

REPORT OF PROCEEDINGS BEFORE

SELECT COMMITTEE ON THE CROSS-CITY TUNNEL

At Sydney on Monday 3 April 2006

The Committee met at 9.00 a.m.

PRESENT

Reverend the Hon. Fred Nile (Chair)

Legislative Council

The Hon. A. R. Fazio
The Hon. G. S. Pearce
Ms L. Rhiannon

Legislative Assembly

Mr M. J. Brown
Mr A. J. Constance
Mr P. E. McLeay
Mr J. H. Turner

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CHAIR: Welcome to the ninth public hearing of the Joint Select Committee on the Cross City Tunnel's inquiry. The committee has released its first report addressing terms of reference 1 (a) to 1 (e), which specifically relate to the cross-city tunnel project, the disclosure of contractual documents and communication and accountability mechanisms between the Roads and Traffic Authority [RTA] and the Government. Today's hearing will primarily focus on term of reference 1 (f), the role of government agencies in entering into public-private partnership agreements. The New South Wales Parliament's Public Accounts Committee is currently conducting an inquiry into public-private partnerships, which will cover some of the same issues this committee's inquiry is addressing. The two inquiries are complementary.

The committee has previously resolved to authorize the media to broadcast sound and video excerpts of its public proceedings. Copies of the guidelines governing broadcast of proceedings are available at the table near the door. Witnesses, members and their staff are advised that any messages should be delivered through the attendants or committee clerks. I advise that, under the standing orders of the Legislative Council, evidence given before the committee and any documents presented to the committee that have not yet been tabled in Parliament may not, except with the permission of the committee, be disclosed or published by any member of such committee or by any other person. The committee prefers to conduct its hearings in public. However, the committee may decide to hear certain evidence in private if there is a need to do so. If such a case arises, I will ask the public and media to leave the room for a short period.

We are aware that people hold strong and divergent views regarding the Cross City Tunnel [CCT]. I wish to emphasise that although this is a public hearing it is not an open forum for comment from the floor. Only questions from the committee and the evidence of the witnesses are included in the transcript. Uninvited interruptions are not recorded and may make it more difficult for witnesses to fully express their views. Finally, I ask that people turn off their mobile phones while in the hearing. I welcome our first witnesses, Mr Alan Evans, President of the National Roads and Motorists Association [NRMA], and Ms Wendy Machin, Director, NRMA. Thank you very much for agreeing to appear before the committee.

ALAN HANSON EVANS, President and Director, NRMA Motoring and Services, 388 George Street, Sydney, and

WENDY SUSAN MACHIN, Director, NRMA Motoring and Services, 388 George Street, Sydney, affirmed and examined:

CHAIR: Mr Evans, are you conversant with the terms of reference of this inquiry?

Mr EVANS: I am.

CHAIR: If you consider at any stage that certain evidence you wish to give should be heard in camera, please indicate that and we will consider your request.

Mr EVANS: Thank you.

CHAIR: Do either of you wish to make an opening statement?

Mr EVANS: Yes. On behalf of its two million members, NRMA Motoring and Services welcomes the opportunity to appear before the committee in relation to the cross-city tunnel. The inquiry is of interest to NRMA Motoring and Services because many of our members have expressed concerns about the level of community consultation undertaken by the Government and the RTA and consequences arising from its opening. We also have concerns about a number of wider public policy issues relevant to the inquiry.

As honourable members of the committee may be aware, NRMA Motoring and Services lodged a written submission to the inquiry on 18 January 2006. Our submission made several recommendations, many of which have been endorsed by this committee in its first report. Accordingly, on behalf of the NRMA Motoring and Services, I would like to congratulate the Chairman and other committee members on their first report. We strongly agree with the 17

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recommendations contained in the report and we call upon the Government to work with the Cross City Motorway to show leadership and to act upon the committee's recommendations.

In particular, NRMA Motoring and Services would like to see an immediate reversal of all category B, C and D traffic measures as well as a permanent reduction in the tunnel toll. We also call upon the Government and the tunnel operator to review category A traffic measures in order to optimise Sydney's local road network in and around the eastern and inner western suburbs. The cross-city tunnel has the potential to ease congestion as well as to improve travel times and public transport services. Unfortunately, to date this has not occurred because motorists consider it does not in many cases meet their journey tasks, or they do not perceive the use of the tunnel to be worth \$3.56 for the full length journey or \$1.68 for the east-north journey.

In relation to the traffic measures imposed, there appears to NRMA Motoring and Services to be little rationale for many of these changes, except to funnel traffic into the tunnel and to make it harder for motorists to take alternative routes. The net impact of the high toll and the 71 traffic measures is increased travel times and congestion. In addition, public transport in and around the eastern and inner western suburbs of Sydney and the CBD is worse off and the connectedness of Sydney's local roads network has been substantially eroded. I ask the indulgence of the committee to allow my fellow director, Ms Wendy Machin, to make some comments in relation to its impact on country motorists.

Ms MACHIN: Country motorists would endorse the view expressed by the President of the NRMA that there has been no benefit generally. Country motorists are not largely affected by the cross-city tunnel, but a couple of points are relevant. It appears from a country perspective to be a distraction. Government resources, both monetary and political, are being tied up in this issue and there have been several changes of Roads Ministers over the past 18 months. There were three fatalities in two days at the end of last week on the North Coast and the locals feel that some focus should be given to those sorts of road issues as well as to the cross-city tunnel.

Access to information about the cross-city tunnel for country people is unclear. We had that restated to us last week at a board meeting and function in Dubbo. People are not sure how they can get a tag if they are going to be in Sydney. I went through the exercise yesterday of making a phone call and found that somewhat conflicting information is provided. As we all know, the toll has been reduced, but different information was provided in regard to administration fees from that provided on the web site. Country people have to make an STD phone call, wait on line and go through a menu, so there is an additional cost to them in simply accessing the information. When they are in Sydney, the signage in and around the tunnel is very poor. That is probably a comment one could make about signage generally. People find themselves on the routes into the tunnel and locked into using it before they realise where they are. Some members have had that experience in recent times.

The closure of roads has also had an impact on country people. Many who will be coming to town for the Easter Show this week traditionally like to go out to the eastern suburbs where the show used to be held. Many of the popular old watering holes are out that way. The road closures are very confusing to regular Sydney residents, so they will no doubt be even more confusing to irregular users. They are the key issues from a country perspective. I emphasise that one of the concerns is that so much energy and so many resources are being directed to this issue. Country people feel there are significant issues outside Sydney that warrant the same level of concern.

CHAIR: So you would argue that there should be an option of paying cash as well as having the e-tag, or are you happy with the e-tag if information is provided?

Ms MACHIN: It is not realistic to expect a cash option. Clearly that is not the way tolls are going. However, there needs to be better information for country people and perhaps more places where they can easily get a tag or a pass of some sort on their way into Sydney. As I said, motorists are on the entry points to the tunnel before they know what is happening. They have only 24 hours to pay. If they do not know how to do that or do not realise they have to do it, they are penalised for that as well. There needs to be better information and more easy access for passes.

CHAIR: Mr Evans, you referred to the lack of consultation. Was the NRMA at any point consulted about the cross-city tunnel and the proposed road changes?

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Mr EVANS: No, we do not feel that we were adequately consulted. In fact, we sought to be involved in discussions, but we were informed by both the cross-city tunnel operators and the RTA that we were not representative of the community and therefore would not be included in the consultation process. We persisted throughout the construction of the tunnel to try to be involved in some consultation. Finally, early last year we were in discussions, but they were arranged simply to tell us what was proposed in terms of the charging regime and the operations surrounding the tunnel.

We went away and then came back, and I specifically met with the then CEO of the cross-city tunnel and the advisers and outlined our concerns about the regime they were proposing. They went to the administration fee and other features that we thought would impose significant burdens on casual users. Unfortunately, that advice was totally disregarded. We again reminded them that in the interests of motorists our two million members represent about 70-plus per cent of New South Wales households and that we would have to campaign vigorously to try to get a fairer deal for motorists. It was suggested that we could try our best, so we did.

One can contrast that with the M7 process. We again raised the issue and we were fully involved. There were regular consultations with the parties constructing and operating the M7 and the RTA, which resulted in a much smoother introduction and a fee or charging regime that was much more equitable and fairer to both regular and casual users. If one contrasts the two, it is a classic example of how to do it and how not to do it. We saw the same thing with the community consultation process. We observed the community consultation undertaken with regard to the cross-city tunnel and the M7. Again, one was an exemplary process and the other was not.

CHAIR: There have been media reports that the NRMA is very unhappy with the RTA's approach in terms of its legal responsibility to provide alternative access for motorists in addition to a toll tunnel. Would you like to comment on that proposition?

Mr EVANS: We expressed our concern to the cross-city tunnel operators. We were persistently told after the issue became a topic of discussion in the public domain that we should have been aware of this and that it was all in the environmental impact statement [EIS]. We have been through the EIS and nowhere can we see the extent of the proposed road changes. Some minor changes are mentioned and there are some impressions. The position we have always adopted is that although we would prefer to see public funding of roads, in the event that for a variety of reasons there is a toll road, there must always be a free alternative and very much what existed previously. That way it is attractive to people to use the toll roads. We have a range of legal advice. We would prefer not to pursue that because of the consequences for the State in upsetting contractual arrangements if it turns out the legal advice says there is a basis for challenge. We are very much about ensuring stability in government and in the economy, but unless we can see some changes that will ease the traffic congestion in Sydney and give a fairer regime for all concerned, it may be an option we will have to pursue.

CHAIR: The NRMA was critical of the high toll when it was announced. Does the NRMA have a policy of being for or against toll roads?

Mr EVANS: That is quite a complex question. Our position, in summary, is that we would prefer to see road infrastructure funded by government, firstly out of recurrent expenditure. We highlight the fact that motorists in this country pay \$14 billion in fuel excise to the Federal Government, \$2 billion of which is given back in road funding. In relation to State expenditure on roads, about \$3 billion, give or take the odd \$200 million here or there, is given back. Over the years it has been declining as a proportion of the State budget and we are concerned if that decline continues we will reach a point, probably in the next year or so, where less is spent on roads by government than is collected at a State level. Certainly at a national level there is a marked gap. We say there is an opportunity for governments, primarily the Federal Government, to return to the State more funds for roads that they collect from motorists.

In the event that for a variety of reasons they choose to use that money for other purposes, be it health, education or whatever, and you start to look at how you fund infrastructure, we believe debt should be the first option. The level of public sector debt in this country is remarkably low, particularly when compared with other OECD nations, with whom we always want to compare

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ourselves. We believe that should be the first option. If you then look at tolls, we have researched our members and one of the things that emerges is that in the event that a toll road is the only option they would prefer the Government to be the toll operator. The Government may use the private sector to construct the road, but the Government should be the operator. That way people have a high level of comfort that the money will be returned to the State for public benefit rather than for private profit.

Privately financed road projects are the last card in the pack. We would have to be convinced that that is the only option left to government in any shape, size or form. That would be if the Government was unable to do it through recurrent expenditure, unable to raise debt and unable to use the private sector to build the road and operate it.

Ms MACHIN: Can I throw in a quick country perspective? This is an issue that has cropped up in regard to the debate about the Pacific Highway, which is, I think, the busiest highway in Australia. It has been looked at for many years and there is still doubt about whether the traffic volumes will justify or make it economic for a private company to build it on a toll basis alone without government support. Generally local communities do not support the use of tolls on the basis that they do not want to be forced to pay to use a road that they have previously used for free. The view in the country would be, as Alan says, that government funding would be very much the first option, but in the case of a major transport link like the Pacific Highway, it would be acceptable if the way of accelerating the project was to use a combination of private funding and some tolling if there were also free alternatives or a fair way of charging local residents to drive up and down the coast on roads that to date have been free. The proposal now, as I understand it, is to fill in the gaps perhaps using some toll roads but giving other bits free. That also raises a whole new approach to tolling.

Mr EVANS: If I could add to what I said earlier, Australian Government debt as a proportion of gross domestic product is about 0.7 per cent, compared with the OECD average of 45 per cent. New South Wales is in a negative debt position at the moment, so there is capacity. There are all sorts of arguments about inter-generational equity if we are going to continue to fund roads either out of recurrent expenditure or by private construction and private tolling.

CHAIR: It just occurred to me that I should put on the record that I may have a conflict of interest because I am a gold card member of the NRMA, but I assume most members of the committee probably are.

Mr EVANS: There are about 700,000 of you, Mr Chairman, not that we would lose you in that 700,000. I think the conflict might be minor!

The Hon. GREG PEARCE: You mentioned earlier your concerns about the administration fees and various other burdens on casual users. Is there anything further you want to tell us on that?

Mr EVANS: I will use the contrast with the M7 again. When you look at the initial \$1.60 admin fee being charged for the cross-city tunnel, there is some confusion, as Miss Machin said. The web site says it is still there but the phone link says it is not. Then there was another fee for the beep pass, which essentially put you in a position of paying \$9.46 for first-time use when the tunnel opened and then seven days later you had to pay that again. We thought that was intolerable for casual users, not only for country people but city people as well. We went through that when we sat in with the M7 operators. We said this was a major issue. They have come up with a better proposition, which is you ring in and give your credit card number, using a 1300 number as opposed to the 92 number that the cross-city tunnel used, and as Miss Machin said, country people have to use STD if they are going to ring up prior to using the road. You can ring up and give your registration and credit card number and then each month you use it there is a one dollar admin fee. If you do not use it, if you use it in April but not in May, you do not get charged a dollar. We think that is a far more equitable approach and it certainly gives a higher level of comfort. It also gets these arrangements across to casual users. We try through *Open Road*, which goes to 70-odd per cent of New South Wales households, to explain what the various charging regimes are, what the options are and how you can go about it. The contrast was very stark at the outset between the M7 and the cross-city tunnel. It is less stark now but a bit confused.

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The Hon. GREG PEARCE: You mentioned you had been through the EIS trying to find the road closures and other management issues. One of the interesting things in this inquiry is that surprise, surprise, no-one has actually owned up to responsibility for the road closures.

Mr EVANS: I understand why not!

The Hon. GREG PEARCE: I want you to expand on the impact on public transport. I think you used the expression "connectors have been eroded".

Mr EVANS: We ran journey times prior to the opening of the cross-city tunnel and we have run them since. We put in our submission that there have been quite significant increases. It has also impacted on public transport. From the information we are given, those who use public transport are also finding their journey times have slowed down. Traffic engineers are doing some examinations for us now, feeding back from the roads that have been closed or changes that have been made, seeing what the impact is spreading out from the centre. That will take some time for us to analyse, but it certainly appears there has been some impact.

The Hon. GREG PEARCE: You will publish that, I suppose?

Mr EVANS: I think we might!

The Hon. GREG PEARCE: What is the association's view on the light rail proposal to ease city congestion?

Mr EVANS: We have a broad approach. While we are an organisation representing motorists, we have a very strong commitment to public transport because we believe a rational human being, given a choice of efficient and cost-effective public transport versus getting in their motor vehicle to get from home to and from work—if they fail to make the rational choice the whole market argument goes down the drain. We support improved public transport measures including options such as light rail, but we think there needs to be an examination involving all of us—government, community and organisations like ours—so we can ensure there is an equitable approach.

We think light rail is an option but you have to look very carefully at its impact on traffic flows generally. The reality is, and our research shows, you are not going to get Australians out of their cars, either for work or recreational purposes. People will use public transport where it is the rational choice.

Mr ANDREW CONSTANCE: Miss Machin, I particularly want to thank you for your earlier words. I think country users are apprehensive about utilising Sydney's toll roads, particularly in light of the fact that a lot of country people do not have credit cards and those types of things. There is an apprehension about driving on some of these roads. You mentioned NRMA doing something about this through *Open Road*. What types of activities do you think the toll companies should engage in to better educate country communities?

Ms MACHIN: It also needs to be borne in mind that probably a lot of people who are confused and apprehensive are older motorists. We had a lot of people to a function last week in Dubbo, which is where the question again arose. The comment was made, "Who uses the Internet?" A lot of country people do not have access to the Internet, and if they do it is not very good; it is very slow. For various reasons they choose not to use it. I think there needs to be a 1300 number. That would be very helpful. People would know they could call toll free, because at the moment they have to ring a Sydney number and go through a telephone menu. They spend a couple of minutes on the phone before they actually get to talk to someone who can answer their questions and then process their credit card, if they wish to use that. That is a cost in itself. A lot of country people still do not use mobile phones, or if they are driving from their home to Sydney it is most likely their mobile phone coverage will drop out, so that makes it difficult for them. Some better publicity is needed in the usual channels, such as print media, and where motorists would normally access information, through organisations such as NRMA. We have a network of offices around country New South Wales and we are looking at doing something using those. It could also be done through the RTA and service stations, so people firstly know where to go—maybe there could be some simple maps to help them with signage. As I said earlier, it is very poorly signposted. I guess that is deliberate because the

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operators want more people to use their tunnel. It is scary and off-putting to people to even think about driving to Sydney and going into those sorts of areas. I think that if they could make that information more widespread, and perhaps make it easier to access, for example, with a 1300 number, it would be a start.

Mr EVANS: We were concerned about casual users, whether they be city or country. The choice was to either purchase an E-tag from any one of the suppliers—and that is an interesting contrast when you look at the cost of the E-tag across the system suppliers. The RTA has the more cost-effective E-tag. Through our counterpart organisations internationally, we have been looking at some options emerging which will essentially be almost like a label, with a chip impregnated which will have an amount of credit in it. That is probably somewhere about a year or so off at the most, but they are starting some trials in the United States with a tag like that, which we could sell. We have 260 countries service centres, which would be useful, but also the networks around Sydney. So the casual users, if they knew they were going to go through a tunnel, could get this. You basically just put it on your windscreen, like a label, and when the credit runs down you have to buy a new one. But we are looking at a cost for one of those, projected in about a year's time, of about \$2.50, if it proves to be feasible.

CHAIR: You never thought about marketing the E-tag?

Mr EVANS: We thought the field was a bit crowded. We have offered the operators to use our country service centre network to market options in terms of either people getting the credit before they come in with their registration et cetera—I have to say, none of them have taken it up with us yet, but there are 260 centres around New South Wales, plus the branches in Sydney, which people would go to if they were going to use the tunnel, give the information, get their credit, or give their credit card details or some means of transacting and getting a credit. But, as I said, none of the operators have taken it up yet.

Mr ANDREW CONSTANCE: Ms Machin, you referred to signage. Does the NRMA have a position in relation to health warning signs upon entering tunnels?

Mr EVANS: We have expressed some concern, because again it is an issue that comes back to us from members who are experienced in tunnels. There is debate about the effectiveness of filtration. We believe there needs to be a trial to demonstrate. There is conflicting evidence as to whether it is effective or not, and as to the type of filtration or extraction that should be used. But certainly, if there is a risk we believe that, with the electronic signs that are available now, people should be given some advice that there may be a risk when they enter this tunnel because of the level of pollution. The percentage of asthmatics in Australia is quite high; they can be adversely affected.

The RTA can put all sorts of warnings throughout its network in New South Wales as to crashes, delays, et cetera. It should be fairly simple to also put up advice that there may be some risk if you suffer from respiratory disease if you enter this tunnel. At least if you have the information you can make a choice, rather than going into the tunnel and suddenly finding that the level of pollution is such that it affects your respiration and you have a reaction.

Mr PAUL McLEAY: Mr Evans, you said earlier that the NRMA is of the view that B, C and D roads should all be open.

Mr EVANS: Yes.

Mr PAUL McLEAY: What is your view on the Premier's recent announcement about the toll being cut in half for at least three months and all C and D roads reversed?

Mr EVANS: Not all C and D roads were reversed.

Mr PAUL McLEAY: What is your understanding?

Mr EVANS: A number of changes that were due to be implemented would not go ahead, and that some C and D roads were changed, but not all. I did not think it was all. We welcomed those, and we said that publicly.

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With regard to the reduction in the toll, we also welcomed that. But I have indicated, both publicly and privately, to the Government and the cross-city tunnel operators that if they put that toll back up in three months time, that will have an adverse reaction. So if it is not financially feasible to maintain it at that level, they may have been better off not reducing it so much but bringing it to a certain level.

We advocated that, on our figures, somewhere around \$2.90 would actually increase traffic levels, give them a level of revenue which was commensurate with what they would get at the \$3.60 mark. And I advised them of that. We supported them bringing it down to that level; we would not have been critical and said they should have brought it down further. Our problem is that if they reduce it by 50 per cent, as they have, but then put it back up at the end of the three months, that will have a negative reaction and we will never get out of the syndrome we are in at the moment.

Our research shows that a number of people are not using the tunnel because they have a negative reaction to the fact that they are either being forced to use the road or they think the rate is too high. Even though there may be some benefit in their using it, there is this high level of resistance, higher than we have experienced with other toll roads.

Mr PAUL McLEAY: Given that they are still in ramp-up, did it surprise you that the evidence we heard last week showed that, on average, there were only about 5,000 additional users per day?

Mr EVANS: No. We have been surprised at the depth of resentment amongst motorists. As I said, we have not seen it. It is almost like, "Even though we may get some benefit from using it, we are not going to, because we think we are either being forced into it because of the road closures or we think the toll is too high." As I said, we have never experienced that to the same level. So I am not surprised; indeed, to be honest I thought it might be a little bit more.

But also, our information was that the level they thought they were going to reach at 90,000 was significantly in excess of what other proponents thought would be the highest volume of traffic through the tunnel. I do not have the evidence in front of me, but from discussions with other proponents I understand that somewhere around 57,000 to 60,000 was considered to be the maximum toll usage at its peak, so there is a gap of 30,000.

If you look at the ramp-up history of toll roads, that might explain why it is only 5,000. If you say the more realistic level in the future is somewhere around 60,000 rather than 90,000, maybe the growth figures are not as bad as it would seem on the surface.

Mr PAUL McLEAY: Do you think the fact that it was Australia's first cashless motorway had any impact?

Mr EVANS: Yes. As I think we mentioned to them, there needed to be a high level of education because the percentage of people who were likely to be the users of that road, and on our analysis had E-tags, was somewhere around 15 per cent. So there was a big gap. You needed to have a good lead time, and you needed to have almost a trouble-free tolling system, and that did not happen.

Mr PAUL McLEAY: Is that because people in the eastern suburbs have never had a toll before?

Mr EVANS: Yes, and people going to the eastern suburbs from the western suburbs had not needed a toll before. So you needed to have that education period, to make sure people knew that the world was changing. But also, you had to make sure that every other part of the system was in sync. Can I say, the contrast was—and we watch things closely—on the M7 they spent nearly 12 months trialling their tolling system to make sure it was debugged, compared with a relatively short space of time, literally weeks, with the cross-city tunnel. And there were a number of problems to emerge. When you go to the first electronic tolling cashless system, you have to make sure it is perfect. But, again, you get resentment from motorists.

