

INQUIRY INTO ROAD TOLLING

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Legislative Council Portfolio Committee No. 2
Inquiry Into Road Tolling
Macquarie Room,
Parliament House
Sydney, NSW 2000

Dear Committee Members,

Inquiry into Road Tolling

I write to provide some comments on the matter of long term infrastructure contracts and road tolling projects.

I would firstly like to commend the New South Wales Parliament on conducting this important Inquiry. Many of the issues with which it is dealing have been matters to which I have turned my research attention over the past decade and a half. I made a submission to the 2014 Productivity Commission Inquiry into Public Infrastructure, and this submission draws in part on this previous work. In this submission, I will structure my comments to the Inquiry as follows:

- a) Introductory Remarks
- b) Toll Deals and Consultation (Inquiry T.O.R. b, c, d, e)
- c) Scrutiny and Transparency (Inquiry T.O.R. c and g)
- d) Value-for-money and Fair Returns (Inquiry T.O.R. g), and
- e) Role of an Independent Regulator (Inquiry T.O.R. f.)

a) Introductory Remarks

Long Term Infrastructure Contracts (LTICs) are a world-wide phenomenon. Often termed Public-Private Partnerships (PPPs), Concessions or Private Finance Initiatives (PFIs), these arrangements cover a huge set of possibilities and offer governments many advantages over traditional ways of delivering infrastructure. This submission argues that:

- 1) LTIC choices such as the tolling regime adopted and its level of confidentiality are public policy choices and ought not be misconstrued as being an inherent part of a contract technology or an economic approach;
- 2) Likewise, the relative roles played by on the one hand, the private contract law domain, and on the other, the independent public regulator are also matters of policy choice and are not fixed;
- 3) Choices on such LTIC contract matters and their regulation are usually part of a bigger context and it is often difficult to separate these decisions from one own beliefs about LTICs in general. On this broader contextual matter of LTICs, this submission argues that
 - i. whilst LTICs are globally popular today, they equally have ambiguities, complexities and weaknesses;
 - ii. we still know little about LTIC success even at the most basic levels (eg value-for-money (VfM) or cost-efficiency); and
 - iii. 'success' needs to be understood through politics as much as any one of the many technical rationales put forward advocating their use. Indeed, perhaps their continuing use owes more to their political advantages and adaptability than to any claimed technical superiority.

These LTICs or PPPs are generally ultimately funded through the public purse, whether by regular contract payments or through shadow pricing. The history of toll roads goes back thousands of years, but they are in one respect different to many other modern LTICs. They are an outlier in the sense that toll roads are usually funded ultimately not primarily through the government's own budget, but through the private budgets of users and citizens. Whilst there is clearly a degree of choice involved in the use of a toll road, this granting of a monopoly right to operate a piece of public infrastructure and fund this through the pockets of citizens arguably calls on the incumbent government to meet just as high a standard of accountability, scrutiny and responsibility as projects funded from their own budget.

These commercial deals are also typically structured partly through competitive processes and partly through a series of negotiations. It is unsurprising that citizens are inevitably concerned about the extent to which the interests of citizens and users have been met and balanced against short term political interests or private investment returns. How do citizens assure themselves that sufficiently competitive bidding occurred and sufficiently hard negotiations took place in their interest?

These are particularly crucial questions in today's environment of increasing distrust of governments, of experts and of hardened ideologies from the right or left. This is unfortunate. It is my strong belief that Australian political processes have, over time, delivered wonderful benefits and whilst far from perfect, have served the general citizenry well over the past century. The benefit of politics is not well understood let alone acknowledged. Having said this, however, it is also my judgment that the age in which we currently live has some unique characteristics in terms of the political economy.

