REPORT OF PROCEEDINGS BEFORE

PUBLIC ACCOUNTS COMMITTEE

INQUIRY INTO PUBLIC-PRIVATE PARTNERSHIPS

At Sydney on Friday, 2 December 2005

The Committee met at 9.00 a.m.

PRESENT

Ms N. Hay (Chair)

Mr G.J. Aplin
Ms K.K. Keneally
Mr S. J. R. Whan

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CHRISTOPHER ANDREW KELLY, Partner, Maddocks, 123 Pitt Street, Sydney, affirmed and examined, and

GREGORY JAMES CAMPBELL, Partner, Head of Construction and Major Projects, Maddocks, 123 Pitt Street, Sydney, and

DAVID JOHN BAIRD, Partner, Maddocks, 123 Pitt Street, Sydney, sworn and examined:

CHAIR: I am advised that you have been issued with a copy of the Committee's terms of reference and also a copy of the Legislative Assembly's Standing Orders 332, 333 and 334 that relate to the examination of witnesses. Is that correct?

Mr KELLY: Yes.

Mr CAMPBELL: Yes.

Mr BAIRD: Yes.

CHAIR: The Committee has received a submission from you or your organisation. Is it your desire for that submission to form part of your formal evidence today?

Mr KELLY: Yes.

CHAIR: Would you like to make an opening statement this morning?

Mr KELLY: Yes, we would be happy to do so.

Mr CAMPBELL: What we were going to do first by of introduction is just to give you some background as to why there are three of us here. We are all partners at Maddocks law firm, so we give legal advice and the views we are going to express today to the Committee are our opinions on the basis of what we do as lawyers. I head up a national construction and major projects group. Chris Kelly and myself and a number of other partners of the firm have wide experience in dealing with PPPs. We come from different perspectives.

The firm has a commitment to PPPs for a number of reasons, but over the course of the last couple of years we have recruited people with experience. Chris has experience in approximately 25 PPPs in the UK, so the perspective that Chris will bring is a comparison of what is occurring in the UK to what is occurring in New South Wales. My experience is some UK experience, but predominantly Victorian experience and some New South Wales experience and the perspective I can bring is a comparison of what is happening in Victoria to what is happening in New South Wales. David Baird heads our local government planning group in New South Wales and has extensive experience in local government and particularly PPPs, and so David will bring a local government perspective.

A couple of things to add. When looking at the terms of reference, one of the aspects that this Committee is looking at is models for evaluation and monitoring private investment in public infrastructure. There is a project that has been initiated by the University of Sydney, post project analysis research. Maddocks one of the sponsors, along with Western Australina Auditor-General and the Victorian Auditor-General and a couple of other organisations, including one council, Warringah. We are sponsoring three year projects for researching projects post construction.

Mr WHAN: So basically how they go financially?

Mr CAMPBELL: What University of Sydney academics have identified is that there is really not enough material in the market place on what happens after projects have been procured and they are up and running, so it is a post project analysis, looking at the second and third generation of projects, how well they are being administered, whether they have really added value. One of the hallmarks of PPPs is supposed to be value for money. Are they really giving value for money? That, we think, is quite important research, and so we are sponsoring all that.

Mr KELLY: And they are looking at building an evaluation model to enable them to provide a framework for evaluation of PPPs and of course that would be academically rigorous as you would expect.

Ms KENEALLY: Is there a timetable for the project?

Mr CAMPBELL: It is a three year project.

CHAIR: Continue with your opening statement.

Mr KELLY: I think that would conclude our opening statement and we would be happy to answer specific questions or take you to specific parts of our submission if you would like.

CHAIR: You also refer to the desirability of applying standard contract terms.

Mr KELLY: Yes.

CHAIR: What in your view would be the main benefits of standardisation and its disadvantages?

Mr KELLY: Stepping back a little from the question and answering that more globally, one of the things we should be seeking to achieve here if we are trying to make this a viable form of procurement that competes equally with other forms of procurement, is an Australia-wide market. So there are two aspects to your question. One is standardised terms within the States and the other aspect I would refer to as standardised terms Australia-wide. If we are talking about standardised terms Australia-wide in the first instance, what in my view that would do is facilitate the creation of a national market. I think a national market for PPPs would assist the procurement of those transactions by driving down what we call deal costs, procurement costs, transaction costs. It would make it simpler and it would also enable and assist people who want to participate in that market, the major construction contractors and other providers who have the sorts of services that PPPs typically require. We do have a bit of an issue in Australia about the depth of our markets and the construction market in particular has a limited number of major players. These are, of course, very large and expensive infrastructure projects which typically cost the private sector many many millions to bid for, and doing anything we can to enable a national market could only assist those people to participate and also the public sector to gather the necessary skills and direct those skills efficiently.

To answer your specific questions: What are the advantages? I think, firstly, the advantages are that lawyers would be a little more removed from the process. So rather than spending a lot of time debating about the meaning of particular words or the drafting of particular clauses, one could instead focus on more important parts of the transaction, and particularly commercial aspects and indeed the specifications, which are of course what set out the services to be provided. I would suggest that being able to direct more energy into that part of the transaction would ultimately result in a better facility or piece of infrastructure, and that is a key part of what this is about.

In terms of the disadvantages, perhaps a lack of flexibility, and this suggests what might be needed to properly formulate a standardised set of contractual terms nationwide. This is a debate similar to that which, at least on one level, occurred in the United Kingdom where a set of guidelines was published and the industry was then encouraged to participate in and comment on those guidelines to determine to what extent they were, if I can use this term, bankable. There is not much point, for example, in preparing a set of standardised contract terms if the private sector will not agree to them or they are not in keeping with expectations in the project finance market, and you will of course be aware that project finance is a notionally international industry. It is not just Australian. The people who play in this market are people who are playing in Europe and indeed other markets where PPPs are developing.

Whilst inflexibility might be one downside, that could be addressed by having a proper forum for these issues to be debated and ultimately hopefully resolve it so that both parties feel that they represent a fair allocation of risk between the parties.

If I could just finish on the State, I would just extrapolate from that to the State, there would not be quite as many advantages because it is a little thin similar, if I could put it this way, to what we had in the 19th century when we had our trains stopping at borders. Having different policies in different States does not really serve the interests of, I would suggest, business or government. As is the case with so many of our laws, one has to master a set of laws in one State but can then not apply those laws in another State. It simply creates another layer of complexity and so that is one of the reasons why we thought a key part of what we wanted to say was that all the States need to engage in co-operative federalism if this is to be a viable form of procurement.

Mr APLIN: You indicate at page 5 of your submission that there is a perception that the New South Wales Government has lacked the will to implement PPP guidelines and you nominate complexity, fairness and skill deficiency as factors contributing to a poor flow of PPP deals. How in your view could this situation be remedied?

Mr CAMPBELL: If I could just make a couple of comments about the current position with standardisation and then I will go on to that question. Just picking up on a couple of Chris' points, legal costs being the single biggest issue for bidders, and the work that I have done in Victoria has been for bidders, but it has also been an issue for government. So standardisation or a standard approach is going to reduce legal costs and that was my first single biggest issue.

A considerable amount of work has been done on preparing guidance material by the Victorian Department of Treasury and Finance. When the department's policy was launched 2001 there was quite detailed guidance material issued, a risk allocation and contractual issues guide, a practitioner guide, a public sector comparator technical note and some other guidance material. Over the course of probably most of last year DTF, we understand in conjunction with Treasury here in New South Wales, had prepared what is now referred to as standardised commercial principles, which is a step towards standardisation. That document is now being implemented in Victoria, we understand probably on the new Royal Children's Hospital project.

Coming back to your question, in respect of New South Wales, my view is that the guidance material issued, to the extent that it is guidance material, is significantly less than what has been issued in Victoria and it is not clear what the Government's position is or Treasury's position is as to whether departments or agencies can or are expected to follow that sort of guidance material, but in particular the standardised commercial principles are a document where we understand New South Wales Treasury were engaged fairly significantly in the process with a view that it would become perhaps not a national document but a document that would be accepted certainly in Victoria and New South Wales.

Anecdotally, I understand that no-one in New South Wales that is contemplating it, that is no department, is saying to the market that we are adopting those standardised commercial principles. The difficulty the market is having is with understanding where New South Wales is at along the process of standardisation. The position is clearer in Victoria. I would say it is unclear in New South Wales. Addressing your question, more work could be done to give certainty to the market about where New South Wales is at in the standardisation, whether they are going to adopt the approach taken by Victoria as a New South Wales approach as well and give some certainty to the market and also government departments as to what is expected with regard to an approach to commercial risk allocation and an approach to commercial principles.

Mr APLIN: Which links with what Mr Kelly was saying about co-ordination across the States.

Mr KELLY: Yes.

Mr CAMPBELL: Absolutely. We think that is critical to the development of a national PPP market.

Mr KELLY: And, indeed, the Victorians have taken steps in that regard I understand to convene a national forum which meets - is it annually or semi-annually?

Mr CAMPBELL: There is a ministerial forum that has met three times. In fact, Minister Costa I think sponsored the most recent, the third meeting of Ministers, which was in October. That is, we understand, designed to promote consistency between States and Territories, but I suppose a view from outside of that forum is that it has not advanced a whole lot at the moment. There is high level discussion about what should be done but we are not seeing a lot being done.

Mr KELLY: Might I venture a comment at this point?

CHAIR: Yes.

Mr KELLY: Based on my experience in the UK, I see a similar point in New South Wales and Australia generally in terms of the development of PPPs as a procurement method or methodology to that which the UK was in in about 1997 and in 1997 the Blair Government was elected. The policy had been live at that point for about five years. It was actually launched by Norman Lamonte in 1992 and a number of deals were in the pipeline and some had been concluded I understand, but it was only with the election of the Blair Government and the commissioning of a report by a gentleman called Sir Malcolm Bates pretty much immediately upon the election of the Blair Government that things really started to move. Sir Malcolm Bates made a series of recommendations; the report was produced very quickly; I think the election was made; the report was produced by June; and the 28 key recommendations were implemented and enacted upon, as I understand the position, by September that year. Those included some legislation to deal with the powers of local authorities to enter into these transactions and also a range of other relevant matters, all of which were directed to freeing up the policy.

I see us in a similar position in that we have got the policy and we are struggling with quite how to make it work and how to implement it, but we need a fillip, if I can put it that way, to push us into a position where these transactions are competing equally with other forms of transactions. One of the key things we want to say is that we are not pushing PPPs as the way to procure infrastructure. It is a way to procure infrastructure, even in those countries where it is popular, if that is quite the word. It does not result in the majority of infrastructure being procured this way, but because it is complex, to enable it to be evaluated and procured properly you do need some infrastructure around it, and that is really I guess key to what we are saying.

To that end, of course, the local government scene is very topical in New South Wales as well because we have the new PPP legislation there and one of the things we can foresee there is that there are going to be some quite considerable demands made upon local government and the Department of Local Government and we query the extent to which the resources are in that department and more generally to facilitate this, and I think, David, you were hoping to say something about that.

Mr BAIRD: If I could just pick up on a couple of things. We have covered anecdotally, Madam Chair, your question about standard documentation. I had some involvement in the Oasis project, in advising both the inquiry and giving advice to Liverpool council, which I might say was ignored. The documentation in the Oasis inquiry was something in the order of a 64 draft contract which was that thick. It had become so bogged down in paperwork prepared by, dare I say, the lawyers that they had to have an explanatory memorandum to understand the contract.

When you get to that level of absurdity, clearly something is wrong. Local government at its best is not perhaps the most sophisticated organ of government or agency and it was clearly beyond the capacity of a lot of people to deal with that that kind of documentation. So a standardisation, whether it is a hybrid statutory form or a statutory template that creates the basic framework for the documentation, is in our view a clear must that should come out of perhaps this Committee's recommendations, and especially a framework which could blend in a mechanism to protect the public interest in the documentation is a must in terms of an outcome.

The other thing that I wanted to mention in terms of the more holistic approach, which I think Mr Aplin was suggesting, is the big picture now with PPPs, certainly in local government, is a framework where State Government has said we will, through the project review committee run by the DLG and now through the Department of Planning, have the ability to call in PPPs and the Department of Planning can be the consent authority for major project development, $50 million project development. That is not a bad thing because it will relieve local government of a lot of probity concerns. It will take away its consent authority role, but there is a political tension there that needs to be addressed which is perhaps in your area.

What we identify as a real threat to the model is that the State Government must recognise that there is an under-resourcing or lack of resources that have been focussed on the two agencies that will have the responsibility for the management of these roles. The Department of Planning will effectively become a super council consent authority and needs resources to make these things happen quickly. We do not want to starve the market through these projects getting bogged down in bureaucratic perhaps red tape. Likewise, the Department of Local Government, through its committee structure, needs to have the appropriate resources thrown at it.

The critical issue which we emphasise is co-ordinating the agency roles, and perhaps this is where a new office could be created within New South Wales Treasury to have an overseeing role to keep an eye on the agencies and make sure that they are performing, because if you have two independent functions, planning and project review running out of two government departments, you have the potential for perhaps mischief, political jealousy, just simple issues of lack of information transfer, lack of co-ordination. You need that focus at the top with an overseeing role, perhaps through Treasury, following the steps and making sure things happen quickly.

Those are two issues I wanted to mention.

Ms KENEALLY: Could I just pick up on this whole discussion of the standardisation across a national market. You have mentioned an international market, you have mentioned a standardised policy across States, you have mentioned co-operative federalism. I just want to drill down into that. How do you see this operating and mindful of something you have just mentioned there, Mr Baird, that the potential for almost political mischief and the political intentions that are involved. Australia is not the UK and the way that infrastructure is delivered in Australia is by the States. So how do you see this co-operative federalism? Is it a standardised policy across States? Is it Federal Government creating some sort of super body? Is it a national market where States would have to go to compete for private sector involvement?

Mr CAMPBELL: Can I say I think it is extremely unlikely that the Federal Government will do anything. It is not a Federal Government constitutional issue; it is a State issue. I think it has got to be driven by commitment at State and Territory level to doing things consistently. That is political commitment and commitment at a senior level in departments.

Just to give you an example of what is happening at the moment, I will go back one step. In terms of standardisation there is a view, and I think I agree with this view, that the market is not quite mature enough yet to have standard documents. We are in a transition. We are probably where Victoria is at at the moment, developing standard approaches to risk allocation and standardised commercial principles, and then when more projects are developed we will move towards standard contracts, but at the moment we do not have consistency in approach, for example, between Victoria and New South Wales on policy and guidance material. That is the first problem, that bidders in Victoria are facing quite different positions when they go across the border.

The second thing we are seeing is that as a product of that contracts are being developed in Victoria along the lines of the risk allocation model developed there and the approach being taken to a number of very important risks or risk issues in New South Wales contracts is quite different. I think that is probably because there is a particular law firm which has been appointed by New South Wales

Government with a particular lawyer who is having an influence on how the contracts are drafted, and I am not saying that is a bad thing, I am just saying that is how it is happening we think, and so New South Wales contracts are probably modelled more closely to what is happening in the UK because of the person involved having had extensive experience in the UK. In the New South Wales contracts, being Long Bay Gaol hospital and the Mater Hospital, the approach taken is more similar to the UK, but the point I am making is that they are different. You look at a contract in New South Wales and the approach to certain risks and clauses used and you go across to Victoria and they are different.

Mr WHAN: Can you be a bit more specific about the difference in the risk allocation? Are there specific examples of it?

Mr CAMPBELL: There are. For example, there is a concept called "acts of prevention". An act of prevention is where a principal, for example the Government, causes a delay on any project. It is not just a PPP, it is any sort of project. There is a view being taken in New South Wales, for example, that a bidder should have an appropriate contingency to allow for any delays caused by government. The private sector will say that is unfair, it is crystal ball gazing, but the point here is that if you go to Victoria there is a concept used in Victoria called "acts of prevention". When bidding a project in Victoria and in New South Wales, the bidders are faced with quite different approaches to those particular risks. That is causing problems. What that means for bidders is it is costing them more money.

Mr WHAN: Is it costing more money in New South Wales to put in contingencies for those?

Mr CAMPBELL: It is costing more money. That increases the price and so there is a question as to whether there is appropriate allocation of risk. So the principle of the allocation of risk for any project, not only PPPs, is allocating the risk to the party best able to manage and control the risk. I am just using one example, but if you say principal caused delays or government caused delays, who is the party best able to manage and control that risk? The Government. Therefore, why is that risk being put on the private sector? Because it is going to cost government more money.

Mr WHAN: Are there significant differences between Victoria and New South Wales, and even the UK, in how we handle risks over patronage?

Mr KELLY: I would venture to say no. I say it has got some patronage risk.

Mr CAMPBELL: Patronage is really more applicable to economic infrastructure, for example the toll roads. The projects we are seeing now are social infrastructure where the Government is actually paying a service charge, so it is not an issue.

Mr KELLY: I think it will depend upon the particular transaction and the location of the infrastructure and that would obviously influence the risks which a bidder might be prepared to accept.

Mr CAMPBELL: To sum up this point, what we are really about, funny as it may seem, we are about trying to reduce legal costs both on the government side and the bidder side, get more certainty in the market with good documentation, good best practice procurement documentation, and move towards more standardisation and across State borders, so that the market understands that the position is the same in each State and each State is working together on consistent guidance material, and our observation is that it is not happening sufficiently at the moment.