Mr PAUL McLEAY: Do you think more people should be using E-tags?

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Mr EVANS: I have said publicly that if you give clear intentions and clear indications that all roads will be cashless, and you give enough lead time, you set a date— We are realistic at the NRMA; we do not live in this world that says you can have your cake and eat it too, and then have another piece of cake. If that is where it is heading, and that is where the Government wants to head it, and it says, "This is where we are heading, and this is the date on which we intend to have all toll roads in Sydney cashless", providing that time frame is sufficient—and we may talk of somewhere around six months or so—if you have the publicity, I think we can reach it. That is where it has to go. Being blunt about it, if we do not increase the number of E-tags on the Harbour Bridge and the Harbour Tunnel, when the Lane Cove tunnel opens you will see a replica of what has happened with the cross-city tunnel.

Mr PAUL McLEAY: Do you have any suggestions as to how the community could be encouraged to take up E-tags?

Mr EVANS: Yes, by basically saying, "This is where we are heading. We want all roads to be cashless." And Government offering some incentive for people who are occasional users to either lease E-tags at a lower cost— Essentially what you are doing is leasing the tag at a lower cost— because the savings to all and sundry, if it is cashless, will be quite significant. There is significant public benefit in getting people to move through those roads and those tolling arrangements much more quickly and with less fuss.

Mr PAUL McLEAY: It is a benefit not only to the Government but also to the road user. Therefore, why should the Government be paying—?

Mr EVANS: Because there is a community benefit as well. This is part of the problem you get when you get privately funded toll roads. There are significant community benefits from having less congestion on the service roads, for example, with the cross-city tunnel. Yet, in this case, the motorists are expected to meet all the costs of that benefit, not only to themselves but to the community as a whole. There it is an argument that says the spill-over benefits that accrue to the community should be, in some ways, paid for by the community. And that would be one way of doing it.

Mr PAUL McLEAY: You are saying that the community should help fund—?

Mr EVANS: We are talking about the argument of moving to cashless tolls, for example. I mean, we are the community; we pay taxes. So, if we are not getting an E-tag now but we are an occasional user of the road and the option is there to get an E-tag, if we want people to use E-tags one way of achieving that is by providing an incentive to do so. The M7 seems to be working remarkably well, with the preparedness of people to advise; they have a 1300 number. The other thing we would say—

Mr PAUL McLEAY: What are some of the other features of that, which you would recommend for future road projects?

Mr EVANS: We have argued very strongly that if you go to Melbourne, with their toll you have 72 hours, once you use the toll road you ring and say, "I have used the road. Here are my credit card details and my registration number." They can then do the matching. It is 24 hours for the cross-city tunnel. We would argue for 72 hours. Often people are doing it over the weekend. They come down to watch the football, to see their team get beaten, et cetera. If you give them 72 hours, you make it more convenient and easier for them. Then, over time, I think you will see people use it because they are much more comfortable about it. But we have to go there. We know we have to head to fully cashless toll roads across the whole network.

Ms LEE RHIANNON: Firstly I apologise for being late; you may have covered this. I am interested to hear the NRMA's attitude to public transport, and whether you see that expanded, more efficient and reliable public transport benefits all commuters, irrespective of whether they are in cars or on public transport.

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Mr EVANS: I am happy to repeat this. We are supportive of making sure that there are increased public transport provisions in both city and country areas. As I have said, in a rational market the rational user will choose public transport if it is more efficient and more cost-effective for them. Where it does not meet their needs, and they do not have that choice, they will use their motor vehicle. But if a rational person is not going to use the rational choice, it destroys the whole argument about the market working properly. As I have said publicly, if you look at the great cities of the world—and Sydney likes to see itself as a great city—look at their public transport systems.

There is a cost. I have to say that if it meant diverting some of that \$14 billion we put in fuel excise and only got \$2 billion back—if the Commonwealth Government is prepared to say to Sydney, "We will provide you with additional funds to build an improved public transport network", we would not have an argument with that. You just have to get a better public transport system in order to make sure you have full choice and it is a rational choice you can make. At the moment people are being forced to make choices that may not be what they would like to do, because they have no choice. To get from A to B, that is from home to work, the journey times on public transport may be too great or too inconvenient, so they can go more directly from A to B by their motor vehicles.

Ms LEE RHIANNON: Does that mean the NRMA would be concerned about clauses such as those in the cross-city tunnel contract and the M2, whereby public transport cannot be developed in the vicinity of the project because if it is the Government will incur a financial penalty?

Mr EVANS: We would have strong concerns about any provision in any contract for any toll road which removed choice for the Government or the community in terms of either the use of motor vehicles, the use of public transport, or the development of options. If a toll road is built, it is to ease congestion, to provide a more convenient journey, at a cost to the motorist, and the motorist can make that choice to go either the old way or the new way, which saves them time. But if you then prohibit further future development, we would be extremely concerned.

CHAIR: You mentioned earlier that the RTA—or was it just the cross-city tunnel consortium—did not regard you as a consumer.

Mr EVANS: That was in regard to the cross-city tunnel, and the RTA. Both the RTA and the cross-city tunnel operator said when they were doing the community consultation that they did not regard us as a community organisation.

CHAIR: Have you been able to rectify that by approaching the Government or the Premier to get some agreement about the fact that you represent motorists in particular?

Mr EVANS: I do not think there is any doubt now about the fact that we are a community organisation and that we represent the views of two million motorists.

CHAIR: And you would be consulted in the future?

Mr EVANS: Certainly. We have learned to ensure that the public knows when we are not consulted and when we are not happy.

CHAIR: Have you been consulted on the Lane Cove tunnel?

Mr EVANS: Yes. We are presently engaged in consultation. We can see some serious problems emerging with that. We do not want to see problems. We would rather get in and work with the Government and the operators, or the constructors, to solve the problems rather than wait until it opens and then say, "We told you so" and start a campaign. We would rather fix the problems at the outset.

Mr PAUL McLEAY: I know that the NRMA has a view about several roads or highways that should be opened. On what basis did you say that the Pacific Highway was the busiest highway? It sounds surprising.

Ms MACHIN: I probably should have said outside metropolitan Sydney.

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Mr PAUL McLEAY: Do you have a league table or a preference as to which highway should be upgraded first? Do you agree that tollways, whether they are public or private, are a suitable way of bringing them forward?

Mr EVANS: We are realistic. If the F6, for example—somewhere close to you—was to be brought forward and it was proposed that one option was a toll, it is highly likely that we would support the Government by saying, "This will be a toll road", provided it met other criteria. We would prefer to see it operated by the Government so that we know the money is coming back into the public sector somewhere or other. That would be an example of where acceleration of the construction, which is not planned, might be beneficial. We can certainly see growth in the traffic there. Do we have league table? Yes, in broad terms. We see the Pacific, the Princes and the Hume as the major arterial roads, or major interstate highways, that need work on them.

Mr PAUL McLEAY: In that order?

Mr EVANS: In that order, essentially, yes.

Mr PAUL McLEAY: I do not want to put you on the spot.

Mr EVANS: I am happy to answer your question, but do not exclude one for the other. The greatest need is based on the risk to the motorist. There is a greater risk on the Pacific Highway than the Princes, and then the Hume. That is the way we have looked at it.

Ms MACHIN: We used accident data and other economic data. So it is not just a gut feeling; it is what the statistics tell us are the areas of greatest need.

CHAIR: Thank you for appearing before our inquiry. You represent the largest motorists' organisation in this State.

Mr EVANS: In the country.

CHAIR: We will give due weight to your submission.

Mr EVANS: We welcome the opportunity to appear before the Committee. Thank you for your tolerance and your time.

(The witnesses withdrew)

Corrected Transcript

EDWARD JAMES BLAKELY, Professor, City and Regional Planning, University of Sydney, 5th Floor, Wilkinson Building, University of Sydney, affirmed and examined:

CHAIR: In what capacity are you appearing before the Committee?

Professor BLAKELY: As Professor of Urban Planning.

CHAIR: Are you conversant with the terms of reference of this inquiry?

Professor BLAKELY: I am.

CHAIR: If at any stage you wish us to give evidence in camera the Committee would be happy to consider such a request.

Professor BLAKELY: Thank you.

CHAIR: Do you wish to make a short opening statement?

Professor BLAKELY: I wish to make a short opening statement to familiarise the Committee with my background on the subject of public-private partnerships. I have worked in this field for more than 30 years, both as a professor and as a practitioner. I was Deputy Mayor of the City of Oakland, which issued many public-private partnerships worth several billions of dollars for ball stadiums and many other projects. At the University of California, system wide, I issued several billion dollars worth of bonds and public-private partnership participation instruments to build our housing program. I have been involved on the boards of directors of several firms that are involved in this sort of project, and I have written a book on the topic. So I am somewhat familiar with public-private partnerships.

I would like to say what public-private partnerships should be and how we might take advantage of them in meeting our future obligations. First, they are very old. Public-private partnerships have been used in relation to toll roads and things like that. We know from the movies and so forth that Robin Hood would not have been Robin Hood had it not been for public-private partnerships. The toll road is an old vehicle for meeting the public's needs. What is a public private partnership? First, it is basically a lease. The Government is entering into a lease for a piece of infrastructure that it requires and private sector ventures are providing the resources, the financing, the equipment and the other assets to make that lease whole.

What has to happen to make this lease work? Primarily, the lease has to work in financial terms. The lessee has to be able to ensure that this lease is paid so that investors receive their full benefit. In order to do that it means there has to be fine financial planning. The financial planning under-girds this and financial companies enter into this because they anticipate a profit. There are two financial partnerships here that I think we should be aware of. The first is with the investor partners whose fees and income are paid at the time the deal is done. The second are the operators who receive cash flows and have to pay back the banks and other people to make the deal work.

In most public-private partnerships this works fine because the information and data are pretty good and one can rely on that data to ensure that the bills are paid. In most instances, the centre of the public-private partnership, and in particular here, has been the cash flow. I think that is a mistake. The real centre of a public-private partnership is the operator. I agree with the NRMA that the Government is just as good at collecting tolls as anyone else. So the operation of a public-private partnership is critical, not the cash flow, and the assets should be in public hands as soon as possible. There are many reasons for this, but the most important reason is that it reduces the risk to the taxpayer.

Risk is the nub of all of this. The risk involved here is whether you have to do something to ensure the cash flows, like closing roads and other things, or reducing public transportation in order to make sure the cash flows are met. That is the reason they should be in public hands as early as possible because the public good is superior to the cash flow. It is important we understand that this

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partnership has to be a partnership in which the public receives very strong benefits as well as the investors. How do we do this?

How do we protect ourselves in the future to make sure that these things go well? And we should enter into more of them, not fewer of them, because public-private partnerships are going to be done for day care centres, for schools, for hospitals and a whole array of services, not just for toll roads. I have recommended—and some of you may have seen it in a report that I provided to you in the *Sydney Morning Herald*—that there be an independent board. By independent I do not mean a board that is appointed just during the term of a government; I mean that the board members should be appointed on the basis of their expertise, that they should serve long terms, and that they should be open to inspection with respect to their appointment and their credentials.

Second, the feasibility study should be done by a truly external set of consultants, perhaps people who do not practise even in this State—they may well be international practitioners—drawn from the best list possible and chosen by the board, not by the toll-operating organisation, be it a hospital, the Roads and Traffic Authority, or whomever. I have done this work as an independent investigator at arm's length from others. But my reports had to be reliable. As a matter of fact, I was liable for the reliability of my own report. I had to have very high liability insurance to ensure that the numbers I presented satisfied the needs of the people who hired me.

Third, there should be a sinking fund to ensure that you can cure any data obligation if something goes wrong. For example, you might open a hospital, a tunnel, or something and there could be some scare—a disease or something—and people do not use your facility. So you have to have some degree of cushion to ensure you can pay that debt during some short, hard times. Fourth, whatever project you enter into should have a long-term strategy attached to it. It should not be just for the cash flow or just to satisfy a momentary need. For example, had the cross-city tunnel been part of the metropolitan strategy, it would have been part of a network of other tollways, roadways, and so forth. The obligation and the risk would have been spread over much larger pieces of infrastructure and the debt would have been spread over a much wider territory.

I disagree with the notion that these should be separately tolled. There should be a uniform toll across all debt structures because this is public infrastructure, not infrastructure for a particular locale. For example, people from the country use this infrastructure, so it should be spread wider and all these instruments should be linked together. It is important that we develop a program of public-private partnerships with respect to a larger set of objectives and not just a narrow set of objectives. We should use the Government as the primary operator of systems verses outside operators, and spread the debt across the entire State, and perhaps even nationally, to meet longer-term obligations.

I think the public-private partnership is here to stay. We should use it because it is efficient. It takes debt off the public books and it provides a way of getting both superannuation and equity into public infrastructure that we are going to need in the future. It provides an efficient way of ensuring that we use our capital well.

CHAIR: You referred earlier to the metropolitan strategy. What do you understand to be the role of the metropolitan strategy reference panel?

Professor BLAKELY: The metropolitan strategy reference panel ceased to exist about eight months ago.

CHAIR: And that panel has been replaced by what?

Professor BLAKELY: By the Minister.

CHAIR: Does that relate to any infrastructure committee that has been set up by the Government under the Richmond report?

Professor BLAKELY: Not that I know of, but there may well be one. I do not know of it but there may well be one.

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CHAIR: You said a moment ago that the Government should be the operator. Do you see any problem in trying to achieve that? Are you suggesting that the Government should have been the operator of the city tunnel and that it should have collected the tolls?

Professor BLAKELY: Yes. I think the Government is perfectly capable of collecting the tolls. It gives the public a great deal more confidence in the fact that it is a public asset. It also prevents the kind of thing we have seen where the operator is more concerned about the collection of tolls than about operating the facility. So you do not close roads and things like that because you have the public in mind. Remember that the Government can spread this over much larger sets of infrastructure. So if something is bad in one place you can look to your cash flows from another place covering it, whereas an operator has only one piece of infrastructure. You might raise the tolls by 25¢ across the board and cure a cross-city problem without having the burden on the users in that location.

CHAIR: When the Government draws up the contracts it gets back to the practical outworking of that contract?

Professor BLAKELY: Yes. I am far more familiar with this in the United States of America than I am with it here. Generally, there is a long-term program in the United States—20 or 30 years—in which these segments are put in place. For example, I think the new United States Federal transportation Act is \$4 trillion over 30 years, which binds all congresses to that. That infrastructure will have tollways and things as part of it.

The same thing is true for the State of California. It has almost a trillion dollars worth of debt. That will have tollways as part of it but they are not one-off deals. So I do not think you can inspect these as one-offs; you have to look at the entire set of activities over a very long period of time, issue long-term debt—and this is the best time in the world to issue long-term debt—and borrow all the sums you need in order to put in all the infrastructure you need across a 20- or 30-year period. It is not one project at a time because one project at a time may not stack up. For example, this toll might have been \$2 but a toll on the Pacific Highway might be \$10, and together they make sense but individually neither one of them would.

CHAIR: You commented in your opening remarks about having a board. Who would be members of this board? Would it be separate from the Government? Would it comprise Government Ministers?

Professor BLAKELY: It could include Government Ministers, as it does in Western Australia and as it does in California. There are two Ministers but the other people are independent, and those independent people are chosen on the basis of their credentials in finance and in infrastructure and their backgrounds. They serve full time in these responsibilities. These are not part-time responsibilities.

CHAIR: So they would be business men or women.

Professor BLAKELY: Yes, but this would be their sole job.

CHAIR: They would be full time.

Professor BLAKELY: Yes.

CHAIR: They would have to resign from their other interests.

Professor BLAKELY: Yes.

CHAIR: I was thinking about potential conflicts of interest.

Professor BLAKELY: To prevent any conflicts of interest they would have to resign from all other boards, commissions and the like.

The Hon. GREG PEARCE: Do you see any conflict in the way that we are going about infrastructure planning and delivery? I am looking particularly at the role of the Department of

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Planning in devising the Metropolitan Strategy and then that same department having a role as the assessor of the individual development applications over a period of time.

Professor BLAKELY: That is a slightly different question. The role of the Department of Planning in developing plans does make sense. As you may know, I have been on record again as saying that there should be a metropolitan planning commission, as there is in Western Australia and South Australia and there is something like that now emerging in Queensland. It would have the responsibility of doing the second job of making sure that people are conforming to the plan because there is a bit of a conflict of interest when you make the plan and then you are charged with almost enforcement versus helping people reach the objective.

The Hon. GREG PEARCE: Are you aware of any different model that you might recommend?

Professor BLAKELY: Western Australia.

The Hon. GREG PEARCE: Which is what?

Professor BLAKELY: They have, I believe, three Ministers sitting on their board and four outsiders. They meet regularly. They review the metropolitan plans and the like and they assist the communities in ensuring that they have the resources necessary to meet the plans. They even have a tax that is region wide—maybe even statewide—per household to get the resources necessary to buy the land and the infrastructure for transportation and so forth so the transportation plan exactly matches the regional development plans.

CHAIR: We have a very powerful RTA in this State. Would those boards take the place of it?

Professor BLAKELY: No, they would not. But they would do a deal with the RTA over roads because they can put money in it and provide the right of way for the roads. So they become partners with other agencies but the equivalent RTA sits on the board.

The Hon. GREG PEARCE: The north-west to south-west rail link is the biggest bit of infrastructure in New South Wales. My question is a chicken-and-egg one. How important is it to get that railway built ahead of the development? Where should it fit in sequentially?

Professor BLAKELY: Think about it this way: most of our rail system was built before there were any people living along it. That is why people now live along it. You really need to build the infrastructure ahead of the development and that will dictate development and where it goes. If you want people to use rail and so forth if you build the rail they will build along the rail system because that is where you create the land values.

The Hon. GREG PEARCE: In your written submission you have semi-posed a question in relation to the Metropolitan Strategy. You said that even if Sydney does not grow in population the structures are old. Do you have any doubts about the basis of the Metropolitan Strategy in terms of population growth?

Professor BLAKELY: No, I do not have any doubts there but there are people who do not want us to grow.

The Hon. GREG PEARCE: He has retired.

Professor BLAKELY: They suggest that we do not need to grow at all in Sydney. The fact is that we are going to grow and it is very important that we do grow. But I was saying that, even if you want to take that point of view, our infrastructure is very old and must be replaced. Our rail system, our bus system and so forth need to be replaced. So you require money to do that, and a lot of it.

The Hon. GREG PEARCE: You spoke quite a bit about the concept of building the network rather than just individual projects.

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Professor BLAKELY: Yes.

The Hon. GREG PEARCE: What sort of experience have you had, perhaps in the United States, of that approach being taken?

Professor BLAKELY: As you may know if you visited California, that is an integrated system. It was a 20-year system to build throughout the State and it is still being built. Come up or down cycles, the road system is still being built and it will continue to be built for another 30 years or so. I think it takes that long-term view. One thing has changed: more money is going into public transportation in Los Angeles, San Francisco and so on. But the voters approved that by putting an additional tax on themselves in order to get that in. The road systems are much like here: they are part of the petrol tax and I believe three-quarters of that money must be devoted to roads and one-quarter to public transport. But the voters passed an additional tax on all bridges and tollways as well as on households for public transport. I believe it passed by 78 per cent.

The Hon. GREG PEARCE: So the process there was to develop a 20-year transport plan.

Professor BLAKELY: Yes, nothing less than 20 years for a transport plan. Twenty years is really at the margins for transport.

The Hon. GREG PEARCE: I think you also mentioned your experience at the University of California, where you raised funds for housing.

Professor BLAKELY: Yes.

The Hon. GREG PEARCE: Could you give us a little more information about what sort of project that was?

Professor BLAKELY: Our academic staff could no longer live near our campuses in places like Berkeley, Los Angeles and many other communities.

The Hon. GREG PEARCE: Because of the cost of housing?

Professor BLAKELY: Yes, the cost of housing was too high. I was tasked with finding whether the university had assets upon which we could build housing. I did find the assets. The next question was: Where is the money going to come from to put in the infrastructure? By a quirk in the US tax laws I found that non-profit organisations could issue debt at government rates for the provision of infrastructure as long as it would serve a public purpose. So we issued that debt to put the infrastructure in and then put in a system where we would build houses for academic staff and they would enter into long-term ground leases so that we could recover the houses when anyone left and then we could pay back the mortgage from the ground leases. It works very, very well. If we want affordable housing here I think that is the way it should be done.

CHAIR: You mentioned a system in Los Angeles whereby the voters had an opportunity to express an opinion. We do not have that system here.

Professor BLAKELY: No, we do not.

CHAIR: Would you recommend that be considered? We could attach those sorts of questions to the ballot at the State election.

Professor BLAKELY: I do not know. I think there are pros and cons. One elects representatives in the hope that they will do the right thing and when the voters get into the act you can get some very pernicious things put on the ballot that might do more harm than good. But I do think the voters should be polled in some way to find out, given all the alternatives we have, which ones they prefer. That should be done by a public institution, and I suggest it should be the university—not because I am there but because I have seen the University of Michigan and the University of California surveys be very powerful in all levels of government. They are totally non-biased and they provide a lot of information for government to make its decisions.

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Ms LEE RHIANNON: You said in your opening remarks that we need to get the assets in public hands as soon as possible. Can you give us a timeline on that?

Professor BLAKELY: Most of these public-private partnerships are 20 to 30 years and that timeline I think makes sense if you are going to go this way. But you can have the perception of the public operating the asset much sooner by the public collecting the tolls.

Ms LEE RHIANNON: Is that what you meant by "as soon as possible"? Taking the cross-city tunnel as an example, how would you apply your formula to the cross-city tunnel?

Professor BLAKELY: I am speaking hypothetically here. I would buy it.

Ms LEE RHIANNON: You would buy it back now?

Professor BLAKELY: Yes.

Ms LEE RHIANNON: And you would have done that before it ran into trouble?

Professor BLAKELY: Yes.

Ms LEE RHIANNON: That would have been part of your formula.

Professor BLAKELY: Yes.

Ms LEE RHIANNON: So you are taking out the operator component. They build, they just own it for a short time and then transfer it to government. It is not a BOOT scheme; we just take out the operate part.

Professor BLAKELY: That is right.

Mr PAUL McLEAY: Is that not just contracting out construction?

Professor BLAKELY: No, it is not contracting out construction because you are leasing that asset and you are the operator of the asset during the lease period. So you are not just contracting out construction. You have a lease agreement with whoever the investors are for that period. So you have construction and all the other things attendant on getting the thing built but you are simply not collecting the tolls.

Ms LEE RHIANNON: So if the Government went with that model it would collect the tolls but we would still pay—

Professor BLAKELY: The way I would do it is that you would pay into a central fund that would pay back the investors—the intermediaries. That is the way it is done in China.

Ms LEE RHIANNON: What is wrong with having debt on the public books?