It may even nowadays be more difficult to govern than at any time in history according to political scientists such as Flinders (2014). He argues that governments face increasingly well armed and well linked interest groups, and a more educated citizenry with higher expectations than in the past. And yet, governments in reality suffer an increasing degree of financial commitment and therefore constraint (through committed pensions, health care payments, etc). This tension exists, as well, in the midst of a voracious media driven by a relentless 24 hour media cycle hungry for news and fresh crises to report. This has led according to Flinders to an inevitable 'expectations gap' between what is expected by voters and what is realistically achievable by governments. In turn, this means that governments now look for solutions which enable the needs of voters and citizens to be met but which are also equally useful in political terms. LTIC arrangements, and toll roads in particular, meet this need like a glove.

b) Toll Deals and Consultation

Tolling contracts, to many commentators, are simply a commercial deal in private contract law. These deals, too, are for huge infrastructure projects which are inherently risky propositions. It is wholly appropriate that modern governments wish to more carefully manage such risks compared to past practices, and proceed with greater reliability as to the likely costs of such projects. And there is a great deal of research and writing extolling the virtues of LTICs and PPPs arrangements from a technical perspective. This point is followed up in section d), below. For myself however, and putting aside for one minute matters of technical debate, I believe that LTIC toll road deals are politically useful and that this characteristic itself has been a primary reason for their modern popularity. For a start, these LTIC deals in general terms are useful in putting the favoured project on the public agenda in an era where government is competing with many others for attention space and news coverage. Second, LTICs immediately focus our attention on matters such as speedy project delivery, as well as project scope, timing, and benefits rather than longer term matters of strategy, planning or consultation. Third, a large commercial deal structured through a single consortium and using private finance arrangements may be particularly useful in ensuring that government controls the agenda and confidentiality can be maintained until an

announcement is made. In other words, this large private contract arrangement helps government stay in charge of the initial debate. LTIC deals, including toll roads, have also assisted governments historically to strengthen their relationship with city financiers and demonstrate they were not anti-business; Hellowell (2010).

Equally, however, LTIC deals have for some time been criticised for being ‘essentially a two-way affair rather than including citizens’ interests - at least directly and explicitly’; Hodge (2002). In other words LTICs are ‘two way government-business deals rather than also involving the community or any other independent accountability bodies’; Hodge (2006). Indeed, once tolls have been set in Australia, little consultation is likely to have occurred and it may indeed be that tolls themselves have been ‘back-loaded’ so that lower tolls are forecast up-front, followed by higher than CPI increases through the long life of the project. This arrangement, with attractive looking (lower) tolls upfront but less visible rises in tolls later on, may well suit the Australian political and business needs of the moment but not necessarily the future needs of citizens or users. Such an arrangement follows the overall ethos of these popular ‘buy-now, pay later’ LTIC schemes. What is more, the visibility of these arrangements is in effect up to the government of the day to determine. But are the toll setting, consultative, transparency and accountability arrangements so often claimed to be ‘part and parcel’ of private contract LTICs set in stone? I think not.

Canada is a country which many PPP advocates like to point to as a highly successful demonstration of LTICs. Interestingly, it has recently done an about face compared to past Australian practice. In the words of my international colleague, Professor Matti Siemiatycki (University of Toronto);

‘Essentially, the government of Ontario got burned by the high profile sale of Highway 407 express toll road in Greater Toronto, where there has been widespread public anger about rising toll rates and aggressive collections by the operator. Since then governments across the country have tended to retain control over toll rate setting and demand risk on most toll roads, to protect the public interest and avoid political risk.’

This direction is also possible in Australia. But this would require a policy choice to be made, rather than continuing past policies (often with each state viewing its own LTIC practice as ‘the one best way’.)

c) Scrutiny and Transparency

Governance of LTICs is crucial. In one sense, many of our concerns over governance matters are not surprising. Governance matters are important in that the public interest needs to be protected despite the delegation of authority to private concerns. But at the centre of the PPP governance challenge there is an inherent and continuing tension. As Skelcher (2010) said, tight governance is needed to protect the public interest, but weaker governance is also required to enable risk-taking and innovation, along with incentivized private actor participation. These mechanisms can together provide a fair basis for potential investors as well as a framework that should reduce risks of corruption and opportunism. But PPPs ‘raise important issues of democratic governance’, and whilst ‘organizations in the public domain are required to account for their activities in the public arena of discourse’, ‘forms of third party government like PPPs muddy the waters of accountability’, and may lead to a ‘democratic deficit’; Skelcher (2010). PPPs are much like a form of quasi-governmental body, emerging in a multiplicity of forms through ad-hoc processes, and frequently a function of executive rather than legislative decision. So to Skelcher, creating effective constitutional oversight remains a priority challenge for PPP. Having said this, observers such as Willems and Van Doren (2011; 2012) oppose these views from the perspective of accountability and argue that most PPP accountability concerns are overstated and fail to understand the breadth of today's multiple and complex avenues through which communities hold governments to account. Perhaps the historical counterfactual of traditional

accountability and transparency mechanisms have also been somewhat romanticised and overly optimistic as well.

