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AusCID

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14 October 2005

Committee Manager
Public Accounts Committee
Parliament House
Macquarie Street
SYDNEY NSW 2000

Dear Sir

Parliamentary Inquiry into Public Private Partnerships

AusCID is the principal industry association representing the interests of companies and organisations owning, operating, building, financing, designing and otherwise providing advisory services to private investment in Australian public infrastructure.

The Council formed in 1993 and currently has 88 members, drawn comprehensively from all economic infrastructure sectors including electricity generation, transmission and distribution, gas transmission and distribution, roads, rail, telecommunications, water, airports and ports. As a result of our membership base, AusCID is in a unique position to consider the views of infrastructure owners, equity investors and debt financiers and combine them with the views of infrastructure operators.

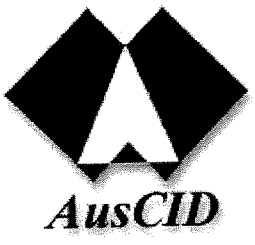
Attached to this letter is a submission to the Inquiry that we believe will be of use to the Committee. We would also be keen to present these views to the Committee.

If you wish to discuss these issues any further, please don't hesitate to contact me on 02 9247 2022.

Yours faithfully
Dennis O'Neill
Chief Executive Officer

Submission to the Parliamentary Inquiry into Public-Private Partnerships

October 2005



The Australian Council for Infrastructure Development

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1. Executive Summary

AusCID is the principal industry association representing the interests of companies and organisations owning, operating, building, financing, designing and otherwise providing advisory services to private investment in Australian public infrastructure. Attached is a current list of the Council's members.

AusCID welcomes the opportunity to make a submission to this Inquiry into Public-Private Partnerships. There are many benefits associated with private sector investment in public infrastructure in New South Wales.

Private sector involvement in public infrastructure is not new. The private sector has a long history in promoting, financing and managing a range of public infrastructure services and facilities. What is changing is the nature of the involvement and the approaches taken by both the private sector and Government.

A key message in this submission is that at all times there should be a focus on the ultimate outcome of any given project, not simply on the financing of a project. A purely economic focus will not reap the full benefits to be enjoyed by the public and private sectors working together.

AusCID aims to assist the Committee to develop a further appreciation and understanding of the importance of private sector investment in public infrastructure in partnership with the Government in this state for the New South Wales economy, indeed the Australian economy, and the New South Wales community.

AusCID offers the following recommendations for consideration by the Committee to assist in defining new structures and processes to enhance infrastructure delivery to New South Wales's infrastructure users and to help ensure that New South Wales taxpayers obtain best value for money:

1. The full cost of funds to the State, including the cost of risk bearing, must be adequately accounted for in publicly delivered projects.

2. The State Government should ensure that project briefs are outcome, rather than output based and adequate information is provided to tenderers. Short lists should be kept as small as possible, in-house bids avoided and tenderers should also be allowed adequate time to prepare quality solutions.

3. There should be continuous and open dialogue during the bid phase (under probity rules) to ensure each party is well aware of the expectations of the other, and bidding and contractual processes should be streamlined.

4. The State Government should ensure it has well trained, expert staff and good advisers with a thorough understanding of PPP projects.

5. Contracting arrangements should now develop partnership characteristics so that both parties can achieve reasonable outcomes over time.

6. Forward pipelines for major projects being considered should be published together with a list of target sectors.

7. The State Government should encourage the Commonwealth Government to take a stronger leadership role in the strategic planning and coordination of infrastructure service delivery across the country, particularly where there are existing gaps in services.

Furthermore the State Government should encourage the development of a single national infrastructure strategy that has support and commitment from all levels of government and the private sector. It is AusCID's strong view that this strategy needs to be supported by regular 'statements of investment opportunities' (focused on market conditions and deficiencies) and identify necessary independent institutional arrangements to ensure the strategy is fully implemented and updated. This should be achieved through the establishment of a National Infrastructure Advisory Council.

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2. Introduction

AusCID is the principal industry association representing the interests of companies and organisations owning, operating, building, financing, designing and otherwise providing advisory services to private investment in Australian public infrastructure.[1]

The Council formed in 1993 and currently has 88 embers, drawn comprehensively from all economic infrastructure sectors including electricity generation, transmission and distribution, gas transmission and distribution, roads, rail, telecommunications, water, airports and ports.