Professor BLAKELY: Nothing. If you do not have it you are in bad shape.

Ms LEE RHIANNON: You say in your paper and when you spoke that that is an advantage.

Professor BLAKELY: It is an advantage.

Ms LEE RHIANNON: Do you mean that it is an advantage for government? From your work in this area you are saying that there is nothing wrong with it.

Professor BLAKELY: There is nothing wrong with it. I think it is a good thing.

Ms LEE RHIANNON: I thought that was confusing. You say it is an advantage but you mean that it is an advantage to government.

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Professor BLAKELY: It is an advantage to government, yes. It is particularly an advantage to government now when world interest rates are so low.

Ms LEE RHIANNON: I was interested in your comments about risk. One of the big selling points for public-private partnerships is often that the public and the government do not have risks. Would you agree that the cross-city tunnel is a glaring example of a risk to the public, in the form of aboveground road changes and the provisions about public transport? Is there not often a risk to the public? The public must bear some burden here.

Professor BLAKELY: Let us separate financial risk from political risk. When you are doing these sorts of deals—PPPs—the private sector groups try to push as much risk onto the Government as possible and take as few risks as possible. So the Government is wearing most of the risk in any of these deals. That is why the private sector operator insists on clauses in the contract that minimise their risk, such as no public transport, closing roads and things like that. So their risk is much reduced. Private capital does not like risk. It is averse to risk. Government is in the risk business, in a sense. There are very few things that the private sector would want to operate that we do in government. They are very risky—hospitals and that sort of thing. So we are in the risk business and the risk calculus does get shifted over. But there is a political risk here and a public perception as to who is in charge. I think you are talking about the political risk, not about the financial risk.

Ms LEE RHIANNON: I am interested in your comments about the independent board and feasibility study. I am still trying to understand that. When the Government comes to negotiate these contracts do you believe it has the expertise to be able to ensure that it gets a good deal? You talked about the independent board and the feasibility study, are you heading in that direction because the Government's does not have the expertise?

PROFESSOR BLAKELY: I think that the Government could get the expertise but I am wondering why it should. The finance business is a very intricate business and requires that you be at the coalface a lot. I am not certain that people hired by the Government can maintain the degree of expertise that is necessary to understand all the arcaneness of international financial markets. So I would rather have people that you employ to do that and have very high accountability on these folks. Certainly the Government could do that but I do not see the need to do it because you can hire plenty of very good lawyers and financial people—at very high prices I must add—but they will deliver the goods for you.

CHAIR: You mentioned the possibility of the Government buying back the city tunnel. Obviously the question is at what cost?

PROFESSOR BLAKELY: That is right.

CHAIR: Would you need an independent arbiter to assess the value rather than the very high commercial value established by the company?

PROFESSOR BLAKELY: It is going to do that anyway because of the nature of the contract. I think the nature of the contract will require a relatively high price because that contract is a contract recognised in law. The question is how can you negotiate that contract and get the best possible deal for the people.

Mr PAUL McLEAY: You referred to the nature of an integrated transport system. I will use an analogy to make sure I understand what you are talking about. Sydney has a rail network with 14 different lines, some of which cost more to construct than others, yet everyone pays the same rate, depending on the kilometres. You suggest a similar kind of pattern with a road network that if people use it they will pay the same rate proportionately, irrespective of construction costs?

Professor BLAKELY: That is right.

Mr PAUL McLEAY: It is easy with public transport because people can either get on it or not. In relation to the roadwork how does one integrate motorways? Which roads do you say will be tolled or do you toll all of them?

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Professor BLAKELY: I would toll peripheral roads that go around the city and those that are inner-city connectors, not in the city.

Mr PAUL McLEAY: Are they easily identified?

Professor BLAKELY: Yes.

Mr PAUL McLEAY: With your work on the Metropolitan Strategy, what proportion of those roads are currently tolled?

Professor BLAKELY: Quite a high proportion of those roads. We toll our M7, M4 and M5. We toll the bridges and the connectors now.

Mr PAUL McLEAY: Only metropolitan roads?

Professor BLAKELY: We could toll well beyond the metropolitan.

Mr PAUL McLEAY: Do you think we should?

Professor BLAKELY: Yes.

Mr PAUL McLEAY: Are there other ways to meet these costs, such as fuel taxes or by freight operators paying a proportion?

Professor BLAKELY: Both. I think freight operators should pay a portion of it. I have not done the calculus as to how much. I think petrol prices, actually by going up the way they do, are having that effect. As petrol prices go up we collect more in taxes automatically. The question is how you are going to dedicate that money back to the road system, not whether you are collecting it.

Mr PAUL McLEAY: Did the evidence we heard earlier this morning surprise you that of the \$14 billion that is collected in fuel taxes, only \$2 billion goes back to the road network?

Professor BLAKELY: It did not surprise me but I think there ought to be some kind of provision, at least three-quarters of the money collected should go to the place where it is collected.

Mr PAUL McLEAY: Do you think it should be hypothecated back to the network?

Professor BLAKELY: Yes.

Mr PAUL McLEAY: Are there more than construction costs but also associated social, environmental and even economic costs? How would they be compensated?

Professor BLAKELY: There are a number of different kinds of costs. We have all kinds of connector costs associated with transportation systems. We also have other modes, such as light rail and other things, that need to be proportioned but that could be done with a plan. As you may know the metropolitan planning organisations [MPOs] in the United States of America are required to submit an integrated plan and then the dollars come back to support that plan. If Sydney had a plan it would be different to the ones in Melbourne and Adelaide and so forth and then we proportionise those costs, but there are some social costs, and you are quite right here.

We have health costs associated with these tunnels and so forth—asthma was mentioned—and other social costs. I am not in the field but I suspect some other people in the health field could give you pretty good equations as to the social costs of tunnels et cetera. And then there are other social costs that we have to think about and that is where jobs are located and how do we get people. For example, one of the things I have been thinking about in the metropolitan plan is that we cannot ensure that jobs are going to locate where people are living. We have young people and other people who do not have access to jobs.

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What if we had a situation where people at a certain wage level got a free pass on the rail network to get to work, as long as they had a job place and their wages were low? What if they had a lower discounted pass to get there because the biggest burden is on the people who live furthest away from work. If you live in Penrith and you are cleaning in this building you are paying a lot more for that than I do to get to the same location. It seems to me that is a heck of a burden. But having people in work is a benefit to the entire society.

Mr PAUL McLEAY: Is that not already done by the subsidisation of the public transport network? For example, every taxpayer in New South Wales subsidises public transport to the tune of \$900 each per annum?

Professor BLAKELY: That is true, but you and I pay the same \$900 as does the cleaning lady, and that is not fair.

Mr PAUL McLEAY: You said that debt is an advantage to government? Should the debt only be in areas where government is getting an income stream, such as construction for which a toll can be charged, or should the Government go into debt to buy national parks, even though it cannot service that debt?

Professor BLAKELY: I think it should do both. National parks is an obligation to the entire world—we owe the entire world green space, so those obligations should be carefully thought about. But most of the debt should be supporting something where there is an income stream. I think the voter, the taxpayer, wants to know how their tax is being allocated and how debt is going to be paid. Most of us, as the voters in Western Australia have done, would pay for green space and they do that. They have decided they are going to pay for their green space.

Mr PAUL McLEAY: Can that be done through revenue?

Professor BLAKELY: I think it can be done through revenue but remember our local revenues are capped and it is very difficult for any legislator to go to the voters and say "I'm going to raise your tax." However, if you said "I am going to deliver you some green space and this is what it will cost you" I think many voters would say "If I know that's where it is going, I am willing to pay."

Mr PAUL McLEAY: Do you think you can only go into debt for non-income generation projects if voters have a clear understanding that it will be hypothecated?

Professor BLAKELY: Yes.

Mr PAUL McLEAY: Generally if the Government wanted to employ more public servants it should not go into debt?

Professor BLAKELY: It should not go into debt for that.

Mr PAUL McLEAY: Are you aware of the recommendations of the Richmond review of motorways?

Professor BLAKELY: No, I am not.

Mr PAUL McLEAY: You say that PPPs are not new. In fact, you have been working on them yourself for 30 years and you have written a book on them. Has the public perception and confidence in PPPs always been high? Are they high?

Professor BLAKELY: It depends on where you are. Public-private partnerships are fairly old practice and have not received as much attention in the same way they have here in the United States and in Europe, mostly because they have been used in a slightly different way. They have been used for long-term infrastructure that the public clearly sees. Most of them are tollways so the public clearly sees what those are. We have used them in Australia for one-off projects so if one of them goes bad it gives the entire system a poor appearance whereas had they been part of a larger system you could cover up in a sense the differences within the system. Let me use one that I know very well. My daughter lives in Boston with the Big Dig, which is \$14 billion over debt right now, but it has not cost

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her any more on her tollway because the State highways systems and so forth have added tolls across the system. So the Big Dig does not impact on her if she crosses town: It is part of a much larger piece of infrastructure.

Mr PAUL McLEAY: How do you need to spread risk?

Professor BLAKELY: Across multiple pieces of infrastructure. For example, I would cross all my PPS in hospitals, not hospital-by-hospital. I would issue one hospital instrument and then cross-subsidise hospitals between the east and west and so on. That is how you get affordable housing and other things with those kinds of cross subsidies.

CHAIR: There is a debate about the Government going into public debt by using private finance. Do you say you do not have a preference to using both?

Professor BLAKELY: It depends on what you are doing. You would use general public debt probably for most green space and you would use PPPs for things where there are transactions. When you go into a hospital you check in so you can collect the toll, in a sense. When you use a road you can collect a toll and you get much more of user-pay. I believe in user-pays. I think the big users should pay more. If I drive a four-wheel drive I should be paying more than a person who drives a Volkswagen.

Mr PAUL McLEAY: A new or old Volkswagen?

Professor BLAKELY: An old one.

CHAIR: You mentioned the problems of the cost of travel for a cleaner. Is that means tested?

Professor BLAKELY: It is almost like means testing. One of the things about where we are now—this is just an aside with respect to our public obligations—if each of us pays the same amount we are actually creating a greater burden for some other people in society, and it just happens to work out that way. The city grew up right here on the coast and then spread out so the people who live here enjoy magnificent benefits that people further west and south do not enjoy but we do not pay any more for that but they pay for it. It is just the way things have worked out so if we want to bring equity in the system we have to find ways, and a tollway is one of the ways we can find that way of equity in order to provide the Opera House in Penrith or whatever. I think we have to start looking at that kind of social equity as well as delivering public services.

CHAIR: What should the Government do to ensure that large infrastructure projects fit into the priorities of the metropolitan strategy?

Professor BLAKELY: First, I think we should have the kind of independent board that I described earlier and there should be an infrastructure plan. The current Metropolitan Strategy does not have one. There should be an infrastructure plan that matches that strategy and the board should begin issuing the debt and the program so that that plan is put forward. That would include bikeways and bus ways and roads and light rail and all the kinds of things necessary to make sure we are the best place in the world to live.

CHAIR: Would the Treasurer play the major role on the board?

Professor BLAKELY: The Treasurer in California, the Treasurer in New York all chair those boards. A couple of weeks ago I met with the Treasurer in California who is on the board.

CHAIR: Is the Government's equivalent is government Ministers with their budget committees and so on within the Cabinet?

Professor BLAKELY: Yes, and I think there is nothing wrong with the Minister for Roads being on that board and maybe the Minister for Planning and then four outsiders.

CHAIR: Can it be three Ministers, depending on the project?

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Professor BLAKELY: No, they should be permanent members but I think it is up to the Premier as to who sits on the board. Other than the Treasurer, the other two could be any Ministers. But, at least in my experience, they seldom change because they have built up a certain amount of expertise.

CHAIR: What are the names of those boards?

Professor BLAKELY: The one in California is called the Debt and Investment Advisory Commission.

CHAIR: Could you give the Committee the title of your book, which we do not appear to have a copy of?

Professor BLAKELY: It is called Economic Development Finance—Sage Publications, only thirty bucks.

Mr PAUL McLEAY: US or Australian?

Professor BLAKELY: US. As a matter of fact, the reason that I have it so earmarked is that the Chinese want it, and so I took out the portions that are US-oriented, so that they can translate it into Chinese.

CHAIR: It seems from what you say that the Chinese are now more advanced than we are.

Professor BLAKELY: I do not know. I am working with the Vice-President of China now. They are going to build 123 new cities, and they have asked me to assist them in that process.

CHAIR: That is a challenge.

Professor BLAKELY: It is a challenge. But that is a challenge for us, not just for them, because they are registering more motor vehicles every day than the number of motor vehicles we have in New South Wales.

Mr PAUL McLEAY: Have they got catalytic converters on them?

Professor BLAKELY: No.

Mr PAUL McLEAY: That is the problem.

Professor BLAKELY: That is the problem.

CHAIR: Do they intend to build a whole rail system and so on in advance of those cities?

Professor BLAKELY: That is their plan. However, I think you have to take into consideration that will require a lot of energy, a lot of steel and a lot of know-how. They are building a city the size of Houston every month.

CHAIR: Will they seek private investment for that?

Professor BLAKELY: They have got all of our money now. They do not need any more investors. They are running a large surplus.

CHAIR: Thank you very much for appearing before the Committee and shedding a completely different light on the whole issue. We very much appreciate the evidence that you have given us.

(The witness withdrew)

(Short adjournment)

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FRANKLIN JOHN BARKLEY STILWELL, Professor of Political Economy, School of Economics and Political Science, University of Sydney, affirmed and examined:

CHAIR: In what capacity are you appearing before the Committee?

Professor STILWELL: In a private capacity.

CHAIR: Are you conversant with the terms of reference for this inquiry?

Professor STILWELL: Yes.

CHAIR: If at any stage you should consider that certain evidence you wish to give or documents that you may wish to tender should be heard or seen only by the Committee, please indicate that fact and the Committee will consider your request. Would you like to start by making a short statement?

Professor STILWELL: Yes. I welcome the opportunity to appear before your Committee. I have been researching issues of urban economic development at the University of Sydney for some 35 years, and during that time it has become my firm opinion that the quality of urban infrastructure is absolutely crucial. The efficiency in the way in which our city functions, the equity of access of its citizens, the quality of life, the prospects for sustainability, all of these depend very much upon the way in which we provide our infrastructure. So it is very important that we get it right, and I fear that at the moment we are getting it rather badly wrong.

Historically, it has been well nigh axiomatic that public goods in our urban areas, and more generally across regions, must be provided by government and funded through public investment. That connection between infrastructure and collective provision has had a central place in Australian economic history, but it has been undermined in recent decades by processes of privatisation, and is now being severed by the proliferation of public-private partnerships. These, as Committee members know, have been used in many spheres of infrastructure provision, including schools, hospitals, prisons, housing, waste treatment, aged care facilities, as well as construction and maintenance and operation of infrastructure for transport and utilities.

Many claims have been made on behalf of public-private partnerships about the way in which they share investment risks, about the way in which they deliver better value for money, and sometimes even that they boost employment. But my analysis of these developments suggests rather different conclusions. For example, the claim of sharing of risk is often, I think, out of kilter with what actually happens where contracts are drawn up in a way that they effectively privatise the profits but socialise the risks, because in many cases these infrastructure projects relate to matters of such public importance that they could not be allowed to fail, so that the government must necessarily underwrite the risk in the last resort. Indeed, many of the contracts are constructed in ways that ensure that governments compensate the private operators in the event of certain eventualities taking place that reduce the expected profits of those operators. So, if that is privatising the risk, it is not what I would understand to be the logic of that process from an economist's point of view.

Similarly, I think one can say that the question of cost effectiveness is very questionable here. Private companies, in general, have to pay a higher rate of interest on borrowed funds than do governments, and so logically they have to get a higher return on their investments in order to recoup their costs and make a profit—usually recovered either through higher user fees, such as road tolls, or direct government payments. And, as for the employment issue, I think the evidence is very contentious, because once enterprises such as this are run privately, there is a strong emphasis beyond the construction phase, in which of course jobs are created, whether the construction is privately or publicly undertaken. But, beyond that phase, is a strong emphasis on workplace restructuring, rationalisation, cutting costs, often by increasing the intensity of labour, putting more stress on the work force.

Finally, whether or not public-private partnerships provide better services is highly contentious, and there are plenty of examples. One need only cite the Port Macquarie Base Hospital to show the potential for extraordinarily bad performance in certain circumstances. On the basis of my

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observations of these experiments with public-private partnerships, including the cross-city tunnel, of course, I have become deeply sceptical about whether this serves the public interest.

Mr PAUL McLEAY: Did you say excluding or including?

Professor STILWELL: Including, that is scepticism is based upon observation of various projects, including the cross-city tunnel. There are, of course, viable alternatives for financing public infrastructure of this kind. Four spring immediately to my mind, one of which is the longstanding arrangement to which I have already referred of public provision of finance through the issue of bonds. Loan finance is a perfectly legitimate way of providing infrastructure that will be of benefit not just to the current generation but also to future generations. Of course, there is an interest burden associated with any loan finance, but, as I have argued already, the interest burden is typically lower for public borrowing than for private. The second possibility is, of course, taxation. Commonly we have financed our infrastructure and service provision through taxation. I am well aware that at the State level there are major constraints here. One is reliant upon transfers of GST revenue and the limited array of other taxation measures, but it seems to me that land taxation offers, at least in principle, a major avenue for revenue raising for the financing of public infrastructure.

After all, much of the public infrastructure increases property values. It is only appropriate that that be recouped for public purposes through land taxation in various ways. Obviously, the current arrangements for land taxation are wholly inadequate for doing that. Therefore it is quite a challenge for State governments and, I would argue, more generally for the national Government, too, to see how we can ensure that the benefits arising from infrastructure improvement are recouped for public purposes rather than privately captured as windfall gains. Thirdly, there is the possibility of financing big infrastructure through little interest, or even zero, interest loans from the Reserve Bank of Australia [RBA]. It is difficult for State governments because, obviously, the RBA is constrained to treat the various components of the Commonwealth without discrimination, but there are many advocates for this form of monetary policy, which, to date, has not been used extensively in Australia.

It is controversial, but there is the possibility that through negotiations with the Reserve Bank it might change its policy in this area. Finally, there are superannuation funds. There is an enormous amount of savings of Australian citizens in superannuation funds, currently in excess of \$700 billion tipped to rise to more than \$1,000 billion by the end of this decade. We ought to ensure some mechanisms by which at least a portion of those funds reliably go into the financing of public infrastructure. In summary, there are no easy solutions to these problems—there never are to economic problems. One famous economist made the notorious remark that the answer to most economic problems are political questions, questions about whether one has the courage to go down alternative avenues, but given the various problems we have seen with the current means of financing public infrastructure the time has come to consider seriously these other options if we are to build better infrastructure for better cities.

CHAIR: Do you think that governments have overreacted to the criticism of having large debt?

Professor STILWELL: I believe so.

CHAIR: They get this idea about achieving and maintaining a triple-A rating.

Professor STILWELL: I appeared before the New South Wales Public Accounts Committee hearing in 1992, I recall, when this issue was being explored as to how the State Government might reduce its debt to keep a good credit rating and finance infrastructure by other means. Since then, as you know, not just at the State level, but also at the Federal Government level, there has been a very strong emphasis—I call it an ideological position—on debt reduction. I think it goes beyond economic logic, not even logic of seeking a better credit rating. It is based on an ideological aversion to debt and public finance.

CHAIR: In your opening statement you said that you have many concerns about public-private partnerships. You are not very supportive of them. Do you have any other criticism of them that you have mentioned?

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Professor STILWELL: One thing is in my mind and it involves the institutions that are involved, in setting them up and the fees they charge for their services. I think these are a major drain on public revenue. I think they are unwarranted.

CHAIR: You mentioned the Reserve Bank providing low-interest loans. Is there any example of when that has happened? I do not think it is possible, is it?

Professor STILWELL: It has not been the Australian practice. It is the sort of policy that is advocated by groups such as Economic Reform Australia as a major monetary reform. It is not something that the New South Wales State Government could do independently of a broader reform of monetary policy. It would have to be done by the Federal Government.

CHAIR: You mentioned four options to raise finance, one of which was superannuation. Obviously, we do not have the detail, but we get the impression that superannuation funds are invested in the tunnel.

Professor STILWELL: Some superannuation funds are invested, but it is up to the fund managers for each of the various funds as to how they structure their portfolios. There is no Government requirement that any proportion of superannuation funds go into infrastructure investment, for example. I am hinting at the possibility of introducing such a regulation because, although at first sight, it might seem to run counter to the primary goal of fund managers to maximise rate of return on the savings they are managing to ensure the highest possible pension for the fund members, nonetheless there is a broader collective interest. In other words, if the superannuation funds as a whole were used in ways that created better infrastructure, more efficiency in transportation systems and the provision of public utilities, that would help other businesses in Australia to make higher rates of return on capital, which would then flow back into better returns, more generally, for the superannuation funds, better retirement incomes for their members. I would argue that we have to step outside the narrow interest of how to maximise rate of return into a broader societal one from which, eventually, all benefit. But, again, I am not saying that there is an easy solution for the New South Wales State Government. Any such position or regulation of how superannuation funds allocate the money at their disposal would have to come through central government. But this is one issue that State governments could have an influence on through negotiations with the Commonwealth.

CHAIR: In spite of your reservation about public-private partnerships, are there any infrastructure projects that you think are suitable for public-private partnerships?

Professor STILWELL: I have been thinking at length about that. It always sounds a little dogmatic to say, "No, never" in answer to any question, but I think my preferred starting point would be to say for the construction of infrastructure there may well be good cases for the engagement of private contractors. In fact, there is no presumption that the construction process is necessarily better undertaken by public enterprises than by private. This can go to tendering according to normal business principles. But the ownership of the assets, then, on my reasoning, should stay in public hands. I would distinguish sharply between the engagement of private contractors in the private construction process and the proper role of public authorities in the management of assets in which we have a public interest.

CHAIR: Following up that comment, from your earlier statements, you have reservations then about privatisation, full stop?

Professor STILWELL: Yes.

CHAIR: And about some of the big areas that have now been transferred from the government sector to the private sector—airports and banks and things?

Professor STILWELL: Yes, I do indeed. I think that one of the problems is that it becomes too much more difficult to carry out the implementation of community service obligations. In telecommunications, for example, in a huge country like this, we have always wanted to ensure that rural users of services are not faced with exorbitant costs or a limited, lesser array of services. Through public ownership, we have ensured that objectives of that kind of community service obligations in general, have been pursued. This is so much harder through private enterprise. One can

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try to set regulations, but then there is always the problem of monitoring and policing them, and there is the problem of dealing with enterprises that say, "That will jeopardise our profitability, even our viability, if we are forced to comply with such public requirements." It seems that, if one has a view of economic interests as ultimately serving public interests, then the more logical way of doing that is through public ownership of those activities.

