skills of the private sector, delivers superior infrastructure and results in cost savings of between 10% to 30% (Shepherd (2000).

In Canada, Daniels, R.J. and Trebilcock, M.J. (1996) remark in their measured discussion that insufficient attention to the institutional challenges raised by complex and highly integrated PPPs has led to "uncritical enthusiasm" by many proponents. Furthermore, they charge – quite rightly – that there is considerable complexity entailed in the use of PPP contracts designed to realize productivity gains and that this, in conjunction with the long time period of operation of typical PPP projects, means that the task of evaluating PPPs is somewhat speculative.

It seems that the economic and financial benefits of PPPs are still subject to debate and hence some uncertainty. Given that PPPs are an inherent part of the ongoing privatisation debate, perhaps this is not so surprising.

Leaving aside the financial and economic benefits ascribed to PPPs, other dimensions of the PPP relationship also deserve careful deliberation. In particular, there is potential for enthusiastic governments to implicitly make trade-offs in the midst of fervent PPP reforms. For instance, with contracts of up to several decades, to what extent are governments now entering these arrangements reducing the capacity and flexibility of the crown to make future decisions in the public interest? There appears to have been little discussion of this at political and administrative levels throughout the PPP era, though independent analysis of such issues exists in the research literature. For instance, Daniels and Trebilcock (1996) observe that public policy decision making cannot be avoided through the PPP mechanism, despite instances of problems occurring and these being seen as simply contractual concerns between the two parties rather than being public policy concerns. PPPs seem to have provided only limited opportunity for meaningful levels of transparency or public participation. Daniels and Trebilcock also note that, with limited transparency and complex adjustment formulae in PPPs, the clarity of partnership financial arrangements can be difficult to fathom. This does not give citizens confidence in the arrangements when, despite the rhetoric of risk sharing with private financing, a significant financial role for government often nevertheless seems to be the reality.

These issues could broadly be interpreted as concerns over fundamental accountability at the levels of policy, project governance and financial transparency. It seems that, as has often occurred in other areas of the privatisation arena, negative judgements are formed by community leaders about the efficacy of private financing, and these policy concerns linger and doubts grow when reformist governments create an atmosphere of less openness in the availability of information. Silence, in this instance, seems to amount to guilt in the public's eyes, whether the case is proven or not. When such doubts are married together with the observation that PPPs can offer short term political attractions to governments by moving capital expenditures off-budget, the implication is that greater attention to accountability mechanisms is warranted rather than less.

PPPs and Governance

There is a wide range of ideas on the meaning of 'governance'. Kooiman (1999), for instance, outlines ten. In this discussion of governing PPPs and the role of PPPs in governance, we might begin by adopting Kooiman's definition of 'social-political' governance as "all those arrangements in which public as well as private actors participate aimed at solving societal problems, or creating societal opportunities, and attending to the institutions within which these governing activities take place". This notion of governance encompasses a wide array of mechanisms ranging from the parliamentary, through the representative, quasi-judicial and independent, to those more local or community based.

Searching for a more straight-forward definition of 'good governance', we might view it as simply "a system that is transparent, accountable, just, fair, democratic, participatory and responsive to people's needs" (Commonwealth Innovations, 1999).

Other elements of good governance have also been codified, such as has been achieved by Hunt, Kiss and Murrell (1999) for local government. Central to their ideas are the areas of community, representative democracy, participatory democracy and corporate governance in conjunction with the governing body – the local council.

These ideas of governance contrast with the notion of corporate governance (i.e the way big organisations are directed and controlled), the notion of governance as some sort of minimalist state which "steers not rows" in Osborne and Gaebler's (1992:) parlance, or the notion that good governance is somehow related to a powerful government which unifies and controls all institutions in order to avoid any appearance of divided, pluralist, and richer liberal democratic debate. So, how are PPPs governed, and what role do they play in governance?