As a result of its membership base, AusCID is in a unique position to consider the views of infrastructure owners, equity investors and debt financiers and combine them with the views of infrastructure operators.

AusCID's 2003 survey of infrastructure investment identified some $114 billion of private investment in Australia's stock of economic and social infrastructure.

A significant amount of material has been released recently that addresses the general state of Australia's infrastructure, the benefits from improving it and the policy issues that need to be addressed. Beyond a growing body of scholarly work, recent major policy contributions include:

- The Australian Infrastructure Report Card sponsored by AusCID and the Institute of Engineers (and a number of state based equivalents).
- Econtech's modelling of the macroeconomic costs associated with current deficiencies in Australia's infrastructure capital stock, commissioned by AusCID.
- The BCA's "Infrastructure: Action Plan for Future Prosperity".
- "Infrastructure: Getting on with the job" published by CEDA in partnership with a range of infrastructure based organisations including AusCID.

We assume the Committee has access to and is familiar with this body of work and given the Inquiry's remit and relative short time frames, little is served by recounting that material. Similarly, except to illustrate important policy issues, we have avoided

[1] Attached is a current list of the Council's members.

of "war stories", especially those relating to the details of individual decisions made by economic regulators.

There will always be tension between infrastructure providers and users and the need to ensure that infrastructure pricing policies are economically efficient. The infrastructure sector will always need to compete with other sectors for the provision of public and private sector capital and in a range of human resources markets. Major infrastructure facilities generally create impacts on groups of people that are much narrower than the groups that benefit from the infrastructure – some environmental and social impact issues are inevitable and can only be resolved within a triple bottom line approach to infrastructure strategy and planning.

Short term focused policies directed at current problems are no substitute for institutional reform and co-ordinated planning arrangements. Improved co-ordination is essential if capital is to be effectively allocated. Robust transparent methodologies for project appraisal and delivery timing must be developed and adhered to.

Additionally, the majority of infrastructure provision projects are highly complex and, as such, require individual consideration on a case-by-case basis with a collective effort by the government and the private sector to ensure that each project and its purpose is properly understood by the community.

3. Private Sector Investment in Public Infrastructure

3.1 PPPs and Privatisation

Private investment in public infrastructure takes many forms. The most important distinction to be made is between privatisation and Public Private Partnerships (PPPs). Put simply, privatisation is best described as the selling of existing assets by government to the private sector, while the creation of new ones, in partnership with the private sector, are Public Private Partnerships (PPPs).

3.2 Forms of PPPs

The forms that a partnership between a government and a private service provider can take are varied. The partnership agreement should be structured to utilise the skills of the respective parties as effectively as possible so that they are responsible for the aspects of service delivery they are best capable of managing. The exact nature of this structure will vary depending on the nature of the sector and the specific project details.

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AusCID recommends that a PPP policy should not prescribe the type of arrangement to be entered into, but allow line agencies to determine the optimal project structuring to meet their service delivery need. This structure will be dictated by the Government's desire to transfer certain risks, to retain control over certain core service delivery functions, and by the nature of the project.

There are many types of PPPs, the most common of which are explained briefly in Table 1:

Contract Type	Characteristics
Design & Construct (D&C)	The government specifies the asset it requires in terms of its functions and the governments desired outcomes. The private sector is responsible for designing and building the asset and any related risks. The asset is then passed to the government to operate.
Operate & Maintain (O&M)	An existing, government owned asset is managed by a private sector organisation for a specified period. The contractor will be responsible for providing the services to the customer (retail or wholesale), maintaining the asset to a specified condition and ensuring that management practices are efficient.
Design Build Operate (DBO)	Effectively a design and construction contract and an operation and maintenance contract rolled together. The service provider is usually also responsible for financing the project during the construction period. The government purchases the asset from the developer for a pre-agreed price prior to (or immediately after) commissioning and takes all ownership risks from this time. The contractor retains the management function and related risks.
Build Own Operate Transfer	