(The witnesses withdrew)

ANNETTE MAREE SCHMIEDE, Health Economist, 17B Stanley Avenue, Mosman, sworn and examined:

CHAIR: I am advised that you have been issued with a copy of the Committee's terms of reference and also a copy of the Legislative Assembly's Standing Orders 332, 333 and 334 that relate to the examination of witnesses. Is that correct?

Ms SCHMIEDE: Yes.

CHAIR: The Committee has received a submission from you. Is it your desire that that submission form part of your formal evidence?

Ms SCHMIEDE: It is.

CHAIR: Would you like to make an opening statement?

Ms SCHMIEDE: Thank you very much. As I said in my submission, the reason I am here this morning is as a private citizen, although over the 11 years that I have been involved with the hospital PPP projects I have worn many hats and what I would like to bring to the Committee this morning I guess is an operator's perspective. We hear a lot about the front end of these contracts and tenders, but having been involved with the operation of a number of them now for a period of time I think it is also important that we bring to the Committee's attention the issues that result in actually trying to work within contracts and work within the real environment further down the track.

As I said, some of the information that I am bringing to the Committee this morning came out of a project that I undertook with a colleague, Dr Abby Bloom, for the World Bank. That was commissioned last year and the previous year I had been a visiting fellow at the University of New South Wales, which gave me the opportunity to bring together a lot of my own personal experiences and also, having access to a lot of documentation that is not necessarily available to most people, to actually review this experience and look at it in a more structured and disciplined way, and that is where certainly the World Bank project, even though it was small in terms of its funding, gave me the opportunity to do that. A lot of the material that I have presented has come out of that bigger document. It has not been published, but at some stage, if the Committee were interested, I would be prepared to share that with them.

CHAIR: You also indicate that there has been no systematic evaluation undertaken of health PPP projects. Is it your view that PPP processes have resulted in good outcomes for the health system?

Ms SCHMIEDE: Yes, I think probably the principal message that I would like to convey to the Committee, and having read some of the submissions that have been prepared for you, I guess it comes as a little bit of a surprise, particularly in the health area, that there has been no what I call comprehensive and systematic evaluation. We have seen evaluations done by particularly government audit officers on particular aspects and a lot of that has been around process, but if you go back and have a look at the stated objectives of the individual projects, there really has not been a comprehensive evaluation of whether those objectives have been met, and I would certainly add my weight to the proposals that are coming up to the Committee that there needs to be a much better evaluation undertaken.

Ms KENEALLY: I want to touch on another point of your submission which I found quite interesting. On page 3 you state that the main driver for the PPP projects you were involved in was macro economic, not health policy. I wonder if you could elaborate a bit more on that and talk about how policy objectives of respective public services should be taken into account when making a decision to engage in a PPP?

Ms SCHMIEDE: I will just maybe track back and talk a little bit about the history. Interestingly enough, New South Wales was really quite a trail blazer in the early 1990s when it announced the first PPP project, which was Port Macquarie Hospital. It was not regarded as a good project at that time and I do not need to go over the controversy that surrounded that project. If you look at the economic environment at that time, we had a Liberal State Government and what we were seeing was not just coming out of Australia, it came out of the Thatcher Government in the UK, with issues around economic rationalism, small government, government did not need to own infrastructure, it needed to be a service purchaser and on and on and on and on, which you would be really familiar with.

What I am saying is that often that policy came out of State Treasury. Certainly then what happened is in terms of government departments with health, they were often picked up by the capital works branches of health departments. In every one of the seven PPP projects that I am talking about, which were very specific projects, the difference was that not only were they about capital infrastructure, there were service contracts for clinical services and these were very unusual. You will not come across too many other examples in the western world where there have been clinical services involved in these projects as well. That is why they are quite a distinct cluster.

What actually happened from my observation was that the procurement approach was picked up by capital works branches and that component was often driven out of that. When the facilities were built and commissioned, the contractual responsibility then transferred over to often the operational branches, who not often had as great an involvement as perhaps they should have. There was often, dare I say, a bit of ideological opposition because of the way State health services were often planned. These projects were often seen as sitting out there a bit on the edge of the margin. So that is what I was getting at in terms of saying that the policy came out of a macro approach. The implementation then had to be carried out within a health policy framework and a service planning and delivery framework.

Ms KENEALLY: In the submission from New South Wales Treasury they make a distinction between the investment decision and the procurement decision and it would seem to me that you are arguing to some extent these PPPs were driven by procurement decisions first.

Ms SCHMIEDE: Yes, that is my view and my opinion. Obviously, other people may have a different view and opinion, but that comes out of my actual experience. What I saw was often service branches having difficulty grappling with the complexity of these contracts, and that went all the way up and down the organisation, particularly when you had area health structures who were then also charged with implementing them.

Ms KENEALLY: I guess what I am getting at in a sense is were these PPPs entered into because there was a policy need for it or because it was feasible to do through a private sector involvement and at arguably less cost to government?

Ms SCHMIEDE: I state this in the submission. At the time of these earlier PPPs the State economies were in a very different situation to what they are now. We were coming out of a fairly deep recession and there were issues about State Government's ability to borrow, and these were off balance sheet transactions. So that was certainly an attractive proposition that I think drove them in the early days, definitely, that is right.

Mr APLIN: We have heard from other witnesses about the difficulties of government departments retaining pools of expertise to develop and manage PPPs. How could the skills of the public service be enhanced and maintained for the delivery of PPPs?

Ms SCHMIEDE: I do make that point and I was interested to hear the previous witnesses say the same thing. After ten years of having been involved, I felt a bit heavy hearted I must say. It is the experience really that you require. I was involved in four of the seven projects, all of the tenders obviously and two of them which were successful, Hawkesbury District Health Service, which is probably considered to be the most successful hospital PPP - I just stepped down as chairman of the board at the end of last year - and another hospital on the Gold Coast called Robina, which was owned and operated by the Sisters of Charity. After two years of operation the operating losses were so great that that hospital reverted back to government. Similarly, in Victoria Latrobe Hospital reverted back to Government for similar reasons and then you had Port Macquarie go back to government earlier this year. So what I am saying is there have been successes and failures over these seven projects and it is really out of the failures that you learn and it is out of the successes that you learn.

Getting back to your question about how do you build up expertise, it is through experience and practice, whether you create a group within government that covers all government departments or whether you have expert groups within various Ministries. Certainly, within the health portfolio, what I saw was advisers who were often advising health departments in say Queensland, Victoria and New South Wales. So it was often the advisers surrounding the public sector who gained the expertise.

It was interesting similarly this morning to hear about contracts. I can pick up a contract and I know exactly who has written it, whether it has been Victoria, New South Wales or Queensland on the health side, because there was obviously a bit of cross fertilisation. What occurred among the operators was that we gained experience because we were doing it in different States. The civil servants were not gaining that experience across different States. How you have some sort of exchange mechanism working really is important because the negotiating environment is quite competitive, it is very professional and you really have to have your wits about you, and that really comes from experience.

Mr WHAN: I just want to follow up on something there. You mentioned earlier the difficulties when the policy and operating arms of health were not involved or were not I suppose on board with the way that the process was done. Is there a conflict between suggesting that that sort of expertise needs to be developed in health and the proposals that we are hearing that we need government-wide standardisation in contracts? Do you see that as being possible? Secondly, the follow on from that is if you are saying that you need specialised health people working on PPPs, is there actually enough business to develop that expertise?

Ms SCHMIEDE: That is a very good point and obviously the experience of these seven projects, and two of them were in New South Wales, brought about a different approach from government. What you are seeing now is the model that has been used in Victoria with the Royal Children's Hospital development and here with the Mater in Newcastle. Government has backed away from the clinical service delivery and are concentrating on the physical infrastructure and what I call the sort of hotel services around that. So in some ways these projects are less complex than the ones that I am talking about and I do not know that we will ever see again that bringing together of clinical services because I think it has been too controversial and almost a little bit too hard.

It gets back to whether you need therefore going forward health expertise around the group of contracts that will go forward or whether that could reside in another arm of government. So I guess I would leave it open. All I am saying is you have to invest in training, education and experience from the government's side.

Mr WHAN: In your submission, and you have referred to it a bit earlier on, you imply that lack of political unity I suppose has been a negative factor in this process.

Ms SCHMIEDE: Yes.

Mr WHAN: That is surely not the only thing that went wrong with some of those projects which have not been seen as successful.

Ms SCHMIEDE: Absolutely, but I guess the point I was trying to make is you cannot in 1993 in a contract foresee what is going to happen in 2003 and unless you are prepared to bring good will and common sense to the table in resolving issues in the operational phase. You will end up with an adversarial, lawyer driven relationship with government and I do not think that is particularly healthy.

Getting back to the question, what I guess I am saying is in a number of these projects, particularly in Victoria and Queensland, I believe the change of government, when you had a Labor government coming in who were in part, particularly in Queensland, ideologically opposed to these models, it created an environment and atmosphere within which the public sector operated which did not really lead to necessarily sensible outcomes.

Another thing that contributed to failure was risk shift that in the cold reality of day was not feasible. It was particularly around open-ended services such as accident and emergency. I would suggest that in every one of these projects in Australia, the operators have cross subsidised accident emergency services because of the open-ended volume. I know it was particularly the case in the Latrobe Hospital, but not so much in the Queensland one because that hospital did not have an accident emergency department. The issues there were about setting the annual operating budget. When you went into these contracts you only got the first or the second year's operating budget around clinical services. From that time on you are going to have to renegotiate, and that has had to be renegotiated on volume as well as price, and it was often the inability to agree on the way prices would be escalated, not all the time but often, that brought some of the grief to these projects as well.

CHAIR: Are there labour issues that you believe need to be addressed as part of a PPP, particularly in regional areas?

Ms SCHMIEDE: You mean labour in terms of being able to access workers?

CHAIR: I mean either that or transfer of labour or movement of labour.

Ms SCHMIEDE: I have seen it done very well. My experience has mainly been with Hawkesbury Hospital where we had an existing hospital operating and it was a transfer of business and it required a lot of hard work, and once again as I said good will, to bring about a smooth transition of staff into the new facility. In the Queensland situation it was a totally greenfield situation, so we then had to commission new staff into it. Certainly, at Hawkesbury there have been issues where we have had some staff on public awards and we have had some staff on private awards and that has certainly caused a little bit of a cultural friction over time but we had to work very hard to minimise that.

Mr WHAN: You were talking about the problems that some of the PPPs and hospitals have had with the clinical and operating framework that they go on with. Why is it that we have seen problems there and yet we do not see similar problems with public hospitals operated by groups like the Little Company of Mary and private or charitable groups, I suppose, running public hospitals funded by the public purse?

Ms SCHMIEDE: Without having the opportunity to go into a lot of detail and having been involved in the Catholic sector for 20 years, having seen how they operate, they are really considered to be part of the public sector, in terms of the way their budgets are set and negotiated. What you saw with the PPPs was a totally different approach to budget setting, both in price and volume.

Mr WHAN: Is that because they are not for profits?

Ms SCHMIEDE: No, I think it just goes back historically to the way in which they were established and how they operated as third schedule hospitals, they were perceived in every way both internally and externally as part of the public sector, that is right.

Ms KENEALLY: I wanted to change the focus slightly. You also note in your submission that one benefit of PPPs is consistent delivery of facilities that reduce initial capital costs. Could you expand on that a bit and give your reasons for that?

Ms SCHMIEDE: This is one of the areas that has been reviewed. Queensland did a review, Western Australia did a review and I think some other State governments, and they consistently came up with the observation that these projects were procured cheaper and faster than what was possible under public sector procurement approaches. The reasons for that I believe are that the planning process is a lot more streamlined. Some will say that has good elements as well as bad elements, but what you had to do in these projects, you did not have necessarily the opportunity to engage in an extensive user group participation process, which is part of the procurement process for the public sector. What you had was actually a lot of expert input and operational experience that drove design. Also, because these processes were highly competitive, both on the capital side as well as the operating side, I think it is worthwhile pointing out that on the operating side you were expected to provide services discounted to what the government could do, and that discount ranged from anything between five and ten percent. So on the capital side it is very competitive as well, but people wanted to win these projects, so there was a lot of emphasis on keeping costs down, and I think that relates to space. Certainly what I saw in the designs of the hospitals that we did, against say a comparative hospital that would have been designed through a user process, was that you ended up with more space and a lot of that was not necessarily space that was efficient. It was often like back office space and it was not necessarily in the clinical areas.

Ms KENEALLY: They ended up with more space?

Ms SCHMIEDE: They ended up with less space, which is less money.

Ms KENEALLY: In the privately designed?

Ms SCHMIEDE: Yes, that is right, and also the process, you often had a construction company would design a construct project, so not only were you designing, but at the same time you had a builder on board, so that was a very efficient process in the design component.

Ms KENEALLY: If I could follow on from that, you talk about not engaging the user input as much in the planning process. Does that then lead to facilities that do not meet users' needs down the track? We have heard one submission that made that argument.

Ms SCHMIEDE: I have been involved in a lot of service planning at that level, both in the public sector and the private sector. Yes, there is a risk that that could happen, but that is a risk that you take, because often when you engage user groups, if you are doing a public sector procurement process, by the time the project is up and running often those people have moved on anyway and you have a new group of people coming in with different views, you have technology improvements, you have work practice improvements, and that is another thing, often the design process in the public arena is a very protracted one.

Mr APLIN: Just following on from that, we were talking about the processes and obviously outcomes there. Has the process of using PPPs resulted in improved accountability?

Ms SCHMIEDE: Theoretically it has. If you have a look at the contractual obligations in terms of accountability, particularly around clinical accountability, around quality issues, I would propose, and it used to be a little bit of I guess a joke we had, that often we were more accountable for quality theoretically than you would often find in your neighbouring public sector hospital. I cannot say whether that accountability has been forced. Aspects of it, certainly around accreditation, reporting against peer benchmarks which were often included in these contracts, initially might have been undertaken and then eventually drifted off. So that is what I meant. Theoretically if you go into the contracts there is a high degree of accountability around clinical issues.

Mr APLIN: Built into the contract?

Ms SCHMIEDE: Yes.

CHAIR: Are there any services that you believe should be excluded from a PPP in health?

Ms SCHMIEDE: You mean in terms of clinical services?

CHAIR: Yes.

Ms SCHMIEDE: As I said, if you are operating a facility, it is very difficult to carve out aspects of it. With the wisdom of hindsight, the issues surrounding the delivery of clinical services through this method probably present a number of difficulties from a State planning point of view, so that you would have to really be very clear about what you wanted to achieve. I am not saying that some of these projects have not done well. As I said, having been involved with Hawkesbury Hospital for nearly a decade I think the services involvement has been exemplary, but one good example does not necessarily make for wholesale implementation. There could often be a very unique set of reasons sitting around difficult projects. Hospitals are very unique very much a part of the fabric of local communities.

(The witness withdrew)

(Short adjournment)

GRAEME ARTHUR HODGE, Professor, Director, Centre For Regulatory Studies, Faculty of Law, Monash University, Wellington Road, Clayton, Melbourne, sworn and examined:

CHAIR: I am advised that you have been issued with a copy of the Committee's terms of reference and also a copy of the Legislative Assembly's Standing Orders 332, 333 and 334 that relate to the examination of witnesses. Is that correct?

Professor HODGE: Yes.

CHAIR: Would you please state your occupation and in what capacity you are appearing before the Committee?

Professor HODGE: My occupation is academic and the capacity in which I appear before the Committee today is that for the last decade I have looked at questions of privatisation, initially reviewing several hundred studies around the world, and following that for the last perhaps four or five years I have looked at public private partnerships as a public policy phenomenon.

CHAIR: The Committee has received a submission from you. Is it your desire that the submission form part of your formal evidence today?

Professor HODGE: Yes.

CHAIR: Would you like to make an opening statement?

Professor HODGE: Yes. Can I just firstly thank the Committee for the opportunity to present my submission. I was requested a little while ago to talk to Treasury and Finance officers in Melbourne about the future of public private partnerships and I duly did that and told them that the future of public private partnerships depended pretty heavily on getting some answers to some critical questions. Some of the questions seem innocuous but they are important. How do we define public private partnerships? There is a long history of the public private mix, and even though public private partnerships have been fashionable for the last three or four decades around the world, there is a huge history which we could talk about. "What does history teach us about that government private mix", I think is a question that is often missed in furthering some reforms. My experience tells me that 82 percent of Drake's fleet of 197 vessels that conquered the Spanish Armada in 1588 were private contractors. So the business of government contracting to private companies is hardly new.

Recent history would also suggest that the deals, I suspect (in fact many suspect), have been tilted in favour of the private sector rather than being for the primary benefit of citizens. So business dealing with government is not new. In fact, the government spending huge amounts of money is not new. Governments have always invested in dams and roads and those sorts of things. So it is critical to find out what is new with these PPPs, but that is a question I will come back to.