Broadbent and Laughlin (1999) note the idea of PFI (in the UK) as a 'steering mechanism' and therefore a part of governance in its own right. They see the issue of governing PPPs as a critical item on the research agenda. They pose two simple questions: who is actually regulating PFI, and how do the National Treasury, National Audit Office and Accounting Standards Board interact to steer the PPP program? These questions seem relevant on a global scale, as well as in the context of the United Kingdom.

Although being somewhat optimistic about the initial evidence on value-for-money for the use of private finance, Hall (1998) was not so positive about governance and policy issues of using private finance. In particular, he was concerned that the ease of applying private finance to public projects might determine infrastructure priorities for implementation rather than the benefits that could flow to citizens as determined through a traditional benefit-cost economic analysis. This issue is critical on the basis that private finance has tended in the UK to be a substitute for, rather than a complement to, publicly financed investment. He was also concerned that private payments, although representing only 0.3% of general annual expenditure, may pose real risks to public sector flexibility when contracts run over 20 or 30 year periods, and where departments such as transport at present are committing 8.5% of their annual budget to PPPs. These issues raise to the fore questions of decision making and governance. The words of Lindblom (1977 cited in Lucas 1997) over twenty years ago ring in our ears with resonance, when he said "power in a market society is shared between business and government". This power combination requires concomitantly greater accountability mechanisms to ensure that this partnership combination does not become the basis of a self-serving, supply driven, infrastructure generation policy.

So, how do we now 'purchase' PPP projects? Under traditional, more conservative uses of the private sector in providing public works such as construction contracting, the selection of partners for the delivery of a project was seen largely as a purchasing decision. For this purpose, strict purchasing codes have been developed. Such was the concern over the potential for conflicts of interest and probity in choosing contractors for public works that elaborate systems of purchasing have resulted. Also critical is the fact that systems of parliamentary accountability have also evolved over decades, with parliamentary oversight of annual budget allocations for cash expenditures having become an enduring feature of the Westminster system (Walker and Walker, 2000:215). The bar has now been raised with PPPs, with bigger financial deals, longer time periods over multiple terms of elected government and the potential to side step traditional parliamentary accountability all raising the stakes if we view PPPs in terms of simply a purchasing decision.

The Partnerships Victoria policy has been supported by the provision of substantial guidance material. Three volumes have been produced with some 437 pages of practitioners, technical and risk allocation and contractual information (Department of Treasury and Finance, 2001). In theory, forty-four tasks are to be undertaken including three points at which Cabinet approval is sought. Interestingly, there are no explicit tasks such as 'community consultation' or 'policy consideration' as one might find in traditional high profile public infrastructure projects. Little guidance is given to the concept of network governance with dispersed and independent bodies to protect the public interest. Perhaps such tasks are assumed to occur 'off-line' to the documented decision process.

The commercially narrow guidelines of Victoria do seem to treat PPPs as if they were simply a purchasing decision, and leave government exposed in my view to re-learning future lessons in that public infrastructure is a part of an inherently policy based fabric, that public consultation is simply part of public policy development, and that public accountability is expected throughout the process. In other words, there appears to have been a failure to recognise firstly the need for strong governance independent of government of the day and secondly the need to see public policy as an inherent part of the PPP decision process. These shortfalls may, as a consequence, result in a risk that PPP promises are not fully met in future. As Walker and Walker (2000:215) comment, PPPs have the potential to side step traditional forms of parliamentary accountability because "they do not involve expenditures from the budget, but from the alienation of revenue streams from the public purse to the private sector". If the public sector is essentially underwriting the financial returns to private investors in PPPs, and taking a smaller slice until the returns to private investors have been accommodated, "it seems absurd that relatively small amounts of proposed expenditure require parliamentary scrutiny and approval, while major contracts involving financial commitments stretching over 30 years can be handled in secret by executive government" (Walker and Walker, 2000:215).