(BOOT)	The service provider is responsible for design and construction, finance, operations, maintenance and commercial risks associated with the project. It owns the project throughout the concession period. The asset is transferred back to the government at the end of the term, often at no cost.
Build Own Operate (BOO)	Similar to BOOT projects, but the service provider retains ownership of the asset in perpetuity. The government only agrees to purchase the services produced for a fixed length of time.
Lease Own Operate (LOO)	Similar to a BOO project but an existing asset is leased from the government for a specified time. The asset may require refurbishment or expansion but no 'new build' assets are necessary.
Alliance	An agreement between the private contractor and the government to share the pain or the gain associated with project risks. The parties agree to a benchmark price, time and service standard and any benefits (or costs) achieved are shared between the parties according to a pre-agreed formula.

Table 1 Forms of Public-Private Partnership

4. In Support of PPPs

'Trust and teamwork ....is the key to getting the best out of PPPs for the public sector. Innovation and competition are other key drivers ....' (Middleton and Davies 2001)

Since the early 1980s there has been a paradigm shift in the way governments around the world provide capital works and infrastructure services to their constituents. Traditionally most governments have provided infrastructure services directly to consumers, and in some cases even retained the design and construction functions in-house. More recently, governments have begun to see the benefits of utilising the private sector's expertise to deliver more efficient and lower cost services to their constituents.

These early forms of private sector participation have now given way to more sophisticated Public-Private Partnerships (PPPs) where each party, the private sector and the State, are responsible for the aspects of project delivery which they can do best.

PPPs are by no means unique to Australia. Governments in the UK, Canada, the USA and Japan have well established programmes which have lead to successfully implemented projects delivering quality services to consumers earlier and at a lower cost than for traditional public delivery options. By 1995 the World Bank estimated that there were in excess of 570 greenfield PPP projects underway, worth more than US$300 billion and spanning 82 countries (So and Shin 1995). During the 1990s, developing countries committed to almost US$500 billion worth of projects involving private investment in infrastructure. Countries such as Chile, Hungary and Argentina are now world leaders in the development of PPPs, along with the UK, USA and New Zealand (Roger 1999). The UK alone has signed more than 690 PPP project agreements.

It is worth noting the UK National Audit office reported in 2003 that an examination of traditionally delivered infrastructure shows that 73 per cent of departments and agencies construction projects had run over budget while for PPPs only 22 per cent had run over budget and these overruns were relatively small. A subsequent report by UK Treasury showed 89 percent of PPPs were delivered on time or early.

Current Australian government capital expenditure programs do not match the sophistication of these jurisdictions. The World Bank estimates that the private sector contributes up to 40 percent of total infrastructure investment in developing countries. AusCID estimates that the corresponding figure for Australia is around 15 percent.

The net result is that the people of Australia are paying too much for infrastructure services that fail to meet best practice in terms of cost, quality and service standards.

There is now almost universal acceptance that, when managed appropriately, the involvement of the private sector in infrastructure delivery can lead to better quality services delivered earlier than they would be if the public sector adopted traditional project delivery techniques and at a lower unit cost. The private sector can contribute skills and expertise in a variety of forms including design, construction, operation, maintenance, finance and risk management. It is incumbent on the government to ensure that these skills are utilised wherever they can lead to benefits to the end user of the services or the community at large. It is therefore essential that the government considers PPPs whenever large capital expenditure decisions are made.

The best reason for procuring infrastructure services through PPPs is that they can deliver value for money benefits. Value for money means much more than merely obtaining infrastructure services at the lowest cost. It also includes quality of customer service, ability and need to adapt dynamically to changing consumer demands and consideration of economic and social impacts. Most of all, it allows significant risk transfer to the private sector, protecting taxpayers from risk and ensuring that the parties best able to manage risk are focused on managing and mitigating them.

In order to guarantee value for money outcomes a clear, transparent process for considering and delivering PPPs must be developed and enforced. This policy should include detailed guidance on the process for implementing a PPP agreement including Cabinet sign off, a methodology for evaluating and allocating project risks and a methodology for determining the value of both transferred risks and risks which the government retains. Ideally, this detailed guidance should be consistent across Australian jurisdictions.

Government should also give consideration to actions it can take to protect the public interest including ensuring certainty of process, guaranteeing transparency, undertaking cost-benefit analyses, demonstrating value for money and funding community service obligations.