On the matter of transparency, I am on record for criticizing Australia's LTIC arrangements as being insufficiently transparent and for arguing that the commercial deals done on behalf of voters have been too secretive. General accusations levelled here from the international literature have included; ongoing analytical manipulation with public sector comparisons lacking legitimacy and favouring private finance delivery; decision-making arrangements lacking transparency; large complex commercial deals clearly being done with business partners rather than with citizens also as equal 'partners'; traditional methods of gaining access to information and review through Freedom of Information or Administrative Law not now available to citizens under private law contracts; and governments lacking accountability amidst multiple conflicting roles. I specifically labelled Victoria's privately financed infrastructure deals 'the illegitimate child' of the PPP LTIC family a decade ago (Hodge 2006: 324). I continue to believe today that there is a crucial need for governments to improve transparency if we wish to improve the legitimacy of private finance structures in Australia. But how might this be achieved?

There is clearly a period prior to the conclusion of commercial negotiations and contract signing during which the release of contract information is unreasonable. However, having said that, I have consistently argued that after the deal is signed and the decision has been made on behalf of the public, the details of the contract ought to be made transparent. Victoria's practice of summarising the contract deal (reforms which I personally advocated) is certainly useful here, but there is still much hidden. Contract details could be released absolutely, and as a condition of the signed contracts. Claims of commercial confidentiality by either governments or businesses could also be overcome at another level; by allowing access by say the state Auditor General or an independent regulator. So, various levels of transparency improvement are possible. But crucially, the material which remains hidden in Australian state government LTICs include the project performance characteristics which are needed to 'increase the assurance to the public that the tolling arrangements represent the fairest possible outcome' as the Committee's Terms of Reference say.

Put simply, citizens still do not know what price is being paid to private financiers to bear which risks, and citizens do not know what returns on investments the private financiers are expecting to earn from this public infrastructure. In my view, they should.

Of course, stock market announcements and share prices give some clues here. Melbourne's Southern Cross Station (in announcing its multi-million shortfall mid construction), the Clem 7 Tunnel in Brisbane, and Sydney's Cross City Tunnel projects all exemplify this. These were all clearly instances where the risks for private investors did not pay off and any government policy preferences for the use of LTICs was, at least in a commercial sense, vindicated. Governments in these instances were shielded from both initial construction financing and whole-of-life financing problems. But policy changes on LTICs desirably require an evidence base of what happens on these projects on average and we simply do not know the average return to private investors for these projects in Australia.

Interestingly, recent research has revealed that top industry 'insiders' are also split in Australia on the adequacy of current transparency arrangements, 'with half feeling satisfied with the current contractual arrangements, and the other half favouring greater transparency, because commercial confidentiality had alienated the public'; Hodge et al (forthcoming.)

d) Value-for Money and Fair Returns

There has been a long debate over the degree to which LTICs provide citizens or users with a good deal. Much has been written. But disappointingly little has been resolved. My reading of the literature is that whilst we might desire balance and objectivity, the public infrastructure research literature is these days filled with as much ideological and conflicted advice as sensible guidance. Most would concur with the Productivity Commission's 2014

observation that private financing is ‘not a magic pudding’ and that neither government guarantees nor tax concessions are costless. My opinion differs from that of the P.C., however, when they argued that ‘well designed user charges should be used to the fullest extent’ (unless of course governments are given a specific mandate at an election for this) and their view that ‘the [LTIC] market appears to be workably competitive’ (the basis of which was not at all clear to me in their report).