Klijn and Teisman (2001) argue that the trend towards a network society is an important feature of our time and that, as a consequence, interdependencies between actors and the resources that each possess result in complexity and a "world in which no-one is in charge". They see the solution in managing the partnership in terms of project management, process management and network constitution. Government, in their view, needs to reorganize internal structures and procedures for successful partnerships. To their mind, government needs to establish a kind of "project organisation in order to deal with the challenges of process management" (Klijn and Teisman, 2001).

The City Link PPP

Melbourne's City Link road infrastructure project has been a massive BOOT[7] undertaking[8]. It has been a large project in engineering terms, and is one of Australia's largest public infrastructure projects undertaken over the past few decades. As well, it has become a symbol of the former Kennett government's approach to public infrastructure and, as such, presents us with an interesting study of public policy implementation through public-private partnerships in Victoria. This case study is used to illustrate the achievements of the project and its shortfalls against promises made and against changing public expectations.

The City Link project links up three major freeways in Melbourne—the South Eastern, West Gate and Tullamarine Freeways through the construction of 22 kilometres of road, tunnel and bridge works (Hepburn et al, 1997). The project involves the construction, operation and maintenance of two sections of roadway_–_the Western Link and the Southern Link. The Western link comprises 13 kilometres of new and upgraded road including an upgrade to eight lanes of the existing Tullamarine Freeway, a new six lane elevated roadway and extension to this elevated roadway including a new bridge over the Yarra River. The Southern Link involves the construction of 8 kilometres of freeway including 6 kilometres of tunnels through difficult silt conditions and an upgrade to an existing freeway. Other works also incorporated into the City Link project include road and freeway widenings, rail infrastructure modifications and traffic management measures.

The history of the project only goes back to the late 1980s when genuine interest surfaced as traffic became increasingly congested within Melbourne. In 1994, an Environmental Effects Statement was undertaken for the Western and Southern Links and, following a public inquiry, a brief was issued calling for parties to register their interest. An assessment panel short-listed proposals against predetermined criteria, and two consortia were chosen for development of the links. A project brief specifying requirements was provided to both and in 1995 the Transurban City Link Ltd consortia was nominated as the preferred bidder[9].

The estimated cost of the whole City Link project is approximately AUD$2.1 billion, including $1.8 billion financed by the consortium and $346 million of associated works and other costs financed by the state. Opened over the period 2000 to 2001, the consortium has leased land from the state to operate a public tollway for 34 years, with ownership reverting to the state at no cost and in a fully maintained condition (Victorian Auditor General, 1996). The risks relating to the project were to be shared between the private sector, the State and users of the link under the principle that the private sector should bear the risks of all events except those that the state alone is able to manage[10]. The predicted benefit–cost ratio for these works was 2.0, with a net present value of $1.3 billion according to economic studies(Allen Consulting Group et al, 1996). The Melbourne City Link also indicated initial investors should expect to receive a real rate of return of 17.5% after tax for the life of the project according to Walker and Walker (2000:208).

In terms of governing this project, the Victorian Government passed specific enabling legislation (the Melbourne City Link Act 1995), and established a statutory authority (the Melbourne City Link Authority) to be the state's contract manager (Russell et al, 2000). As well, an Office of Independent Reviewer was also established to approve the technical adequacy of the project throughout the design and construction phases. Furthermore, through the Melbourne City Link Authority (MCLA), the government entered into a series of contractual arrangements with the consortium for the 34 or more year project life[11] including leasing public land to the consortium, and undertaking to construct works associated with the project valued at $170 million as well as covering other expenditures of $176 million (Russell et al, vol 2, 2000: p86).

So, how has the empirical experience been in terms of governance, and in terms of operational outcomes?