CHAIR: On top of your obvious reservations about public private partnerships, there do seem to be some reservations in the community as well, or mistrust as to whether somehow the banks or others are making more money from this particular project. What can be done to reduce that public mistrust? How can public private partnerships be presented in the best light?

Professor STILWELL: I certainly share your observation that there has been growing public mistrust, and I think in general it is well grounded, so one resolves the problem at root by making sure that private enterprises are not feeding too vigorously at the public trough.

The Hon. GREG PEARCE: Where do you get the money then for public ownership of all these projects, or do you simply not develop the country?

Professor STILWELL: I think the issue of bonds is the most obvious way of generating revenue.

The Hon. GREG PEARCE: So, government borrowing.

Professor STILWELL: Although, as I have said earlier, there are various forms of taxation that can be used. Ultimately someone always pays. It is a question of whether or not you want to pay, for example, through user charges or whether you want to pay more indirectly through taxation for provision of public services or infrastructure. I think the government borrowing thing spreads it over generations and ensures that future generations, who will indeed benefit from infrastructure improvements, contribute to some part of the cost because that is what happens when there is an interest flow-on from those bonds. Bonds undertaken today to generate revenue generate costs which flow over a future period of time and, broadly speaking, the profile of those costs corresponds with the times profile of the benefits. It seems to me to be perfectly reasonable and questions about over reliance on public debt are usually driven, as I say, not by some economic reasoning, but by some ideological aversion to debt, as if in some sense it was a bad thing, as if being in debt is indicative of poor household management.

Well, think about the parallel more generally. Who could possibly in Australia buy a house without going into debt? It is perfectly logical to do so. Then you meet a stream of payments which correspond with a stream of household services you are enjoying as an owner/occupier, or a business person going into debt to buy the tools to generate the revenue which then enables not the payment of the interest on the debt but the repayment of the principal. In that sense, debt is a perfectly sensible and logical strategy for dealing with problems, whether they are within the individual household, whether in the business or in government. We should not be averse to borrowing if there is an economic rationale of the sort that I have described.

Mr ANDREW CONSTANCE: Surely, though, it is about a combination of various forms in terms of financing. At the moment we hear the Government prattling on about its \$30 billion infrastructure plan. It is of concern that the Government does not have the overall bandwidth to deliver everything a public way, as you are suggesting. I would have thought that public-private partnerships are about a suite of means to be able to finance activities across the board so that public goods can be delivered in a more timely and efficient fashion and ensuring that governments meet community expectations.

CHAIR: Can you frame the question? I think you are giving a policy position.

Mr ANDREW CONSTANCE: Yes, well I have listened to his.

CHAIR: Yes, but we do not to state our own.

Mr PAUL McLEAY: But it is not your job to do that.

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Mr ANDREW CONSTANCE: I just want to see whether the professor has any views in relation public-private partnerships being part of a suite of mechanisms rather than just excluding it altogether, as you are suggesting.

Professor STILWELL: Well, my normal inclination would be to consider all possibilities. Indeed over the last decade we have developed quite a wealth of experience of those various possibilities. The upshot of my observations is that the public-private partnership model has created more problems than it has resolved and that is why I favour the other mechanisms to which I have referred, such as public financing through loans, taxation or through trying to steer superannuation funds more into this form of public investment. I would not rule the PPP option out as a matter or ideological principle but I am suggesting that the weight of the experience is frankly rather discouraging.

CHAIR: You seem to have very strong views. I am just thinking of Professor Blakely. Were you here for any of his comments?

Professor STILWELL: I did not hear, but I know of Professor Blakely's comments on other matters to do with urban planning.

CHAIR: Two academics having fairly different views—I suppose that is not unusual.

Professor STILWELL: Indeed. I have known Professor Blakely over many years. We are at the same university together.

CHAIR: That is right.

Professor STILWELL: We actually have not talked about this particular issue or compared notes in preparation for this hearing.

Mr PAUL McLEAY: This is obvious. There is no collusion between you and Professor Blakely.

CHAIR: Together you have provided the exact opposite views.

The Hon. GREG PEARCE: You sort of grudgingly acknowledged that governments need to tender out civil works. Were you suggesting that governments in fact go back to the old days and build up their own public works departments and their own capacities to do those sorts of works? At the moment, governments basically outsource most things that the private sector can do better and they retain things like hospitals. Are you suggesting a reversal of that sort of trend?

Professor STILWELL: Again, I think there are some good lessons from history. The public works model to which you allude did have its problems. There is no question that efficiency concerns were often commonplace—inefficiency in the use of labour, difficulty in meeting planning targets for production. Again, I would not rule it out but it seems to me that the contestability principle is the appropriate one here. Yes, governments can build things themselves, but it has to be demonstrated that they do so in ways that are at least of comparable efficiency to public providers, so contestability in tendering processes might well involve some public agencies as well as private contractors. But the one thing I would say, as a consequence of that, is that here too I think we have to think of our economic social accounting a bit more broadly.

It may be possible, for example, for contractor A to build a project more cheaply than contractor B, where B is a public sector provider. It may be that B indeed provides more featherbedding jobs for its workers but were it not to do so the public sector might pick up costs in other areas too—the costs associated with high levels of unemployment, for example. So I am not saying that government agencies should be sheltered workshops for the otherwise unemployable. If one looks at the costs and benefits of these alternatives in a broader way, one must take account of not only getting the cheapest providers for a given job, but also the environmental, employment and other social consequences in a broader cost-benefit analysis.

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Ms LEE RHIANNON: When we took evidence from the Roads and Traffic Authority [RTA] representatives on Friday they were adamant that there is no risk with the cross-city tunnel project. It is something we hear as a selling point for public-private partnerships [PPPs]. Do you have examples to illustrate where there is a risk to the public in PPPs and how that plays out?

Professor STILWELL: One example that springs to mind is the airport rail link, which, frankly, turned out to be a disaster in many respects. It was developed as a PPP, but wound up costing the citizens of the State about \$800 million. That seems to me to be a case in which a risk was indeed socialised and borne by the public when it should have been carried wholly by the private contractor. If the private contractor goes out of business, the Government picks up the tab. My general point is that where we are dealing with projects of such public importance that they cannot be allowed to fail, the Government always ultimately bears the risk.

Ms LEE RHIANNON: Coming back to the cross-city tunnel, and considering your comments and concerns about PPPs, do you think the Government should buy it back or commence negotiations on that front?

Professor STILWELL: Of course, it is very expensive to buy out of a contract and to buy back huge infrastructure of this kind, although logically there is no reason why it could not be done by the issue of bonds. If government borrowing to build infrastructure has a sound economic logic, so too does government borrowing to buy back existing infrastructure. However, I suspect that it is not quite so politically saleable. The same economic logic applies. If an asset is of public value, particularly if it is an earner—for example, generating tolls that could be used to generate the revenue that is then used to pay the interest on the loan—it seems to me that there is no economic reason that one could not do so if there were public support for it.

Ms LEE RHIANNON: Something else which comes up with regard to PPPs and which seems to be part of the selling point for the Government in justifying going ahead is a public sector comparator. We have looked at how the public sector would do it and then compare what would be the cheapest option and what would work best for the public. I am interested in your comments on this comparator and how reliable it is. Is it a political exercise rather than a genuine comparison?

Professor STILWELL: It is important to have some such basis for evaluating the costs of providing things publicly and privately. However, my experience as an economist over 35 years has been that these processes are very difficult to make wholly objective. I would not go all the way and say that economic evaluations always involve rubbery figures, but I think there is a tendency for people to come up with the answers they want. It is not uncommon, I think, to hire economic consultants for that purpose. Dare I say, I think there are strong pressures on public servants—although I do not have direct experience of this—to come up with the answers that their political lords and masters want. I think it is an open secret, for example, that when the cross-city tunnel was built the staff in the relevant government department had great difficulty coming up with economic calculations to prove that the benefit-cost ratio was in excess of one; in other words, that it was an economically viable project. They were told to go back and do their sums again by their political masters. Some public servants resigned at that stage feeling that they were under duress to come up with economic calculations that were against their professional judgment and responsibilities. So, in summary, yes, there are many—

Mr PAUL McLEAY: Do you have any evidence of that?

Professor STILWELL: This was public knowledge at the time. I cannot present the documents, but the public servants who resigned made it known that that was the ground on which they had done so. Economic consultants in the private sector and public servants sometimes come up with calculations that are highly questionable. One could get another team of economists to come up with quite different calculations. Frankly, this is one of the inherent limitations of my profession. I am not necessarily blaming the politicians for leaning on people to come up with the answers they want to hear. Economics is a highly inexact science.

CHAIR: Reference was made to the Government's buying back the cross-city tunnel, the problems it had with the airport rail link and whether the Government should include in the contract a provision covering what would be done if circumstances changed and they needed to buy back the

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infrastructure to limit public overpayment for the asset. There was some suggestion about an independent assessment being carried out and so on. It probably sounds negative to include that in a contract at the very beginning, but from the Government's point of view that may be a safeguard.

Professor STILWELL: It sounds thoroughly appropriate.

CHAIR: How do you think that could be done? We would need some system of independent assessors, because obviously the owners of the project would get every dollar they could. They probably did that with the airport link.

Professor STILWELL: I cannot think through a smart answer to that one off the cuff. It seems to me that in principle it should not be a problem to extend the contractual arrangements in that way. In general, it would make it a less attractive situation for the private partner, but that is part of the wheeling and dealing that always goes into these processes.

CHAIR: Could you give some more thought to that and take the question on notice?

Professor STILWELL: Sure.

CHAIR: It is optional. If you feel you have more information to give to protect the public interest, the committee would like to hear it.

Professor STILWELL: Yes.

Mr PAUL McLEAY: You made a point about contracts written to enshrine privatisation of profit and socialisation of risk. You provided two examples of where benchmarks were included—the airport rail link, where customer patronage was guaranteed, and Port Macquarie Hospital, which also involved guarantees. The Government did not guarantee any patronage for the cross-city tunnel, therefore the risk was completely with the private operator. Have governments learnt from the experiences of the past?

Professor STILWELL: Certainly, the examples you have given suggest that there has been a move towards ensuring that the private operators bear a substantial part of the risk. However, I would be loath to generalise from three examples to say that we have solved the problem.

Mr PAUL McLEAY: Can you provide an example from the past 10 years—and I use that timeframe specifically—of a major PPP that has been flawed in that regard; that is, that the risk has not been shifted to the private sector? If you wish, you can take that question on notice.

Professor STILWELL: Yes, I think I need to do so.

Mr PAUL McLEAY: Do you see a difference between privatisation and PPPs?

Professor STILWELL: Yes, the formal difference being that the PPP's ownership normally reverts to the public sector after a given period, such as, typically, 25 to 30 years in the case of a motorway.

Mr PAUL McLEAY: Do you have any view about the maximum time lines? We have heard that in some cases in America roadways have involved a 99-year lease. Typically in New South Wales they are 20 to 30 years. Do you have a view on how long the leases should be?

Professor STILWELL: As a general principle, the shorter the better. My earlier argument tends to suggest that the optimum is zero. If there has to be arrangements of this kind for whatever reason—economic or political—the shorter the period, the less the uncertainty and the greater the capacity to reassert a public interest when the ownership of the asset returns to public hands.

Mr PAUL McLEAY: Given that it does return, if the ownership is shorter, would the repayments be higher in that shorter term, or is it okay to spread that?

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Professor STILWELL: From a commercial point of view, obviously the private operator would normally be seeking a higher return if its ownership of the asset were shorter. That is the trade off.

Mr PAUL McLEAY: If a Government makes a policy decision to have someone else construct and maintain a piece of infrastructure for a period, how does it decide on the length of the lease? Should it not simply be what represents best value on repayments?

Professor STILWELL: It is very difficult. Take for example the case of an urban motorway, tunnel or whatever. Over 10 years or more it is very likely there will be other major changes in the urban transportation network. Consider the current context. Oil reserves will run out, oil prices will change and there will be strong demands for improved public transport. It is inconceivable that we will maintain the same transport arrangements with just one change, such as the introduction of a tunnel or motorway. Many things will change over 10 years or more. It is very difficult to write contracts that take account of all possible eventualities. The risk might go either way in the case I have just given. In general, any such arrangements, if they have to be entered into at all, should be for short periods when some of the other variables are reasonably predictable and fixed in character.

Mr PAUL McLEAY: If you believe that we will still have motorcars in 30 years then it is okay to have it for 30 years.

Professor STILWELL: That is one extreme interpretation of what I have just said.

Mr PAUL McLEAY: They may be powered by hydrogen and be safer.

Professor STILWELL: Obviously it would be crazy to enter into a contract providing one form of infrastructure if the demand for it was going to evaporate within the life of the project.

Mr PAUL McLEAY: So you would not recommend a coal-burning power station for 200 years?

Professor STILWELL: I certainly would not.

Mr PAUL McLEAY: You said that private interest rates are greater than the rate at which the public can borrow money. What is the current rate available to the private sector?

Professor STILWELL: Well, I guess you can—

Mr PAUL McLEAY: Just in general terms.

Professor STILWELL: I will say 9 per cent.

Mr PAUL McLEAY: I am reminded of the example of the Reserve Bank paying zero. What is generally the base rate at which the States can borrow money?

Professor STILWELL: Say, 6 per cent.

Mr PAUL McLEAY: Therefore, by definition, would a private sector provider pay 3 per cent more?

Professor STILWELL: Yes, you are looking at a premium of something in the order of 3 per cent.

Mr PAUL McLEAY: Therefore, for the project to go private, do they need to show another 3 per cent worth of efficiencies or risk exposure?

Professor STILWELL: Yes.

Mr PAUL McLEAY: Is there a formula for pricing risk?

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Professor STILWELL: In the case you have described, if the private and public provider's work is of equal efficiency, one would assume therefore that the toll or other charge to the public for the service would be 3 per cent higher in the case of the private provider, all other things being equal.

Mr PAUL McLEAY: That is what it boils down to when you are talking about contracting and privatisation: Can you guarantee that all other things will be equal?

Professor STILWELL: That is my point exactly: you cannot. But, of course, what proponents of PPPs often argue is that public provision tends to be more expensive and more inefficient than private, and that that may commonly be more than the 3 per cent to which I have just alluded, so the net benefit lies with the private provision. But the argument depends wholly upon there being a demonstrated tendency to more inefficiency in the public sector than in the private sector. That it is what I have cast some doubt on, particularly when you take account of the broader array of considerations—environmental impacts, social impacts and employment impacts.

Mr PAUL McLEAY: Things like optimism bias? Are there trends that show when the public sector can do it, they think it will cost X dollars and it ends up blowing out? If you are only guaranteed a certain price, is there a smaller chance of having that optimism bias if someone else is providing it?

Professor STILWELL: Perhaps so. I think optimism bias seems to be a pervasive feature in both public and private sectors. One can think of so many projects whose costs have overrun—most notoriously the Opera House, but in many other cases since.

Mr PAUL McLEAY: I will take another road as an example, the old F6 from Waterfall to Wollongong. When that road was built, it was contracted out. They built the road, but they could not recover the money, and therefore when they lost it the State bought it back. In effect, they got a road for free, because it had been built and then they had to buy it. In the end, they could not maintain it, so the State took it back at a much cheaper rate. If it had been the public sector completely, taxpayers would have been borne the total cost. Can you see any similarity between that analogy and the cross-city tunnel?

Professor STILWELL: I suppose it is possible. If, as Ms Lee Rhiannon has raised the possibility of the State buying it back, getting out of the contract, so to speak, at a bargain basement price, then there would be a parallel.

Mr PAUL McLEAY: When you answered Ms Lee Rhiannon's question, the way I heard it your default was that they would have to buy it back at the price they wanted, that is, for \$800 million. Why would we not be able to buy it back at a much reduced price? Or was it is wrong for me to make that assumption from what you said?

Professor STILWELL: I am not an expert on how one negotiates the buying out of contracts, but it seems to me that if the private provider is not making the profits they were expecting, they might indeed be willing to sell out at bargain basement price.

Mr PAUL McLEAY: Surely, in your normal experience of the way economics works and the private market, if the holder says, "I now want to sell my product, which includes a 30-year licence to operate it", the market responds to how much anyone is willing to pay, not the seller?

Professor STILWELL: Yes, that is correct. Although, in this case it may not be a marketable commodity in general. In other words, the Government may be the only alternative buyer.

Mr PAUL McLEAY: If they said it is for sale for \$1, I suspect you might purchase it, because you have a guaranteed income from it?

Professor STILWELL: Yes.

Mr PAUL McLEAY: When you talk about superannuation funds allowing to invest, how do you allow private superannuation funds? Even the public sector funds are, in a sense, operated by the management committees.

Professor STILWELL: Yes.

Mr PAUL McLEAY: How do you allow them to invest into infrastructure projects that do not have a private capacity, except for them to purchase bonds? How do you allow private sector funds to invest in infrastructure groups that are not listed or freely available or competitive?

Professor STILWELL: If the Government, State or Federal, financed infrastructure through the issue of infrastructure bonds, then they could be bought by the superannuation funds as part of their investment portfolio.

Mr PAUL McLEAY: But when they are done by the private sector, they still sell those bonds?

Professor STILWELL: Indeed.

Mr PAUL McLEAY: Then what is the difference? They are either buying them from the Crown or from the private operator.

Professor STILWELL: No doubt many superannuation funds do buy into the companies that are providing infrastructure—Macquarie Bank, for example. I imagine that its shares are held widely by superannuation funds. I do not think there is any difficulty in doing that. Indeed, superannuation funds are increasingly offering choices to their members: whether you want to invest your savings in ethical investment, for example. It would seem to be perfectly appropriate for funds to be encouraged, or even required, to offer that alternative option to their members.

Mr PAUL McLEAY: Would you see private motorways as an ethical investment?

Professor STILWELL: No. Well, not unethical. I need to think carefully about that, because the boundaries as to what is ethical and what is unethical—

Mr PAUL McLEAY: Surely, providing infrastructure to the State is an ethical provision—

Professor STILWELL: My opening remarks suggest that I am in accord with that view. I suppose I am hinting that the questions of ensuring ethical standards are less problematic when those processes are publicly owned and managed.

Mr PAUL McLEAY: But then you could not purchase them?

Professor STILWELL: Other than infrastructure bonds. I might say one other thing on that topic. Since you have referred in passing to public sector superannuation, there is at least one more direct avenue through which State governments could exert their influence to ensure more funds flowing into infrastructure provision.

Mr PAUL McLEAY: Do you know that there is a lack of funds being fed into infrastructure, considering superannuation funds have to diversify their risk and about 20 per cent of it goes into Australian capital investments?

Professor STILWELL: Yes, certainly a balanced portfolio would want some items of that kind which are relatively low risk. I fear that there is a tendency for more risks to have entered into the infrastructure outcomes as a result of PPPs.

Ms LEE RHIANNON: With regard to the state of PPP infrastructure when it returns to the State, given that most of these projects are around 30 years duration, do we have any evidence about in what state they are returned? Sometimes we read in the literature that there is a concern that the private sector will allow the project to run down because they know that their time will be up in 30 years, and perhaps even the way it is built is designed in a way that it will start to run down, at a point where they will no longer have responsibility. They will have had their period when they have gained their profits, and the burden of maintaining that infrastructure will then be with the public. Is there any evidence on that?

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Professor STILWELL: I think it is a very real concern, but I think it is too early to say, since, to the best of my knowledge, the lifespan of these project have not reached that stage yet. But I share those concerns that that is a likely, if not probable, outcome.

CHAIR: When Professor Blakely gave evidence, he told us about his idea of setting up some sort of superannuation board—chaired by the Treasurer and, say, 10 members, two of whom may be Ministers and the remainder being experts with business knowledge—to somehow supervise infrastructure projects in the State. Apparently it works in America, and I think he said Western Australia was setting up something similar, and they would have the oversight of any PPPs and government projects. Does that appeal to you?

Professor STILWELL: I have not heard that proposal or thought carefully about it. I must say, my personal predisposition is to be wary of any corporatist arrangements that undermine democratic accountability. I think the Parliament has an essential role here, and I am a little anxious about introducing another institution that might seem to take some of those powers and knowledge away from the democratically elected representatives of the people.

CHAIR: It may give too much influence to the corporate world?

Professor STILWELL: That is my concern.

Mr PAUL McLEAY: What if there were academics on board?

Professor STILWELL: I do not have any great confidence that academics would be the appropriate people to represent the public interest. But were such bodies to be established, I would feel more comfortable if there were representatives of consumers and environmental interests, for example.

Mr PAUL McLEAY: Earlier you used the analogy of purchasing a home. You said it was reasonable for citizens to purchase a home and defer their payments because of the intergenerational benefit. People who purchase a home have an expectation that at the end of that 30 years they would have an asset, and that that asset that would have increased in value. If you knew your asset was decreasing in value—such as a motor car—would you also recommend having the State absorb that?

Professor STILWELL: Obviously it is more attractive to buy assets that are increasing in value rather than those that are decreasing. But even those that are decreasing in value, such as the motor car to which you refer, it might be a perfectly sensible investment if that motor car, in the short term, is used in ways that are generating surplus: generating profits, generating benefits, perhaps economically or socially. There is no reason why one should not purchase a deteriorating asset if, during the period of its life, it is generating a surplus of benefits over costs.

(The witness withdrew)

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DAVID RICHMOND, Special Advisor, Infrastructure Implementation Group, Premier's Department, on former oath:

CHAIR: Do you wish to make an opening statement?

Professor RICHMOND: I do not on this occasion.

CHAIR: In what public private partnership is your Infrastructure Implementation Group currently involved?

Professor RICHMOND: Just to go through some of the projects, the answer is that most of the projects with which it is currently involved have yet to reach the stage where the procurement methodology has been decided. So that consistent with the Treasury gateway processes and the Government's policy, the process is one of scoping the project, addressing the environmental planning issues through, under the new legislation, the concept approval, a business case which comes to the Cabinet and at that point the decision is made about the method of procurement. One of the options at that point is that the project could become a PPP or, in particular, a PFP where there is a substantial component of private finance.

For example, we are working with the Sydney Ports Corporation on Port Botany expansion. It will probably be a design and construct contract where the private sector construction industry provides the basic infrastructure for the Port and then subsequently that will be leased out and improvements actually placed on that infrastructure by private sector operating companies, so it is not a PFP in that sense. Having said that, that is yet subject to confirmation but that is the kind of project that it might be.

CHAIR: Is that Sydney Ports Authority for Port Botany. That is just an example where it is a private public partnership in a generic sense but at this stage it probably would not involve private finance of the project itself.

The Hon. GREG PEARCE: What dollars are you looking that the public sector has to put in?

Professor RICHMOND: I think the estimate is of the order \$600 million, which has just been confirmed. That would provide all of the capacity consistent with the Government's decision and the process that has gone in which is to scope the additional port capacity. The private sector, as well as building that for the Ports Authority, would be the one that invests on that land to turn it into operating at port capacity.