On the basis of my international research, I make the following observations:

1. Private financing models for infrastructure include a wide range of options such as DBFO, DBFM, BOO’ etc and many possible combinations exist for the two sectors to work together. There are hundreds of ways of structuring contracts to emphasize whatever dimension either party wishes to pursue. Fundamental dimensions pertain to the degree of finance from each sector, project specification and risk bearing, as well as incentives for performance, questions of performance measurements, issues of transparency, accountability and governance. Different Australian states use very specific versions of ‘LTIC’. But *there is no such thing as a single LTIC model*. There are in reality ‘hundreds of different models or public-private structures’; UK National Audit Office (2009, p. 6).
2. Most Australian infrastructure commentators and academics would view three dimensions as characterising LTICs; a preference for private finance; a bundled contract led by a consortium; and new accountability and governance arrangements. Leading international academics such as Boardman, Poschmann and Vining (2004)¹, however, would caution us and say that there is still huge variation in what is completed as an LTIC. Their analysis of jurisdictions such as Canada, catalogued 76 major North American ‘P3’ projects a decade ago, and noted that ‘less than half included a significant private financing role’. They also noted that ‘in practice, there ha[d] been considerable variation in the degree to which financial risk has been shifted to the private sector... and in some cases ... projects ha[d] ended up largely or completely financed by the public sector’. More recent analysts such as Siemiatycki (2013) likewise supported this stance saying *that there had been a range of ‘PPP’ approaches used to deliver infrastructure in Canada* and both the extent of the use of private finance and the extent of risk transfer had varied widely. He observed that whilst most Canadian PPPs have involved some amount of private capital, many also ‘received substantial up-front public investment...’ The example of the \$2.1 billion Canada Line Light rail project shows this with some two thirds of the funding in this case being public. As well, he argued that Canadian PPPs had also been structured conservatively and had incorporated construction risk transfers, with little demand risk transfer. Such contracts are seen as more conservative compared to the frequent contract renegotiations and even project bankruptcy noted elsewhere. Thus, in the face of considerable diversity in approaches across that country, Siemiatycki rightly questioned whether there was even such a thing as ‘the Canadian PPP model’ at all. We might similarly question whether the degree of variation existing in Australia warrants a similar conclusion of diversity, rather than the more usual assumption of convergence.
3. In international comparisons of the performance of modern privately financed LTICs versus more traditional delivery models, results have been mixed. One recent example of this is the paper attached; Hodge and Greve (2017); *On Public-Private Partnership Performance: A Contemporary Review*, published in *Public Works Management & Policy*, 22(1), 55. On this particular matter, we might observe:
 - a. First, as Hare (2013) put it, *the available PPP evidence is ‘both weak and mixed’*. And as Sarmiento and Renneboog (2014) noted, academics were generally skeptical that PPPs generated VfM, whereas governments were

¹ See also Boardman et al (2005) on this point.

not. These comments follow several reviews which have traced the international VfM arguments; (eg. Hodge 2010). The UK NAO (2009) found financial modelling which was ‘error-ridden and given undue influence as the basis for decisions’, and in which ‘too much weight [wa]s placed upon subjective judgments of risk, which can easily be adjusted to show private finance is cheaper’. It also explicitly noted the difficulty in properly evaluating the UK’s use of PPP, and stated ‘[so] government cannot satisfy itself that private finance represents the best VfM option’. The recent wider analysis of Boers et al (2013, 470) also reviewed 48 audit reports from 21 Audit offices around the world and concluded that ‘there is still no hard evidence to show that DBFM(O) projects represent the most efficient form of government procurement’, and that whilst there are potential benefits to be gained from using PPPs, ‘there is no reason ... to assume that these benefits will automatically accrue’. These recent analyses follow earlier sobering independent assessments, including those of my own.