City Link PPP Experience

Russell et al (2000) undertook an independent review of major government contracts following the ascension of the Bracks Labor Government in Victoria. Their review of the City Link BOOT infrastructure project found in essence that a large and complex project had been delivered on time, but whilst meeting the government's objectives, these achievements had been made at a considerable price. Indeed, no publicly available economic or financial evaluation had been undertaken prior to this project being commenced. After reviewing the liabilities of the state under the contract deeds, Russell et al concluded that the state should in future avoid contractual obligations that impact on its discretion for up to 54 years, and that regulatory powers should be established for such projects through the State's Office of the Regulator General. Moreover, they recommended that future projects should also be subject to parliamentary scrutiny prior to implementation and incorporate public consultation and disclosure.

An earlier review of the City Link by the Victorian Auditor General (1996) had also found to the government's credit that processes for assessing and choosing a successful tenderer were "fair and equitable", although a comparison between undertaking this task in the public or private sectors had not been done. Looking at the contract itself, substantial risks were indeed transferred with, for example, "almost all of the construction risks" being borne by the private contractors according to the Russell review team (2000). Governance, then, was achieved through strong government intervention under a "watertight" 321-page Melbourne City Link Act (Costa, 1997), somewhat contrary to the laissez faire liberalist rhetoric of the Kennett regime. As Costa put it, "contracts provide the basis for governance and thus fulfil a social ideal..." (1997).

Of course this model of governance was subject to heavy criticism. Muetzelfeldt (1994), for instance, argued that because accountability had been defined solely within this contractual discourse, the government did not accept the legitimacy of those who sought to hold it accountable for its exercise of executive power. In Costa's words "the City Link contract is one agreed by two agents. There is no room for a third and hence no room for public discussion on issues not directly covered by that contract" (1997). The Victorian Auditor General (1996) put it another way in admitting the paradox that despite the tender bid process being fair and equitable, and despite the probable existence of long term economic benefits, the question of accountability remained[12].

In entering this PPP deal, it is apparent that governance was viewed in terms of being a source of power and control. In this light, we can begin to appreciate the tentative conclusion to the question posed in the title of this paper – the City Link contracts appear to steer this state given the government's signature to this PPP.

Discussion

Were these City Link achievements worth the price and what of the balance obtained? There are several threads to this debate.

Firstly, there has been a strong sense that this partnership deal was essentially a two-way affair rather than also including citizens' interests – at least directly and explicitly. The state's enabling legislation provided scope, according to Russell et al to override any potential delays from the normal complications of due process. They commented that "the corollary is that there appears to have been less emphasis on due process, given the desire for rapid implementation. This highlights the need for government to balance the risks of extremes on a continuum between 'paralysis by analysis' and action with diminished accountability" (Russell et al, 2000).

Such claims, secondly, are also particularly important in view of the accusations made by Dufty (1999) that investors' interests were protected over citizens' interests. The appearance of high returns to private investors which, in practice, seem to have been minimized through concession deed arrangements, has been the subject of some understandable criticism.

Third, importantly, the concession period may in the end, be as high as 54 years, depending on the profitability of the consortia. Russell et al (2000) termed this the "lock in effect" which constrains future governments from policy development and implementation. The claims by the Department of Treasury and Finance (2001) that PPPs provide governments with "strategic flexibility" are hard to fathom in this light.

Fourth, Russell et al (2000) remind us that there is no provision for the protection of consumers in balancing up commercial and social interests. As well, they suggest that the aggressive legislation[13] adopted to ensure a speedy project should be repealed following the completion of construction[14].

Against this, however, it should be said that from a technical point of view the project has been a very challenging one, requiring a large technical advance in the tolling technology, real construction risks in tunnelling through soft Yarra River silt and considerable risks in environment issues concerning air quality and the height of the water table around the river. Most of these risks were borne by the private sector and, as such, it could be argued that investors earned their margin.

The strength of this fifth point is lessened by the observation that the financial arrangement for the annual concession fee payable to the state, for what is effectively a monopoly facility, may vary by a factor of four depending on flexibility in timing options. And in any event, these amounts may only be claimed after private investors have achieved over a 10% return on their equity investment and if a reasonable cash flow is available from the consortium.