Most important of all, a whole of Government commitment to the policy must be guaranteed with the policy being adopted by all Government departments and agencies. Without this commitment the policy cannot succeed.

4.1 Benefits the Private Sector Can Bring

4.1.1 Risk allocation

One of the fundamental benefits of adopting a PPP approach to project delivery is the reduced level of risk to which the State, and taxpayers, are exposed. Where appropriate risks are transferred to the private sector the contingent liabilities to the State are reduced and a better project should result.

4.1.2 Earlier project delivery

While the State is capable of procuring most projects directly, often funding constraints and interface difficulties with private building contractors lead to delays that are not necessary. Experience has shown that projects that are designed and constructed or, even better, designed, constructed and financed by the private sector, are delivered consistently earlier than they would have been if they had been procured by traditional methods. Earlier project delivery leads to increased benefits for customers and the wider economy.

4.1.3 Enhanced efficiency

It has been widely documented that when there are competitive pressures from a marketplace or competitive tendering, the private sector usually delivers capital works for a lower cost than for public procurement options. This enhanced efficiency is also present when private companies operate and maintain assets. The reasons for this are many but include the greater accountability and financial discipline of private sector firms and the desire to maximise shareholder profits. By contrast, the public sector has a tradition of providing detailed specifications that reduce the scope for innovation.

4.1.4 Better customer focus

In a PPP environment, the private contractor depends on continued use of the services it produces in order to maintain profits. As a result, private firms are focussed on the customer. This service ethic leads to better quality services for infrastructure users.

4.1.5 Access to broader funding

Private sector organisations have much broader sources of capital than governments which are generally restricted to issuing guaranteed bonds and hence pass on all project risks to taxpayers. The ability of the private sector to use structured finance allows project risks to be allocated to investors with an increased appetite for risk bearing and therefore helps to reduce overall funding costs. By contrast, when the State funds a project directly taxpayers have no choice regarding the risks they bear.

4.1.6 Whole of life approach

Traditional models of asset procurement separate the design, construction, operation and sometimes maintenance tasks. This leads to conflict between the parties responsible for each role and inefficient outcomes.

One of the great advantages of PPP projects is that they can be structured so a single party is responsible for designing, constructing, operating and maintaining the asset. That party is required to assess the asset on a *whole of life* basis. This means that trade-offs between investments during the various life cycle stages of the asset need to be considered. Ultimately this leads to lower cost services for consumers.

4.1.7 Access to latest technology

Private sector organisations which deliver infrastructure services tend to be reasonably large and are often multinational. These firms often have extensive experience in operating infrastructure elsewhere. They may have access to operating philosophies and patented technology which would not be available to the government if the project was undertaken within the public sector. By involving private organisations in the delivery of services, the quality and standard of those services may therefore be improved.

4.1.8 Economically sound decision making

When private companies choose to invest in infrastructure, they perform detailed studies of potential markets for those services, and the costs of providing them. As a result, only financially viable projects proceed. This process removes the temptation for politicians to choose winners and potentially create white elephants.

4.2 New South Wales – The Way Forward

The New South Wales Government must continue to recognise the benefits to be gained from developing infrastructure projects in conjunction with the private sector in its policy. AusCID strongly supports such a policy and, together with its members, looks forward to continuing to work with the Government to deliver infrastructure services to the people of New South Wales.

It is AusCID's view that policy should in no way detract from both private and public sector confidence in the commitment and consistency of government's approach to private investment in public infrastructure.

The Government and the private sector have already worked well together and invested significant intellectual capital in developing policy. This consultative process undertaken to inform the formulation of policy is itself an excellent example of the benefits of the two sectors working together. There must also be a collective effort by the government and the private sector to ensure that each project and its purpose is properly understood by the community.

5. The Evidence So Far

There is a growing body of evidence outlining the benefits and efficiencies to be found in PPPs.

In 2001 the Institute of Public Policy Research (IPPR) in the UK published its final report on its Commission on PPPs (IPPR 2001) . This was the most comprehensive independent analysis of the UK's PFI programme ever undertaken and lasted for 18 months.