- b. Second, I regard much of the *on-time and on-budget delivery analyses* as *fraught and often closer to advertising than to science*. And whilst analyses purporting better on-time/on-budget delivery are oft repeated, rarely repeated are analyses such as Pollock *et al.* (2007) who criticised the UKs on-time and on-budget findings as having no solid evidence base, stating that ‘all claims based on [this] are misleading’.² Importantly, analytical results independent from industry or government (ie proponent) funding are rare and peer open-ness of original data for careful analytical review is also almost non-existent.
- c. Even Australian results comparing PPP with ‘traditional’ project delivery (which includes both ‘design and construct’ and ‘alliance’ delivery methods) are subject to doubt. DTF (2009) showed that alliance contract costs increased the most after the business case at around ‘50%’, followed by ‘traditional’ (at ~20%) and then PPP (at ‘~ 5-10%’). *Including alliances in with traditional delivery would appear to have resulted in artificially overstating the difference between ‘traditional’ and ‘PPP’ delivery methods* (at least when ‘outperformance’ is defined in terms of cost projection reliability).
- d. Fourthly, and most importantly of all, *most of these studies either did not directly tackle or control for multiple confounding variables in order to answer the real question to my mind - the cost of infrastructure ‘per unit’*. That is, some projects may well come in better ‘on-time’ or ‘on-budget’, and private finance based prediction methods may be more reliable than ‘traditional’ projections (however these are defined). But that does not guarantee that projects have a lower unit price. Indeed, the only study in the literature that I have found which specifically tackles the project costs of LTIC private finance projects is the analysis of Blanc-Brude *et al.* (2006), which conducted careful regression analyses across EU countries and found PPPs were 24% more expensive than expectations from traditional procurement – ironically, at about the same magnitude of traditional project cost-over-runs.³ In other words, from a statistical perspective, we must control for the amount of work done, and in the absence of controlling for this, analyses of PPP vs ‘traditional’

² Difficulties in extracting this research data from behind government claims of ‘commercial-in-confidence’ also amplified the concern that peer review scrutiny of the UK’s well publicised studies of on-time and on-budget performance was not welcomed because they lacked rigor.

³ This review rightly cautioned against making any further VfM conclusions, however, arguing that life-cycle costs over the longer term were still unknown.

construction methods risk simply continuing the old public bad versus private good debate with little statistical control, and hence little veracity.

4. *The Public Sector Comparator*, after decades of criticism and as confirmed by the UK NAO, *is a tool highly capable of being manipulated*. Because of this, value-for-money estimated using the public sector comparator ought be regarded with a significant degree of scepticism. It is, in reality, closer to a broad guesstimate than an accurate forecast of improved value.
5. Locally, Fitzgerald (2004) argued that the *size of costs savings claimed* in his Australian PPP assessment *was largely dependent on the discount rate used* (with a lower discount rate suggesting a cost increase of 6 percent rather than the 9 percent cost saving estimated using the higher discount rate). This aspect of the PSC calculus is also interestingly still subject to considerable academic debate. Indeed Zwalfe et al (2014) looked at discount rates being adopted in eight international jurisdictions and found that most relied on a variable project specific discount rate formula; and that a prescribed number was rare. Moreover, most jurisdictions departed from the major theoretical views in applying a rate; the inclusion of risk in the discount rate remained controversial as the literature suggests; and no two jurisdictions had the same approach. As well, although certain themes were common, most governments had developed a tailored, jurisdiction specific approach to setting discount rate policy⁴.
6. Perhaps just as importantly here, is the likelihood that *we will still be having the PPP VfM debate in 10 years time* (which is what I suspect). Assessing the extent to which superior VfM may be achieved under particular public-private structures is an admirable ideal. But I currently argue, contrary to popular mythology, that at this point in time we still know very little about PPP success even at the most basic levels such as value-for-money and cost efficiency. Real technical challenges continue to confront PPP evaluation, and it remains a politically loaded task from the beginning. The PPP brand promises political success on the basis of symbolizing innovation and forward thinking from both sectors, and there has been much political capital invested in advocating jurisdictions across the globe. The ideal of PPP has power in the public psyche as well. Exactly what we mean by PPP success (or VfM) deserves more sophisticated consideration to my mind. PPP contracts should not be conflated with the broader planning processes in which they exist, and I am glad the Productivity Commission's report acknowledged that LTIC PPP contracts can be applied to projects which are most worthwhile, iconic and successful as well as being applied to projects which have been badly selected or badly conceived. Viewing PPP as simply a technical tool and VfM as a financial or economic matter, however, conflates political and technical rationality in my view. More than two decades after the initiation of private finance as a preference for public infrastructure, we still contest the value this provides for citizens compared to traditional infrastructure delivery methods. I for one have been explicit in my judgment in acknowledging that despite controversial legitimacy and VfM findings, 'PPPs have usually been politically effective for reformist governments'; (Hodge, Greve and Boardman, 2010). But *there is huge linguistic slipperiness in the matter of PPP VfM and 'success'*. Davies (2008, 200), for example, comments that in the face of Australian governments all providing 'directions for managers to achieve value for money, but [being] silent on how value for money should be measured', even our Parliamentary watchdogs, the Auditors General, have been frightened by the 'nebulous' VfM concept; Davies (2008, 216, 242). The VfM debate will continue for a long time yet.
7. One reason for this ongoing VfM and 'success' debate is the nature of the *multiple goals set for PPPs*. I have documented two dozen explicit and implicit goals of PPPs covering both technical and non-technical arenas; Hodge and Greve (2013). And only one of these goals is 'value-for-money'. Political judgments as to success are thus