A crucial issue here, point six, is noted by Russell et al (2000), who also reported that this information was "not readily ascertainable from the Concession Deed in the Schedule to the Melbourne City Link Act 1995[15]". In other words, it was not at all clear, even when the contract documentation had been analyzed what the 'deal' was that the state had committed itself to. It would seem that the citizens of Victoria not only paid a price in terms of lack of clarity here, but they may also literally have paid a high financial price for the consortium to take the construction risks, although considerable uncertainty still exists here.

Politically, this has been an interesting project as well, with unique dynamics. Both sides of politics agreed early to the overall need for the project, and both sides of politics were also of the view that the project ought to be privately funded, given Victoria's $32 billion public sector debt in the early 1990s (Russell et al, 2000).

On this bipartisan still water, though, has been the torrent of politically damaging commentary including:

a) wildly varying estimates for the net benefits expected from the City Link project which, when they eventually became accessible to the public, differed by a factor of some 15 (Russell et al, 2000)
b) the amendments made to the Victorian Freedom of Information Act that specifically excluded the City Link project from FOI enquiries (Walker and Walker, 2000:216)
c) the appearance of favourable treatment of the consortia – such as land valued at $80 million being rented for the concession period for a paltry $100 p.a. (Costa, 1997)
d) controversy surrounding the installation of ventilation stacks to remove air from the tunnel, including misleading environmental impact emission information being provided by the consortium to the MCLA (Holmes, 2000)
e) the need for a tunnel redesign in 1998, after cracks began appearing in the tunnel walls –and cracks which were not acknowledged by City Link until some 17 months later (The Age, 2001)
f) further engineering problems with leaking tunnels, causing delays to the tunnel opening (Das (2001, Davidson ,2001)
g) state of the art electronic technology being developed, but this also delaying the Tunnel opening as new technology was tested, almost on the run[16]
h) the fact that the existence of tolling (rather than a shadow toll paid by government based on traffic volumes) has probably diverted between 15%–37% of traffic off the link and into adjacent side streets (Russell et al, 2000)
i) the pumping of drinking water into the tunnel surrounds to ameliorate a lowered ground watertable (Das 2001).

These issues, in conjunction with the use of a 'crash through' culture legitimised through the legal powers of the project[17], provided a colourful cocktail of politics and power.

Longer term governance issues of political and public policy concern also included the former State Treasurer, an ardent supporter of public-private partnerships, taking on a top job with Macquarie Bank in its infrastructure investment group, the downfall of the Kennett government with the ascension of the opposition through a "Good Governance Charter" platform, and reviews such as that from Russell et al (2000) recommending that "the state should avoid contractual obligations that impact on its discretion ... [to govern] ... for up to 54 years". Furthermore, we might also consider the serious point made by Dufty (1999) that given the effective natural monopoly status of City Link, its regulation long term by the Office of the Regulator General would seem judicious.

What might we conclude about the achievements of this PPP project and its shortfalls when we judge them against political promises made and growing public expectations?

Conclusions

If privatization is a story about delivering government services over the past few centuries, PPPs are the latest chapter in the book. They are not only technically different to traditional contracts in that they involve joint decisions for shared goals with shared resources, but they have also attracted different decision making and subsequent governance arrangements. Whilst PPPs may have the potential to provide infrastructure at more reasonable prices than comparative delivery through either the public sector, or through traditional contract arrangements, experience to date has been mixed in Australia. Governments have tended to view the use of PPPs as a purchasing device and, with the objective of quick delivery, have risked due process and adequate public policy consideration in doing so.