CHAIR: You said you would consider the method of procurement, PPP or private finance. Did you include government finance?

Professor RICHMOND: I did not include that but where it would be a design, build and maintain contract it would normally be so, something that is totally funded by the Government. In other words, the up-front construction costs in that case would be funded by the Government.

CHAIR: Would you consider that it would be either one of three as one of the recommendations?

Professor RICHMOND: No, at this stage we will be looking at all three. However, what I am suggesting as an example is that the more likely outcome for a project like that is not a PFP but rather a project where the Government invests in some basic infrastructure and then the private sector competes to lease that infrastructure, and it is the private sector that then invests its own infrastructure on the site in a way that is operationally consistent with the private operations of the stevedoring company. They are the ones who know best what they require and as long as it is done in accordance with the planning approval, they would be able to do that. That was just one example.

Other projects such as Liverpool Hospital, stage 11 and Royal North Shore Hospital, again it is too early to say because we are going through the process where in the next couple of months

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business cases will come to government and at that point decisions will be made about whether those projects are traditional projects in the sense that the Government funds the design, building and maintenance by a contractor; whether there are some services outsourced to the private sector; whether there are some areas where private funding might be considered, in particular, in relation to land transactions around the Royal North Shore Hospital where there is obviously an opportunity to not only upgrade and renew the hospital facilities and services but also to undertake some commercial development with the private sector.

At this point it is too early to say definitively but I suspect in both those cases it will be a combination of some direct government funding and perhaps some private financing. They are just a few examples. We are working on water recycling projects. Again it is probably the case there that that may result in private sector investment in water recycling and that resource, and the water from it, being available to the Government on an availability fee basis. But again it is too early to say what the final offer and acceptance will be but certainly in at least one of those cases it is likely it will be something along the availability fee theme that we have seen people refer to which is consistent with what happens here with social infrastructure and with what work is done in other places, such as the United Kingdom.

At this point we do not have a definitive PFP on the books. We are looking at these projects as they move through each stage which is Government policy and position that you scope and formulate the project, get the necessary approvals and then at that business case point you decide how it will be procured. We are not quite at that stage in relation to those projects.

CHAIR: Are there other projects in the pipeline that are not before your group?

Professor RICHMOND: There are various projects which are not on my agenda. I take on very specific projects but certainly Treasury, the Office of Infrastructure Management would be working to a program of current PFPs and they are working closely with agencies. Future PFPs would be something that they would be scoping with agencies when projects get to that point in relation to their business. I am not across the detail of those sorts of projects but certainly in the next stage of the schools program and those kinds of programs would be to consider PFPs. But they are not at the present time, so to speak, on my desk.

CHAIR: Projects such as rail developments in the north-west and so on?

Professor RICHMOND: It is far too early. We are still scoping that project that we are co-ordinating. We are still very much scoping alignments and fundamental costs and operating issues so it is far too early to tell what kinds of projects they will be. But again the decision as to whether they are PFPs will be taken at the point where business cases emerge which indicate benefits or otherwise from different methods of procurement. The way in which the system has tended to work, and I am sure it will continue to work in the future, the decision to move to a PFP does have to have quite demonstrable advantages which may or may not be such things as bringing the project forward earlier, relative to the Government's ability to fund the project, and other opportunities for innovation. It is very early days in relation to those projects. Again, as I say, our focus there is on the scoping of alignments and those sorts of issues. There are massive projects in the south-west, north-west and the centre of city itself to be able to provide that long-term duplicated capacity for Sydney's rail system.

CHAIR: Those projects do not come to you unless a firm decision to go ahead with them has been made by the Government? When you get it can you say "I do not think that is a wise thing to do"? Can you veto it?

Professor RICHMOND: No, but we would have a view about the appropriate delivery mechanisms so, for example, in the Port Botany case when the business case is put to the Government from the Ports Corporation we would express a view about the best way to deliver the project. But, no, it is not our job to tell the Government it should not be doing a project. However, of course, the business case by its very nature does explore the benefit cost ratio and other considerations and obviously business cases do give governments a chance to reconsider projects and their scope. But I do not think that any of the projects that we are working on will be reconsidered to the extent that they would not proceed because they are high-priority projects, and that is why we are dealing with them.

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CHAIR: Are there any plans in the future to restructure the Infrastructure Implementation Group?

Professor RICHMOND: No.

CHAIR: Is it an interim group that will be expanded? Earlier Professor Blakely talked about a board chaired by the Treasurer to supervise all infrastructure projects. On that board are two Ministers and a number of full-time business and commercial people.

Professor RICHMOND: No, I do not profess to have any plans to that end. We have been set up to expedite specific projects the Premier has referred to us. We are working on a range of projects. At the moment we have additional responsibility to ensure that the Infrastructure Planning Committee of the Cabinet has timely reporting on key projects and is able to make some key decisions about the progression of projects and then ultimately put those recommendations to the budget committee.

There is, therefore, a process within government for projects to be progressively reviewed during their project life. In the motorways review that we did last year, we did suggest some changes to that process to make sure that there was more oversight at the Cabinet level. We still would say that is the best set of recommendations at this point in time. We are not proposing setting up other entities in relation to the management and procurement of capital works projects because, fundamentally, those are decisions that the government itself has to make.

We certainly have suggested and recommended in the motorways review that at the next level—that is, at the level of steering the projects—it would be very valuable if an agency like the RTA did bring external expertise into its steering committees and its project control groups. We certainly would reaffirm that recommendation, which has been adopted by the Government. We think that is the point at which the opportunity exists for independent senior people in the private sector to assist agencies, not just as paid consultants but as people who come onto some of the steering committees and act as peer advisers to the chief executives of those agencies and indeed, if necessary, to the Ministers.

CHAIR: What do you think are the key challenges for agencies seeking to deliver social infrastructure, such as hospitals, through PPPs? How will the lessons of past social infrastructure PPPs be reflected in the work of your group?

Professor RICHMOND: I think the major lesson that is coming out of the social infrastructure that has been delivered by PFPs is, first of all, how important it is to get the scoping right. I think the recent review by the Auditor-General of the schools projects indicates that the education system has got the scoping right; in other words, it is clear what it is that the private sector, as well as providing the money, is required to do both in terms of the construction process and also in the operations process. I think that is the first lesson.

The second lesson—which has come out, I think, in recent times—is that it is important, and indeed achievable, that there are clear requirements as to standards of performance in relation to the operation of social infrastructure. My understanding is that the schools work, for example, has borne that out. It is fairly early days in relation to hospitals, but again there is the same focus: get the scoping right, and make sure there are proper performance standards once the asset is operational, so that maintenance is attended to, and those kinds of issues.

The third, and most important issue—and it has not been a problem in New South Wales in respect of social infrastructure—is to make sure that the public policy aspects of the asset are well and truly controlled by the government. In other words, essentially, the private sector is a partner who is providing the facilities management and support component, and that as much as possible the public policy issues about the nature and character of health care are in the hands of government, and that of course would apply in a situation where there is a private contract to provide those sorts of health care services. It seems to me that is the third lesson: to make sure there is very clear control over those public policy issues about what actually happens in terms of services. To date, as far as I am aware, there is only one contract which embraces that concept in any significant way, and that has been Port Macquarie. But, if one were to look at those sorts of arrangements, it is very, very important that there

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are clear policies and procedures, and that the government stays in control of the character of the health services that are actually provided in the premises that are built by the private sector and maintained and, to a large extent, operated by them.

The Hon. GREG PEARCE: Professor Richmond, what is the time frame for getting started on the Port Botany project?

Professor RICHMOND: You are testing my memory a little bit on Port Botany. We would certainly see the Government make decisions in the next few months, probably about June, so that we would be out to the marketplace in the latter part of this year. I cannot recall whether it is the third quarter or the fourth quarter, but it is certainly a high priority project that would progress quite quickly once the business case, the financial arrangements and procurements method have been determined.

The Hon. GREG PEARCE: Presumably the \$600 million does not include transport costs that will be incurred.

Professor RICHMOND: The \$600 million, which was the estimate announced at the time of the approval of the project, would not cover ancillary transport. It would cover some localised issues relevant to the planning consent. But, no, it does not cover, if you like, major arterial roads or construction of rail lines and that kind of thing. The rail projects are very much a matter for the Australian Rail Track Corporation, a Commonwealth instrumentality; and, in relation to roads, it is a matter for the RTA. But the \$600 million estimate certainly would not encompass those sorts of issues.

The Hon. GREG PEARCE: So you are not looking at the road and rail transport implications of the Port Botany development?

Professor RICHMOND: We are looking at the general question of movement of freight. We have provided some preliminary advice to the Government, and we are in the process of undertaking some more work on the issue of the implications of the Port Botany expansion and, more importantly, the general implications of the growth in content that traffic over the next 15 to 20 years, consistent with the Government's policy of taking efforts to move the modal shift so that up to 40 per cent of freight—that is, in this case, container traffic—is carried by rail. We are certainly doing work on that for the Government, and I would expect that to be publicly released, I would imagine, round about June. That also links to the environmental assessment work being done on the Enfield logistics terminal too. All of that we are involved in.

However, on the latter, it is very much a matter for the Minister for Planning to make a determination on the application. But we are certainly scoping for the Government and working with the various government agencies, and indeed Commonwealth government agencies, on the future provision of freight services in Sydney, with a particular emphasis on rail, in order to take the necessary steps to assist the Government to start the process to achieve the modal shift that they are looking at, with an emphasis very much on rail as the priority, particularly given that rail investments are of such a long-term nature.

The Hon. GREG PEARCE: I guess I am just concerned that I am hearing you say that the Government is going to proceed with the Port Botany development knowing that the transport links are not there.

Professor RICHMOND: I did not say that. I said that the cost did not include any future arterial or major rail works.

The Hon. GREG PEARCE: But they will be required?

Professor RICHMOND: In the longer term they will be, yes. We are talking about a project that is going to take some years to reach its full gestation. In that time, we would anticipate significant progress with rail connections through the ARTC program, and obviously the local roads issues are in part addressed by the planning approval process. But, in the period of the gestation of that project, yes, these issues will be addressed. The big challenge, however, in my view, is to take the steps now to achieve that modal shift—because I think one of the difficulties with these kinds of problems is that

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we can focus a great deal of energy on improvement, say to road systems, and they will get you some benefits, but if we do not focus more energy now on the rail system we will not get the long-term benefits we need and we will get to another situation in a decade's time. So our priority—and the Government's priority, as I understand it—at the moment is very much to facilitate the rail construction, which is in the hands of the ARTC.

CHAIR: Do you make strong recommendations? You are looking at these projects, and you obviously are going to see major problems if there are no road improvements and no rail improvements. Do you have some role in alerting other agencies that this is going to be a major problem—because rail is usually built first, rather than later?

Professor RICHMOND: The reality is that investments in rail are massive, and the current situation in respect of freight is that the Commonwealth has accepted the responsibility for the provision of rail freight services for the construction. We will be very much encouraging the New South Wales Government to do everything it can to facilitate the construction of the ARTC's program, which is the rail freight lines that are needed to clear the port in the future—and I emphasise "in the future"—and the rail freight lines that are needed for interstate commerce generally between the capital cities. I do not see that as a major issue right now. What I am saying is that now is the time to do the work that will lead to that kind of an outcome where in fact we do achieve a modal shift to rail.

In terms of issues generally, the State, through its various mechanisms—the Infrastructure Planning Committee of Cabinet, the Budget Committee—is developing its long-term State infrastructure strategy. Obviously, it has regard, amongst many things, to the sorts of issues we are talking about now. Ultimately, the State capital works program, which is in excess of \$8 billion, will over time be addressing a whole range of issues, from the provision of hospitals through to the right mix of road and rail across the metropolitan area. Particularly in the case of rail, it is obviously focussed on passenger services, but, to the extent it has to, to the way in which it can support the Commonwealth program of freight rail. So, yes, there is a process for considering these sorts of issues, but in my view the important point at the moment is to do the work to make sure that the co-operation occurs at a Commonwealth level to facilitate the freight rail expansion that is necessary for the future.

These are issues of the growth of our economy, the growth of our domestic market in terms of importing massive goods. Most of Sydney is a major importer in its own right, and the population depends for its standard of living and for the choices that it makes on having a very substantial flow of imported goods into a major global city like Sydney, so that I can go to my supermarket and buy the range of things, or to the big hardware stores to satisfy my needs. So it is fundamentally a product of growth and prosperity, and it does have to be managed in a sensible way over the next decade or so. As I keep emphasising, the key is to start the work that achieves the modal shift, so that we can get a significant amount of traffic—up to 40 per cent—onto rail. That will be a very major benefit to Sydney and to Australia, because Sydney is still very much, and will continue to be, the engine room of Australian economic growth.

CHAIR: One of the problems is that industry prefers to use the road system for transport of containers, and not the rail system. So it seems that there will have to be some incentives for efficiency and economical charging to make them choose the rail system.

Professor RICHMOND: I think that is true.

CHAIR: That is why the M5 and other places are now being heavily used.

Professor RICHMOND: It is true, obviously, that for much of the movement of freight there is great flexibility in road that suits the market. However, the Sydney metropolitan area is continuing to expand, and the ability to move freight over long distances, across the metropolitan area, in the future will be important, so that freight can be decanted at other locations, and then moved by road vehicle as appropriate. So I think industry does acknowledge that in the long term there has to be a modal shift. I think the first incentive, of course, is to have infrastructure in place that can be used. Much of the debate is a debate in the absence of infrastructure. We know we have got roads, and one can debate the adequacy of the road system, but we have seen a massive investment in roads; we know they are there, and therefore can make a market judgment about using the roads. We cannot really make a market judgment unless we have the rail infrastructure.

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Secondly, it not only has to be in place but it also has to be able to operate in a reliable and effective manner, and that has not been necessarily a feature of rail freight in the past. That is the second hurdle. The final hurdle is that no matter how many big roads you build out at the port, there is a physical limit to how many you can build and there will be a point where the market can say that the economics of rail will be quite attractive because, as I say, no matter how much you build there is a physical constraint. It is the best place for the port. Historically it is the logical place and it will continue to grow. But one cannot say, "We will build more roads from the port." There are physical limitations to that. As the rail interchange comes on line they will be much more conscious about making that sort of choice, but you have to have it first and it has to operate in an efficient and timely manner. I agree that it is very much up to the market, and then the market will make an appropriate response. I am confident that, in the long term, it will make a response that makes sense in terms of the community good, that is that we get a reasonable mode share and, hopefully, the Government's target of 40 per cent of containers onto rail.

The Hon. GREG PEARCE: The Royal North Shore development you are talking about, is that the \$450 million project that has been announced already, or is it new stuff?

Professor RICHMOND: Yes. I am not suggesting that it is new in that sense. What is new is that in the past, for various reasons, the project has not been named precisely. The procurement and commercial issues around the project have not been determined. We are working very closely with Health and the various stakeholders with a view to finalising those issues so that we can guide the marketplace with a properly scoped project in the latter part of this year.

The Hon. GREG PEARCE: You mentioned water recycling, but you did not mention the desalination plant. Have you given up working on the desalination plant?

Professor RICHMOND: I gave some examples and, you are right, I did not mention the desalination plant. No, we have not. We are still working with Sydney Water so that the Government has available to it a capability, should it need it in the future, to proceed with procurement of such a project. Yes, we are working on that to finalise the planning approval, which is in train and also to make sure there is an adequate specification available. That is still an important project from our perspective, but one that, given the Government's current decision on that and the policy position that it has moved to appropriately, has a capability that it will be available should it be needed. I was giving examples; I was not giving an exhaustive list.

The Hon. GREG PEARCE: The north-west and south-west railway extensions, I thought the north-west was due to be completed in 2012 according to the Metropolitan Strategy, or is it the other way round?

Mr PAUL McLEAY: Point of order: Is this a question about the Government's policy on PPPs, or an update on public policy decisions? You can read the newspapers to find out the latest and greatest.

The Hon. GREG PEARCE: Dr Richmond mentioned that he is working on it and I am asking some further questions in relation to what he has said already today.

Mr PAUL McLEAY: Which are completely outside the terms of reference.

Professor RICHMOND: I mentioned them in response to a question from the Chair on the basis that there is a steering committee for those projects, which I convene. Yes, there are various dates that have been put forward. I cannot recall exactly what we are operating to in terms of these because at the moment we are looking carefully at the scope of those projects. There are two countervailing issues. On the one hand the rail system will need extra capacity because essentially it is a system that drafts from a central point to get through the city. That is one set of dates. On the other hand, the metropolitan plan provides for the development of the new release areas, which generate a demand for transport. What we are working through in developing the business case and the economic evaluation of these projects will be an alignment of when is the best time to plan for those sorts of projects. Again, the priority is to do the groundwork, which is some good scoping and to preserve and

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protect the alignments so that they are there in the next decade and a half when one needs to do one or the other to assist the rail system and the population growth.

The Hon. GREG PEARCE: We have some academic evidence on Friday and earlier today about the public sector comparator. Basically we got the opinion this morning that the first ever public comparators are likely to provide the result that the Government or its masters expect. How reliable do you think it is? In particular and on a more serious note, evidence on Friday related to a discount rate being used and whether and how the discount rate was selected.

Professor RICHMOND: I would have to say that I am not an expert in that area. Obviously, there are a lot of technical issues about how one develops comparators. My comment would be that it is a guide. One of the risks that we run in all of these processes is placing our favour too heavily in one particular artefact. Obviously it is important. It is a proxy for an important public policy decision. That is, can one make an assessment as to whether you will get the value in the delivery from going down a private sector as distinct from a traditional public sector procurement process was with some variation on a procurement process. It is important, but it is only a guide to the process. I can spend a lot of time debating discount rates and that kind of thing. But at the end of the day one does one's best to come up with this robust methodology.

If there are others with better methodology I am sure that Treasury would be very happy to receive the methodologies, apply them and get them. But I stress that, as important as it is, it is a guide and it is one element in making a decision. One of the problems with a lot of these things is that people get very carried away with one particular thing and say, "This is it." It is not it, but it is important. If one wants to experiment with discount rates one can do some sensitivity analysis. It is not a big issue. As I say, I am not an expert, but conceptually that is how I would approach it and say, "Okay, let's try it with a different number." But, clearly, some of the numbers do not make a lot of sense. I wrote a thesis on this many years ago, but I am very old and outdated.

Ms LEE RHIANNON: I to go back to the report that you prepared last year for the Government, which has a series of recommendations. I am interested in the status of those now and how they are progressing. For instance, the one under Government decision-making processes says, "The Minister for Planning, in consultation with relevant Ministers, should prepare for the Cabinet Standing Committee on Infrastructure and Planning agreement a consolidated set of environmental and amenity criteria and standards." Overall, how they are progressing and, specifically, how it happened?

Professor RICHMOND: The overall process is one where the Government has signed off on an invitation program, which allocates tasks relating to each recommendation to different agencies—sometimes a specific agency, sometimes a group of agencies. We are working to have each one of those limitations signed off in its implementation form by the end of June. However, as I said before, one of the things that may impact on that target is recommendations that might come from this Committee and from the Public Accounts Committee inquiry. It would be foolish for the Government to decide on a number of detailed things only to discover that there are better ideas from the parliamentary inquiry. Subject to the caveat, that is the timetable. The first set of issues that have been considered by the Government and will be announced in due course has been in relation to tidying up and enhancing the disclosure arrangements, and that is being considered consistent with our recommendations. That is in process now.

In relation to standards, yes, work has commenced on that. That is being led by the Department of Planning. We are asking them to look across a wide range of issues. The intent of the recommendation, as much as anything else, was to try to ensure that there was a consistent approach to issues during the life of projects and that for any reasonably discreet period of time people knew what the ground rules were, whatever project you did, there are the kinds of standards. That work is in train and in the hands of the Department of Planning. As I say, subject to revising things in the light of recommendations that may come out of the parliamentary Committee, we expect that work to be complete by the end of June as a totality.

Ms LEE RHIANNON: Going on to the specifics about public disclosure, your recommendation is quite clear. It is one of those areas that has been given quite a bit of coverage. I wanted to explore it little bit further because they were provisos on how it will play out. When you go

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further into the document and appendix 14 the schedules establish it is Government practice to limit the extent of commercial in confidence material to very specific areas and not disclose it unless required by law. I was interested in how you define commercial in confidence. At the end of appendix 14 you have the information listed in schedule 3, and I will come back to that, and further down you have dot point 3, "The preferred tenderer is to be invited to nominate items it considers commercial in confidence and why." Further on, when you get to schedule 3 it says, "Defines commercial in confidence information. Items not to be disclosed for any contracts." If it is the contractor's financing arrangements, the contractor's cost structure or profit margins, items of the contractor have intellectual property characteristics, the full base case the national model when used, any other matters where disclosure would place a contractor in substantial commercial disadvantage with its competitors. Although your recommendation says very clear cut, that all project deeds and other agreements will be released, when you read the provisos it seems as though a great deal could be left out.

Professor RICHMOND: I think the provisos relate to the draft Treasury guidelines, which we attached to the report, which we said we generally endorse. The issue is, and it has not changed fundamentally and we canvassed this in the report, is that there are some issues where there are, in my view, some grounds for things not being released that do not go to the public interest that are about the business of the contractors. That always has been a tension in this area. I do not have any great difficulty in saying that by and large those sorts of things should not be disclosed. If the contractor is a public company, there are a lot of disclosure issues there with which they have to comply under the law. If they are private organisations they are entitled to be able to manage the business with some privacy. This is not a new principle. The point that we made in the report is that, notwithstanding the Government's guidelines, it is always open to the Parliament to ask for things.

Again, I caution that there is a reasonable approach to what is released. People are entitled to go about their business in a manner that their private financial affairs are not necessarily disclosed to everybody. If, in some way, it impacts on public interest and that is a judgment that others can make. We never pretended that there would not be some exclusions, that is why we said that generally we endorsed the guidelines. There is always this issue of how much is appropriate for public information. Critical public information is around the contract and the value to the Government, the output from the contractor and the arrangements rather than necessarily the private affairs of the contractor. There is a point at which confidence in the transactions with Government are placed at risk. If I decide to enter into a contract with the Government everything about my private affairs is going to be on the public record. There is a point where you do have draw a line.

Ms LEE RHIANNON: I do not think everybody is asking for all details of a company's work to be out there. But, clearly, your recommendation took the heat of the Government and it is being used—it has been quoted back to us—even this inquiry was such a clear-cut recommendation that the contract be released. But when you dig to the back of the report is quite otherwise.

Professor RICHMOND: That is not the contract.

Ms LEE RHIANNON: To recommend that the full base case the national model should not be released, where this leaves us is that we will still have to call for papers in Parliament. We are not going to find out very much the way you have structured this.

Professor RICHMOND: I am sorry, I do not understand what you are trying to find out.