⁴Australia's use of two discount rates in the analysis of social PPP proposals was noted as 'novel' amongst all jurisdictions reviewed.

likely to cover many criteria (as well as economic matters). To my mind, more thought is needed as to how PPPs contribute politically, and how to develop stronger analytical frameworks to analyse PPP as a governing mechanism with political payoffs as well as considering success from narrower perspectives such as VfM. (The place of PPPs as a potent governing tool to promote visible economic development is an example: 'nation-building projects'⁵ and 'cranes on the skyline' carry much political weight as visible measures of prosperity and signs of success.) Perhaps the PPP (LTIC) approach has helped put the politician back in the driving seat of economic activity and infrastructure development⁶?

8. The possibility of today's road tolling discussions morphing into tomorrow's strategy to initiate a system of *road user charging* is also an important aspect in this debate. On the one hand, no government would seriously wish to outsource its brains to a single tolling company. On the other, though, I am reminded that this road user charging debate *is also an old debate*. Interestingly, Pigou (1912, 1920) initiated the idea of road pricing to optimize congestion on public roads. Now, a century later, we still debate not only the technicalities of the market mathematics (or post-GFC - imperfect markets), but the reality of what we as a society wish to achieve through such a market mechanism, including just who wins and who loses when such policies are initiated. And rightly so, as this discourse itself part of contesting when markets may or may not serve the public interest.
9. One overarching concern on the question of VfM and the need for a fair and efficient return to private investors is the fundamental issue of *the capability of the public sector* to achieve this. Interestingly, this was a matter noted briefly in my early book *Privatisation: An International Review of Performance* (Hodge 2000, 152). It is also a matter on which I am about to publish.
 - a) In my early book, the research of Holcombe (1991) was quoted. He looked at contracts for a series of water treatment plants in the US, and then contrasted these against the operational experience of each. Holcombe's work voiced two concerns. First he argued that contracts for municipalities might often be less than favourable due to the informational advantage of privatizing firms, since they already knew a great deal about the task and probably about other agreements. Also, the private firm has an incentive to strike a profitable bargain, irrespective of unforeseen costs or circumstances. Second, he found that privatizing firms were allowed to pass on most of their costs to the municipality, so that deals were not in the interests of citizens. So, although contracts should in theory have resulted in lower costs to the service recipients, they did not and the end customer paid for any cost inefficiencies. This old illustration has relevance to today's considerations because it emphasizes the requirement to assess not only the theory of contracts but the practice of contracts, the capability of governments when signing deals and the need for independent economic intelligence when monitoring what citizens are getting out of such deals and achieving a fair balance for all involved.
 - b) In a forthcoming article submitted to the Australian Journal of Public Administration, a series of interviews with Australian LTIC experts are reported on the question of how well we are undertaking our LTIC governance task; Hodge et al (forthcoming). This article argues that 'governing LTICs is just as challenging as building public infrastructure in the first place'. It also suggests that debates around the legitimacy of

⁵ See <http://www.theage.com.au/victoria/channelling-his-mentor-treasurer-looks-the-goods-20130507-2j5ux.html#ixzz2gQxAHGJu>

⁶ This 'cranes on the skyline' led approach has been criticized, however. Buxton (2013) for example comments on the most recent Metropolitan plan for Melbourne saying that 'this is not a plan...it is a hoax driven by money', where government has 'largely given away planning to private interests', and now does not link infrastructure investments to land use.