Another question is: What are our PPP objectives? Initially, in the UK the primary objective was fundamentally to get around a public sector borrowing ratio. It was about being able to borrow and reduce public debt at the same time. That objective has now been moved sidewards and it made way for a second objective which was to reduce pressure on government budgets. That objective has now also been moved sideways because it is a fairly simple piece of arithmetic to understand that we are simply turning a capital injection upfront into a series of recurring annual payments, rather than having any greater capacity for reducing pressure on government budgets.

The critical objective, however, is to search for whether or not these new PPP arrangements give us in fact better value for money, and we might say better accountability, and other objectives. So one of the questions to my mind is "how do PPPs perform", and I would have to say that there is a wealth of evidence. The evidence varies from one extreme to another. It varies from this extreme where Steve Savas in the US, a huge advocate of public private partnership contracts, in his book says there are no dramas with them, you have just got to get on with it and it is all good news, (a little bit like the Minister who told me a little while ago that he has never read anything bad about PPPs). It varies from that end to the other other end of someone like Jean Shaoul, who put out a report in the UK last year and Jean advised that in the first road projects in the UK, the government paid 400 million pounds compared to conventionally acquiring those road projects at 300 million pounds. Her observation was that it is a pretty crazy move to make. She also suggested that private investors were making returns of up to 86 per cent post-tax. She also made the observation that more information was being provided to stock markets and to financial markets than was being provided to citizens. A huge array of evidence and there is lots of things that we could go through. I have reviewed some of that evidence.

One of the UK academics, Michael Pollock, says that he suspects that good value for money in the UK has been achieved in eight out of ten cases, which is actually a pretty good positive statistic. In Denmark the evaluation of PPPs has suggested that in the city of Farum, several of the local elected members have ended up being taken to the police and that it has resulted in the most spectacular scandal in the history of Danish public administration with taxes needing to go up in order to pay for the contracts they have signed. So you do have these varying assessments.

Peter Fitzgerald in Victoria did an assessment in 2004 and his results were quite fascinating. He looked at eight projects and he found that if you evaluate using the Treasury and Finance discount rate of 8.6 per cent, we suspect that those deals resulted in a 9 per cent saving to the public purse compared to conventional procurement. If, however, we make that same analysis based on a lower discount rate of 5.6 per cent, you find out that those savings evaporate and it actually costs 6 per cent more than conventionally acquired projects. So Peter Fitzgerald's evaluation to my mind is quite important because it was saying that the discount rate that is used in this complex public sector comparator evaluation matters a lot and we have got to understand more about how it directly relates to calculating relative merit.

Having said all that, of course past public sector delivery has hardly been a model of success. Lots of studies in the UK suggest that government projects are delivered late and over budget and so on. There has been some work by the National Audit Office in the UK and Mott McDonald talking about PPPs coming in more often on-time and on-budget, and the figures are quite interesting. Something like 76 per cent of projects are delivered on time under PPPs compared to 30 per cent traditionally and something like 78 per cent are delivered on budget with PPPs and 27 per cent delivery traditionally. Looking at those reports you would have to say that PPPs have come up pretty well as being on-time and on-budget.

Before I accept those findings though, I would have to know a bit more about survey methods because when you ask a public sector manager anywhere in the world the question, "Are you doing a good job", you get a pretty predictable answer. In fact, if you go around checking if they have done a good job, there is a whole lot of things that will happen behind the scenes to brighten up the picture somewhat. So I would need to know a little bit more about the survey.

I would say, however, that the PPP area is alive with rhetoric. If you read the international material, “evil bandits getting away with the loot”, PPPs cause “problems, problem, problems”. That is what you read in the rhetoric. On the other side it is a marriage made in heaven. In fact, even yesterday there was a news release by an institute in Melbourne saying that the first detailed evaluations of PPPs were being released yesterday. Obviously, they are unaware of *Mega Projects and Risk*, Darren Grimsey's book (Pricewaterhouse), *Public Private Partnerships, Public Private Partnerships* in the UK and *Public Private Partnerships* from France, *Public Private Partnerships* European, and one which is edited by myself, *Public Private Partnerships,* which came out about two weeks ago. So all I am saying to you is that people who say there has not been much evaluation done need to get across the books that have been written, let alone not counting academic articles and special issues of journalists and so on. There is a lot out there. The real trick is to sort the wheat from the chaff and to sort out the rhetoric and advertising from the cold facts.

In an effort to do that, I do want to try and start with what is new. Governments spending a large amount of money is not new, governments having deals with the private sector is not new, even over multiple generations. What is new to my mind is the preferential use of private finance, the highly complex contractualisation and bundling of these infrastructure arrangements and new governance and accountability assumptions, including assumptions that we make about transferring risk. So those three things I think are worthwhile following up on and they in turn suggest to me that we are yet to get sensible answers to the following questions.

Question number one: What do we as citizens think of PPPs that are signed in our name? I have not read many surveys of what citizens think and I am a little surprised at the number of people that I speak to who have some kind of concern over public private partnership deals.

Question number two: How ought governments now best steer the State with these large intergenerational contracts? When these things are signed, they are often for a dozen governments and there are questions. Some serious questions should be asked around whether, in an environment of imperfect contracts, anyone should be signing 30 year contracts, or perhaps we should be allowing for options, so that after let's say four or five years we can buy out the contract or we have some kind of flexible arrangement in which we take the deal over or the private sector buys it.

Question number three: How can we actually get meaningful PPP transparency to parliament and to citizens? It strikes me as really odd that when I speak to even members of Cabinet they cannot give me a succinct summary of what the deal was with these projects, billion dollar projects. Having spoken to some top government officials in Australia and asked questions about why this is not possible, they tell me that it is very detailed legal contractual arrangements stretching metres from the floor to the roof, that you cannot summarise that in two or three pages, to which my response is okay, then on what basis did parliament approve this deal? If you cannot summarise the deal, on what basis was it put to parliament and was it approved? The usual answer to that is "trust". We trust that there is sufficient public sector expertise to get a good deal. And what are we paying for various risks to be borne? When it says in the contract that risks will be borne, there are no evaluations around to actually say that risks are borne in that way. How are monopoly rights being valued? By the way, when you did this calculation of the public sector comparator, what exactly was the counterfactual? Was the counterfactual going back decades and comparing the new public private partnership proposal to us doing it in some public works department or was the counterfactual simply getting sensible private sector contractors in, as tends to be the case in many countries. So there is a question of counterfactual. There is also a series of accountability functions as I say and I do worry that we do not know often what we are signing up for.

Question number four: How can we assure that a skills balance exists before deals occur and how do we also assure that partnerships are later evaluated after they have been delivered, hopefully evaluated away from the cheer squads? It seems to me that there is an important role here for independent accountability bodies, whether that is the Auditor-General or whether that is an independent regulator general. I think there is lots of room for those bodies to be far more involved than they are at the moment.

Question number five: How do parliamentary committees regain stronger oversight of PPPs? That is something that I hope we will get an answer for during this inquiry.

Question number six: Who looks after PPP customers? One of the interesting things about many PPPs is the notion that it is a deal that is done between government and business. It is a kind of two-way partnership if you like. In fact, it is a two-way contract, principal/agent contract, not a real partnership. But the deal is essentially between government and business, leaving out any role for citizens directly being involved, and I think that there is a question there about who actually does look after PPP customers.

Question number seven: How can government acknowledge and resolve conflicts of interest? One of the comments I made in Victoria a few months ago was I do get concerned about treasury and finance departments who used to have a role that was boring, the role of a public steward with their sharpened pencil and keeping accounts and whatever: but I am not sure whether they are the steward or the advocate now for these deals. Perhaps I am speaking about a different State from New South Wales but I think treasury and finance departments, certainly in the UK and certainly in Victoria, have now a huge tension between stewardship on the one hand and being an advocate, tensions between being a planner of infrastructure and being some kind of infrastructure promoter, questions of being a regulator and some kind of deal manager, questions of being an evaluator of these deals and being the legislator, conflicts between being a protector of consumers and being a policy developer. There is a whole series of conflicts that I think government has to first acknowledge before we then decide how we overcome these in order to know who we believe.

Question eight: What drives the private finance preference? It may be sensible public policy; it may be party donations; it may be banking advisers; it may be the desire to please markets. I am not sure, but I am yet to try and put my hand on precisely what is driving the preference for private finance.

Question nine: What are the lessons from PPP project controversies? Whether it is the Cross City Tunnel, or the Kurnell desalination plant or Canada's motorway 407 in which a deal was signed which said that they could charge any price they wanted (the deal was signed to the surprise of government) or whether it is the M6 inquiry in the UK, there are lessons to be learnt. I do not think we have spent enough time at the moment trying to learn those lessons. I am getting towards the end of my questions.

Question ten: What is the appropriate public sector comparator framework? At the moment it is a hugely complex black box and if you read the UK assessments you would have to say when you read the words "this as manipulatable framework", then I personally get concerned that we are moving out of the realms of finance and evaluation and we are moving into the realms of policy advocacy. So what is the best framework and what is the appropriate discount rate? As I say, in the Fitzgerald studies in Victoria when you used a lower discount rate, PPPs seemed to cost more. When you used a higher discount rate, as suggested by Treasury, PPPs seemed to save us money. It does matter. I know on the domestic front for my home mortgage I chase a half percent off if I can get it somewhere else. It strikes me as odd that governments would not question the availability of private finance at three percent more than they get it through government finance.

The second last question: How do we ensure that governments now use their ‘mega credit card’ wisely? I have said on a number of occasions I do not think there is inherently anything bad about governments having this credit capacity, in the same way as I do not think there is anything wrong with having a domestic credit card, but you do pay for what you purchase sooner or later and if the deals are paid for much later, then I think there is an issue of public accountability.

Last question: How can we better measure project risk experience? How can we better forecast it? It is amazing to me to see how project risks are estimated and projected. They are done in a workshop environment; people make them up next to a whiteboard. It is really very amateurish the way that we go about public risk at the moment, although government pays real money for these risks. The insurance industry does it better than we do with these contracts, and if you compared the way we look at risks in infrastructure at the moment to something like road safety risks, we are quite amateurish at it. So I just contrast the seriousness with which we tackle road safety and give that a billion dollars of funds and the much quicker and more a black box approach that we seem to apply, be happy to apply even, to public private partnerships. So there is a whole series of areas that I think we have really got to firm up on before we make a decision on whether PPPs are really a public benefit.

In conclusion, I would say that PPPs have a long historical pedigree. They are a language game and governments are signing long-term contracts as a new form of governance, which I think we have yet to give proper consideration to. But I would say they have given a range of experiences, in some cases positive, in some cases negative. My assessment is that the jury is still out on this PFI, this private finance initiative version of partnerships, despite the fact that yes, they deliver quicker infrastructure for governments currently in power. In summary, there is a wide range of governance, of public accountability, of public finance, as well as risk issues relevant to PPPs, as well the basic question of value for money. Thank you.

Mr WHAN: There is a number of issues you have raised, but I guess there is a theme coming through a lot of it of governments' failings in some of the private partnerships that are out there, and you talked a bit about things like, as you just said then, project risk assessments being very amateurish and also your concerns over the discount rate and that sort of thing. What sort of accountability mechanisms do you think we should be putting in place so that the people through their Parliament can actually see how this should be being governed or can see that accountability coming out?

Professor HODGE: There is probably three or four things I could say and thank you for that question. Number one, I do make the comment that there ought to be a brief summary of these deals after they are signed on the public domain, accessible so that people can understand what it is the government has signed up to on their behalf. Number 2--

Mr WHAN: In most cases there is, is there not, a contract summary posted on--

Professor HODGE: I do not believe what is available would satisfy truth in advertising, or perhaps that is a bit strong. But I do not think that it would cut the mustard with Auditors General as an accurate summary of the deal. I know that this was so in the case of Victoria City Link: just in order to understand – (this is Bill Russell's, Ewan Waterman's and Nick Seiderman's report several years ago, -their review of government contracts), they looked at the contracts. They employed a team of lawyers for months; the contracts, I am told, stretched from the floor to the roof, and it is even difficult to understand their dozen page summary of the deal. What they said was that there were all sorts of things buried in all sorts of appendices in various parts of the document which had huge implications for returns to government and returns to citizens and the whole thing was shrouded in incredible complexity. So I do not think we are there yet at just getting a simple version with integrity in two or three pages.

Secondly, I think contracts ought to be available anyway, despite their complexity. I just think it is a basic matter of spending public resources and having public access to these things.

Thirdly, there is a contrast in my mind between what I seem to read about returns to private investors and the absence of information about returns on public funds invested. The few bits and pieces that you can get out of various reports talk about, in terms of private investors of 10 to 20 percent right up to Jean Shaoul's figure of 86 per cent, as I said. The reports on public funds invested seem to be around two to three per cent where I can pick them out. So there does seem to be a huge difference in who is getting what from these deals.

If we wanted to improve public accountability, one of the simple things we would try and do is we would try and estimate what the returns for public funds invested were, both on a financial basis and an economic basis. Benefit-cost analysis on the economic side is nothing new, it has been around for several decades, and we have now moved away from benefit-cost analysis into financial analysis, but we only seem to do the financial analysis alongside matters for private investors. It strikes me as rather odd that we cannot be more clear about the returns to the public funds invested.

I think the other question is in terms of once these deals are signed. There is a question in my mind as to the degree to which those precise deals are adhered to over the whole length of the contract. We have had cases in Victoria where a couple of years into train franchises, for example, the private provider has shut up shop and walked off. Instead of incurring the risks expected, the contractor disappeared, although they have suffered financial loss I agree. What I am saying is that in many commercial contracts it is not the upfront deal that is signed that is crucial, it is actually what is negotiated after that which is crucial, and I think this is an issue that we are missing with many of our longer term deals at the moment. There does not seem to be any independent oversight; there is no regulator general that is overseeing these longer term contracts. They are not in the office of the Auditor-General unless it is some kind of specialised project. So I think we are missing out on the long-term monitoring of these deals when and if things change.

CHAIR: Do you think that is the way the independent scrutiny should proceed then, the recommendation of the Victorian Regulator General that future projects should be subject to parliamentary scrutiny prior to implementation and incorporate public consultation and disclosure?

Professor HODGE: I guess that is what I would be suggest in my home State and I could not see any reason why you could not have a similar arrangement up here.

Mr APLIN: Professor Hodge, in your opening remarks you did touch on the access to the mega credit card through this PPP mechanism. Could you expand on that particular view and why you think it is damaging?

Professor HODGE: The reason that I used this term ‘mega credit card’ I guess is because I wanted to use accessible language. When people say “what are these deals all about”, I think the onus is on someone to say “do not be too concerned, it is just government using an arrangement, it is a bit like me taking out a mortgage with my house or taking out a credit card”.

On the use of the term "credit card" though, the reason I use that for public policy debate is because I know that some credit cards are better than others and I would much prefer to use a credit card where I can buy credit on three per cent interest than use another credit card that is going to require me paying 18 per cent. It is an accessible way of saying to people this is a financing deal, when you borrow money you do have to be careful. There is nothing bad about a credit card. I think they are rather handy sometimes but unfortunately I usually have to pay my all bills with a credit card, in the same way governments have to pay bills. It is just the government has to pay much later.

The other thing about using that term is that for the specific instance of toll roads in fact the government is not using their own credit card on the deal, they are essentially using the private citizens' credit card. They are signing up citizens to pay future payments back to a consortium and, again, I guess at the end of the day parliamentarians are held to account for that once the public finds out what the deal is and they will make an assessment as to whether it was a great thing or not.

Ms KENEALLY: On that very point, I think your submission made the point that whilst governments can shift financial risk, they can never shift the political risk, and that is that public always expects that government provides the service, regardless of whether they are privately or publicly owned, and as you have just said the public will make an assessment on whether or not a deal is a good one or not.

Are there ways that government could better manage that political risk? You have talked about things like the option to have shorter term contracts, for the options to be flexible with contracts to buy out contracts. Are there other ways that government could better manage that risk?

Professor HODGE: That question probably goes to the very basis of the way ahead and I think the overriding ethos is one of transparency such that for one reason or another, whenever governments make contracts commercial-in-confidence or deem these deals to somehow be secret, the public immediately assumes there is guilt without any proof. So I think the overriding requirement is for transparency one way or another.

I also think that there is an overriding onus on government to build up its own capacity to separate out on the one hand advocacy for these deals, being the policy proponent, and on the other hand being a steward in the public interest. In respect of these two responsibilities, if they sit in the same office, in the same department, I find it a paradox to then be asked to both trust an organisation as a steward but also as an advocate. So I think government is going to have to figure out a way of having these kind of deals checked and double checked if it wants to learn from past failures.

There probably are very smart ways of drawing up more flexible contracts, and for all I know they may well cost money in order to purchase that flexibility if you like. But I suspect that a five year deal is going to be better in the long-term interest than a 30 year deal if the implications of a 30 year deal are that the liabilities for the State are indexed to CPI, if the implications are that the assumptions made about traffic are actually wrong and they are going to be wrong for an additional 25 years. So I think there are contractual ways of guaranteeing that flexibility. It is not particularly my area, but there is also some recent work by Professor John Quiggin that suggests this kind of call and put option at the end of five years that might be a possibility, which I think actually demands a bit of debate.

On BOOT projects, I do not think there is anything wrong inherently with boot projects or many of the other PPP models, but I do think we have to be a lot more careful about signing up to large deals than we have been.