Analysis of the report's key finding shows that, while expressing cause for some concern in specific areas, the IPPR has found that PPPs can drive significant value for money savings for taxpayers and improved public services for users. The IPPR also recommends an increased role for the private sector in the provision of health and education services, initially restricted to pilot programs.

Also released in 2001 was a report by PriceWaterhouseCoopers (Middleton and Davies 2001). PWC surveyed 27 PPPs in the United Kingdom covering transport, defence, water, health and education. PWC's report *Public Private Partnerships. A Clearer View* presented the following findings:

- PPPs work. The benefits the public sector requires are being realised. The partnerships have delivered new infrastructure and facilities as planned, on time and, as far as the public sector is concerned, to budget.

- There is room for improvement in the shape of PPP models and in the roles the public and private sector assume. But there is also clear evidence that the difficulties, where they exist, are being resolved.

- Trust and teamwork, rather than confrontation, is the key to getting the best out of PPPs for the public sector. Innovation and competition are other key drivers for further improvements.

- Public comment on PPPs is poorly informed and, in some cases, misleading. The overall impression created in the media is negative - that PPPs are worse than what they have replaced, and are responsible for many current problems in the delivery of public services. Most of their impressions are inferences and are contradicted by what users say about their projects.

In January 2000 Arthur Andersen completed a study commissioned by the UK Treasury TaskForce titled *Value for Money Drivers in the Private Finance Initiative* (Arthur Andersen and London School of Economics 2000). The key findings were:

- The survey of public sector project managers suggested that from a public sector perspective there are six key drivers of value for money in PFI projects. These are: risk transfer, the long term nature of contracts (including whole life costing), the use of an output-based specification, competition, performance measurement and incentives, and private sector management skills.

- The gap between the cost of private sector capital and public borrowing has been narrowing as PFI matures and the public and private sectors gain in experience, and is not as high as some of the literature suggests. The additional cost is not so significant that value for money is inherently likely to be imperilled, provided the private sector is able to deliver savings in other aspects of the project. The business cases examined suggest these savings are deliverable.

- The average percentage estimated saving against the PSC for our sample of projects was 17%. On the basis of the public sector's own figures, the PFI therefore appears to offer excellent value for money. Projected savings are, however, sensitive to risk transfer valuations that accounted for 60% of forecast cost savings.

- PSCs incorporate a public sector reference project that provides a snapshot of value for money at a particular point in time. The ongoing use of PSCs will require periodic review to ensure their continuing relevance and application as a benchmark, as an increasing proportion of major contracts are let under the PFI.

- The success of PFI as a procurement method is becoming well established and a robust procurement framework has been developed. Large and small projects have been successfully procured across a range of industry sectors. The operational benefits of PFI will take much more time to establish. Some of the early signs of the benefits of focusing on project outputs, thorough risk identification and management and on whole life costing have been promising. The long term value for money of PFI projects will depend on how well the private sector manages the risks transferred to it and on the public sector's success in managing the contracts over their duration, a significant proportion of which are for 25 to 30 years.

The evidence cited suggests that there are significant benefits to be had through PPPs. The reports do not say that PPPs are without need of some improvement and adjustment, but the overwhelming message is that PPPs work and that they can drive 'significant value for money savings for taxpayers and improved public services for users' (IPPR 2001).

6. Terms of Reference

6.1 Legislative and Policy Frameworks

AusCID strongly supports the development of a policy to work with the public and private sectors to promote PPP's, together with meeting the challenge of execution of projects in adherence with the policy.

Put simply, the private sector needs to have confidence that the PPP guidelines are being observed when projects are 'in the trenches'. There is a need for someone with a good understanding of the rules and a vested interest in achieving value for money to be involved at the project level. Investors require certainty and predictability and to develop and maintain investor confidence it is essential the processes set out in the policy are adopted.

6.2 Government Models

As stated, AusCID supports the development of policy, and a process for evaluating investment in public infrastructure, which incorporates a public sector comparator process and provides a clear benchmark to test value for money.

A formal policy on monitoring investment needs to be well defined. AusCID supports the important role of the Auditor General in contract oversight and reviewing a value for money test.

An essential requirement for evaluating and monitoring private investment in public infrastructure is properly trained and experienced public sector staff. The importance of well-trained and experienced public sector staff should not be underestimated.