In concluding, there are some remarkable parallels between this Australian experience and the UK learnings. The future of PPPs depends on the provision of initial decision making processes with high integrity, and subsequent governance arrangements that have stronger public accountability and transparency than in the past. In this context, a policy of cautious use of PPPs with the consent of communities rather than one of hardened determination seems sensible. As well, the narrowness of the 'procurement philosophy' should be broadened. Each of these learnings from Victoria's experience has been independently documented in IPPR (2001) as well[18]. In view of the more far reaching consequences of PPP decisions crossing multiple future governments and involving massive financial implications, these requirements for improved governance are now critical.

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Endnotes

1. See McIntosh, Shauness and Wettenhall (1998) for an account of contracting in Australia over more than a century.
2. McIntosh, Shauness and Wettenhall (1998) report that in 1894, the well accepted practice of competitive contracting for construction works was interrupted by a Royal Commission which found widespread rorting of the contracting-out system, schedule rigging, and widespread dissatisfaction with inferior quality work. In less than a decade, the contracting-out system was replaced by a government supplied day labour as the dominant mode of labour for construction. Improved work quality, better working conditions and more secure employment was said to have resulted from this. Importantly, McIntosh et al recognised also that more swings of this private/public pendulum occurred over subsequent decades.
3. We might note that the majority of these cost savings were attributable to risks transferred from the public to the private sectors in these business cases, according to Arthur Anderson and LSE Enterprise (2000).

4 The history of this contract has since been controversial. Substantial contract variations were requested by government following the initial letting, and then subject to a detailed inquiry; (Comptroller and Auditor General, 2001). In practical terms, smaller cost savings than that quoted by Hall would have eventuated here, though the exact extent of this is uncertain. Controversies such as this appear to have added to the political sensitivities of the PFI policy.

5 Interestingly whilst the majority of authorities (55%) employed 'open book accounting' as a value-for-money mechanism, only 43% nominated profit or gain sharing arrangements and only 15% shared re-financing benefits.

6 It is perhaps also not surprising that the public does not care for the fine distinctions made by professional groups of what is and what is not a PPP or whether one type of relationship is the same as another. As a consequence, the demise of the British Railtrack, although itself not strictly a PFI/PPP, carries with it judgements of all PPPs and takes the sheen off of a wide range of partnership possibilities with different characteristics.

7 BOOT- Build, Own, Operate and Transfer.

8 It is noted that the Melbourne City Link project could also accurately be described as a privately financed BOOT project rather than a PPP. The partnership terminology, however, is used in this paper given that it's common usage, and given the unlikely PFI label being brought back into currency after its demise in the UK. The strong preference for the use of "partnership" terminology is likely to continue, at least in Australia, given the warmer, more cooperative connotations of this label.

9 Transurban City Link Ltd is a joint venture between Transfield Pty Ltd and Obayashi Corporation.

10 Risks outside the control of both the state and the private sector were to be shared between users of the link and the private sector consortium; Victorian Auditor General (1996).

11 By the time of the review by Russell et al in 1999, this project life had stretched out to 37.75 years.

12 It should be noted too, that the City Link PPP came to Victoria in the context of a government determined to 'get the state moving again', and in the midst of the fastest privatising government in the world through the 1990s on the basis of relative sale proceeds as a proportion of economic product. It was an administration that was ruthless and quick, with traditional values underpinning checks and balances being temporarily suspended upside down. The values founding this PPP deal were the same ones that were silencing the State's Auditor General, sacking Accident Compensation Tribunal judges, enacting a bill to remove the right of citizens to review government decisions to close schools in the state, removing the independent Public Service Board, removing the Director of Public Prosecutions, ousting autonomous local government, watering down F.o.I. laws and removing "some 100 odd avenues citizens had pre-Kennett to recourse to the Court for redress"; (Russell, 1999). Privatisation and PPP deals, it appears, were just part of a bigger culture of governance as domination and control.

13 One example of this aggressive legislation was the ability of City Link to use the state's PERIN (Penalty Enforcement by Registration of Infringement Notice) system of debt collection. This is not open to other private businesses.