Ms KENEALLY: You did raise one point about who looks after the users shall we say, the customers, the patrons, the toll payers. One submission has made a suggestion - in this State we have IPART, Independent Pricing and Regulatory Tribunal - that IPART should set the prices when there is a monopolistic situation where a private partner has built in user pays pieces of infrastructure. Do you have any comment on that?

Professor HODGE: Yes, my comment is that I fully endorse it and that is precisely the sort of arrangement that I have been suggesting informally in Victoria.

Mr WHAN: One of the points that you made about the difficulty in actually getting the diversity of opinion I suppose on whether PPPs are cheaper and the difficulties you have in actually making those assessments, I suppose inconsistencies in the way they are applied. What is the solution to that? We have had lot a of suggestions of standard contracts, standard administration, I suppose, of PPPs across the State and across Australia. Is that a solution to that, to try and get a standardised framework for actually assessing it perhaps?

Professor HODGE: Okay, I am not convinced in my own mind that it is a solution. Whilst standardised contracts would help understand the deals more quickly, I think the whole issue of assessment and evaluation is such a complex area that it goes back to the need to have an independent body to have a look at the deal that is being signed, and whether it is a huge international event like Olympic Games, Commonwealth Games or some other kind of deal, car races or infrastructure provision, there are huge complexities in evaluating whether or not this is a good deal for the State and assessing that compared to the more traditional, publicly funded option, presumably, and privately provided (obviously) if we get private contractors to build the thing. I think you need to separate the question of complex evaluation from the nicety of a standard contract.

I notice that a lot of the literature talks about the need for lower transaction costs on these deals. One of the strange paradoxes of evaluation of partnership deals in Australia and elsewhere is that very rarely have governments evaluated the PPP route in totality, both including the deal that is done as well as the future transaction costs that go on, both inside the government sector as well as questions of taxation and how funds are being funnelled through various overseas financial channels and so on. It really is quite a complex area and there again is a need to have a very authoritative and independent body having a closr look at that area.

Following up the comment about IPART, again the PPP area sees in many ways the granting of a monopoly right to provide a facility, and despite protestations to the contrary by the Ministry, I am not convinced that the arrangements that we often enter into in Australia are anywhere near as competitive as they are claimed to be. We do not need to look too much further than all the banking policies and so on, how competitive they are in delivering in minimum cost solutions to citizens. So I think in terms of doing the evaluation, as well as just value for money, there are questions of whether there are competitive arrangements being entered into as well as good arrangements for citizens.

Does that answer your question?

Mr WHAN: Yes, I think so. To sum it up, you are coming back to the point about needing some sort of independent body who can assess it before the contract is signed but who does not have a conflict of interest in also being part of an organisation promoting it, it should be a central agency that deals with it?

Professor HODGE: Yes.

(The witness withdrew)

DAVID GREGORY ROSEMAN, Executive Director, Head of Infrastructure Management, Macquarie Bank, 1 Martin Place, Sydney, and

ROSS ALEXANDER CAMERON, Macquarie Bank, 1 Martin Place, Sydney, sworn and examined:

CHAIR: I am advised that you have been issued with a copy of the Committee's terms of reference and also a copy of the Legislative Assembly's Standing Orders 332, 333 and 334 that relate to the examination of witnesses. Is that correct?

Mr ROSEMAN: Yes.

Mr CAMERON: Yes.

CHAIR: The Committee has received a submission from your organisation. Is it your desire that your submission form part of your formal evidence today?

Mr ROSEMAN: Yes.

CHAIR: Would you like to make an opening statement?

Mr ROSEMAN: I think we are happy to just have a general discussion and for you guys to fire any questions that you want at us. I think as we represent Macquarie Bank, you will have a fair idea where we are going to come from, but hopefully we will give you a fairly balanced view of our views of PPPs, both here and overseas and the benefits and the shortfalls of them. So we are happy to have an open discussion.

CHAIR: In your view how could the public sector comparator process be improved, both in terms of its calculation and disclosure?

Mr ROSEMAN: We have done a lot of these transactions and we find that, for example, on a road transaction, there have been a number of road transactions done, there is virtually no mention of the public sector comparator in truth. There is almost an understanding that if the deal provides value for money to those charged by the RTA or whoever it is, it will go ahead. On the other deals there is a bit of inconsistency I think in terms of whether you actually have one or not. Some transactions it is transparent to us and some it is not. I think in truth we do not really mind as long as it all consistent in terms of the approach. At the end of the day, even if we see what the public sector comparator is, typically our experience is that in a lot of transactions it does not reflect reality. We are not builders and so forth and we have probably just as much trouble, if not more, than the people assessing it on your side to work out whether the construction cost, for example, is a competitive construction cost, but we have experienced probably 80-90 per cent of the time the builders telling us that it is just not a fair number.

Mr WHAN: Are they suggesting that it is favouring one side, that it is favouring Government options for building--

Mr ROSEMAN: Yes, that it does not reflect the true costs of actually building the thing, forgetting about the risk premium, forgetting about that number, just the raw actual construction cost. From anecdotal evidence, my practical experience is that the builders always tell us pretty much that it does not fit what is happening in the market in the last three years, the wages, et cetera, you cannot actually build it for that price. So yes, that is a little bit of an issue, because the worst thing for us on these transactions is people to start a process and not actually complete or for it to be a very long, unwieldy process, which has happened both in this State and in other States on a number of occasions. I think often the reason for that could be that differentiator from the start.

Mr WHAN: So do you feel that that process should be a more open process from government? Should that process of determining whether to proceed and what the parameters are should be more open?

Mr ROSEMAN: It would certainly help us if it was more open, not just the number, for example, but actually the logic behind the number. We are not experts in building. We get the building price and they say, "Here is the price", and we say "Great", and we have an independent expert come in and say it could be ten per cent cheaper and we have the usual fight, but we do not have enough real ammunition to argue meaningful as to whether - if the PSC will say 100 and our building price is talking about 150 or that sort of number, which has happened on a number of deals, to allow us to actually have a meaningful debate with it as to was it a 100 deal or not, we do not have enough information to do that. That can be a bit frustrating.

Ms KENEALLY: Many of our submissions have made the argument that the PSC should be available to bidders during the bidding process and that bidders should have the opportunity, within probity rules, to question the logic behind the PFC. So, do I hear you endorsing that view?

Mr ROSEMAN: Absolutely. I think that would give us more confidence in making a judgment call as to whether we can actually deliver a transaction that is going to make sense, and if there is a differentiation between where we are coming out as a consortium and a PSC, at least it gives us more intelligence so we can have a meaningful discussion with our builder around what the elements might be, whether they are different, and then we can form our own judgment call as to whether we think the PSC was wrong or our builder was wrong or the truth lies somewhere in between.

Mr APLIN: In submissions to the Committee various parties have actually referred to the desirability of a national framework for PPPs. What is your view in this regard and in particular what sort of role do you see for New South Wales?

Mr ROSEMAN: This is a difficult question. Ideally, absolutely, yes. I think the problem we have in Australia, we do a lot of these transactions, obviously in the UK as well, if there is a quick standardised framework they roll these transactions off very easily. The trouble is in Australia is there are not enough transactions done by bodies to actually do that up. In an ideal world it would be good, it would be good if there was a centralised type agency that was responsible for the procurement of projects. I think it is a really difficult exercise for departments, who might only do one deal every two years or one deal of this type every three or four years, to really be on top of the issues and up to speed.

We have people doing this. For example, we have got a group of 80 or 90 people in Australia doing transactions and we might have 20 or 25 people who just do PPPs. So they do it every day and they are in the market every day. They have got the knowledge every day. Unless you are doing it, it does provide a difficult exercise. So I think in theory, yes, but in practice it is not that easy.

Mr WHAN: Given that you have 25 people dealing with this area every day, has the public sector got the expertise to actually be negotiating with the private sector on an equal basis or are they at a disadvantage do you think?

Mr ROSEMAN: I think in Australia you have got probably one of the most competitive markets for business. We, not only ourselves but others and the investing market too, invest in these transactions. It is an extremely competitive environment, so you throw something out there and you do get, just by the fact that Australia is very competitive, a very competitive process going. Some bodies are better than others, obviously, because they have done it more times and they just know how to close off issues. I think there is an expertise. I do not think there is a risk that the Government is not going to get a good deal on something, but I think there is a risk that processes will take a lot longer than they should.

CHAIR: In terms of there being strong community interest in the effects of private sector profit and risk allocation and management, how in your view can the community's concerns about PPPs be allayed?

Mr ROSEMAN: This is a difficult big issue for us because the success of these deals does depend on community acceptance and we are absolutely aware of that. We really do not want to do deals that do not get accepted by the community, and deals can get not accepted by the community for a whole lot of reasons, some of which may be completely independent of the fact that it is a PPP. There are a lot of decisions that the private sector do not make, that government makes that might affect the community's attitude as well.

We have done a lot of polling over the years, going back on just what the public thought about these sorts of things. Take toll roads, for example, we did a poll three or four years ago and if you ask people the question, "Do they want a free road or a toll road", there will be a very simple answer obviously, but if you actually ask people, "Do you want the road now or do you want the road in ten years time and now it is a toll", the answer is also very clear in the poll.

I think transparency in terms of what is really achievable by the government with the government's sum of money and, therefore, it is necessary to make the public understand that there is a finite pot of cash there and some of these things do involve conscious choices to actually have things earlier or better or whatever, and I think that message really does not get across enough. I think if people understood it in that framework, they would be a lot more accepting because there is obviously a large part of the community that would prefer to have something free than pay for it now. They pay for it anyhow, by taxes or whatever, but it is a much more hidden cost to people.

I think just an understanding of what is achievable, what are the government's priorities, and each government has its own priorities, and we do not try and set government priorities, and getting that message across to the public who elected them and who obviously wanted that set of priorities, is probably the thing.

Mr CAMERON: Can I just make a couple of other observations. One is you talk about the profitability and if the community feels they are getting sort of gouged over an asset and there is this sort of very strong reaction in addition to the general reluctance to pay tolls but in terms of the reality of the risk allocation, in the current deal which is creating all the controversy, there is a very good chance that all the equity investors will lose all their money. It is not Macquarie's deal but there is a very good chance that Li Ka-Shing will in effect swing for $200 million. That will just be a donation to the people of Sydney. In the same way you look at say the Spencer Street Station development in Melbourne. It is alleged to have brought PPPs into - it has been a very difficult deal for them. Leighton Contractors basically lost - I do not know exactly what the number is, but it has got to be close to $150 million and lots and lots of people have been sacked. People have to go home and explain to their families why they do not have a job and the reasons for the risk. The risk sharing is real and Leighton have not walked away from the deal and said, "It doesn't work for us" or "the taxpayer has got to pick up the bill". They just keep paying, even though they are never ever going to recover a cent of whatever they have spent in that project.

These deals, as David said, are always imperfect, but very often the choice government faces is not do we do this as a PPP or as a government funded deal, much more often the choice is do we do this as a PPP or not do it or not do it for another ten or 15 or so years. The choices you guys have to make, with respect, is you have got a certain amount of consolidated revenue which you have extracted from the taxpayer and then you have got a certain appetite for debt, which by definition is a number which future generations are going to have to pay.

One of the reasons that I am attracted to PPPs is that the generation that uses the asset pays for it, and rather than getting into a situation where a government wracks up very substantial debts, the ones coming in subsequent generations have got to pay not only their own way but also for the assets and the intended use which the previous generation has generated. So I think in terms of the so called justice argument, it is a fairer approach.

Ms KENEALLY: Running counter with that, an argument against PPPs, particularly in those PPPs that involve patronage levels and user pay models, is that the government can negotiate away in the contract its ability to govern in the future for the next 30 years. A 30 year contract that excludes building a competing piece of infrastructure actually restricts government's ability to govern, not just today but in the next generation. One of the submissions we have had from the private sector has said that private sector interest in PPPs would not evaporate if government were to not agree to those sorts of clauses in contracts. So, one, I would like your view on that; and, secondly, in terms of allaying community concerns, other submissions we have had have argued that in monopolistic PPPs, a monopolistic provider of infrastructure, that IPART should actually set the fee for charges for that piece of infrastructure. Could you comment on those two issues?

Mr ROSEMAN: Our position on those two issues, coming back to the issue about communities, community acceptance of infrastructure is critical for us, so in a lot of ways we just play by the rules that are set for the deal, but if we had to say what would we like those rules to be, we would prefer no road closures, for example on toll roads, we would prefer no fettering of the government's rights. I am a director down in Melbourne of Kent Thiess which is the company building the Mitchell Frankston freeway and there is virtually no fetter on the ability to upgrade. They can do whatever they like to the road network going forward.

The issue I think is to set those rules, have no fetters. The private sector will bid on them. We will be actually very happy to bid on that basis. Obviously it will result in a more risky deal for the private sector and that risk will be factored into the whole transaction, but if you know that upfront, absolutely fine, because we know the community acceptance will be so much higher, which is really the critical thing. We are more than prepared, in fact we prefer the big transactions where there is no fettering of governments' rights to do things and we can make our own commercial judgment call as to what might be happening to the road network and when and we can build that into our traffic forecasts. We will get it wrong, but traffic forecasts we get wrong anyway. But we will take a view and bid on that basis. Coming to the second issue - the second issue was--

Ms KENEALLY: About in monopolistic situations whether IPART should set the fees and charges for users.

Mr ROSEMAN: A lot of our assets that we own are obviously monopoly assets. Yes, that is fine. Again, we do not set the tolls on our toll roads. We just bid a transaction. If governments say we want the toll to be $2.50 or $2 or whatever it was, we were happy to bid on whatever basis the government wants.

Ms KENEALLY: Going forward, if Sydney Water wants to raise their prices, they cannot just raise their prices, they need to go to IPART.

Mr ROSEMAN: I think the important thing is transparency. For example, if you bid a toll road and the government tender it out and they say the toll is going to be $2.50, the private sector bid on that basis and that leads to a certain transaction. To turn around four years later and say the toll should be $1.50 for example, that is not a risk that people can take. If the government want to say the toll is going to be $2.50 and it is going to be $2.50 for ever, there will be no increases or whatever, that is fine as well, as long as you know.

We take risk when we buy regulated assets like electricity transmission distribution which we own. They are regulated assets. People take a view on the methodology a regulator might use from time to time and we will build that in. Again, we are very happy for monopoly assets to be regulated and prices to be set by a regulator, and regulatory risk is obviously a risk the private sector takes and is happy to take and take a view of. It is harder with toll roads. If you knew the methodology, if you could actually get into the head of the regulator and he said, "Now this is the methodology", the rates of return and we know what they are, "This is the methodology we are going to apply", you have got that deal on electricity distribution and so forth, you can take the view. He might come out one year and change his assumption about debt equity mix or whatever, but broadly if we know the methodology, it is tried and proven, we are happy to take a risk on what the outcome of that should be, but in a vacuum it is very hard.

Mr CAMERON: Can I say on that point that there are risks associated with monopolies whether they are in government hands or private contractors' hands. One of the functions of pricing from an economic standpoint is to find that mix between demand and supply which also provides sufficient revenue to invest in the assets and the infrastructure over a long period of time. Under the model, if you talk about water for example, or we could look at lots of different areas where you have a historical government monopoly over infrastructure, there are actually a whole range of very strong pressures to artificially deflate prices in such a way that the sector cannot attract the investment required to maintain assets.

For example, at the moment we are losing probably ten to 15 per cent of Sydney's water supply from leaks under effectively a government monopoly situation, partly because it is very very hard. If governments put pressure on organisations to return dividends and politicians put pressure on organisations to keep prices low, then you can wind up really heavily running down your infrastructure, whereas if you give a long term contract to a private sector operator, who is then responsible for the design, the construction, the operation and the maintenance, you actually get much much higher levels of maintenance in assets because the private sector carries the risk throughout the life of the plant, and so here the private sector could be losing a commodity or the availability of a service, whether it is a train carriage or whatever it is.

CHAIR: That did not prove to be the case in the UK with the railway, did it, with the train maintenance on the lines?

Mr ROSEMAN: In terms of the--

CHAIR: In terms of higher maintenance delivery, do you agree?

Mr ROSEMAN: I am not sure. I am not familiar with UK transactions per se. I am not sure if that was a regulated asset or what the regime was for it. There are some assets that we have the view are much more rigorous to do by way of a PPP than others. Don't get us wrong. We are not saying PPP is a solution for all assets. Personally, I think the rail network is a very difficult asset to do by way of a PPP. It has been tried in a few places. It just raises additional issues over and above the usual ones which make it more difficult. There is integration networks between a private asset and a public asset; there are timetabling issues; there is what obligations does the government accept in terms of providing it. There are all these issues which get raised, and fundamentally trains are an asset. They are public transport. People do not even pay their fare. So you are starting with an uneconomic, a very social function, and integrating all those things does make it difficult. We have tried a number of rail transactions and they are difficult transactions.

You can apply the PPP role to pretty much most things, but the degree of difficulty jumps up with a number of assets and the risk increases. Some assets we put on a relatively easy scale to do and some we would not.

CHAIR: Just following on then with the next question I need to ask, which is what types of projects would you believe should not be conducted as a PPP, and I take it that you would feel that way about rail?