In addition, the application of all usual Government accountability mechanisms for capital procurements should be adhered to.

6.3 Evaluating & Monitoring

6.3.1 New South Wales Government & the Public Interest

AusCID supports transparency at all stages of the PPP process. In fact, transparency assists in certainty of investment and is therefore an essential aspect in ensuring ongoing investment. Investors require and prefer certainty therefore government efforts to protect the public interest through greater transparency is supported by private sector investors.

AusCID supports initiatives in probity and openness and recommends a range of transparency measures be set. The use of a Probity Officer (PO) is important to ensure fair treatment of all bidders in a project and to demonstrate to the community that value for money is being delivered. The role of the PO should be to guarantee fairness of treatment to all bidders.

The probity process, however, has the potential to be of concern. While probity is a highly desirable and essential part of the process, there is a need to look at conducting probity more efficiently. If inefficiencies in the probity process develop the high costs may start to affect the efficiencies of projects, particularly very small projects.

A well-trained and informed public sector is also needed to ensure projects are implemented efficiently and properly. This point is also pertinent regarding protecting the public interest: it is essential that the public sector is well-trained and informed to optimise the skills of the private sector in the best interests of the community.

6.3.2 Evaluating the Private Sector

The mechanisms the Government uses to evaluate the effectiveness of private sector investment in public infrastructure projects to determine whether they represent value for money for the Government and therefore to the benefit of the community are important

In this context AusCID makes the point that any assessment of the mechanisms used to date still lack the benefit of real implementation experience and it is therefore difficult to make a proper and accurate assessment of the mechanisms used.

AusCID makes three main points about effectiveness comparisons: They should:

- Take account of the full and true cost of public sector delivery including all overheads.
- Realistically, value cost and time over-runs under public sector delivery based on prior experience.
- Value in a monetary sense the money risk passed to the private sector e.g. patronage.

AusCID supports a State sponsored review of major projects similar to the report published by Mott MacDonald in July 2002. Projects examined should vary in size, scope, risk and sector.

6.3.2.1 Public sector comparator

The primary tool used to demonstrate value for money is the Public Sector Comparator (PSC). This is a risk weighted cost for delivering the PPP project using traditional public sector delivery and funding sources. Usually this will involve outsourcing various aspects of the project such as design and construction. Once the PSC has been determined the community can be assured that value for money is being delivered if private tenderers better it.

Development of a comprehensive PSC is an in-depth process and the work involved should not be underestimated. However the construction of the PSC does more than provide a benchmark against which the private sector bids can be evaluated. The development of a comprehensive PSC requires a solid understanding of the nature of the outputs being sought, the forms of project delivery to achieve those outputs and the risks involved. As a result, the development of a PSC requires the sponsoring agency to develop an understanding of project risks and key related issues. It also ensures that any taxpayer subsidies required to deliver the project on a financially viable basis are identified at an early stage. Cabinet should sign-off on this level of subsidy prior to the market being approached.

The presence of a comprehensive PSC as a 'benchmark' provides comfort and certainty to the private bidders that, should they beat the benchmark, the Government is committed to proceeding with the project as a PPP. It also provides certainty to the community that value for money is assured.

In most cases, the Government should make the PSC, or aspects of it, available to bidders. This will indicate to bidders the type of solutions the Government is seeking (without providing detail) and give comfort that the Government is committed to delivering the project if the PSC is bettered.

6.3 Risk Allocation

One of the fundamental benefits of adopting a PPP approach to project delivery is the reduced level of risk to which the State, and taxpayers, are exposed. Where appropriate risks are transferred to the private sector the contingent liabilities to the State are reduced and a better project should result.

In a PPP the risks which the State bears are explicitly identified so it is in a better position to focus on the risks which it bears and to practice both passive and active risk management. Well developed risk allocations and well structured contracts focus both the private sponsor's and the government's thinking on the potential risks to the project.

The key principles of risk allocation should be:

- Risk is allocated to the party best able to manage it or deal with it if the risk event occurs.
- Where a risk is shared a true partnership approach should be adopted so that

both parties have the incentive to deal with the risk properly and effectively.