LTICs will be long term because citizens hold expectations of the state to govern democratically in the long-term public interest and these are inevitably in tension with the need to maintain responsible commercial behaviour. In terms of governing these long term contracts, 'it was found that 'there [wa]s no single dominant type of institutional arrangement for LTICs' in Australia. Industry insiders argued that the state was adequately overseeing LTICs in general terms.

e) Role of an Independent Regulator

If public assets are to be privately financed and decision making is to be heavily influenced by the private sector, what rate of return ought be expected as 'legitimate' for many 'safe' public assets - both for their initial construction, and for their ongoing operation? Another important governance issue, this seems to me to inherently be a question for a professional independent economic regulator such as an Essential Services Commission rather than be subject to ad-hoc deal by deal arrangements at the whim of the government of the day. We are yet to have a serious debate about differences and similarities between our traditional expectations of independent regulators of say electricity or water assets, and the long term contractual arrangements inherent within an LTIC PPP. It is now needed.

This has not been the first time that major reforms to our infrastructure delivery mechanisms have been suggested. I argued fifteen years ago that 'there appears to have been a failure to recognize ... the need for strong governance independent of the government of the day...'; Hodge (2002, p12). I also stated before Victoria's 2006 Parliamentary Inquiry that insufficient attention had been paid 'to aspects of policy, planning and public accountability'; PAEC (2006, 90). In the same Inquiry, Duffield also added the comment that 'the neutrality of a regulator would assist in protecting the interests of all parties including the public interest'; PAEC (2006, 90). In the intervening time, I have continued to argue that it was time to 'try some new policy experiments in public finance and capacity building through new strong institutional options'. What is important to acknowledge here, too, is that LTIC approaches are flexible enough to adapt if governments wish. Infrastructure delivery today still offers manifold possibilities.

Academic literature has made a contribution here as well. Stern (2012), for instance, focuses an entire article on analysing the independent regulatory role versus the role of a contract. He firstly differentiates:

- i) Regulation by Contract, and
- ii) Regulation by Agency.

He reminds us that the history of 'economic regulation' (ie regulation by agency) was invention 'in the 19th century to provide a way of reviewing and revising infrastructure contracts, primarily for railways and later for electricity, town gas, and telecoms'. He warns that 'much of the standard economics literature is hostile to infrastructure regulation by agency (particularly regulation with discretion), and also to concession contract renegotiation'.

Despite this observation, he sees a large degree of equivalence between the traditional role of independent regulators (of privatised utilities for instance) and the long term concession contracts adopted for public infrastructure. He comments, for instance, that although independent regulators of privatized industries typically involve the use of regulatory licenses, 'these licences are essentially contractual documents. They are in many ways very similar to concession contracts in terms of their function and content' ... 'However, all long-run contracts have one fundamental problem. No long-term contract can possibly imagine all possible contingencies, let alone adequately cover them. Aside from known risks, there are just huge uncertainties. As a consequence, major economic and commercial surprises will arise, both positive and negative. Hence, all long-term contracts

are seriously 'incomplete'. As a result, they need monitoring and review processes that allow the modification of contracts and contract terms in an ordered and accountable way. That is where, for infrastructure industries, 'regulation' comes in', Stern (2012, p475).

After discussing several international case studies, he concludes that regulatory agencies have an important continuing role to play in public infrastructure. To Stern (2012, 495), 'regulation and contracts are complements, not substitutes' ... 'effective external, independent regulators, operating under clear and transparent procedures and legal 'due process' are crucial for successfully addressing the issue of uncertainty with large-scale, sunk network assets. They can help successfully address the problem that long-term contracts are inevitably incomplete'. Moreover, he notes that it is trust that is needed to underpin arrangements and he comments that even for developing countries, 'where infrastructure regulatory agencies can establish a reputation for effectiveness and fairness, they can contribute considerably to creating the trust necessary between supply companies, governments, and consumers for industries, which require long-term franchises / contracts and very long-lived investments. This pattern has been found over the last 25 years in much of Western and Central Europe...' (Stern 2012, 495).

And in conclusion, he states:

'Infrastructure regulatory systems and agencies may have many failures, but as yet, there seems no better mechanism for creating the trust necessary to sustain operations and investment in these long-term contractual arrangements. When they work successfully, they seem to be by far the most effective mechanisms yet devised to enable the orderly review and revision of contractual terms and to address the problem of contract incompleteness.'

I trust that these comments assist your Inquiry, and I look forward to speaking with the Committee in more detail.

Best Regards,

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