Mr CAMERON: I think the carriages obviously.

CHAIR: We accept carriages are.

Mr ROSEMAN: Yes. I think rail, for example, we have always held the view that because rail is such an integrated thing and because it is linked into a whole network and because the value from rail is not really coming from a fare box, it is coming from the value of creating the communities that it goes to, that unless you capture that value, then economically it is very difficult to make the transaction work. Now, what other transactions would you think of? I think transactions where the government wants to have flexibility to make a whole lot of changes, whatever they might be, that does not make sense by way of PPP unless the private sector is willing to take the risk that the government will not make those changes and not fetter its ability to do so.

The desalination plant is an interesting one. It is very topical at the moment. In a lot of ways I am glad it is not a PPP because I think it is such a controversial transaction in its own right, regardless of whether it is a PPP or whether it is not. It is going to be an issue that is going to hit the papers every X days, when something happens, it rains, it does not rain, whatever, that I think associated with a PPP as well it is just going to, from my perspective, attract the PPPs into a lot of those arguments which are really unrelated to the PPP debate. Yes, I think certainly the private sector could build it and operate it more efficiently and in a less risky way than government otherwise but I am not unhappy it is not a PPP.

Mr WHAN: Do I take it from that that you would say that you and some of those commercial partners would be nervous about projects which had controversy attached to them?

Mr ROSEMAN: Especially in this environment when there is a debate about PPPs. It is very easy to point the finger and say it was a PPP that caused that. The Cross City Tunnel, we did that transaction - this is probably on the record, isn't it?

Mr WHAN: Of course, it is all on the record.

Mr ROSEMAN: The frustrating thing is with that transaction really and the road closures and the whole plan for William Street and all that sort of stuff, and I drive in from there and it is a pain in the arse, but that was not the private sector's doing. That was actually the Government's vision for it. That was the Lord Mayor's vision for it.

Ms KENEALLY: The Lord Mayor's vision?

Mr ROSEMAN: It was someone. The point is it was not the private sector. If they had said we are not changing William Street at all, fine, we would have bid the transaction on that basis. I think people are losing sight and it is easy to point at the PPP and the private sector as doing it but it is actually not.

CHAIR: I do not think there is much disagreement with that issue.

Mr ROSEMAN: Yes, but when it hits the paper it sort of you know--

Mr CAMERON: Can I say on this broader question of what is a good project for a PPP and what is not, one of the things you are doing with the PPPs is you are mobilising - right now there is about $750 billion worth of assets under management in superannuation funds and it is growing by nearly $2 billion a week. That is Australian equity capital looking for somewhere to go. Every dollar you reach into either consolidated revenue for or Treasury bonds, that is a dollar that is not available for you to do policing, to meet nurses' salaries, to put airconditioning in comprehensive public schools, to do all these other things. So there is a sense in which I would say on each project, if there is private capital available, what is the best available use for the scarce taxpayer funds that we have at the moment, and if it is to put it into building another toll road, then well and good, but if there is an appetite in the investor community to support projects like that and there is capital available, I think that is one of the reasons why every major addition to the Sydney and Melbourne road networks in the last 15 years has been through in effect a public private partnership.

The other thing I would say is when you are saying the rail area, the British model I would say failed partly because of the architecture that was chosen by government for that model where they separated the below ground and the above ground and then they had a large number of operators running across the track on top. What they have done operationally was, as David said, the network was so deeply and intimately connected that it did not really work operationally to separate the above and below ground. But on the rail carriages the PPP, that is a $1.5 billion project New South Wales is doing at the moment, I think there is a very good feeling that it could emerge as part of a model for how to do these effectively.

CHAIR: My comments were drawn from the suggestion that the private sector being responsible would increase the maintenance of it due to protection in relation to the risk and so my comment on that was specifically about the assumption that there would be increase in maintenance. I actually think that the PPP for the rail carriages, as you say, is a good example but I come back to the maintenance section.

Mr WHAN: Is there not a fundamental difference though in the ideal one there, the rail carriages? You have got no patronage risk there. You know how many you are going to sell, whereas in a lot of these other projects you are taking on a risk of patronage.

Mr ROSEMAN: Sure. The rail PPP that is going on at the moment, and we are obviously advising somebody, that is delivery and maintenance. We are not fettering the network. The Government is going to do whatever they like with them, et cetera. There is a way you can do things which is more easy and more difficult.

Mr WHAN: There is less risk for your partners in that.

Mr ROSEMAN: Sure, and that will all get priced in. What people do not realise is that the Australian market is really competitive and in a lot of ways what the governments do when they do PPPs on large complex projects is quarantine the costs, because governments, if they do not do that, often want to change their minds during the transaction and all of a sudden the deal that was going to cost $100 million will cost $250 million or be a significant rate, only because people might change their mind. When you do a PPP you take that risk away; one, because the private sector takes it; two, because it is all bolted down from the beginning.

Mr APLIN: Just getting back to risk, and I know we looked at some of the negatives when we discussed this before, but in terms of risk allocation and management, there is an increasing focus on the inherent risk for both parties, obviously government and the private sector, in restructuring the project. Could you comment on the expectation that parties would share in the financial benefits resulting in a project restructure and what constraints would there be in that process?

Mr ROSEMAN: Again, from our perspective it is really quite simple: Just tell us what you want to do in terms of PPPs. If people want to share in the upside, just tell us at the beginning and we will take that into the equation. If people do not, right, we will pay more upfront. It is all in the number. We try and refinance roads all the time.

CHAIR: It seems to be a common theme. A lot of the evidence we have received is about governments being clear.

Mr ROSEMAN: Just be clear, quite right.

Ms KENEALLY: For example, in the UK I understand they are bringing in Partnerships UK.

Mr ROSEMAN: A sharing, absolutely fine, no problem, and a lot of the recent deals, the road deals have matured over time here in Australia. For the first deals there was none and in the later deals now there is a very explicit sharing and there is a regime. Absolutely fine, just set it in the contract and that will be the deal.

CHAIR: And we have had the benefit of evidence from Garry Sturgess on the changes and the more positive changes and the certainly improved position that PPPs in the UK are in today as compared to what they were.

Mr ROSEMAN: It is a bit of a balancing risk. In deals where we actually have that benefit for ourselves and we have been able to share refinancing benefits, actually you will get more money upfront. Yes, it is just a conscious draw as to what government wants to do and a bit of a perception publicly. If there is a refinancing or something going on, do they want to have the benefit at the time or do they want to be paid upfront for the right to do that.

Mr WHAN: Can I just ask about your attitude to disclosure of contracts and when you feel that should happen and how much of a contract should be disclosed to the public and also what the attitude in your sector would be to having some sort of independent review of a contract before it is actually put in place?

Mr ROSEMAN: On the stage, full disclosure after the contract is signed from our perspective is great. We are all for it.

Mr WHAN: All details of the contract?

Mr ROSEMAN: Great all around. Yes, these are negotiated over a long time, they are complex, there are rationales for it. Absolutely, put it out. Anyone can take a view, but yes, no issue whatsoever. From our perspective in terms of intellectual property each is such a deal specific thing. I think the only people who may legitimately have an issue is the DMT. If they have just signed a big contract with you to build a road for $2 billion and they have not actually set in place their subcontracting or their whole strategy, they might not want that out in the market for a little while until they have done that because it might affect their negotiating position, but from our perspective, put it out there, the model, the terms, the deal, the risk, the benefits, absolutely.

Mr WHAN: Do you think there should be scope for some sort of independent assessment of an agreement before it is actually entered into?

Mr ROSEMAN: To protect the government?

Mr WHAN: To protect the government on behalf of the Parliament, the users or whatever. The issue that was raised earlier this morning was that often the government body which perhaps is assessing the deal has also got a vested interest in its side of the deal rather than just being an independent overview authority?

Mr ROSEMAN: I do not think we would have an issue if there was some sort of central body within government that had the power or had the obligation or right to actually, after the deal was negotiated by a particular department, so we sit down and say yes, there is nothing in there that we do not particularly like. I think it would be good to get them involve from the beginning. It is like negotiating it with two people. You do not want to negotiate a deal and then have to negotiate it with somebody else. There is that sort of commercial issue, but from a concept, as long as you knew what issues were near and dear to the heart of government that they were trying to protect or what they were going to look for, I do not think that would be an issue for us.

(The witnesses withdrew)

JOHN ERIC PIERCE, Secretary, New South Wales Treasury, and

KERRY ELIZABETH SCHOTT, Executive Director, Private Projects and Asset Management, New South Wales Treasury, affirmed and examined, and

DANIEL GRAHAM, Director, Privately Financed Projects, New South Wales Treasury, Level 26 Governor Macquarie Tower, Sydney, sworn and examined:

CHAIR: I am advised that you have been issued with a copy of the Committee's terms of reference and also with a copy of the Legislative Assembly's Standing Orders 332, 333 and 334 that relate to the examination of witnesses. Is that correct?

Mr PIERCE: Yes.

CHAIR: The Committee has received a submission from your organisation. Is it your desire for that submission to form part of your formal evidence today?

Mr PIERCE: It is.

CHAIR: Would you like to make an opening statement?

Mr PIERCE: I might just make a brief one, first of all to thank the Committee for the opportunity to appear before you and to perhaps explain a few things that are in our submission. The detail of our approach and our practices in relation to PFPs, and this is in response to the terms of reference, obviously is in the submission and I will not take up time repeating what is there, but would perhaps make a few brief comments concerning the broad framework and some of the things that are at the top of our minds when we are dealing with these types of projects. Hopefully, that will provide a bit of background from both our submissions and some of the questions.

The first thing to say is that we have always tried to take what might be considered to be a balanced or considered approach to privately financed projects. PFPs are not, and have never been seen to be, viewed as a cure all for all of the infrastructure issues that the Government faces or the public sector liability management issues. They have to be seen in the context of the overall fiscal strategy that the Government is trying to pursue. However, we are not in a binary world where PFPs are good or bad. It depends on the project which you are looking at and how you approach it. Like everything else, they are simply a means to an end and they have their good points and their weaknesses. The experience over the past decade, in fact longer than that, within New South Wales has taught us things along the way. Governments, and I use the word "governments" in the plural possessive sense, approach to PFPs has been an evolving one and one where we will continue to improve.

I would make a request to the Committee to bear in mind that not all privately financed projects are the same. We have tried in our submission, for instance, to highlight some of the differences, some of which are quite obvious and others perhaps a bit more subtle, between economic and social infrastructure PFPs and they are treated a bit differently as you are trying to assess how to allocate risk and how to apply good value for money tests. PFPs are just one of a number of ways in which government can procure projects.

Secondly, to help put PFPs into some sort of perspective, on page 7 of our submission we provide some aggregates that show that the value and the number of PFP projects that have been entered into over various points of time and it is certainly true that there are some big numbers there, but in terms of the total State's capital program, PFPs have been and will continue to be a relatively small proportion. Over the last ten years, if we just look at the public sector contribution to those projects, they tended to average about three per cent of our total capital program.

Generally it peaked just prior to the Olympics at about seven per cent. Perhaps a truer measure is if you include the private sector contribution to those projects and if you did that then over that ten year period the average ratio of PFP projects in the total program is around the eight per cent mark. From the very beginning I suppose we have always said that we would never expect PFPs to account for more than maybe ten to fifteen per cent of the total capital program. There is a lot of capital delivered by other methods other than PFPs.

Secondly, above all else PFPs are really just a procurement method, one of many, and like all procurement methods the objective is really how do you buy this thing in a way that provides the best value for money for the public sector. It is that that drives choices of procurement methods.

We, in our processes, try to separate out clearly the investment decision a process by which the Government decides what is it it is going to buy. It does that through the budget process. It is the budget process that determines what is going to be in the capital program. And then having made that decision then your next decision is how are you going to buy it. And it is really at that point that the comparison of the different procurement methods, including PFPs, comes to the fore. So our investment decisions are not driven in and of itself by the way in which we are going to procure it.

The third point touches on the accounting treatment which flows from that second point, in the sense that whether projects procured through PFPs end up being on the State balance sheet or off the State's balance sheet is a by-product of that procurement decision, it is not a driver of it. You do not do PFPs for the sake of it and because we effectively make investment decisions on the basis the Government that makes the investment decisions has got to be prepared to fund and finance the thing itself. If you are and it becomes part of that investment decision how are you going to buy it?

There are a number of options available to you. Irrespective of the way the accounting standards operate or whether it ends up on or off balance sheet a key consideration is the economics of that underlying decision about which procurement method to follow, I suppose internally you refer to as the rose by any other name type of principle, which is touched on in those terms on page 14 of our submission. Essentially if you are going ahead with a PFP you are substituting one form of financial liability, the obligation to service and repay public sector debt and to manage the risks associated with the project with another form of obligation, being the obligation to make payments under the contract. We are starting from a fiscal framework leading to what investment decisions you are going to make. When you are making those investment decisions you have to be happy to go down those routes. A rose by any other name teaches us that one is similar to another. When the credit agencies are assessing the credit worthiness of New South Wales in relation to our debt they just do not look at the debt on issue, they look at all the liabilities in our balance sheet and the obligations that we have under major contracts to come back to a view about credit worthiness or the security of people's deposits that they make to us.

There are a number of issues that have been touched on through other submissions and in ours, particularly issues around how you measure value for money and public sector comparator and costs of capital. I might conclude there and allow those issues to come to the fore during the questions.

CHAIR: A strong criticism of the way in which governments account for PFPs assets is that they are used to shift expenditure off balance sheet. In your submission you refute this. How should public concern about this aspect be addressed?

Mr PIERCE: Public concern, my colleague will embellish the answer a bit. We have got to go back to what is the primary objective here, which is providing public services that are the ones that people want the most and being able to demonstrate that we are getting value for money irrespective of the procurement method. So for me that is not just an issue about PFPs, it is about our whole procurement policy of which there has been a considerable amount of work done within Treasury on that within the last couple of years. If there is an argument about explaining to people more about those processes and being more proactive in talking about them then that is certainly something that, from a Treasury perspective, we would be comfortable to participate in.

Ultimately the things that we get to explain and talk about publicly is a decision for the Government. When we launch the Working With Government Guidelines, not just myself but particularly the two people beside me spend a lot of time getting groups of people together, explaining them both within Government and outside Government and going to various forums and conferences and talking about it. My Victorian equivalent are in a similar stage of the process and I did a number of presentations explaining the way we were approaching this both in Sydney and Melbourne, partly not just to explain ourselves but to also highlight to people the similarities between the approach that was being taken in the two states because we thought it was quite important that when somebody turned up to bid on say a schools project within New South Wales that when they went to Victoria to do something similar then the rules of the game were as similar as possible and obviously vice versa. The Australian market is not large enough for all the jurisdictions to have different processes which would just add to transaction costs.

Ms SCHOTT: If I can go back to the on or off balance sheet question. I think there is some misunderstanding about it. At a conceptual level it is actually reasonably easy to understand. If there is no risk to the Government in the project then it is off balance sheet. There are very few projects that fall into that category and the ones that do are what we refer to in the submission as economic infrastructure and that includes things like water treatment plants where somebody is paying for the water or toll roads. All of the other projects that we do are on the balance sheet and the way that they appear on the balance sheet is as John said, it is as a liability because we have a liability to make an on going payment for a school or a hospital or whatever and that ticks out every month.

With rolling stock for rail cars that we are currently working on there will be obligations to pay for that as the cars are made available by the provider. That gets recorded on the balance sheet as a provision. So instead of being a borrowing, it gets recorded as a liability provision, that is really the principal difference. There is a bit of misunderstanding about this, I think, because a lot of people seem to assume that everything is off balance sheet but that is actually not the case.

Mr PIERCE: As I tried to explain in the opening statement, whether it is on or off balance sheet is not the driver.

Mr WHAN: I wanted to follow that up. If you are looking at the driver of the decision and you are looking at that economic infrastructure which is off balance sheet; when you are looking at the infrastructure program that you are going to pursue over X number of years then you are making a decision at that stage on how much you can afford based on what is going to be on and off balance sheet, surely if you are projecting that you want to build an M7 or a Cross City Tunnel and you also want to build a whole lot of regional roads which you can not raise any revenue out of, at that initial stage you must be making a decision as to how much is off balance sheet because otherwise presumably you could not budget for the whole lot.

Ms SCHOTT: It is a real key to getting good policy to not let your financing decision drive what it is you do or frankly you will come unstuck. It is very important that the first decision that is made by the Government is what capital do we want to provide the services that we have to provide. The fact that toll roads, for example, can be provided by users paying for them does mean that you can sometimes do it faster but it certainly does not mean that the Government does not have that road in its investment program. If it was not in the priority programs of the agency it would not even come up on the radar to be considered. If you allow something to be done just because a smart investment banker comes through the door and tells you you can finance it you are heading down a path that frankly it is not good Government.

Mr PIERCE: The key decision in that example is really whether the road is going to be built with or without a toll irrespective of whether it is public or private.

Mr WHAN: At what point would you be making that assessment?