- Transferring risk to the private sector for risk transfer's sake is not worthwhile and adds unnecessarily to the cost of projects.

In a PPP the government is able to allocate appropriate risks to the private sector. The risks which are transferred should be the ones the private sponsor is best positioned to manage and control. The management of those risks should therefore be more effective and the total cost of the project, and hence services to the customer, should be reduced. This is because the contractual structure creates appropriate incentives for all parties to reduce the chances of risks occurring.

A study of risk allocation in Australia (Arndt and Maguire 1999) determined that private sector parties often consider the initial government position on risk allocation as an ambit claim. It was thought that a more commercial approach to risk allocation, made clear earlier in the bidding process would contribute to a significant reduction in overall bid costs.

The fact that risks are born by the private sector results in outcomes substantially different from situations where the same risks are borne by Government. The fact that private capital is at risk forces the parties to focus on actions which will remove or reduce the effects of those risks from the project. Ultimately, this leads to better outcomes for infrastructure users (ie the community). These outcomes cannot be simulated by a theoretical analysis of the cost of risk bearing, they are an additional benefit from the process of risk transfer which is inherent in a PPP project.

AusCID supports a position where default risk is handled via contractual mechanisms that outline events of default and regulate for compensation payments. This will ensure that the financial risk to taxpayers from private sector default will be very low.

6.4 Sharing of Knowledge

AusCID supports informal discussion between bidders and the client agencies in order for both to develop clear understanding of requirements and expectations.

The development of capabilities within government and across and between agencies for delivering PPPs should occur and expertise must be developed.

However, we accept that it is in the interest of government for expertise to be available to all projects to enable proper bid evaluation and contract delivery.

AusCID recommends that the State look for opportunities to collaborate with other jurisdictions in developing an improved information base. In Victoria, the adoption of the *Partnerships Victoria* guidance material in other jurisdictions has contributed to knowledge sharing in various states and the Northern Territory. Heads of Treasuries meetings already provide opportunities for collaboration and exchange.

There is an urgent need for collaborative strategies and planning by all jurisdictions in support of national outcomes, with appropriate consultative institutional arrangements to reflect the current investment framework.

6.5 Managing Intellectual Property

Intellectual Property (IP) is defined in the Working with Government Guidelines for Privately Financed Projects (at page 53) as:

> Inventions, original designs and practical applications of good ideas protected by statute law through copyright, patents, registered designs, circuit layout rights and trademarks; also trade secrets, proprietary know-how and other confidential information protected against unlawful disclosure by common law and through additional contractual obligations, such as confidentiality agreements.

AusCID recommends that the guidance provided in the Intellectual Property Guideline for Private Sector Proposals prepared for the Working with Government procedures of NSW Treasury be maintained.

6.6 Other Relevant Matters

6.6.1 Transaction Costs

Transaction costs need to be minimised. This is particularly the case for smaller PPPs. At present, there are vital, smaller infrastructure projects that are not going ahead simply because the transaction costs are too high. At this point, there is not enough profit available given the tight tendering and mismanaging of risk transfer and contract administration. Reduction of such costs through standard contracts, and more efficient project and contract administration would assist in bringing forward the development of these projects.

There are a few reasons for these high transaction costs at this point in time. The first is simply a lack of experience. As more projects are undertaken experience will enable the Government and the private sector to address some of these issues. In this context it is therefore important that the volume of projects is maintained and even lifted where possible.

A second reason is that governments are not always clear about what they want. Clarity and precision are key to keeping transaction costs to a minimum. A related issue concerns tendering times. Delayed tendering processes add to the costs of a project. It is therefore essential that tendering timelines be adhered to as far as possible.

The opportunity exists for an investigation into bid processes and an identification of the opportunities for reduction of the procedural burden imposed on project proponents, with a consequential reduction in bid costs. Bid costs and the extensive time taken in the bidding process are key hurdles to widening the market.

6.6.2 The Cost of Funds Issue

All risks have an intrinsic value. It has often been the case that public sector agencies have failed to adequately identify, manage and value the risks they bear in commercial activities. This lack of discipline regarding the analysis and costing of risks raises the danger that those risks may not be managed appropriately, as well as introducing a contingent liability to the State's budget.