Ms LEE RHIANNON: We are trying to find out how the contract works. A statement, "All project deeds and other agreements signed on behalf of the Government with consortia should be released."

Professor RICHMOND: That is right.

Ms LEE RHIANNON: That is what has been reported and we think, "Wow, we actually have made some progress", but we have not.

Professor RICHMOND: But the contract is financing. If I get a loan from a bank to finance my business activity and I can demonstrate that that is a prudent and sensible financial arrangement, and I enter into a contract with the Government to supply whatever it is I do not see why my loan with

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the bank should be released. It is not a part of the contract. It underpins some judgment of that, that I have the financial capability, but frankly I do think there is a point where there is some right to privacy in some of these commercial relationships. That financing arrangement may not be a part of the contract. It may simply be that there has been a citing of financial capability. It may be that somebody has said, "Yes, I have adequate security for this arrangement", and you cite that, but I am not going to then release the detail of my deal with a private bank. I do not believe in all that.

Ms LEE RHIANNON: Taking your point as you have described it, and it is good to have that on the record, do not you think it would have been more accurate to have these qualifications actually in the recommendation rather than having to dig into three different places right at the back of your report, where we do not have an index and we do not have a contents page, to be able to find those qualifications? Do you not think it would have been more accurate to have presented it as you have just detailed?

Professor RICHMOND: Yes. It is about releasing the documents that have been signed as part of the contract. I am not in a position to go into every contingency to cover each contract. We did say very clearly "draft Treasury guidelines", which the review generally supports are at appendix 14. I said, "generally supports": If I was of the view that the commercial exceptions were unacceptable, I would have said so because I do cover that issue later on and do make the point that the material includes items which the proposed Treasury guidelines would continue to see as inappropriate. We say that we have no problem with that, so I do not think we would be misleading. We said we generally support the Treasury guidelines. On the particular issue, we acknowledged that was there. We recognised that; indeed we go further and say when the Parliament looks at these things, it should also be sensitive to these issues because it can affect private people's rights as private citizens, not as contractors, per se, and there are issues where the release of some information would compromise the Government and its contractors in getting the next stage of the job done, particularly with subcontractors. I am quite comfortable we have covered off that issue. I do not accept that we have misled. We have made it very clear that we generally supported it. We discussed that issue in the back of the report. If I had thought that that bit of the guidelines was so inappropriate, and I do not and I did not, I would have said so.

Ms LEE RHIANNON: Thanks. On another matter, have you advised the Government about the impact rising oil prices will have on motorway use?

Professor RICHMOND: I have not personally addressed that issue in the terms of that particular manifestation of the issue. I think the more significant issue is just generally addressing in the future the balance of the mode share across the major forms of transport, that is, public and private transport, rail, bus and car. Certainly that is an issue which is implicitly and explicitly looked at in the Metropolitan Strategy and is an issue of ongoing work. But I have not, and I am not aware of others who have looked at the particular impact of oil pricing. It was not something that we have particularly addressed. Again, it is something that will manifest itself in the way in which prices work in the market place, actually.

Ms LEE RHIANNON: Considering that there has been speculation that rising oil prices are creating uncertainty among investors, would this not be something that would be very relevant to your work and would be part of your brief to alert governments to that?

Professor RICHMOND: I am sorry: By "uncertainty among investors", you mean generally, or are you talking about roads? I am sorry.

Ms LEE RHIANNON: There is speculation in the financial pages and other places that there is uncertainty about for investors, considering that, well in the future, we are not sure of the level of usage.

Professor RICHMOND: The major uncertainty, as I understand it, for investors is just generally the impact of oil prices on any investment. It is not, you know, if you decided to invest in a company, in a warehouse somewhere. Obviously, if oil prices were to change dramatically, that would be something that you might want to factor in, if you thought that was going to happen. I think that kind of comment is more a general comment on investment rather than a particular comment on investment in roads. But the short answer is no, I have not looked at oil prices but certainly the issue

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of the appropriate long term modal share is an issue. It is inherent in the Metropolitan Strategy and it is something that the Government does have to continually turn its mind to. As I understand from recent announcements, there is obviously a thrust toward greater investment in public transport now. That is a way of addressing the issue you have talked about, but there has not been a similar examination, that I am aware of, of the impact of oil prices per se.

Mr PAUL McLEAY: Professor Richmond, should there be more centralised control over the terms and conditions which agencies use in determining PPP contracts? Would there be a benefit in creating a centralised body in government which handles all PPPs?

Professor RICHMOND: I think that as we, as a community, and in particular the public sector in this State have learnt more and more about the issue of private investment into infrastructure projects. It is become, I think, increasingly clear that there is a need for greater co-ordination and surveillance at a central level. The office of infrastructure management is doing that and they, in my view, have to play a very strong role in providing independent advice to the Treasurer on the terms and conditions of public-private partnerships—in particular, private financed partnerships [PFPs]. I think they are doing that but I believe that that capacity does need to be enhanced and I certainly have been advocating for that for some time. I think one of the reasons that the Auditor-General was able to give what seemed to me to be a fairly favourable report on the schools committee in that process was that, while it was led by the Department of Education and Training, there was a strong guiding influence from the Treasury through the capability of Dr Kerry Schott and her team. I think that team needs to be strengthened. The short answer: yes.

Mr PAUL McLEAY: You mentioned before during some discussion about the public sector comparator and you said it should be used as a guide. Is there any value—or, should it be provided to the tenderers?

Professor RICHMOND: I have no problem in it being provided. It is a question of when it gets provided, I think, and it will depend a bit on the project. It may be that for some class of assets where the provision of this kind of private financing is a bit different, it might not be too wise to provide it the first time you do a particular class of asset, but as we mature in our ability to engage the private sector in these projects, I do not have any problem with the private sector comparator being provided at an appropriate time.

Mr PAUL McLEAY: The public sector comparator.

Professor RICHMOND: I am sorry—the public sector comparator being provided to contractors. But, again, I think one needs to think about when that happens in the process and ultimately, certainly after a contract is complete, there is no reason why it should not be a matter of public record. But, again, one does need a little bit of discretion. As I said, if you are moving into a new class of assets, one does not want to rush into making available what, if you are in the private market, will be commercial information as you start to evolve into procurement of a new class of assets through the PFP process. Once I think that process is reasonably mature, I see no difficulty, at the appropriate time, with releasing details of the comparator.

Mr PAUL McLEAY: You have a concern over the cost of bids for PPPs and contracting generally?

Professor RICHMOND: Yes, in the sense that the costs are higher for a whole lot of reasons, not the least of which is that the parties are trying to anticipate in year one all of the likely impacts of 30-year contracts. Therefore the level of due diligence is much higher and there are multiple parties, usually on both sides—the Treasury and the agency at least on the Government side, sometimes more than one agency, the various members of the consortia on the other,—so inevitably there are going to be higher costs. The real concern is to make sure that those costs are justified by the outcome. In other words, part of the decision, as we have suggested in the motorways review, to proceed with the PFP must have regard to those kind of transaction costs, which includes the costs both of the successful consortium and the Government, but also the costs of other bidders. So there is an issue about costs. Obviously, anything that can be done to try to reduce those costs is a good thing. However, I would caution, as I think I have said before, that one of the real benefits of the PFP process is that it does force all parties to do a lot of good work up front to try to quantify, clarify and

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confirm the details of the contract, and there is a much higher level of due diligence on these projects than would be on a traditional design and construct, and even design, construct and maintain projects. So I would be careful about taking that too far.

I think, yes, have a look at how you can reduce costs. Costs can be reduced in different ways—for example, for multiple competitors in the marketplace, by making decisions earlier rather than later on, how many you want to take to a given point. If you start with six, do not keep six indefinitely in the process. The way in which the Government manages and clarifies who is actually in the competition can be a big help to the private sector in reducing the costs of people who decide to compete for PFPs. So there is a range of things that one could do, but while I am concerned about the cost, I would just caution about assuming that that is a wasted cost, particularly the cost in getting the final preferred bidder, if you like, to a completed contract. That is money well invested, in my view. The area where I think there needs to be more work is in that process of the competitors and how much they have to spend in order to get to a particular point.

Mr PAUL McLEAY: How much would a competitor spend on a bid? I know that is similar to how long is a piece of string, but how much?

Professor RICHMOND: I do not have precise numbers. In some cases we would certainly be talking a couple of million dollars, it could be, in some projects, depending on the scale of the project. It very much depends on the requirements of the proponent agency, but it can be quite expensive, there is no doubt about that. There may be other ways of starting to clarify the scope of contracts and the way in which the negotiations might progress through the point of the project to where you actually formally sign a contract. I think there is some work to be done on that issue. But we can be talking about very substantial amounts of money.

CHAIR: I have just a general question. I know there has been some discussion about the Working with Government Guidelines. While you are here with us, do you have an opinion on whether they should be legislated to ensure certainty and clarity? The Working with Government Guidelines—I would generally raise some questions about them.

Professor RICHMOND: I think, chairman, there is a real dilemma here about the fact that there are some things that do need to be prescribed and need to be highly prescriptive. However, given the wide range of class of assets that we are dealing with, I am always reluctant to say everything should be prescribed. So I do think there is a place for guidelines, as distinct from some legislative sort of piece of mandated detail that one has to go through. So, again, I would be fairly careful about wanting to overmandate through legislation because I think you do need some discretion in managing projects. I think the bottom line for these kinds of projects is that essentially they are commercial deals. It may well be that ultimately people like or do not like the character of the deal, but at the end of the day there does have to be the flexibility to come to a sensible commercial deal. It is very, very hard to legislate for that, so I suspect that there may be some areas of the guidelines that could be mandated. It may be that there is a legislative requirement to have guidelines and to identify in the legislation the kinds of things that perhaps have to be mandated in the guidelines without turning all the detail of the guidelines into a piece of legislation. That could be a compromise position.

Mr PAUL McLEAY: How can the Government improve the alignment of the project approval processes through Cabinet with the Environmental Planning and Assessment Act approval processes?

Professor RICHMOND: Basically, we did start to address that in our review of the motorways procurement. Essentially, for major projects at least, it is very much the opportunity to get a better integration between the new part 3A changes of the Environmental Planning and Assessment Act and Government projects.

We have identified that initially, as well as doing a commercial appraisal, the Government should have the Minister for Planning do an environmental appraisal that identifies up front the sort of issues that the Government will have to address should the project proceed. That is one step. Before the project proceeds to a development application, there should have been a serious Cabinet consideration of the likely implications in terms of the Environmental Planning and Assessment Act.

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Secondly, after the public consultation and environmental assessment process—whether it is an EIS or an environmental assessment—the Cabinet should reappraise the likely conditions and issues that have emerged. In that way it would be very clear what additional costs might be involved and whether or not there were opportunities to change the scope of the project to accommodate additional requirements and perhaps not do some things that are not as important to the project and to the community.

They would be two critical points right at the beginning and before the proponent, under part 3A, develops the commitments. There would be a clear mandate from the Government that if planning approval is likely to require a commitment from the government agency that is the proponent, the Cabinet would be comfortable with that sort of commitment. In that way, there would not be this misalignment or situations in which projects are not properly funded, even at that late stage. Finally, there should be a serious discussion, at least at the cabinet subcommittee level, considering a range of issues. It should not be left to one Minister. The reason for not doing that is simply that sometimes there are benefits to other parts of the government that the Minister may not be aware of that could come out in the discussion.

CHAIR: We have had reports that the Department of Local Government discussed what local councils may be going to do in the future with PPPs for large projects valued at \$50 million or more. Do you have any role in looking at those projects?

Professor RICHMOND: No, we do not have a role. I think the issue is one of scale. We just talked about fees and transaction costs. We would need a substantial scale of project to justify the transaction costs. That is the only comment I can make.

CHAIR: Thank you very much for appearing again and for the information you have provided. If honourable members have any further questions they can forward them to you. I think we have covered all the areas we wanted to cover today.

Professor RICHMOND: Thank you very much, Mr Chairman.

CHAIR: Thank you very much for playing your important role.

(The witness withdrew)

(Luncheon adjournment)

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KERRY SCHOTT, Executive Director, Private Projects and Asset Management, NSW Treasury,

JOHN PIERCE, Secretary, NSW Treasury, and

DANNY GRAHAM, Director, Private Finance Projects, NSW Treasury, on former oath:

CHAIR: Thank you for your attendance at our inquiry. Mr Pierce, would you like to make an opening statement or table any documents?

Mr PIERCE: I would, Mr Chairman, if that is okay with you. Thank you for this opportunity to appear before you today. The Committee has already released its first report on this inquiry. Treasury will be taking into account the Committee's recommendations in that first report in the review and update of the Working with Government guidelines that we are currently undertaking, which we will submit to the Government. We will also take into account any subsequent recommendations made through this inquiry, any further results of audits from the Auditor-General on some of the projects that we have got on the go at the moment and the forthcoming recommendations from the Public Accounts Committee, which I think is due in April. It is also inquiring into PPPs.

In relation to that, so it is consistent with your recommendations, the updated guidelines that we will draft for the Government's consideration will include a strengthened public interest evaluation process, our principles for evaluating non-conforming bids and guidance on integrating procurement with the new planning processes that the Government has in place. In addition, the guidelines will be amended for changes to government structure that have been made since the original guidelines were published. Also consistent with your recommendations, a new ministerial memorandum for disclosing government contracts with the private sector is being finalised. For privately financed projects I expect that this memorandum will require disclosing the full contract, excluding confidential information, and disclosing material variations to the contract. In line with that, the contract deed for the recently signed Newcastle Mater Hospital redevelopment privately financed project has been posted on the New South Wales Government tenders web site. As I understand it, the focus of the second stage of the inquiry is in relation to terms of reference 1(f), the role of government agencies in entering into major public-private partnerships. With your permission, I will table the document entitled "NSW Government Procurement Policy".

Document tabled.

Since June 2003 Treasury has been responsible for government procurement policy, remembering of course that these privately financed projects are just one case within the broader set of procurement options that are available to government. That government procurement policy was released in July 2004 and sets out the required procedures for the strategic planning of all projects and the process and analysis required before a request should be made to the budget committee of Cabinet to invest and fund a particular project. It applies to both government and privately financed projects.

The objective of that policy is to ensure essentially that adequate preparation occurs up front prior to an investment decision so that we can have greater confidence that a project will come in on time and on budget and deliver what was intended when the investment decision was being made. At the back of that document is an outline of an agency accreditation scheme that Treasury manages which outlines the way in which we accredit agencies for the planning phase of a project as one distinct element in the process. Secondly, there is an accreditation arrangement in place for the delivery phase of the project. Perhaps we can talk about the nature of that accreditation arrangement.

Treasury is also now responsible for establishing a strategic infrastructure strategy that identifies and prioritises potential government infrastructure requirements consistent with expectations about demand, government service delivery priorities and funding constraints. Essentially, that strategy helps to guide agencies as to which sorts of projects they may put up for an investment decision to be consistent with the general direction that government wants to head in relation to its capital program.

Except for projects that are predominantly funded by user charges—as I have said in previous evidence—budget funding must be approved before a decision can be taken on whether to procure the

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infrastructure using private finance. That is the separation of the investment decision from the procurement decision. If it is to be procured using private finance then it puts us in a position of really only being able to assess it on the basis of whether doing it in that particular way will yield value for money. If the Government decides to privately finance a project the procuring agency must follow the Working with Government guidelines. Those guidelines will include a suggested project management structure and the roles and responsibilities of the various people in government who are managing the project. Depending on the capabilities of the procuring agency, they should seek either assistance from the Department of Commerce or an accredited external consultant for project management and other technical support. Furthermore, given the complexities of privately financed projects, external, financial, legal and technical advisers are required.

Remember that the procuring agency will be the owner of the infrastructure. Hence it must take responsibility for procuring the infrastructure and for making sure that it meets the service objectives. Typically, the agency chairs the steering committee and participates in the project team, tender evaluation and the negotiation team. The steering committee oversees the project and makes, essentially, the sorts of critical decisions around risk allocation, legal, planning and public consultation as well as the tender documentation. Given that set of accountabilities, Treasury's role in procuring privately financed infrastructure varies depending on the capability of the agency. In the case of agencies that are experienced in procuring privately financed infrastructure, such as the RTA, Treasury's role usually involves being a member of the evaluation panel, primarily dealing with the financial and legal aspects as well as being a member of the steering committee. We are also involved in the development and signing off of the public sector comparator.

Treasury has much more involvement and a more proactive role where the procuring agency is less experienced in privately financed procurement. Health, Education and Justice are those sorts of areas. People in those agencies do not do these things on a regular basis. In these cases we tend to be a critical member of the project team and get involved in day-to-day project decisions. The other role we play virtually irrespective of the nature of the agency is to monitor compliance with the Working with Government guidelines and preparing advice to the budget committee at critical stages during the project as it goes through its processes. We also facilitate the sharing of information about privately financed projects between agencies and external consultants. We tend to act, I suppose, as a central repository of PFP information, to try to ensure that there is a common approach amongst projects and agencies. We want to try to ensure that the experience that private sector parties have in dealing with one arm of government is consistent with the experience they have in dealing with other parts of government.

Recently an Auditor-General's performance report on the new schools privately financed projects was released. We think this provides some external testament, if you like, that there is evidence of the capabilities and benefits of active Treasury involvement in projects, as well as the ability of the Department of Education and Training to take on a new procurement method. The report stated the contracts in the new schools privately financed project were established and met in a way that greatly assists their potential for delivering value for money.

I thank Committee members for their attention. As always, I would be happy to take on notice any matters that we are unable to deal with today in this hearing.

CHAIR: You referred to the recommendations that our Committee made in its first report about the Working with Government Guidelines. I think you said that you are looking at updating those guidelines.

Mr PIERCE: Yes.

CHAIR: Is there a timetable for that? Would you regard it as major updating or minor updating?

Mr PIERCE: I think it will get fairly close attention. I am not sure of the date by which we would finish our work, but then, of course, we will have to submit it to the budget committee of Cabinet.

CHAIR: I was referring to your timetable.

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Mr GRAHAM: We are looking at mid year, June or July. It is a major task because we will be reviewing the whole of the guidance material to make sure there is consistency between recommendations coming out of the various inquiries to ensure that we have linked them all together. Consequently I have a team working on that at the moment. That will be matched by what we call standard commercial principles, a document that will supplement the Working with Government Guidelines to assist agencies in structuring their contracts, and a few other technical documents that may help agencies in undertaking and conducting their PPP procurement. The focus is on the new guidance material, but there will be other information to assist agencies in a technical sense to undertake the projects.

Mr PIERCE: I would expect that whilst we will do that work, say up until the middle of the year, the whole budget process is effectively what is dominating the rest of Treasury and the Budget Committee of Cabinet. So it is a case of when we can get it on the agenda, given the budget process which we are at the pointy end of at the moment.

CHAIR: Would you be making any recommendations as to whether the Working with Government Guidelines should be incorporated in legislation or regulations, or a summary of it, or any of its headings? Or would you leave that to the Minister?

Mr PIERCE: Naturally, it will be an issue that we will have to address, and I expect we will be making recommendations to the budget committee about that. At this point in time I am really not in a position to deal with what sort of recommendation we would be making. But it is something that during the process that Danny outlined, we will have to evaluate and come to a view on, because no doubt we will be expected to make a recommendation to the Budget Committee.

CHAIR: What is the relationship between Treasury and the Department of Commerce in relation to both PPPs and conventional procurement?

Mr PIERCE: As I said, since June 2003 Treasury has been responsible for procurement policy generally. For all types of infrastructure procurement, whether it is privately financed or not, agencies mainly undertake the planning phase and then the delivery phase, if they are accredited by Treasury. If an agency is not accredited, it must seek assistance from the Department of Commerce, or a prequalified external consultant. Whilst Treasury sets down the overall policy, the Department of Commerce is available to agencies to use, so that when they are going through these processes they can have some confidence that they will be complying with that policy. Although, we do not direct people that they must use the Department of Commerce—the department charges a fee for this service, of course—the agency can choose to get external help from someone other than the Department of Commerce.

Where the Department of Commerce provides that sort of support, they would be involved in the development of the tender documentation and be a member of the appropriate evaluation committees. The Department of Commerce also provides an approved procurement system. This system consists of a number of templates and guidelines for things like risk allocation and tender processes. Whether the Department of Commerce is used or and external party is used, they must essentially use this procurement system.

The Department of Commerce also facilitates what we refer to as gateway reviews. Again, it is part of our procurement policy that projects have to go through these gateway reviews. A gateway review is essentially a review of a project through its various stages of development to help identify problems at certain points along the way, in particular things like evaluating the adequacy of the business case that the agency has put up prior to a request for funding approval.

When we are presented with a submission to Treasury, and hence to the Budget Committee, one of the first things we look at is whether they have gone through these various gateway reviews, to give us some confidence that the intended outputs of the project are there and that the time frame for construction and the dollars associated with the project will still be there ex-post.

For conventional projects under the procurement policy, Treasury ensures that all the business cases and other documentation are adequate prior to a request for funding being put forward

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to the Budget Committee, and that the gateway processes are completed and are part of that documentation. We also monitor the tender and construction process for major capital works in the normal budget monitoring type of role that we do.

For privately financed projects, the Private Projects Branch of Treasury also monitors compliance with the Working with Government Guidelines and advises the Budget Committee on that. In summary, whilst Treasury owns the overall policy, the Department of Commerce is there as a resource for agencies who are trying to develop projects and put them to the Budget Committee in a way that is consistent with that policy.

We have quite a constructive and positive working relationship with them. One of the things we said at the very outset when we rolled out these responsibilities was that whilst Treasury needs to own the overall policy, that policy needs to be informed by what actually happens on the ground and it is the Department of Commerce people who are the closest to what happens on the ground. So there is a lot of two-way communication in the application of policy with the department.

CHAIR: What proportion of infrastructure is delivered through the PPP arrangements in New South Wales? Are you able to table a list of the projects?

Mr PIERCE: I do not have a list here today, Mr Chairman.

CHAIR: Perhaps you could take that on notice.

Mr PIERCE: Yes, certainly. As I may have said in previous evidence, even when we started down this route we never expected PFP projects to be any more than 10 to 15 per cent of the overall capital program, which is to say a lot of capital is delivered through traditional procurement and financing methods and we never want to lose sight of that because we want to get the 85 to 90 per cent of the capital program right as well.

Since 1993-94 the proportion of government infrastructure delivered through PFP arrangements—including projects that, strictly speaking, are off-budget transactions, such as toll roads—has averaged around 11 per cent, which is within that 10 to 15 per cent bracket. If we exclude things like toll roads, and straight-out private investment in private infrastructure, and include only traditional government-funded PFPs, the ratio is about 2.5 per cent, which is quite small.

CHAIR: Do you have any relationship with any other jurisdictions in Australia in relation to PPPs?