Mr PIERCE: It would come up in the proposals we get from agencies about when they make their submissions to us about what should be in their capital program and they will identify, say in that example, this one will be a toll road and this one will not. The key issue about whether it is or is it not drives just from a public finance perspective is a reasonably obvious one that if it is a toll road there is an additional source of revenue that in the absence of a toll you would not have. It is a decision that needs to be made; is it or is it not going to be a toll road up front and the way we put the public sector comparators together is based on the presumption that essentially we create a SOC that would do the project as a public project if a public sector comparator was not there. It is one the key things with the public sector comparators generally of all types of projects that when we put it together we have to be confident that if the public sector was to deliver it that is the cost of doing the project, if it is not then that becomes the budget numbers that get fed into agencies to go away and do it.

Mr WHAN: In the last 20 years there has been a lot of media and I suppose political focus on Government debt levels. Are you saying to me that the overall level of Government debt is not something which influences that decision making process or is it something that comes in once you have made the decision?

Mr PIERCE: It is the other way around. You start with your fiscal strategy; for instance the targets that are expressed in the fiscal responsibility bill now, which expresses a bunch of targets on operating results and in our balance sheet. Given that you can derive well what is the total value of the capital program that the Government can afford and that, in part, is determined by those issues about what is the level of debt that you can sustain. It is really at that point, if those parameters stay fixed as you go into a budget process, then the projects are then assessed within that envelope and compared with one another, if you like. You have already fixed a total amount of debt that you are going to take on and it is a question of how does that get allocated between the different projects that people are putting up, bearing in mind the number of ones that come in within each budget process that are going to be PFPed as relatively small. I might add on the debt issue, Treasury has been accused of having an anti debt fetish, perhaps it is an opportunity to clarify: We see the objective of fiscal strategy as being to manage the resources in a way that supports service delivery and supports service delivery not just in one year, but over time. Governments, again plural, tend to want to provide services at a reasonably constant rate of growth from one year to the next. Our revenues are very much influenced by what is happening in the economy generally and particularly asset markets and property markets.

Our expenditures, however, tend to be fairly constant through time. In order to deliver those constant rates of growth, given the volatile revenues, we want to have in corporate terms a relative low gearing so when you have a down turn it is acceptable to go into deficit and incur debt in order to maintain that reasonably constant rate of growth of expenditure. We are trying to put the governments into a position where you do not have to cut back on services because the property market has gone into a down turn.

On management: The issue becomes is there an acceptable way of financial expenditure at a higher level than the trend rate of growth that your revenues allow you to sustain? It is at that time we say debt for that purpose is qualitatively different thing than using debt to manage your growth and cyclical fluctuations in revenue.

Mr APLIN: Let us focus briefly on some of the outcomes, because in your submission you commented on desirable outcomes achieved through privately financed projects; could you expand on that comment?

Mr PIERCE: Ultimately the aim, not just with PFPs, but with any procurement method is the provision of the services the Government has decided it wants to provide. With PFPs that can take the form of either, I suppose, better quality services at the same price or a lower price for the same quality and quantity of service. That is the two extremes. Reality is always in the middle.

How is that better service obtained? As you go through the process it usually comes about through innovations in the method of service delivery, the way in which the private sector has thought about asset design, the way in which the design of the project mixed with the maintenance costs and the operation of the entity, perhaps there are some additional services in there that the public sector would not have provided. There are a few cases like that. The transfer of risk to the private sector is obviously a key thing in being able to say the public is getting value for money.

Having some assurance, this might be very much a Treasury perspective, but having the discipline associated with the process of getting all the Government agencies lined up and being very specific about what they want to buy, how long they want to do it, in the context where they know at the end of the day they are going to have to sign a contract with the private sector tends to focus the mind a bit better about what it is. It is one of the key things of deciding should it be a PFP or not, is how specific can you be in the contract you are going to buy.

Secondly, the way in which these assets are going to be operated and maintained, if it is embodied in a contract over a long period of time then perhaps we have a greater degree of surety that the asset will be maintained at that level as distinct from the annual budget processes and the tradeoffs that people may want to make further down the track between maintenance and other priorities.

Ms KENEALLY: Many of the submissions we have had have made an argument that, they have made the point that they find it difficult to work sometimes with Government in the bidding process and they have made many recommendations. One of which is that there needs to be some sort of central agency or body in Government that works with the private sector and negotiates on behalf of the public sector in putting together these deals. I am wondering if you have any view on that?

Mr PIERCE: There is a lot of things people say about that and perhaps one of the ironies of the situation is today, as compared to two years ago or a bit longer, two or three years ago the major complaint that was made to me was that we weren't doing enough PFPs and weren't getting them out quickly enough. There is no doubt that Treasury sits at the centre of these things, which is not to say that Treasury knows everything but as distinct perhaps from some others we think we know what we don't know and hence we are in a position to know what other skills need to be brought in particularly during the negotiation phase of the process before you sign a project. We will build up a team of people with various technical, service delivery, financial expertise as we go into this process. That is just a necessary part of the process if you are going to be sure that you have the right people with the right skills on your side of the table. What people often want on the other side though is one central agency that can negotiate all these contracts. One of the problems with that is that is fine if all you are concerned about is deal flow, just getting a lot of deals through. If your primary directive is service delivery and bear in mind that is an objective which does not fall away as soon as you have signed a contract, it extends over the contract life, then it is very important to us that the agency that has specified these are the services that we want and has to manage the contract over the longer period of time is deeply involved in the process. They have to take ownership of it if they are going to take ownership of the outcomes, the services being provided and have the commitment of the appropriate skills and resources to manage the contract over a period of life.

Ms KENEALLY: What about an agency that would only do a deal once every few years? The RTA would be building up expertise but another agency may not.

Ms SCHOTT: Given the amounts of those we do that is pretty well everybody. The RTA is an exception. I think if you look at education the first schools PFP that was done they went up a very steep learning curve on that but they now have that expertise and they know, as John said, what they don't know at least and they will get experts in. I think the danger of setting up a central agency to do it, which Treasury could certainly do, but we do not wish to do is that you can just drop things on top of people and then it is not theirs and if there is something wrong with it, it is because Treasury has done it. It has to be driven by the agency.

Ms KENEALLY: The policy objective.

Ms SCHOTT: The first time they do it it is difficult and it takes time. The second time it is a great deal better. You see that with health and education and housing at the moment are going through a very steep learning experience. So it goes on.

Mr PIERCE: It has not been completed yet but the amount of time that it will take to do the second lot of school PFPs will be considerably shorter than the first lot. The key point for us is to make sure that whilst we would not want to see the establishment of that unit which would be, I suppose, like the UK, very much part of Treasury, we do not want to see that, there is still a role for people such as the people here to be involved in each one of the deals with the agencies, each one of the projects with the agencies, so you get consistency of approach and you identify what the agency needs, check that you have gone and got it.

Ms KENEALLY: Where would you see the Infrastructure Advisory Group recently announced by the Premier working within this whole context?

Mr PIERCE: The objective of that, that just highlights that PFP, we should have the tail wagging the dog here, PFPs are a small part of our procurement and capital program. They are part of the process from conception all the way through but various agencies take the lead at various parts of the process from conceptualisation to doing it. They start to take the lead towards the back end of the process where the concern is having made a decision to invest in something, having made a decision about how you are going to procure it, that it actually gets delivered, if you like. In simple terms; it gets delivered on time and on budget. I would expect that whilst they will look and Professor Richmond is looking at some aspects of PFPs, most of the work will be in the traditional capital program making sure there is sufficient project management expertise and I suppose a lot of technical engineering expertise being brought to bear.

CHAIR: The union New South Wales submission argues that the public sector comparator is biased against public procurement because it double counts the cost of risk and calculating hypothetical risk, adjusted costs, and the high discount rate to reflect costs, your submission points out that the discount rate varies between projects; how is bias against public provision avoided?

Mr PIERCE: I suppose you could equally ask how bias the other way is avoided as well. There is a lot of things under that question. On the discount rate issue the argument I think within that submission, but certainly arguments I have seen elsewhere, have been that the public sector can borrow more cheaply than the public sector, therefore the private sector should build or own these projects. That is a simple one step of logic argument that leads to an intuitive but in our view and I think in the consensus view, is inaccurate. The shear simplicity of that argument tends to potentially cause people to stop thinking beyond that point. It can be responded to effectively in one of two ways. If it was true that the public sector could borrow more cheaply and therefore we should do them, the extension of that argument could be that therefore the public sector should be building everything within the economy, we should nationalise everything because we can borrow more cheaply and can build it more cheaply.

CHAIR: There are some who might argue that.

Mr PIERCE: The problem with that one is that if you start down that track then our credit rating would go into junk bond status. Why, because we do not have the tax base to support the level of debt we have to service, which gets to the heart of why we think there is a difference. That is because the rate at which people are willing to lend to the New South Wales Government has very little to do with the nature of the things we spend our money on. It has more to do with what our aggregates look like but also the wonderful thing that distinguishes a Government borrowing from a private sector borrowing, being the coercive powers associated with taxation. Essentially, their willingness to lend to us and the price that they are willing to lend to us is an assessment of given our taxation powers and how our aggregates look like what is the risk of them being able to get their money back? Which has very little to do with the individual projects that we are investing in.

In a sense the project risk or the costs associated with a project are particularly accepted specific to that project. The borrowing rate is not reflective of the risks in that project. Essentially the taxpayer is subsidising the cost by accepting the risks that the project would have associated with it. Hence, going back to my point about when we put the public sector comparator together we want to make sure that it reflects the cost of us doing it, which includes risks associated with over runs, delays, that sort of thing, which is not reflected in our borrowing rate but is certainly a risk that is inherent within the project.

One, for instance, it was not a PFP, because this applies generally; the redevelopment of the conservatorium. There is a cost associated with that. They got budget approval. They went ahead and did the project and digging along they find some gutters, certain heritage value, and hence because of the need to respond to that the actual cost that you end up with is significantly different. That sort of thing tends not to be reflected in our borrowing rate unless all your projects are like that and then you have so much in your capital program which you can not afford to pay back anyway. When the private sector, in general with project finance, the rate in which people are willing to lend to them is particular to that project and the ability of that project to pay for itself or the ability of the people behind to deliver it on time and manage the construction and do all those sorts of things.

Mr WHAN: Following up on the PSC; we have a lot of people tell us that they feel it should be a more transparent figure or they should be able to see up front what the public sector comparator is and any other information like that. What is your view the on the transparency of the process at the moment?

Mr PIERCE: We would like to see more stuff on their side of the project.

Mr GRAHAM: Can I answer that one. On social infrastructure projects it has been the practice for the ones we have had in the market place to release the PSC number to the relevant bidders. The guidance material has taken the position that we are trying to maintain the Government's competitive position in regard to these transactions, so the release or non release of the PSC to the bidders is a function of whether or not we feel it will achieve a better outcome for us. With the social infrastructure projects we have take the view that releasing the aggregate numbers to the private sector to ensure a better and more competitive outcome and to target our affordability level is clearly a good outcome for us.

There is a bit misinformation about whether or not the PSC is released, it is released to the bidders. It is not widely released in terms of public disclosure at that point in time because we are running a competition to get the best outcome from the bidders in the market place.

Can I address the issue of whether or not we are biased against procurement. A lot of people are unaware that traditional procurement requires a PSC, it is called a pretender estimate. If they do a pretender estimate and it exceeds the budget they have to come back to Treasury to ask for more money or they have to review and refine their project. They can not go to the market with a pretender estimate that exceeds their budget. When they go to the market and the market price comes back, if it exceeds the pretender estimate once again there is a check, they have to come back to Treasury to seek supplementation funding. What goes into the pretender estimate in a capital sense is no different in a PSC as it is in traditional procurement. So to say we are biasing is incorrect because we are putting in what we regard as our pretender estimate for the capital component of a PSC.

Mr WHAN: Do you have an assessment of how accurate your pretender estimates have been, how many of them are being exceeded by the market cost or vice versa?

Mr GRAHAM: The market place has changed slightly in the last six months but in the previous period the budget bids were coming in on or below the pretender estimate. There has been a number of things happening in the market place over the last 12 months. We have got international pressure or steel prices, oil prices, cement has been going up, there has been a cost push pressures there that are coming through in our tenders at the moment and this is being reflected in some of the tender prices. However, what we are asking agencies to do is to look back and see how they can refine their projects to better fit the budget they are given in terms of scope of work and type of arrangements they are entering into.

I think there is a misunderstanding that we do not to PSC for traditional delivery. We do. We call them a pretender estimate. The PSC does have a whole of life which is another difference. We are looking at the service delivery components, maintenance over whole of life and that creates another difference between a pretender estimate which is normally just for building of the asset.

Mr WHAN: Do you release PSC after the contract is signed?

Mr GRAHAM: Yes.

CHAIR: We have a number of other questions but due to time constraints are you prepared to take some questions on notice, because there are a few questions here?

Mr PIERCE: Absolutely.

Mr APLIN: In the face of the broad cynicism about the mechanism of PPPs/PFPs including the trading of accusations between parties when deals sour, do you have any views as to how to better develop 'partnership' in these projects?

Mr PIERCE: To date there is probably been only one project where that has occurred to any significant extent, being the airport rail link. I think we concede that original contract was overly complex and contained omissions and some ambiguous elements within it, bearing in mind that was a contract that was signed some time ago. I have tried to describe we have moved along the way. The approach taken today, certainly more recent ones, is to try to ensure that the contract terms are negotiated ex ante to reflect things like the intended or agreed risk allocation between the two parties and very explicit about who is taking what sort of risk and that can be written down. You can try and address the extent of any possible areas of disagreement that may emerge over time.

It would be true to say that in any contractual relationship, be they PFPs or anything else, there will be during the term of the contract areas where people disagree. It is not possible to anticipate what all those areas are but in light of experience over more recent years we do provide a very careful attention in the negotiations so that we can very clearly specify things like default termination payments and figures, indemnities and required insurances that people have to have and dispute resolution processes. When disputes arise people often think that there is a problem but when you go back to the contract details the way to resolve those quite often can be very clear. It is just people reacting to the existence of a problem without reference back to that which creates some of this atmosphere that there is something wrong. If somebody did get into financial difficulty with some of these it is often quite clear; the operator goes into administration, the banks come in and get a new operator, continue. At the extreme. Just to paint a very extreme position.

Mr GRAHAM: That has only occurred on one instance and that is the airport link instance. There is a lot of false information. The history has been quite good. Disputes have been able to be resolved within the contract framework we have got and as I say we have tried to standardise our dispute resolution procedures with the other states and territories by having a set of commercial principles that we are all agreed upon as to when certain things will happen, how to trigger and resolve those. It is not just in New South Wales, we have agreement in Victoria, Queensland and other states on the commercial principles that should be adopted on these contracts on PPPs.

CHAIR: Thanks very much for that. I am going to read on to the record the questions on notice without needing response, so they are on there.

In your submission you comment on the need to update the Working With Government Guidelines on PFPs; what changes are envisaged?

The Committee understands that the accounting treatment for PFPs is in a transitional stage pending development of an international standard. Unions New South Wales has recommended that there should be additional disclosure requirements of projects: Do you agree?

You also note in your submission that the PSC is only one of the criteria used to evaluate bids, does this generate confusion and should the criteria be more transparent to bidders and to the general public?

At page 33 the submission states that it is standard practice to conduct risk workshops involving key stakeholders to identify major risks in the project prior to financial close: Is this working?

Mr PIERCE: If the committees have any follow up questions or issues that trigger your curiosity please feel free to give us a ring.

(**The witnesses withdrew**)

MATTHEW JAMES THISTLETHWAITE, Deputy Assistant Secretary, Unions NSW, Level 10, 337 Sussex Street, Sydney, and

BETTY CON WALKER, Consultant to Unions NSW, Principal, Centennial Consultancy, 40 Lang Road, Centennial Park, Sydney, sworn and examined, and

NICHOLAS LEWOCKI, Secretary, Rail, Tram and Bus Union, NSW Branch, Level 4, 321 Pitt Street, Sydney, and

ROBERT GRAHAM WALKER, Consultant to Unions NSW, Professor of Accounting, University of Sydney, affirmed and examined:

CHAIR: Thank you for appearing before the Committee today. The Committee is pleased to hear your evidence. I am advised that you have been issued with a copy of the Committee's terms of reference and also a copy of the Legislative Assembly's standing orders 332, 333 and 334, that relate to the examination of witnesses, is that correct?

Mr LEWOCKI: Yes.

Mr THISTLETHWAITE: Yes.

Prof WALKER: Yes.

Ms CON WALKER: Yes.

CHAIR: The Committee received a submission from your organisation, is it your desire that the submission form part of your formal evidence today?

Mr THISTLETHWAITE: Yes, it is.

CHAIR: Do you want to make an opening statement?

MR THISTLETHWAITE: Yes, if I could. Can I thank the Committee, firstly, for the opportunity to give evidence this afternoon and can I offer the apologies of John Robertson, the Secretary of Unions New South Wales. He is attending John Ducker's funeral this afternoon.

What I thought I would do is give you a brief overview of our submission and how it came about and I will ask Nick Lewocki, the Secretary of the RTBU, to make an address to the Committee followed by Betty and Bob who drafted the report commissioned by Unions New South Wales.

In 2005 at the ALP state conference the union movement moved a resolution to establish a public inquiry into public private partnerships in New South Wales. A copy of that resolution is contained in appendix B to our submission.