Governments often do not value risk bearing adequately because they mistakenly believe that the public sector cost of funds is less than the private sector cost of funds and therefore are predisposed to obtain financing from public borrowing.

This argument is incorrect because it is based on taxpayers implicitly guaranteeing government risks. The government cannot isolate its borrowings for a single project from more general government borrowings. Therefore, if project risks arise the government would have to pay the lender with funds raised from increased taxes, cuts in expenditure or further borrowings.

If governments had to fund projects on a stand alone basis the cost of borrowing would be similar to that faced by private firms. Another way to state this is that if a government raises funds for projects directly then the contingent liabilities which it faces increase.

It is pleasing to see the Heads of the New South Wales and Victorian Treasuries addressed the 'cost of funds issue' (Pierce and Little, 2002):

> It is a myth that Governments have access to "cheaper" finance to undertake projects - a Government's ability to borrow more cheaply is purely a function of its capacity to levy taxes to repay borrowings. However, when it comes to raising finance for a project, it is the risk of the individual project that determines the real cost of finance. The difference between the private and the public sectors is that private sector capital markets explicitly price in the risk of a project into the sources of finances. In the public sector taxpayers implicitly subsidise the cost of a project by bearing the risk of cost overruns, time delays or performance failures, which are not priced into the government borrowing rate.

While it is true that it is more efficient for a government to assume some risks than others it does not necessarily follow that this reduces financing costs.

One argument mounted here is that government can spread systemic risks across many projects and therefore is in a better situation to bear them more efficiently than private sector parties. This may be the case but need not be so given the large size and scope of operations of many private sector sponsors and investors. Many of AusCID's members, for example, operate across the globe in a variety of sectors and undertake projects worth many tens of billions of dollars. International insurance markets are also capable of facilitating risk spreading across many projects.

Furthermore, equity investors themselves may spread investments across many sectors and countries, thus spreading their own risks. AusCID submits that the very presence of a government in a transaction increases some risks. This situation arises for two reasons. First, while it is a commercial party to a business transaction a government also has the power to change the rules which govern the agreement itself in order to obtain commercial gain. Secondly a government is not purely a commercial party but is also driven by other, political considerations.

7. Conclusion

The private sector stands ready to invest in required infrastructure in New South Wales. The benefits which private sector ownership and operation can bring are many but include reduced risks to the State and taxpayers, earlier project delivery, more efficient service delivery, an improved customer focus, access to broader funding sources, a whole-of-life approach, easy access to the most appropriate technologies and the avoidance of white elephant projects.

AusCID, together with its members, looks forward to working with Government to deliver infrastructure services to the people of New South Wales.

To fully develop a competitive PPP market the State needs to ensure there is certainty of policy and process to encourage investor confidence as well as sufficient dealflow with deals of sufficient size with appropriate returns.

AusCID recommends that the Government publish a five and ten year forward pipeline of major projects. Every effort should be made to ensure that the market can have confidence in such a published pipeline. Properly managed this would provide the private sector with greater certainty in planning its necessary resources and in turn provide the state with better value for money outcomes.

AusCID offers the following recommendations for consideration by the Committee, in light of its experience, to assist in defining new structures and processes which will enhance infrastructure delivery to infrastructure users in New South Wales and to help ensure that taxpayers in New South Wales obtain best value for money:

1. The full cost of funds to the State, including the cost of risk bearing, must be adequately accounted for in publicly delivered projects.

2. The State Government should ensure that project briefs are outcome, rather than output based and that adequate information is provided to tenderers. Short lists should be kept as small as possible, in-house bids avoided and tenderers should also be allowed adequate time to prepare quality solutions.

3. There should be continuous and open dialogue during the bid phase (under probity rules) to ensure each party is well aware of the expectations of the other.

4. The State Government should ensure it has well trained, expert staff and good advisers with a thorough understanding of PPP projects.

5. Contracting arrangements should now develop partnership characteristics so that both parties can achieve reasonable outcomes over time.

6. Forward pipelines for major projects being considered should be published together with a list of target sectors.

7. The State Government should encourage the Commonwealth Government to take a stronger leadership role in the strategic planning and coordination of infrastructure service delivery across the country, particularly where there are existing gaps in services.

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