Mr PIERCE: We do. When the Working with Government guidelines were being drafted we were very conscious of the fact that in capital market terms Australia is relatively small and the transaction costs of doing these things can be quite high. Hence we were keen to work with other State governments, principally Victoria, which has the second largest volume of these transactions, to try to establish common processes and documentation as much as possible so that when, say, somebody came and put a bid in on a schools project in New South Wales the things they had to get, the documentation, was very similar with how they were bidding for a schools project in Victoria or if it was a hospital vice versa. We saw having as much commonality as possible between the jurisdictions as an important contribution to keeping the transaction costs of these things as low as possible so that things like the contracts and the need to employ lawyers to go through them was minimised.

We have regular contact with the other jurisdictions on both a formal and an informal basis. Formally, there is a National PP Forum—this Forum consists of Ministers who are responsible for PFPs in their respective jurisdictions, and the Chair rotates between them. The New South Wales Treasurer chaired the last interjurisdictional forum meeting which was in October 2005. I think the next forum is expected to be chaired by the Commonwealth. That forum is supported by a working group of senior officers from the various jurisdictions. That working group meets on a reasonably regular basis, essentially just to exchange information and ideas on PFPs and try to develop common approaches.

I think I am right in saying that some time ago the Victorians were doing a project and I had somebody from New South Wales Treasury down there not so much working on their working groups

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but observing how that process ran, and when people were doing our first schools project there was somebody from Victoria working with us. We are often contacted by our interstate counterparts for informal advice on specific aspects of projects that they may be dealing with. Both those formal and informal channels of communication help ensure that, first, we know what each other is doing and how they are thinking, and where lessons can be learnt from one jurisdiction's experience that can be translated very quickly into the way in which other jurisdictions undertake these projects. Having said that, there are always peculiar issues.

CHAIR: What are the differences? We notice that between the New South Wales model and, say, Victoria you are trying to get some common ground.

Mr PIERCE: I think it is true to say there are more similarities than differences between New South Wales and Victoria as part of this process. When we originally launched our Working with Government document and the Victorian Government did something similar, my Victorian counterpart and I held a number of forums in both Sydney and Melbourne outlining how these were going to be approached in the jurisdictions to give people an opportunity to see how much we were doing was actually the same. The differences are I think marginal. The approval and tender processes are virtually identical in terms of when you go to your Cabinet committees and that sort of thing. I suppose one point in contrast with Victoria, the New South Wales guidelines clearly differentiate between social and economic infrastructure, and we describe those two things separately. But in practice the processes followed by Victoria for infrastructure are very similar to those in New South Wales. Their documentation tends to emphasise the application of this financing technique in the social infrastructure area somewhat a bit more exclusively.

The other point of difference I suppose is that Victoria allocates more resources to providing guidance from an oversight by its Treasury throughout the procurement process, whereas New South Wales tends to view the procurement process as primarily an agency responsibility, given that they are the ones that will own the asset and manage the contract. It is truly the agency that is in the best position to specify what services are required out of that asset. I think we have less involvement than the Victorian Treasury in the contract management after the contract becomes effective. Again, in New South Wales that is allocated to the agency responsible. I suppose that is a difference in the way in which these things are operationalised, rather than in the decision-making process.

The other point—I think this point of difference will disappear—is that the Victorians have had a longstanding policy of publishing their contracts with the private sector in full except for the confidential information, whereas we have only just recently moved to that sort of system, having previously published just the contract summaries. I expect that what we will be doing is publishing the contract summaries and the full contracts, rather than just putting out the contract documents themselves. The Committee having recently seen the nature of these contracts and the need to spend a fair amount of resources to wade through them and read them, we think there is an added layer of transparency and accountability that go with the contract summaries.

CHAIR: Last Friday the Committee heard evidence from Professor Graeme Hodge that there are a range of discount rates that can be used in determining the public sector comparator and that the decision to use a higher discount rate distorts the real value of the PSC, making it more expensive when the private sector bids for the same project. How does New South Wales Treasury decide which discount rate to use and why?

Mr PIERCE: I suppose this gets back to the argument about how the public sector can borrow more cheaply than the private sector so therefore all the investment should be done by the public sector, which is one of those simple, one-step-in-logic type conclusions which unfortunately masks a whole bunch of issues. The rate at which people are willing to lend money to the Government, other than in the most extreme situations, which New South Wales has never been in—probably have to go to Argentina to find examples of this—does not reflect the capital market's attitude towards the virtues of the projects we are investing in, the things we are building or necessarily how well we build them. What it relates to is the fairly unique position that government is in, in that it is able to tax people. It is no accident that—in other than the most extreme situations—governments tend to be able to borrow more cheaply than the private sector because we have this taxing power.

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So what people are essentially making an assessment of is, "When I lend to government what is the risk that I take on that they will be able to pay me my interest and pay the money back to us?" As I say, that is a function of our taxation powers and the overall financial strength of the State, and obviously reflected in credit ratings. In that sense there is an implicit cross-subsidy between the taxpayers that pay the tax and the individual characteristics of the project. If we are going to be evaluating these things on a like-for-like basis we should be looking at the risks associated with the project, which is in the nature of the project, and they tend to be risks that are there irrespective of whether it is a public sector project or a private sector project because it is the nature of a school, a hospital or a toll road.

The adjustments we make to the discount rate are adjustments to reflect those project specific type risks. If we did not do that then I would argue that we would not be taking full account of the costs of investing in a particular project because we would be ignoring some of the risks involved. For instance, if there is a risk associated with budget overruns, with late delivery, with the sorts of services that are expected out of the asset not materialising. The public sector comparator is essentially put together on that stand-alone basis. As I say, if we were not to make those adjustments then we would be explicitly building on that taxation power, which is independent of whether this is a good project or not.

Mr ANDREW CONSTANCE: This morning we heard from Professor Frank Stillwell in relation to the ability to use debt as a means to finance projects. Can you comment in relation to the level of State government debt and the ability of the State Government to finance more projects through debt as opposed to public private partnerships?

Mr PIERCE: Yes, happy to do that but I point out, as I think I have on a number of occasions, that we approach these things from the viewpoint of separating out the investment decision from the procurement decision. So when we are making that investment decision—does government want to buy this asset—we are essentially treating it as if we are going to be funding it ourselves, as if we are going to be funding it out of tax revenue or, if it is something that has a user charge, as if it is going to be part of the Government's public trading enterprise sector. If it passes that hurdle, that is, it is something that government wants to buy or invest in, then we fall to the next question: What is the most efficient way to procure it? It is at that point that the decision as to whether it will be PFPed or traditionally financed gets made.

In general the decision as to which things will be PFPed or not does not affect how much capital in total we procure. We essentially make that assessment as if we are going to be doing it ourselves. The one exception is that if it is done in a way that generates an additional stream of revenue that would not be available if the Government procured it, then that can cause projects—because there is additional revenue stream—to be procured usually earlier than they would be otherwise. One classic example would be the first lot of schools that were undertaken. The private sector proponents had some, I cannot remember now whether it was preschools or long day centres, but they put in those sorts of facilities on that site.

The Department of Education and Training thought that that was good from an education perspective but because of the fees that could be charged associated with that preschool as additional revenue stream it could allow a bit more to be done. But in general we treat the two separate. Having decided what level investment we will undertake, irrespective of whether it is privately financed or publicly financed, you then get to that question of how much of that investment should be financed by public debt. That then leads to the question of what debt is for. I suppose we could say our traditional view has been that debt is fine provided you are using it to manage cyclical mismatches in expenditure and revenue, by which I mean in a balanced budget situation revenue equals expenditure and financing of current year's activities through current revenues.

Our expenditures do not tend to move much with whatever is happening in the economy out there. Our expenditures are driven more by longer term demographic variables. Demand for education, health and transport does not tend to move up and down very much depending upon what the economy is doing in the short term. Our revenues, however, are very volatile, as we are experiencing now, and they tend to vary a lot with not just what is happening in the economy but what is happening in the Sydney property market.

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Given that governments tend to want to maintain a fairly constant rate of growth in service delivery, and hence a fairly constant rate of growth in capital expenditure to support that service delivery, we want to be able to use debt to finance that during the slower times, like they are having now on the revenue side during a downturn in the property market, and then pay it off during the upswings. So using effectively what you might have heard Treasurers say, "a strong balance sheet helps to support service delivery into the future, and that is essentially what we mean by that. If we have got a strong balance sheet to begin with then during the downturns in revenue we can borrow more to maintain that service delivery. In effect, we can insulate service delivery from the ups and downs of the property cycles.

That is a very different use of debt from saying "We are going to increase the rate of expenditure to a level that is higher than our trend revenues would support." That is a use of debt which we would advise against primarily because it is saying "Well, we do not like the fact we cannot afford to do these things based on the revenues we get through taxation, we want to increase that level of expenditure. We will finance that through debt." That is fine, as far as step one is concerned. Step two is you have to service that debt and pay it back and unless your trend revenue streams allow you to do that then you are on a path of ever-escalating increases in debt to an unsustainable level.

We are quite relaxed about debt being used as a consequence of cyclical ups and downs in revenues but the use of it to expand expenditure above what you can afford to do otherwise is on a path to an unsustainable debt level. Often there are parallels drawn between household purchases and government or between businesses and government. People borrow to finance a house—that is fine—and then they pay it off over 25 years or 7 years or whatever it may be. Why does Government not do the same? It is primarily because governments are not in the business of buying a house once. It is effectively in the business of buying a house every year. If you use debt to finance part of the purchase of your house the first year, and then you buy another one the second year, and you again use debt, and the third year all that happens is that your debt levels escalate to a point where servicing that debt through interest payments gobbles up a huge proportion of your annual budget.

Mr ANDREW CONSTANCE: In light of the \$30 billion worth of projects that the Government is crowing about currently, obviously you would see an increasing role for PFPs in order to finance a lot of that infrastructure?

Mr PIERCE: Not necessarily. I would say the level of investment is determined by, if you like, what we would think the Government would be able to finance as if it was doing it all itself—that is how that number is struck. Whether it is then a PFP is a separate decision as to "Can we purchase this asset through private financing in a way that is cheaper"—

[Interruption]

I will go back to my point earlier. Do not get the current budget deficit perspective that is in the mid-year review as anything other than what happens when you have a downturn in the Sydney property market. Using debt to maintain service delivery when your actual revenue growth is below trend, is something that we are perfectly comfortable about. It is for that very reason that for 10 years emphasis was given to reducing debt levels and other liabilities and increasing the strength of the balance sheet so that when there was a downturn in revenues it was okay to add to debt to cope with that and for the resulting total stock of debt that you end up with, not to threaten the triple-A rating.

Ms LEE RHIANNON: Can you provide the committee with an example of where the PSC has shown that it would be better to go with the public rather than the private?

Mr PIERCE: The closest example I can think of where I was directly involved concerned a proposal to extend the Bondi Junction railway line to Bondi Beach. It was a project that was an unsolicited proposal, that is, it was not one that was in the Government's capital program. It was not one of its own volition that the Government decided it would invest in within its priorities but the private sector came forward with a proposal, supposedly at no cost to government. "Let us do this and in net terms it will not cost the Government anything."

We went through the evaluation of the proposal, as well as what it would cost government if it did it. We came to the conclusion that the revenue streams that the private sector was basing its

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assessment on were unlikely to materialise, in plain English, and that it was not a project that the Government should be supporting as a privately financed project.

Ms LEE RHIANNON: Did that project fall over because it was ill-conceived and would not have got the revenue streams rather than the PSC showed that the public side could have done it cheaper? That is the sort of example I was looking for.

Mr PIERCE: I will make this point, cheapness in these terms is a net concept, so it is not just the cost side, it is net of revenues. So the likelihood of a revenue stream emerging is just as relevant to that cheapness consideration as is a construction cost or a maintenance cost.

Dr SCHOTT: I make a general point that where a PSC is unlikely to be beaten by the private sector is where the Government is largely just doing a design and construct of something that is pretty ordinary—it is moving dirt around, not much room for innovation, not much room for any other party to add anything to it and it is just straight up and down. Things that could fall into that category are things like the Port Botany expansion where they are just putting in pylons in the sea and filling it in. There is nothing that the private sector is likely to be able to do that will make the private financing of it add anything. And a project of that kind would not beat the public sector comparator and would be done just through a straight design and construction. Projects that tend to fall into that sort of general category would never beat the PSC.

Mr PIERCE: The Government goes along with an investment decision-making process, we end up at the end of the budget process with a list of projects the Government wants to undertake. Given that starting off down the PFP route requires a lot of resources and can be quite expensive, you tend to look at those lists of projects and make a qualitative assessment and say "Which of these are likely to give us great value for money through delivery of the PFP?" When it passes that test then you start the whole machinery of your steering committees and PSC construction.

Ms LEE RHIANNON: I do not know the history of PSCs but when were they first brought down? I have the impression that it is something that has been brought forward to assist governments when they are under criticism about PPPs. What are your comments on the recent Auditor-General's Performance Report "The New Schools Privately Financed Report" dated 8 March 2006? The report shows that relatively small changes in assumptions produce massive variations in the estimate of public sector costs, suggesting that the model cannot make reliable predictions. We all know that with mathematical modelling the output should be robust so small changes in the inputs are not going to have this big impact.

The Auditor-General observed at one stage that a public sector comparator is very sensitive to the assumptions that are made. The conclusion that it made is it is unlikely that the public sector comparator would ever be lower than the private sector's PFP bid. Is it real? Is it something that is not so much beneficial for you people behind the scenes but is useful for the politicians in giving a justification to projects that are coming under increasing criticism?

Mr PIERCE: Given the efforts we go to to put the thing together I can assure you it is a very important part of the process from our viewpoint. Whenever you make a decision of this sort you need a counterfactual to compare it against, like with a standard benefit cost analysis you need to have a view of the future which is just taking it as your base case, if you like, that you are comparing alternatives to.

Ms LEE RHIANNON: You say that it is useful, but after it is completed what do you require should change after you have made the comparison?

Mr GRAHAM: I point out that the public sector comparator is not a new thing. It is a new name for an old product. The product is normally called the pre-tender estimate. It is not like a pre-tender estimate is something new to government. All capital projects have to have a pre-tender estimate. If the tenders coming in do not beat the pre-tender estimate then it has got to come back for approval to the Government to seek approval for extra funds to do the project anyway. So there is always a test case out there that the private sector has to beat: it is called the pre-tender estimate. The difference between a pre-tender estimate and the public sector comparator on PFP projects is we are taking into account certain services that are also included in the tender price, and we are going for a

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longer period of time than maybe three to five years during a construction period. It is a balance of evidence there. The Government has to produce a pre-tender estimate anyway and it is a requirement of the pre-tender estimate to take out the time period that you are actually asking the private sector to fully price it all.

Mr PIERCE: A lot of that sensitivity that you refer to is generated merely because it is over a long time period. A small change over many years can appear to be a bigger number.

Ms LEE RHIANNON: What is your comment on the Auditor-General's report of one month ago, which seems to be quite damning in terms of the usefulness of a PSC? It is not suggested that it is very vigorous?

Mr PIERCE: I must admit I have only read a summary of that particular part of the Auditor-General's report.

CHAIR: Do you want to take that question on notice?

Ms LEE RHIANNON: I have a quick question. Just answer "yes" or a "no", or you might prefer to take the question on notice. Does the public sector comparator allow for bungling of expenses? By that I mean suppose you are getting costs in for a school. Are they able to estimate how much it will cost to buy detergent for, say, all nine schools? Instead of buying one lot do they take into account that they are buying a lot of things?

Mr PIERCE: It would be based on whatever it is that government would do in procuring the asset and servicing that asset. To the extent that it gets economies from the bulk procurement some of those inputs then, yes, that would be reflected in the price.

Ms LEE RHIANNON: There would be no difference between how the private and public sectors do it, that right?

Mr PIERCE: It would be based on, say, whatever is the approach that government would take, what government was doing.

Ms LEE RHIANNON: So that it could be different?

Mr PIERCE: It could well be different from the way the private sector is doing. That is one of the things you are trying to help to identify.

Mr PAUL McLEAY: I note that you made a detailed submission to the Public Accounts Committee inquiry into public-private partnerships. I wonder if you could make a submission to this inquiry?

Mr PIERCE: Yes. I would appreciate some guidance.

Mr PAUL McLEAY: Even if it is on similar terms.

Mr PIERCE: In similar terms, yes. Most certainly.

Mr PAUL McLEAY: On Friday the Committee heard evidence from the Acting Deputy Secretary of the Department of Treasury and Finance in Victoria. He said:

As part of our process we very much focus on the public interest. There is a formal public interest test. A project has two parts, if it is a PPP project. I am unaware whether New South Wales has such a stringent process in terms of public interest and that is an area you may want to consider further.

What do you say in your defence?

Mr PIERCE: I will make one comment, but I might ask Danny, who is very familiar with Victorian processes, to comment if there is really a difference between the two of us. I think one of the things that we have observed associated with this particular project in relation to the cross-city tunnel is the time lag between the environmental assessment processes and the final signing of contracts. A

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lot of the issues that you are trying to identify under a public interest test recognise that ultimately the public interest is not so much a technical question but one for governments to make with information that is supplied by people such as us—things like what are the aggregate benefits, what are the costs, who pays, who bears the costs and what are the distributional outcomes? We can provide people with that information. The different groups have to be weighed and decisions made on the part of government.

One of the things we would observe from this cross-city tunnel experience is that the gap between when those issues—what are the benefits and costs, what are the impacts on people—and when contracts were finally signed was quite a lag. The awareness when the contract was signed of information that came up through these environmental impact statement [EIS] processes and planning approval processes was quite long. In thinking about how that might be managed in the future perhaps the information that comes forward through those normal planning processes and the EIS-type stages may need to be collated and restated, and communicated back to people later in the process, where there are those lags. So that when you get to the point of signing a contract, just prior to that, go through a process of collating that information and going back to people and saying, "This is what we learnt from you," a year ago, two years ago or perhaps longer, before actually signing the contracts. That timing issue is one that we are having a think about at the moment. Whether the Victorians do that in a different way to us, I am not sure. I would not expect so.

Mr PAUL McLEAY: Given the difference points of view, is any effort made to develop standard principles, when it comes to PPPs? You spoke before about your joint working groups.

Mr GRAHAM: Can I answer firstly about the public interest test? There is the public interest test that is in the guidelines at the moment. The outcome of this particular inquiry has put a greater focus on the breadth of what could be seen to be a public interest test. We are currently reviewing that in the context of some of the debate and discussion that has come out of what is public interest; to incorporate that into the public interest test. The second point that has come out is that the public interest test is probably not a once and only test; it is a reassessment as you go through the processes to see whether or not you are still complying with the requirements that you originally set up. There may be practical differences between the way the Victorians may be applying their approval process and the way we have been applying it in New South Wales. At the detail level, I am not too sure of it that we do have a public interest test that is required.

In terms of standardised commercial principles, last year we were working closely with Victoria. We partly funded the work that was done on standard commercial principles. We are working at the moment to modify the standard commercial principles as developed by the Victorians to reflect the contractual arrangements and the contractual form that New South Wales is using for its product. We are about 80 per cent to 85 per cent consistent with Victoria. In some areas where there is a difference we are documenting those differences. As I mentioned earlier, in terms of production of a new set of guidelines, we anticipate having the New South Wales standard commercial principles available at the same time, to give guidance to both agencies and the private sector parties about where the risk allocation should be on a privately financed project. We are using the Victorian principles as a check and balance at the moment for our projects and modifying it to reflect what the contractual form that New South Wales has had adopted would produce.

Mr PIERCE: Like any of these things, two jurisdictions could have exactly the same starting point, but as you do things differences can emerge in practice. It is appropriate from time to time for each of us to look at how we are actually doing things on the ground, to see whether the broad policy documents are saying the same thing, to then try to bring people back into line. We find that within New South Wales as between different agencies.

Mr PAUL McLEAY: In brief terms, in general does Treasury have a view as to whether some costs are controlled better by the private sector and some costs controlled better by the public sector?

Mr PIERCE: It is hard to generalise. In principle, yes, there will be costs that are controlled to different degrees in each sector. It is hard to generalise because the question to ask is: What is the incentive structures that are operating in the two sectors in each individual particular case? People respond to incentives, so they will control costs where they have the strongest incentives to do so.

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CHAIR: As we are running out of time I would ask you to take this question on notice. It is straightforward question. What is the relationship between the Department of Planning's Metropolitan Strategy and Treasury's Strategic Infrastructure Strategy?

Mr PIERCE: Yes.

(The witnesses withdrew)

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RONALD EDWARD QUILL, General Manager, Asset Solutions, Sydney Water Corporation, 113-115 Bathurst Street, Sydney, affirmed and examined:

CHAIR: In what capacity do you appear before this Committee?

Mr QUILL: As general manager, asset solutions, Sydney water Corporation, but more particularly because of my direct responsibility for procurement and contract management for Sydney Water.

CHAIR: Are you conversant with the terms of reference for this inquiry?

Mr QUILL: Yes. I am.

CHAIR: If you should consider at any stage that certain evidence you wish to give or documents you may wish to tender should be heard or seen only by the Committee, be Committee would be pleased to consider your request to take that evidence in camera.

CHAIR: Do you wish to begin by making a brief statement?

Mr QUILL: No, Mr Chairman.

CHAIR: How do Sydney Water's alliance projects differ from the conventional public-private partnerships [PPPs]?

Mr QUILL: Essentially there are two different forms of contracting. The PPP form of contract at its very essence is designed to transfer virtually all risk to the private sector partners. However, the alliance contracting method is an explicit sharing all risk is between the participants to the alliance. In the case of a Sydney Water alliance contract we would share the risks associated with the project with the alliance partners that were involved in the project. That is the fundamental difference.

CHAIR: What risks are shared in an alliance project and exactly how are they shared? Do you have a percentage?

Mr QUILL: In principle, the actual risks on the project are shared across the participants. However, the rewards or penalties, shall I call them, are shared differently. For example, if there are cost underruns on the project, Sydney Water normally shares 50 per cent of the cost overruns (sic) and the alliance partner share the other 50 per cent of the cost under runs. As far as the private sector partners are concerned, although we are not privy normally to the commercial arrangements they make between themselves, typically speaking if it is a design and construct-type contract, the costs or the proportion of the risk-sharing is pretty much aligned with the cost of the design or the construction. For example, on a \$100 million project the construction costs might be \$80 million and the design costs \$20 million. Then the 50 per cent sharing of the cost underrun would be roughly in the proportion of 20 per cent and 80 per cent.

CHAIR: What would you say is the definition of an alliance project, from Sydney Water's point of view?

Mr QUILL: We have entered into a number of them. In fact, we have four alliance contracts currently on foot. Previous to that we closed out two alliance projects, the first of which was the Northside Storage Tunnel. There was a fair amount of controversy around about project at the time, as members of this Committee may recall.