That resolution was not moved out of any ideological opposition to public private partnership, it was merely moved as a means of looking at Government utilisation of methods of financing major infrastructure projects and trying to determine what is the best interests not only of union members in New South Wales but also taxpayers when we talk about the provision of major infrastructure.

The union movement has been concerned for many years regarding many aspects of public private partnerships, in particular the details of contract contracts. We find they are quite complex and many of the provisions and the negotiations associated with them are secretive. There is overall a lack of accountability in regards to the process that is being used by governments to look at public private partnerships, and in some respects we see there is no need for public private partnerships in many of the tasks or undertakings that are being entered into.

We are extremely concerned about the employment effects of the way that public private partnership contracts operate. In particular we have been concerned about the effects on public sector employment. In particular, skills acquisition and retention and the way that it has effected training and apprenticeships in this State.

We were pleased to see that the Committee had established an inquiry and when we were made aware of the terms of reference we did commission Betty Con Walker and Bob Walker to prepare a submission on our behalf. The basic reason is that public private partnerships are quite complex. We would not mind betting that there is not too many politicians that understand public private partnerships, let alone the members of the public. It is on that basis that we sought to get advice from experts and people who have been working in that field to prepare our submission.

We did establish a number of parameters in which we wish them to work and principally we went to them with the view that we weren't ideologically opposed to public private partnerships per se. We took a pragmatic approach and we asked Betty and Bob to have a look at whether public private partnerships are in the best interests of our members and New South Wales taxpayers. We asked them to look at the processes that have been used in the past by various governments in establishing public private partnerships, particularly in relation to major infrastructure projects in New South Wales. We have asked them to analyse that process and have a look and say, if that is not the best way what is the best process that the Government should be using to assess PPPs and negotiate contracts to ensure better accountability and a better deal for the taxpayers.

You will notice in the report one of the major recommendations that we make, I think it is the first recommendation, is the Government should be involved in setting public sector priorities, particularly in relation to infrastructure and condition reporting should be extended to the State level in respect of infrastructure in New South Wales. We have made that the base line for the establishment of where we should go with public private partnerships in the future.

We have also, as I mentioned earlier, made a heavy emphasis on the impact on employment in respect of public private partnerships and we have asked Betty and Bob to have a look at the issue of skills wealth in New South Wales, in particular in relation to the public sector. I think it is well known that the public sector has been a major employer of apprentices and trainees and skilling up young people in particular occupations. We believe that the economy at the moment in New South Wales is facing a deficit in relation to skills retention in a number of important sectors in the economy and one of those is construction, where public private partnerships tend to be quite prevalent and we have no doubt that an increase in contracting out in the public sector, public private partnerships has had a correlated effect on skills retention in the public sector. That was something that we asked Betty and Bob to have a look at in some detail. At page 83 of the submission there is quite an extensive analysis of the employment effects of public private partnerships.

That is an overview of the submission. As I said we do not hold any opposition to PPPs per se. Our report is aimed at improving the process and improving accountability not only for our members but for the taxpayers of New South Wales.

CHAIR: Can I make a comment here on the record: Obviously I want to thank you, or Unions New South Wales, for the many helpful suggestions for asking Government agencies about the policy framework. Part of your submission refers to your identification of the need for a review of the condition of State infrastructure and I should point out now that these issues are outside of the terms of reference of this inquiry. We do however have a series of questions addressing the terms of reference. So because a member of the Committee needs to go, or leave here, I am thinking because we do have a substantial number of questions to ask, perhaps we can ask some questions first and then if you feel that the opening statements need to be propped in we can do that then. Is that okay?

Mr THISTLETHWAITE: I have no objection to that.

CHAIR: You discussed the consequences of PPPs and the indications are negative. Are there any positive consequences of PPPs in your view?

Prof WALKER: I am not sure whether you are really aware that we made twelve very detailed recommendations. Some of those address some of the positive consequences. Ultimately public private partnerships in some form have been part and parcel of government procurement for a long period of time. The concerns that we have are that there has been, I think, a failure of accountability. I would stand back from the immediate terms of reference and say if we look back at the history of Westminster accountability the general view was that Parliament would have control of budget spending and the original idea was that all revenues would be paid into a consolidated fund and would only be spent as a consequence of parliamentary appropriations through budget bills.

The biggest erosion of that accountability structure that occurred was probably the establishment of statutory authorities which sold services to the public and received fees. But Parliament responded to those by establishing rigorous accountability regimes on Government owned businesses, requiring them to provide annual reports in very considerable detail to Parliament. Public private partnerships are a new, and I think probably the most substantial challenge to parliamentary accountability in several centuries. What is at stake really is whether deals made outside the scrutiny of Parliament are good for the taxpayer. There can be good deals and bad deals, the devil is largely in the detail.

Secondly, there is a concern about a lack of disclosure and accountability for some of these projects, because the detail of these contracts is often not readily available for public scrutiny. Ultimately some projects can be innovative. Within the submission there is a list of criteria which we think are relevant for Government to consider the merits of particular public private partnerships proposals. Some obviously would be good deals. Other could be bad deals. A lot of it turns on the elements of the contractual arrangements and the prospective returns being enjoyed by the operators. In essence the profits of an operator are the opportunity costs of Government. They represent the effective cost of financing these deals through public private partnerships. If a public private partnerships operator makes a return of 24.4 per cent, as is the case with the M2 introduced by the previous Government, that is effectively the cost of finance to Government of structuring this project through this form of off balance sheet financing. In other instances they could be good deals. It comes down to analysing each contract and looking at the detail.

Ms CON WALKER: In terms of the good aspects of PPPs, when you ask the same question of the touters or the advocates of PPPs, and we listened for a short while to the Macquarie Bank representatives this morning, and they seem to say that the benefits are if you take money out of consolidated revenue then you do not have it to spend on services. Their only other concept of a source of funds for Government was debt and they claim debt imposes debt on future generations, but then they went on to say that generations that use assets should pay for them. How do you do that without borrowing? Are they saying that if you build a road today then it should be paid by the today generation and used only today. It is a contradiction in concept. So asking us about the good aspects of PPPs, I am always interested to hear the benefits as put forward by the touters of PPPs.

CHAIR: Perhaps I can help you out there. We have asked the proponents for the negatives. It is asking you if you saw any positives and asking them if they saw any negatives.

Ms CON WALKER: We should say in preparing this report the Professor and I prepared what we believe is an independent report. Unions New South Wales, who commissioned the report, made no changes to our report. So we believe that it is an independent report. We have no ideological position which says that we are opposed to PPPs per se. I am not sure that that was clear too.

CHAIR: I am not sure that was my question.

Ms KENEALLY: If I can maybe switch to the PSC, because you have made a number of comments about the public sector comparator. You have expressed a view that the PSC disadvantages the public sector delivery of projects; could you expand or your views about what should be included in the PSC to overcome that bias?

Prof WALKER: This is a reference to recommendation six of our report?

Ms KENEALLY: Yes. I don't have the number in front of me.

Prof WALKER: First off I think the broad concept of the PSC was positive. The idea was that Government would provide assurance to the community that these were value for money. The Government at the time spelt out, through some guidelines, what should be contained in the public sector comparator. One of the points made in the submission is that those guidelines have not been followed. Contract summaries were to include the product of the PSC and a cost benefit analysis, I think they need to be looked at together. Of the reports we have reviewed that material was either not there, there was very little cost benefit analysis in all except as I recall one of the contract summaries. Incidentally, there was not an Auditors-General's report on them either and we have been unable to obtain copies of those. The results of the public sector comparator was summarised in a few lines. Moreover, another defect of that is that it is quite evident that a lot of public private partnerships have been subject to major design changes after the contracts were signed. The guidelines should have seen a revised PSC being prepared and placed on the record. I don't think that has happened either.

Ms CON WALKER: That takes us back again to a statement by the Macquarie Bank representative who said PPPs are bolted down from the beginning.

Prof WALKER: His comment was that Government avoids design risk because that can not happen with a PPP, but the evidence before you with the cross city tunnel demonstrates how that is just not factually correct. The evidence is there. The original announcements of the cross city tunnel were for a much smaller project and it got massively changed later on.

Mr WHAN: The private sector have said in evidence to us said that that generally disadvantages them when it changes part way along and imposes further costs on them.

Prof WALKER: The former Auditor-General made a somewhat sexist comment and said that if your wife calls for contracts for a new kitchen you are dealing with a competitive market, you get different contractors. If the master of the house wants to change the design, once you have accepted the contract, now you are dealing with a monopolist and they can charge you a fortune for any design change. Once you have signed up you cannot change. Once you have signed up it is not a competitive market at all.

Ms KENEALLY: In your view would greater transparency around the PSC, that is what went in to formulating it, making it available to bidders, publishing it after the bidding process, would that assist and aid in the fairness, the transparency of a PPP?

Prof WALKER: I think it certainly would. I have never seen a full PSC published, I have seen a table of one line without any detail about the calculations. That is not providing any assurance at all. The original part of the question asked about bias in the PSC. We reviewed this in the report. For a start, the idea was that estimates would be drawn as to what it would cost Government to provide conventional Government delivery as opposed to an indicative pricing for a PPP. That would be fair enough. Then the guidelines propose that an additional allowance be placed on the public sector delivery estimate to allow for risks because there is a high probability that there will be cost over runs. Some of the guidelines contain formulae to do that. For example, if there was a one hundred million dollar project and people believe that has a fifty per cent chance it will be twenty million over budget, they say the real cost to Government is a hundred million and fifty per cent of the twenty million over run. They put up a figure of one hundred and ten million dollars. That is a misrepresentation because the estimate was a hundred million, not one hundred and ten or one hundred and twenty, it was a hundred million.

Ms KENEALLY: In some sense that bias might be grounded in some fact. We have heard some evidence given earlier today about the percentage of publicly delivered projects. The percentage of those that are delivered either on time or on budget and the percentages delivered by the private sector. The private sector on the information we received had a much better track record.

Prof WALKER: It is grounded in fact. There is a book by a Scandinavian economist which looks at public sector projects world wide and attributes cost overruns to strategic misrepresentation by the proponents, and in brackets he says "i.e. lying". The proponents of these projects often deliberately underestimate them to get Government approval.

Ms CON WALKER: Because in any case we are not saying that the public sector will build these roads, we are saying as in the past there should be contractors building those roads. That has always happened. That has happened for the last fifty or more years.

Prof WALKER: My point is this; if there is a history of cost overruns first you should compare the private sector proposal as well on the same basis. If you are adding on a risk of cost overruns to the Government delivery but not to the private sector it is not a level playing field. It is tilted.

Mr WHAN: If you are a private sector person tendering on a fixed price contract you have built in your possibility of cost overrun already. If the RTA is building a road it says this is what it is going to cost and we build in a fifty per cent extra amount for costs going up in the process of doing it. Even when we are doing a Government job they do that.

Prof WALKER: By all means be consistent between one side and the other. That is why we suggested to the Committee it would be fruitful for you to get the agencies to give you all these public sector comparators, put them in the public arena, let there be informed scrutiny, then proceed. The way it is presented, I think it is symbolic behaviour. If I could just recount, I think in our submission we do recount, an experience in the United Kingdom where the deputy Auditor General in the UK said they are "mumbo jumbo", they are prepared at the last minute after the deals have been signed and changed and it is symbolic behaviour.

The second element of bias we mention in the report is that you either account for risk by adding on your estimates of future cash flows from the Government side or the alternative, which is generally rejected in the finance literature, is that you use a high discount rate to account for risk. Most academics disagree with using a high discount rate to account for risk. In the report we give an example of some of the dysfunctional consequences of that. For example the way the Government sold the State Bank for less than one years profit to Colonial and in the process lost two and a half billion dollars in the next two and a half years.

Mr APLIN: Can I move to another topic. On page 25 of your submission you suggest the statement:

> "The Government will only proceed with a PPP arrangement where it is satisfied that this is the best value for money option"

equates to 'Government will only proceed with a PPP that offers significant savings over conventional procurement options.' Now, do you have evidence to support the view that the Government's only consideration is economic?

Prof WALKER: I come back to my comment before that the Government guidelines about cost benefit analysis have not been published. A cost benefit analysis will go to nonfinancial aspects of these proposals. Our observations are that if you look at the contract summaries published since these guidelines were introduced they have not provided any details about the cost benefit analysis which looks at nonfinancial factors.

CHAIR: Could you please expand on the concern you have about privatisation and related practices effecting the decline of apprenticeship positions, recommendation twelve, is it not this an over simplification of complex structural changes to work force planning and I think part of that I am interested in as well is what you say about the effects on labour, movement of labour, transfer of labour, how you see that?

Mr THISTLETHWAITE: As I made the point earlier the public sector has been traditionally a hirer of younger members of society with a view to training them and skilling them up for careers in the public sector and in the wider community. The traditional method of doing that has been through the traineeship, the traditional method has been through apprenticeships. What we are seeing with privatisation and contracting out in particular Government departments is that there is not that emphasis any more on providing that skills wealth for the community. It is more an emphasis on bottom lines and being able to deliver the service as cheaply as possible, for obvious reasons. We believe that has had a correlated effect on skills enhancement and skills retention in terms of the wider wealth of the working community in New South Wales. We make some recommendations in the report about those issues being considered also, along with the economic considerations, when governments are considering public private partnerships.

CHAIR: We had evidence from Gary Sturgess from the Serco Institute and in his evidence he talked about, in the early days of the UK of PPPs, that there was not sufficient consideration of dealing with workers. He did not use the term “fairly”, he used "decently", which was an interesting term, his evidence suggested that now though, many years later, after many woes, that part of the PPP process there actually deals with and protects the transfer of workers and therefore their employment in law, which was of interest to me. The Committee asked him a number of questions in relation to that. It has been suggested in other evidence before this Committee that other countries experiences in the early part on PPPs have brought them to a position where we may be able to benefit from that new expertise and how one would go about protecting not just the worker from say Government to the private sector but transfer from private to private, such as contractor to contractor. Have you had any thought in relation to that?

Mr THISTLETHWAITE: We certainly have. That is the basis on which we negotiated - the union movement that is - a procurement policy with the Labor Government. That procurement policy recognises that in the contracting out of Government services any contractor should be abiding by laws and conditions, decent conditions, relating to employment standards in New South Wales. That is something that we have always considered fundamental to any process of contracting and something that I suppose in decades gone by has probably been overlooked in terms of the considerations that governments take when they look at these proposals.

The problem is that in terms of private to private transfers and the like with the federal governments impending work choices legislation the whole approach to private sector employment relations will be overtaken by the Federal Government, and will be out of the realm of New South Wales and that is a concern for us.

Mr LEWOCKI: If I could just talk about, in a practical sense, of the industry that I come from. We will use the example of the State Government handing over the interstate rail tracks to the Australian Rail Track Corporation and what has happened in that area when it comes to skills development, apprentices and training. In two years their training figure is zero. The Belmore training college that used to train the Government agencies three to four hundred people a year is now defunct. Of the one point five billion dollars of Auslink money has been made available for the first time to upgrade our rail system. I believe a lot of that money will be wasted because of the acute skills shortage out there. Private contractors and body hire companies who are approaching us to get the appropriate industrial agreements in place beg us, "Do you have any skilled workers out there?" Nobody is training. If you go to the rail industry and the privatisation there is an Australian shortage of train drivers. Cannibalisation is out there. What is holding back the competition of the private freight forwarders is they cannot get drivers. The Victorian Government is paying twenty thousand dollars a year bonus to drivers over fifty-five years of age to hold them in the system.

The Australian Railways Association has said a body placed in there from immigration where they are now looking to go to India and other locations to try and find qualified railway workers so they get migration visas to come to this country. That is what privatisation is doing to skills development in Australia. It is holding back industry. It is holding back the economy and in the UK, that you talk about what they have done, all I know is that as late as February it was reported in the Guardian newspaper that Jervis, which was a major rail infrastructure maintainer, withdrew from that area. It is now in trouble with twenty-four schools, three hospitals, and five accommodation projects.

You look at WS Atkins in the UK, a major engineering company, it has pulled out of its contract to run the entire education system. You only need to look at the airport link rail system under the previous Government, the taxpayers have paid out one hundred and thirty-eight million dollars, they are now going to flog that. What does the New South Wales taxpayer get for that? Very little. Nothing. If you look at the air train project, another project in Brisbane, it has had to be refinanced. You look at the disaster of Spencer Street, a PPP project down there, there are not many runs on the board that says these deliver value for dollar.

When we then talk about what do they do for skills, apprentices and trainees we see no evidence of that. That is a real concern that we have when you look at that. If you look at the procurement now, one point five billion dollars for the four hundred and ninety-eight railway carriages that are proposed to go out under PPP, it means that not only will the supply and maintenance be done by the successful bidder, the potential is that those carriages will be built overseas. What will that do to the skills base in Australia for rail manufacturing? Once it is lost and we detool how will we ever retool? Who will fund that. We are finding valuable railway skills in the maintenance area, people will take the redundancy package and go because they will not, in a lot of cases, accept the lower standards being offered in the private sector.