14 Russell et al (2000) also made the observation that although the government had entered into a contract as a commercial partner rather than as a government act, it would usually be very difficult for a government to renege on its undertaking not to rely on Crown immunity. Its international reputation would need to be upheld.

15 Russell et al (2000) report that "the stipulation that the fee can be paid in Concession Notes appears in a separate agreement, the Master Security Deed" ... and ... "in Exhibit W inserted by the First Amending Deed cl 3.1 (b)".

16 The spectre of Melbourne's abysmal 'Met Ticket' debacle in the background did not help here. Public transport ticketing in this city, is still, after a decade of various ticket machine contracts, regarded widely as a mess and subject to constant weekly radio talk-back criticism.

17 An often cited example here was the use of the State's infringement notice system of debt collection.

18 IPPR (2001;) aptly calls the procurement focus "a mono-culture of procurement" and argues that it should be avoided.

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A Model for Evaluating Public/Private Alternatives in Network Services Provision

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Abstract

In recent years privatisation and contracting-out of network public services have emerged as key policy options in several countries. When these alternatives have been not applicable at least substantial improvements of performances of public organisations entrusted with the service provision have been required. In this context, the present paper presents a model for identifying the forces enabling or disabling public firms' capability to be efficient and effective in network public services provision. The evolutionary path of the behaviour of such firms when either privatised or commercialised has been defined and a model that attempts to categorise whether the conditions push or not for the public ownership/management has been proposed. The model analyses the need for public ownership considering six variables, namely social priority, presence of private agencies able to provide the service, entrepreneurial skills of the incumbent public supplier, inhabitants' revenues, constraints in public expenditures, and need for investments. Eight main combinations of such variables have been investigated in order to determine the strategic entry criteria in network public services sector.

Keywords

Network public services, public private partnerships, state owned enterprises, strategic entry criteria, contestability.

Introduction

The network industries make up 5-6 % of European Union gross domestic product and employment (even if the relevance of such industries as a sector can vary significantly between countries) but their economic importance is greater still because the price and quality of their outputs are important determinants of the growth and competitiveness of industrial sectors and the users' living standards.

Network industries are characterised by the delivery of products or services to final customers via a network infrastructure linking upstream supply with downstream customers. Industries that should be considered network ones are telecommunications, postal services, energy, transport and water. The network structure is typically rather costly to establish and embodies substantial fixed costs, implying lower average production costs for larger scale production. Common characteristics can be found among the network industries: existence of natural monopolies, dominance of incumbents, obligations to provide services of general interest, importance of regulation, etc. However, significant differences exist between sectors since the network industries cover very diversified industries in terms of growth, capital intensity, degree of internationalisation and degree of competition. These industries are also organised very differently across countries. In some countries, network industries have traditionally been organised in centralised, vertically integrated public monopolies while in others, private regional or local companies play a significant role. These differences explain why it is difficult to analyse these industries within an overall generic framework.

In these industries, market liberalisation, introduced competition and regulatory reforms are expected to enhance resource allocation and the dynamic efficiency of firms via innovation, new products and technologies. This should lead not only to cost and price reductions but also to quality improvements and increased demand. However, changes brought about by competition also imply adjustment costs because deregulation can be accompanied by employment losses in the short term in the sectors concerned.

In recent years privatisation and contracting-out of public services and, in particular, of network public

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The trouble with public-private partnerships

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The jury is still out on one of the great policy experiments in Victoria's history, writes Graeme Hodge.

So, construction giant Leighton Holdings is threatening to take the Bracks Government to court over project delays and cost blow-outs on the Spencer Street Station upgrade, the privatised Victorian rail network is to be subject to an inquiry concerning its safety, and there are even suggestions Treasury John Brumby is thinking of leaving politics and taking up a private sector job.

The wheels seem to be falling off Victoria's modern infrastructure arrangements and the Government's contentious policy of public-private partnerships (PPPs).

Has the Government got it right? Is more public infrastructure being delivered to citizens at lower prices - or has it all been just another good money spinner for a bunch of merchant bankers and consulting companies eager to exploit the Government's "no-debt" addiction, and a citizenry spooked by MPs repeating the mantra that any public debt taken out by government is evil? Worthwhile questions indeed.

There are several important points to make about PPPs.

We ought remember up-front that contracting relationships between governments and the business sector go back centuries. About 82 per cent of the 197 vessels in Drake's fleet that conquered the Spanish Armada in 1588 were private contractors to the Admiralty. Contracts in government are hardly new. And neither is government provision of assets for the long term. Dams and roads have been built under public debt since time began.

We ought note as well that there are dozens of different types of PPPs around the globe, and some international commentators argue that contracts such as those in Victoria are not really partnerships at all, but privately financed "master-slave" contracts.

So, what's really new here - and are citizens winning?

Three things are new. First is the use of private finance to underpin the deal - a government "mega-credit card", if you like. And just like in our private lives, it's not necessarily a bad thing for governments to use a credit card for sensible purchases. But you do pay for it in the end and in the small print can be details that mean the cost quickly adds up.

Second is the incredible legal and financial complexity of the contracts bundled together so that a consortium can then quickly deliver a new piece of infrastructure. Contracts for Melbourne's CityLink deal, for instance, measured several metres high and we needed a gaggle of lawyers just to interpret them so that citizens could understand what the state had signed up to!

And third, we have now entered an age of altered governance and accountability assumptions. Increasingly, governments are beginning to tell us that we can't do this or that "because it's not in the contract". Perhaps it's time we all called for clarity and total transparency on these deals and began thinking about whether these long-term arrangements reduce the ability of the next dozen Victorian governments to govern in the public interest. It certainly deserves some debate.

And what about gains for citizens? This is where it gets fascinating - because there is a huge diversity of findings on whether PPPs are cheaper and better. This is complex, and the claims need careful, independent scrutiny to sort out.

At one extreme, cost savings are claimed by the UK National Audit Office, and some academic analyses suggest good value for money in eight out of 10 cases. And anyway, our record of traditional project provision in the past has hardly been exemplary, with many colourful examples of over-expenditures and delays.

At the other extreme, though, are stinging attacks on treasuries accused of hastily signing up to these deals and, under advice from the finance industry, willingly turning a blind eye to much of the accounting trickery.

The jury evaluating the overall worth of these PPP schemes is still out because we are only a few years into contracts that operate for long periods, and because legal fights over contract clauses are probably now part of the expected deal. We therefore all need to be careful when assessing whether governments are actually being trustworthy stewards of our tax money or whether they are being policy advocates for these deals and signing up at interest rates higher than need be.

As well, we need far more debate on whether we should trust legal commercial contracts alone to regulate and govern Victorian infrastructure services for decades into the future. Accountability obviously now needs to be strengthened - and I don't mean contractual accountability for risks.

In this privatised state of Victoria, the public is concerned that there is now less public accountability in politics, not more. So with PPPs, the public are beginning to ask, who will oversee new legislation and planning? Who should look after the contract deals, and regulate them for decades to come? And who will protect users and evaluate these projects on behalf of citizens?

Perhaps the work of parliamentary committees, auditors-general and regulators should all be strengthened.

Victoria was arguably the world's keenest privatising state through the 1990s. We now need to learn, from successes such as our sophisticated electricity regulation, as well as from failures such as transport.

We all seek better services for citizens, sure. And new financial techniques and project delivery options for governments present new political opportunities. But learning from the past is not always easy in politics, and governments that say there are no risks and only good news with PPPs need to go back to history classes.

Professor Graeme Hodge is director of the privatisation and public accountability centre in Monash University's faculty of law. This article draws from a book he is co-editing, *The Challenge of Public-Private Partnerships: Learning from International Experience*, to be published by Edward Elgar.

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