These are some of the concerns that we have when you talk about PPPs and as the report puts, it is not idealogically we are opposed to it. Our union supported the privatisation of Freight Corp from a pragmatic point of view because what we understood that if national rail was privatised by Federal Government they would cherry pick our contracts and a very valuable Government asset would be worth zero. We supported privatisation, after a hundred years of opposing it.

In the PPP area we really worry about this Government strategy of worrying about debts, borrowings and what about the alternate processes, alternate funding processes that are available? What is happening in the USA, Canada and Europe? Governments are issuing special bonds. The superannuation systems in Australia, they have got so much money now that they cannot invest locally. They have to go offshore. Why isn't the Government issuing special bonds, green bonds, health bonds, low risk? They do not need to earn sixteen and twenty-four per cent. There are alternate funding models. That is why we support this report. Let's not just look at what is the good and bad points of PPPs, but what are the alternate funding models. From the railway's point of view there has been a long history of lack of service, a run down of our infrastructure, our signalling, and it is almost as if the Government has raised the white flag to say, we can not manage. I have heard this argument; the reason we are going to go to PPPs is because the private sector can do it better. They can do it cheaper somehow. What do they do? They get exactly the same employees. I think we should be sacking the boards or the CEOs if they raise the white flag up and say that they can not manage a work force to get the sort of productivity.

The answer is not to go to the PPPs and hand it over because we don't know what the blow out costs could be for overseas workers being brought to this country. They are the sorts of issues that cause our union concern and other unions and that is why we are thankful that we have been able to put the report before this Committee. We think it does raise issues of honesty and saying let's be transparent. There are processes in place. In the work place we do risk analysis, occupational health and safety. I am not an economist, I am a union official, but I tell you what, this projects smells. You get out there and you talk to our people and it really stinks.

I see the guys coming in to my office with the pin stripe suits because they have to do EBAs and you ask them some fundamental questions about what are you going to do about training? What are you going to do about apprentices? What are you going to do about traineeships? They roll their eyes. They talk about subcontracting out again. We ask them what responsibility will you have for subcontracting out the work because the New South Wales Government will be saying well we expect proper conditions. They are saying market forces will determine that. They are the real concerns we have when you talk with about skills, retention of skills, apprentices and value for dollar in the railway industry, and I am sure it applies in health, education and other areas.

Mr WHAN: I was interested in the skills area as well. It seems to me that a lot of what you are talking about there is related to privatisation which is not really what we are dealing with here. There is also skills shortages in other industries. Would it not be true to say that one of the arguments for using privately financed projects, which is to bring it on earlier, for instance, a major infrastructure project would be beneficial to a lot of your members, that is construction industry employment?

Ms CON WALKER: That assumes that Government can not.

Mr WHAN: That is the argument which Government is getting. The argument which is out there at the moment, which Treasury provided us with earlier today, that they look at the overall level of debt and finance most of the projects through Government funding and then choose to bring some of the other projects on through privately financed projects. If those projects weren't happening surely you could similar argue from that that employment would not be there if that project was not happening?

Mr THISTLETHWAITE: It is a process of balancing. We are not saying that you shouldn't have any public private partnerships but we are also saying that there is complete aversion to any borrowing and debt and it is about budget bottom lines these days and every single major infrastructure project assumes now it will be done through a public private partnership.

Mr WHAN: I don't think the current rail untangling is happening through a public private partnership, it is off budget, the track work that is going on, the clear ways?

Mr THISTLETHWAITE: That is being done in the public sector.

Mr LEWOCKI: Are you suggesting that we get some guarantee that it is going to happen that way. Are you saying that work will not be contracted out?

Mr WHAN: No. All I am saying to you, I am pointing out to you that there is work still happening in the public sector, and a lot of capital infrastructure work is happening in the public sector. What I am putting to you is that, and you acknowledged that you do not have an ideological problem with PPPs, perhaps we need to acknowledge that where a PPP happens because the Government can not finance it otherwise, that it is providing more or does not wish to, makes a policy decision not to, perhaps then we should be focusing on how we, in writing up those contracts, how we make sure that we keep, protect the employee's rights and all those sorts of things?

Mr THISTLETHWAITE: That is one of the recommendations that we make.

CHAIR: That was what I was alluding to earlier.

Mr APLIN: Clearly we are concentrating on PPPs with this inquiry. How in your view could training of parties proceed to better manage PPPs, given that we want to focus on the terms of reference and they are a fact of life.

Ms CON WALKER: Training Government officials.

Prof WALKER: Public servants.

Ms CON WALKER: I am a former treasury official and in my time what I noticed was that the genesis of privatisation in New South Wales occurred by what I now call touters by advocates of privatisation or PPPs would come to the public sector and/or the Ministers and tell them a good story about how they can get a project done for them. It would be done off budget and it would be completed with all sorts of promises following. A lot of decisions were made on the basis of just that simplistic approach.

Mr APLIN: By the government department.

Ms CON WALKER: By Ministers, because Ministers make the decisions of Government. They were made as simply as that without any analyses of the Government undertaking the work versus the private sector, none of that was done. We are talking only ten years ago.

Mr WHAN: Treasury's evidence would contradict that.

Ms CON WALKER: Treasury's evidence today is telling us that only three per cent of current capital programs over the last ten years were undertaken through PPPs. That is my recollection. My comment on that is why bother? Why not borrow?

CHAIR: I did indicate that there is a time constraint, members do have to get away. What we are trying to do is get as much evidence as we can. If you could finish with the question because that is the member of the Committee needs to lead.

Mr APLIN: I am just interested in the training. Obviously we have not got to the point of whether there is a possibility of training. That comes to the expertise within the Government departments. How would you suggest it best be arrived at?

Ms CON WALKER: You need to recruit people who have that expertise and are able to stand up to consultants and able to stand up to advocates of the approach that they are taking on PPPs. The summary contracts of PPPs are actually written by consultants, not even a public servant writes the summary of the contract. If you look at the source of who prepared it they actually say so-and-so prepared it and they are all outside consultants. Where does the knowledge of the public sector lie in that regard? They cannot even summarise a contract or they choose not to. I don't know.

Ms KENEALLY: With all due respect, isn't this a bit treading on thin ice for you; you are consultants, you could make the argument that the union lacks the expertise to make a submission here today. .

Ms CON WALKER: Come on.

Ms KENEALLY: You are making argument that relying on consultants is somehow inherently bad or wrong.

CHAIR: I actually do not think that is a question. We need to move along.

Prof WALKER: Could I make two points in response?

CHAIR: If it is in relation to that statement I prefer we do not go any further on that.

Prof WALKER: I was going to comment on training.

Ms KENEALLY: It does relate to training. It comes to this core question of developing public sector skills in negotiating the PPPs and my point about consultants might be frivolous but I do want to pursue this question of how you develop these skills.

Prof WALKER: I have been observing public private partnerships since 1994. In 1994 the predecessor of this Committee, about a decade ago spent two years doing little else but advocating public private partnerships. Several overseas trips, and so on. I was so concerned about what I saw as a lack of skills in the analysis of these deals that I spoke to the then director of the Public Accounts Committee and offered my services to design some training programs and unpick the details of contracts, to train people how to work out the effective cost of capital being imposed on Government through these projects. I never heard from them again because it was a different Government in place. Later on in 1995 I was honoured by the former Premier to chair a body called The Council on the Cost of Government, which reported independently to Parliament and cabinet and in that position I saw some of the proposals about public private partnerships come through but I am not allowed to talk about those.

One of the things that the Government recognised was a lack of skills in the public sector and indeed New South Wales is the only jurisdiction in Australia whereby the leader of the Government has announced that after a grandfather clause chief financial officers of Government agencies should have tertiary qualifications and updated and continual membership of professional bodies. Again a predecessor of this Committee said that was élitist and recommended to Parliament that it should not be pursued. I still maintain that stance.

Mr WHAN: We have had a lot of people refer to the need for skills in the public sector and how we need to retain them. What we need to know is if you have any clear and simple suggestions about developing and retaining those skills?

Prof WALKER: There is now a Graduate School of Government and I hope courses in that area can be offered through the University of Sydney in the future. It was regarded as not important by previous members of this Committee.

Mr WHAN: A quick comment from Unions New South Wales about disclosure of PPPs and what your view is on what would be a satisfactory disclosure of PPPs for the community of the contracts basically?

Mr THISTLETHWAITE: Subject to the legalities associated with commercial contracts we believe the process should be as open and transparent as possible. The public and employees in areas affected have the right to understand what the contracts entail and whether or not they are value for money for New South Wales taxpayers.

Prof WALKER: Three quick points: First, the proposal to publish contract summaries is good. I don't see why it has to be two months after the contract is signed, why not immediately when it is in public view, so people can assess the merits of it.?

Secondly, it is interesting to note that there is currently a view that public private partnerships do give rise to liabilities of some form or the other. I heard Mr Pierce saying earlier in evidence before this Committee that it involves substituting one form of liability for another obligation. The Auditor General on ABC702 the other day said every one now recognises they give rise to liabilities. I wait to see whether that gets reflected in future financial statements. This seems to be a change of stance in the last year.

Ms CON WALKER: One concern I have; for a decade now the aim of Government has been to ensure what they call competitive neutrality for the public sector. I would like to just say that on 15 October in *The Economist* in the English journal this was one short paragraph,

> The common theme behind this disparate group of assets, says Mr Moss of Macquarie Bank, is finding businesses that have some protection from the full rigours of competition.

Yet we are trying to ensure that the public sector is totally on a competitive neutral basis. They are looking for the ones with the least risk and most profit.

Prof WALKER: I had three quick points and I only gave two. The third one was that disclosures and contract summaries should be updated when there are significant design changes.

Mr WHAN: Most of the private sector people have said that they do not object to the entire contract being out there.

Prof WALKER: The Bracks Government said they would seek to place all public private partnerships into the public domain subject to agreement by the private sector partners. I have undertaken a review of those contracts that were placed in the public domain and there were some notable omissions. It was the private sector particularly it seemed who are reluctant to provide the base case financial model, that was always withheld. We have heard today Macquarie Bank saying they have no objection to it being placed in the public arena.

CHAIR: Macquarie Bank, it was like a lot of other people giving evidence saying that one of the things that they thought was beneficial in terms of PPPs is that Government is clearer up front about what the desired outcomes are for them and the suggestion has been in some evidence that where Government has been, according to them, vague in what their expectations are that then you have the tenderers really having the opportunity to come back for a couple more bites to renegotiate later on, on the basis that no one quite understood what was wanted on either side. In fairness we have had a number of pro PPP people talking again about clarity, about transparency, not unlike many of the comments you have made yourselves today. I would like to thank you for coming in and taking time to give your evidence today.

Prof WALKER: Do we have a chance for our opening statements now?

CHAIR: I did indicate that if you felt that some of the questions asked did not allow you to make the points you would have made in your opening statements I am happy that you do that.

Prof WALKER: I for one want to make one statement. Earlier on you said that the evidence we presented about an audit of public sector infrastructure were outside the terms of reference the Committee. However, you did receive a lot of evidence from Macquarie Bank which said that governments set priorities for infrastructure spending and for capital works and you have allowed that evidence to be admitted. I would suggest that the proposals about an audit of infrastructure are consistent with that evidence in so far as it is suggesting how Government might establish those priorities. Macquarie Bank made a great deal of play about how PPPs would be entered into if Government regarded them as priority projects.

Mr WHAN: I think the point is that our Committee's terms of reference, we will not be able to report on telling the Government how to determine its priorities in infrastructure or how to determine the condition of infrastructure in New South Wales.

Prof WALKER: Of course not. Nor can you tell the Government anything either, you can only make recommendations to them.

Ms CON WALKER: Did not you set your own terms of reference.

CHAIR: I am advised that was Treasury who made the comment not Macquarie Bank.

Prof WALKER: Hansard will show. We were here and wrote it down.

CHAIR: I think the intent here was we would seek to gather as much information, we have the reports, we would gather as much information from you as we could to assist us in relation to the inquiry under our terms of reference and that if you felt that some of the questions or any of the questions asked did not allow you to cover some points, that I and the Committee would be quite happy that you cover those points at the end. You indicated that you had that one point you wanted to make.

Prof WALKER: I might amplify it a bit further: I once saw some documents obtained in an FOI from a previous Government about how they set capital works priorities, and the process seemed to be to invite members of parliament to nominate projects they thought were good ones. That was a previous Government. I don't suggest that you take the politics out of the budget process, not at all. But I think judgments should be made in an informed fashion.

Mr LEWOCKI: The time constraints we have got is not going to allow me to cover all areas I would like. We fully support the report and recommendations but the area that I particularly wanted to highlight is the PPP proposals within rail. Our real concerns that with the history of PPPs in New South Wales, particularly in those rail projects, they have failed and they have cost a lot of money. We are particularly concerned that we have reached a stage with urban transport in New South Wales, if not Australia, where the cost of maintaining urban transport is getting beyond State governments and needs to be looked at as a Federal issue. If we are putting one point five billion dollars into a PPP project we are not confident that we are going to get value for dollar, for the skills.

Mr WHAN: If you could specify a project.

Mr LEWOCKI: The four hundred and ninety-eight suburban rail cars that have been asked for. The experience that we have seen with PPPs, if that is repeated as a result of this, we will blow this money and this is once in a generation opportunity we have got for State Government funds to do this type of work. I am extremely concerned whether we call a contracting, privatisation or PPPs, what is going to happen to our country interstate track work where the first time we have received some serious Federal Government funding through Austlink that I am concerned because of skills shortages and very poorly thought through requirements on the contractors to provide the sort of training and skills, that alot that have money will be wasted because they will have to pay. I am not arguing about high rates of pay. They are going to have to go out and find people and poach them from other organisations and cannibalisation is occurring out there already.

Those are the points I make about PPPs. I am not opposed to it if it is good and it creates jobs, I am not opposed to it. What I am opposed to is I have been in this industry since 1963, I have been a full-time official since 1979, we have been under funded, we have allowed the infrastructure to run down, we react to crises, whether it is Glenbrook or Waterfall, the solution seems to be PPPs. Based on the report before the inquiry nothing convinces me that the Government has gone through the process other than from an ideological point of view and to some extent lazy Government by saying we can not manage in the public sector, let's give it to the private sector.

CHAIR: Just on that, just as a result of your comments what do you propose is the solution?

Mr LEWOCKI: I think the solution really is to look at value for dollar. What we have got out there; we have a skilled railway work force, we have workshops paid by generations of taxpayers, let's set some proper KPIs, let's set some benchmarks and challenges out there, let's put some management structures out there that say we can do it. And if we have tried that and we are doing it fairly and we fail let's give it to the private sector. But we have gone through generations of change; we have been told to up skill, cross skill, down size, up size, right size - the work force has done that. I think they deserve, for the first time when there is money available, the opportunity to get in and build and construct here in Australia and for the skills that we have been able to build up in our rail industry of maintaining, cleaning, servicing the new rail carriages, you will not get that through the PPP because they will be part-time contractors as we have with OSCARs, they are casuals, they are backpackers that they are employing, small numbers and I don't think that that leads to any real long term job security or skills in this country.

CHAIR: Just so we have got it on record - I separate, just because of my experience and knowledge of what happened in the UK in terms of rail, if we keep separate the carriages at the moment, that is for a different debate to the rail - are you saying that you believe there is sufficient labour there with sufficient skills and sufficient training to carry out whatever is required at the moment?

Mr LEWOCKI: Yes. To do the maintenance work on new carriages because understand that the new carriages will be replacing old carriages. We are not adding to them. If we are maintaining our existing rolling stock with the skills base we have got and we bring in new carriages, we may have to up skill, new sort of technology, computerisation, might have to do that, but we should be doing that. There is a work force out there. What will happen is that work force will transfer from Government employment in to private employment. The new companies will not come in with a completely new work force, all they will do is take the old work force and take them across. If that is the case, why do the private sector think they can do it cheaper. I say as a union official, not as an economist, not as a professor, it has failed everywhere I have seen it: The Airport Link, Spencer Street Station, the Air Train in Brisbane, the UK experience we looked at, the experiment with British track, the experiments with RAC in New South Wales, the experiment in New Zealand about handing track over and splitting it up; it has cost billions and billions of dollars. I am yet to see the argument saying how can we improve on what we are doing? The trade union movement has put its hand up and says we want to participate, work force says we want to participate; why are we playing around with PPP projects in this sort of area where it has failed before and the risks are so high. The taxpayers in New South Wales do not support it. You can see what is happening with the cross city tunnel.

Mr WHAN: Give the in-house option a fair go you are basically saying.

Ms CON WALKER: The mention by the Committee of Gary Sturgess and his assurances on employment give me no comfort at all, because he is an advocate of PPPs. He makes those comments from a self interest point of view. Finally, on the terms of reference, we felt that the Committee, by setting those terms of reference, accepted the concept of public private partnerships without much question and was examining the processes rather than the actual basis of public private partnerships.

CHAIR: That is probably correct, because there are some actually happening.

Mr THISTLETHWAITE: That is the basis on which our report has been prepared.

CHAIR: Can I say on behalf of the Committee thank you for taking the time to give us your evidence today. I should place on record my thanks to the staff of the Public Accounts Committee, Committee members and the dedicated hard working people of Hansard.

(**The witnesses withdrew**)

(The Committee adjourned at 2.15 p.m.)