In principle, the arrangements put in place for those types of contracts are fairly much the same, however there are variations on the theme. In a classic sense, the types of contracts that lend themselves to the alliance approach are those that are fairly large in size—say, \$100 million or more; projects that are complex in their scope and bear considerable risk; and projects that typically are very short in their time frames. The reason we quite often enter into an alliance contract is simply that all of those factors are in play—not always, but typically. And you can enter into an alliance contract much

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faster than you can say a conventional contract, whether it be a PPP, a design-construct type contract, or any other form of contract.

CHAIR: You mentioned that in the alliance project you share the risk. What risk do you share?

Mr QUILL: Sydney Water always undertakes the planning, and therefore takes responsibility for obtaining approval for the project from, typically, the Department of Planning, sometimes on concurrent approval from the Department of Environment and Conservation, and also acceptances of the conditions of approval that are prescribed by the Minister for Planning. Once the contract has been entered into, through the life of the contract the actual risks are shared between the parties. However, having said that, I should say that elements of the project are better managed by different participants. For example, construction management is always better managed by the construction party or parties.

Getting back to Sydney Water: in respect of the communications element of the project, particularly when the project becomes controversial and newsworthy, Sydney Water often will step in and manage that element of the project, rather than the private sector participants. So, even though the risks are shared, the actual task involved in managing the various elements of the project normally is taken by the party or parties best able to manage it.

CHAIR: You mentioned the North Side Storage Tunnel was an alliance project in respect of which you shared the risk. What are some others that are current?

Mr QUILL: The Northside Storage Tunnel was a \$465 million project. We have completed the upgrade of some 300 sewage pumping stations, at a cost of around \$250 million, through an alliance process. We are also going through a process of systematically sewerage a number of what I will call outlying villages on the periphery of Sydney with an alliance group. We also have an alliance established for renewal of water mains throughout the whole of our operating area. They are typically of the alliances we have running at the moment. There are a few others.

CHAIR: I think you did a large sewage project with a French company in the Kiama-Gerroa-Gerrington area, where I live. Is there any problem in an alliance with overseas companies?

Mr QUILL: Mr Chairman, that was actually a design-build-operate contract, as opposed to an alliance.

Mr PAUL McLEAY: It was a priority sewerage plant for northern Illawarra suburbs.

Mr QUILL: Yes, it was a priority sewerage program for the northern Illawarra and it involved Stanwell Park, Coalcliff, Coledale, et cetera. It was also an alliance project that sewerage Jamberoo. We are currently sewerage the Warragamba, Wallacia and Silverdale area. That project is now nearing completion. When we finish that, that same team will move on to the sewerage of Brooklyn and Dangar Island.

CHAIR: As you said, the alliance projects seem to be able to be completed more rapidly.

Mr QUILL: We can get the project up and running much faster, so that the front-end time frame is a lot shorter. As far as actual physical progress is concerned, it is not necessarily faster, but it tends to be because of the performance requirements and penalties that attach to the project. Typically, there are performance requirements around time and cost. There are also performance requirements around non-cost objectives, such as community satisfaction, environmental management and safety. Those are the three areas that we look at very closely, and we have independent audit processes on all of those KPIs. There are rewards to both Sydney Water and the private sector partners if they achieve better than "business as usual", for example.

CHAIR: It seems you do not have much sympathy with or interest in public-private partnerships. Do you have any of those?

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Mr QUILL: Sydney Water, back in the early to mid-90s, entered into a style of contracting very similar to public-private partnerships. We entered into a build-own-operate contract for four of our major water filtration plants. Those contracts are still running; they were 25-year contracts. Sydney Water entered into three of those, with two French consortia and one English consortium. Those were among the first public-private partnership type of contract that we entered into. Sydney Water has an open mind on the procurement methods it adopts for any particular project. So we are not for or against any particular form of contracting.

CHAIR: But you do not seem to have many of them.

Mr QUILL: No, we do not.

Mr PAUL McLEAY: Well, you do, but no new ones?

Mr QUILL: Yes, no new ones.

The Hon. GREG PEARCE: How do you go about estimating your project costs?

Mr QUILL: We carry out an estimate ourselves, and it is independently verified by a cost estimator. Also, with alliance projects in particular, once again a target cost is developed—and we participate in that development—and that is once again independently verified. That cost remains fixed over the term of the contract unless Sydney Water determines or approves a scope variation. That is essentially how it is done.

The Hon. GREG PEARCE: So you get what I might describe as a pre-tender estimate?

Mr QUILL: Essentially, it is a price for the project that is fixed for the duration of the contract. In that way, the target price estimate is a fixed price for the project, and that is what the performance of the contract is measured against, and that is what determines whether or not Sydney Water or the other participants receive a reward or sustain a loss.

The Hon. GREG PEARCE: If tenders that come in are lower than your estimate, do you still leave your estimate in place as your working number?

Mr QUILL: Yes, that is the measure upon which we gauge whether or not we are getting value for money. Nonetheless, once we have entered into an arrangement with the private sector, we have been able to renegotiate the price, because sometimes they offer us better alternatives through smarter solutions. When you have in place a rolling alliance, like we had with the sewage pumping station program, which has finished, and also the priority sewerage program, which I referred to earlier, you have an opportunity, as each tranche of that contract moves forward, to set a higher and higher performance bar, or even remove some KPIs that you are not prepared to pay any better performance on. So you have opportunities to modify the terms of the contract, if you like, while it is on foot, and as it moves from one stage to the other. We have done that with some of our alliance contracts.

The Hon. GREG PEARCE: Is the figure that goes into budget capital works reporting your target price?

Mr QUILL: No, it is not typically. The figure that normally goes into our budget forecasts is an order of cost planning estimate, rather than a target price, because we have not tested it in the marketplace.

The Hon. GREG PEARCE: Was it your group that was working on the desalination plant?

Mr QUILL: Yes, part of my team was.

The Hon. GREG PEARCE: Are they still working on it?

Mr QUILL: Yes, they are still working on it. As members of the Committee would know, the Government decided that it was necessary to continue work to get ready to build a desalination

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plant in the event that a severe drought continues. Essentially, that has meant that we are proceeding with the necessary planning and design work, and investigation work in some cases, to get ready to build a desalination plant if the storage levels were to drop to 30 per cent.

The Hon. GREG PEARCE: How does your group interface or work in with Dr Richmond's infrastructure group?

Mr QUILL: An interagency type of steering group, or project control group, has been established, with members of Treasury and the infrastructure group sitting on that group as well as senior executives of Sydney Water, including myself. Our strategy is control of the project, and we work closely with the infrastructure control group in that way. So discussions take place along the way about how a project is being managed, the procurement strategies that we are pursuing, et cetera, before we actually make a recommendation to the board and/or the government.

The Hon. GREG PEARCE: So it is a sort of consultative role; it is not a directive sort of role?

Mr QUILL: It is a consultative role, and an assistance role.

CHAIR: Is there any part that you play in whether it should be a PPP or an alliance project, or is that still further down the track?

Mr QUILL: That is further down the track, because that is a procurement decision. Essentially, in getting ready, we will have plans on the shelf that will enable the contract to be let to build the desalination plant, if that is required down the track. When I refer to "plans on the shelf", we are proceeding with only sufficient design work to enable that work to be done in the future, if it needs to be done. So there will be elements of that design that will not be fully completed, and there will be other elements that will be fully completed. That depends on where the various elements of the project sit in terms of predicability on the time line. So, for example, there is an access shaft that needs to be built for the tunnel's inlet-outlet works to the desalination plant, that is on the critical path. So there will be a high degree of design development done on that, probably fully detailed design. However, with the desalination plant itself, there are two issues that we have to confront: one is obsolescence and technology changing as times goes by; and the other issue is timing, or when it needs to be done. So at this point in time we think, on average, we will probably only need to do about 30 per cent design-development of the desalination membrane reverse osmosis plant that is needed because the rest of it can be done once the contract is let.

CHAIR: There is going to be a small trial unit, is there not?

Mr QUILL: Yes. A pilot plant has been established. We are in commercial negotiations with the owner of that pilot plant at the moment so that we can lease or acquire it so that we can continue on with the necessary testing of the raw water so that we can prove and refine the treatment processes required for the plant. It is a two-step process. One is the pre-treatment, which is absolutely critical and we have to get it right so that the reverse osmosis membranes can operate efficiently and reliably. It is that front-end pre-treatment we have to get right. That is the reason we need the pilot plant testing.

CHAIR: Do you call that an alliance project or a PPP?

Mr QUILL: No, Sydney Water will do that work using the expertise of a German company called Fichter, GHD in Australia. They will assist us with the pilot plant testing.

The Hon. GREG PEARCE: So the pilot plant is already in existence?

Mr QUILL: Yes. It has been established at Kurnell. It is sitting there.

The Hon. GREG PEARCE: It is part of somebody else's industry of some description, is it?

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Mr QUILL: No, it was put in as part of the process that we were formally following until the new water sources were found and the Government decided then, based on that, that we would not proceed with the building; we would just proceed with the get ready.

Mr ANDREW CONSTANCE: Is it on private land or public land?

Mr QUILL: It is on Sydney Water land. We have compulsorily acquired the land that is necessary to build the plant if we need to.

Mr PAUL McLEAY: Point of order: I refer to the terms of reference. This is interesting but it has nothing to do with a PPP.

CHAIR: We are relating it back—

Mr PAUL McLEAY: Chair, you asked whether this was an alliance or a PPP and he said no.

CHAIR: We have to find out what it is we are asking—

Mr PAUL McLEAY: It has got nothing to do with it. It is interesting but it has nothing to do with our terms of reference.

CHAIR: Ms Lee Rhiannon has a question.

Ms LEE RHIANNON: Thank you, Mr Chair.

The Hon. GREG PEARCE: Sorry, Lee. How do you handle things like unsolicited proposals? I think one of the gas companies suggested using some gas lines for water recycling.

Mr QUILL: It is government policy that all unsolicited proposals are to be referred to the Director General of the Premier's Department.

The Hon. GREG PEARCE: So you just refer them to him?

Mr QUILL: Yes.

Ms LEE RHIANNON: There has been a bit of publicity lately about Services Sydney proposal with regard to the sewerage and water that Sydney Water has control of. Sydney Water has been resistant. I was interested in what your modelling shows with regard to the viability of this project, how much it would cost and your assessment of it.

Mr QUILL: I am sorry, I am not directly involved in that scheme and I have no detailed knowledge of it. I would have to take that question on notice.

Ms LEE RHIANNON: Thanks very much. This question is not related but it may be a similar situation. I understand that Sydney Water signed a contract with the French company that is now known as AWB with regard to the water purification plant.

The Hon. GREG PEARCE: Prospect?

Ms LEE RHIANNON: Yes.

Mr QUILL: I think it is AWS.

Ms LEE RHIANNON: Thank you. There is a no-competition clause in the contract. What impact did that clause have in terms of Sydney Water's response to people's interest in water tanks? I am talking about residential water tank installation here.

Mr PAUL McLEAY: This is not an estimates inquiry, Chair. Come on!

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Ms LEE RHIANNON: I am just trying to find out how it all works. If you have information on that I am interested in how that played out.

Mr QUILL: Once again, I do not have any direct knowledge of that and I am unaware that that particular issue has ever arisen, even in the executive discussions, which I participate in.

Mr PAUL McLEAY: What have been the benefits of Sydney Water's alliance contracting process? You explained how the process worked before. What are some of the specific benefits?

The Hon. GREG PEARCE: I think he went through all that about 20 minutes ago. You might not have been listening.

The Hon. AMANDA FAZIO: Do not be smart, Greg. I know it is very hard for you.

CHAIR: Let the witness answer the question.

Mr QUILL: There have been numerous benefits. I guess the most important benefit that we have realised on alliance contracts of late is that we have had outstanding safety performance. That is one of our primary considerations on any contract. We are quite proud of that. The alliance partners are also proud of that because it means that people are not getting hurt on our jobs. We have carried out post-implementation reviews on those contracts that have been completed. We have also saved money on particularly the Northside Storage Tunnel and the sewage pumping station alliance, which is also a benefit. Sydney Water has shared directly in the benefit of that by obtaining 50 per cent of the cost underruns involved. I also have to say that customer satisfaction, particularly with the priority sewerage program alliances, has progressively improved over time. Our project teams, working in co-operation with our Sydney Water customer staff, have developed protocols and systems and information particularly which has assisted our customers enormously as we move quite intrusively at times through their front yards or backyards or across their streets. We work one-on-one with each and every customer where we can when they are at home and let them know what we are doing on a day-to-day basis and do whatever we can to minimise any inconvenience. They are, very quickly, some of the benefits that have been achieved to date. We are always looking to make further improvements as projects progress. Technology is another area, methods of delivering projects, particularly where there is repetition involved by having a dedicated team. The team becomes familiar with doing the same activity time and time again and as they become familiar they work smarter and smarter through the activity. I have referred briefly to technology. We have introduced new technologies, particularly on the priority sewerage programs with low-pressure sewerage systems. The methods that are being used to install that now have been refined and developed and are quite competitive—in some cases cheaper than conventional sewerage technologies.

Mr PAUL McLEAY: You said earlier that when there is a cost overrun you share the risk in the cost blowout. You also referred to cost underruns. When you develop a new technology as you have at Stanwell Park, moving to a low-pressure system which is cheaper to build, do you therefore save money?

Mr QUILL: When we entered into that arrangement we knew the sort of technology that was going to be installed where. We knew that it was cheaper to put low-pressure sewerage in the lower parts of that area—Coalcliff, Coledale et cetera. That was part of the price. So they did not get a windfall gain by using that technology at that time. In fact they only marginally saved money on that because it was a new technology and they had to learn the methods and techniques to do it efficiently. It progressively got better.

Mr PAUL McLEAY: So if a project did run under—

Mr QUILL: If a project runs under cost Sydney Water and the alliance partners get a benefit. If it runs over cost Sydney Water only pays 50 per cent of the direct cost and the alliance partners then have their profit and overheads and the remainder of their cost at risk.

Mr PAUL McLEAY: You said earlier that there are four alliances and some of them are ongoing. When do you select the alliance contracting process over a traditional or PPP kind of program?

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Mr QUILL: It has been a bit of a journey for us. We were the first public sector organisation to enter into a textbook pure alliance in Australia. It has been a learning journey for us and we have developed a decision-making matrix that we use to determine the particular procurement method that we will adopt. It acts as a guideline. We take into account a range of considerations before we determine the procurement method to select. There has been discussion this afternoon about alliances but just to put it into perspective, I guess, about 25 per cent or 30 per cent is about the number currently in terms of expenditure of our projects that are under alliance contracting mechanisms. The rest of it is basically hard dollar contracts, design-construct type contracts.

Mr ANDREW CONSTANCE: What percentage of your projects would be alliance projects—in total?

Mr QUILL: As I said, it is about 25 to 30 per cent.

Mr ANDREW CONSTANCE: Who is the commercial operator with the pilot project you mentioned before?

Mr QUILL: As I mentioned before, Sydney Water will be totally responsible for running and managing the pilot plant with the expert assistance of two consulting firms. In fact they are a consortium, GHD, which is an Australian-owned company, and Fichter, which is an internationally recognised desalination expert.

Mr ANDREW CONSTANCE: You mentioned before that there was a commercial operator running the pilot.

Mr QUILL: No, I said the pilot plant was installed by Veolia Water Systems as a precursor to the decision that was previously made to build the plant, which has subsequently been changed, to build only if we need to. That is owned by Veolia Water Systems. We are currently negotiating commercially with the company as to whether we lease or purchase that plant.

Mr ANDREW CONSTANCE: What is a rough estimate of the cost of that?

Mr QUILL: If we were to buy—here again, I think this needs to be commercial in confidence—

CHAIR: You might want to take that on notice.

Mr QUILL: I would rather do that, Mr Chairman.

CHAIR: Thank you for attending as a witness. How long have you been in this position?

Mr QUILL: Five and a bit years.

CHAIR: You seem to have a good grip of it. We appreciate all the information you have supplied. Thank you very much.

Mr QUILL: Thank you, Mr Chairman.

(The witness withdrew)

(Short adjournment)

Corrected Transcript

SIMONE COOMBES, representative of South East Region Training and Enterprise Centre, 8A Collins Street Merimbula, sworn and examined:

CHAIR: In what capacity are you appearing before the Committee?

Mrs COOMBES: As a representative of SERTEC.

CHAIR: Are you conversant with the terms of reference of this inquiry?

Mrs COOMBES: I am.

CHAIR: If you should consider at any stage that certain evidence you wish to give or documents you may wish to tender should be heard or seen only by the Committee, please indicate that fact and we will consider your request. Do you wish to make an opening statement?

Mrs COOMBES: Yes. My name is Simone Coombes and I represent SERTEC, a not-for-profit company that promotes employment and economic development in south-eastern New South Wales. SERTEC made a submission in October 2005 to the Public Accounts Committee [PAC] into public-private partnerships [PPPs] because local governments find it increasingly difficult to maintain and develop infrastructure in rural and regional New South Wales, and SERTEC believes that PPPs have the potential to play an important role in addressing this situation. SERTEC approached me to assist in the preparation of its submission because of my international experience in the development and fermentation of public-private partnerships. As the Senior Development Analyst for the Victoria and Alfred Waterfront Company in South Africa, I defined, developed, analysed and implemented highly profitable PPPs that demonstrate a significant triple bottom line value in Africa, Britain and Europe. The Victoria and Alfred Waterfront is an internationally acclaimed 123-hectare mixed waterfront and marina project in Cape Town the 749 tenants and an annual visitorship in excess of 20 million people.

The very existence of the Victoria and Alfred Waterfront Company is, in itself, an example of a highly successful PPP in that it holds internationally lauded private-sector expertise within government structures. As the National Business and Economics Analyst for Mobil Africa, I developed the technical expertise required for rigorous political, economic and financial analysis of a multimillion-dollar investment spanning economic lives of up to 50 years in the oil industry. As the head of corporate governance for the same company I was responsible for all the operational and performance audits of the organisation. One major audits focus was the ongoing post implementation review of major projects. In this capacity I implemented the Business Approach to International Auditing methodology, the same methodology used to perform the internal audits of the United Kingdom Government after the Cadbury Commission in 1992. For the past 21 months I have explored and developed the opportunities for successful PPPs in New South Wales, focusing on the south-eastern region. During this period I have held discussions and consultations on the applicability of PPPs with State and local government, and with selected private-sector organisations.

Before addressing this inquiry's terms of reference 1 (f) it is necessary to defy successful PPPs. In SERTEC's submission to the PAC, we state that PPPs succeed when the partnership delivers a new or improved efficiency or effectiveness that translates into higher returns. The financial gains implicit in these higher returns can then fund agreed interest rate requirements, for example schools, hospitals and roads. In my experience these higher returns are better generated as income streams to the life of the partnership as well as a significant capital gain at the end of the partnership. This improved internal rate of return [IRR] is therefore both the reason for the partnership and the reward for the partners. This growth approach to public-private partnerships is also practised by the Government of the United States of America—the Blount Street Redevelopment is an excellent example—and the Government of Ireland in its Urban and Town Renewal Program. Public-private partnerships have three main dimensions: political, economic and financial. They cannot succeed unless all three dimensions are proven viable. Furthermore, triple bottom line value and environmental sustainability are impossible unless the PPPs political, economic and financial definitions are sound.

The role of government agencies must start with the acceptance that the agency is a partner and must, therefore, contribute its resources in an equitable way. Expertise is one of the key resources

to be contributed. This capacity to deliver the strategic and specific expertise required to develop, implement and manage successful PPPs is non-negotiable. Market principles penalise the private sector with rapid corporate failure when expertise is inadequate. This penalty does not apply in the context of stable government. Disparity between government and private sector expertise required for successful PPPs exists and can be addressed by establishing a dedicated public sector advisory consultative agency equipped with the requisite expertise in all matters relating to PPP. We made this recommendation in the second proposal contained in a submission to the PAC. Without the availability of this expertise to all agencies entering into or contemplating entry into PPPs, the potential for successful outcomes is compromised. In Britain, Partnerships UK superseded the UK Treasury task force, which pioneered project finance deals in the UK public sector. This organisation provides consulting services to the public sector, drawing heavily on both sectors in its recruitment strategy.

It succeeds in creating best of breed expertise, which is then extended to public agencies in various capacities. It also established a formal distinction between civil servants in core delivery services and in key consulting services. The task of providing consulting services to British government departments and agencies is continued in the Public-Private Partnership Program [4Ps]. This organisation is governed by local authority associations in the UK, and is mandated with the task of increasing investment in local authority services. At the hearing held by both this Committee and the PAC this issue has been explored. At the PAC hearings all those who expressed broad support for PPPs also supported the benefits in establishing a dedicated public sector and advisory consultative agency. These proponents came from both the public and private sectors. The views put forward by the Secretary of the New South Wales Treasury are particularly interesting.

The decision as to the merits of establishing a dedicated agency possibly is now superseded by the decision as to where such an agency should be housed. The establishment of both the Infrastructure Advisory Group and the Infrastructure Implementation Group actively addresses this need. It is worth noting that while Partnerships UK evolved from within the UK Treasury, and notwithstanding that its advisory council is appointed by the UK Treasury, Partnerships UK is itself a public-private partnership with its majority stake held by the private sector. It is not a part or an extension of the UK Treasury. Useful public consultation relies on informed public dialogue. In addition to establishing a dedicated public sector advisory consultation agency, a non-profit, non-partisan national body is needed. I refer to the recommendation made in the first proposal contained in a submission to the PAC. A core objective of this body would be to provide inputs to the public dialogue in support of the use of PPPs and removal of impediments to their implementation.

One key value of this body would be to deliver full and open participation by public and private members, and encourage frank communication between all stakeholders. One of the core benefits of this body would be to bring people face to face. The role of government agencies is establishing the terms and conditions included in public-private partnership agreements must not be separated from the need to evaluate and monitor these PPPs. The terms and conditions must contain the quantifiable measures by which performance will be managed. These measures must include all three drivers of value—that is triple bottom line value indicators. The performance to be measured must be stated clearly in the outcomes required from a PPP. The role of the government agency in clearly establishing these parameters reinforces the need for the agency to access the required expertise from the outset. That concludes my opening statement.

CHAIR: Thank you very much for that informative and concise presentation. It probably answers many of the questions we were thinking of asking. Is the organisation involved with any PPPs at the moment?

Mrs COOMBES: We are, to the extent that we are involved in the planning and development of PPPs. It is an important aspect to distinguish between planning a PPP, developing it, which is where that political, economic and financial definition needs to be established, implementing, of which one phase is building so, clearly, we are not yet building any but we certainly are exploring, planning and developing the potential for PPPs in our region.

CHAIR: Are they confidential?

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Mrs COOMBES: To a certain extent, they are. For example there would be the potential for a PPP involving the old hospital in Bega and, likewise, a PPP involving the current hospital in Bega.

CHAIR: Would you call these unsolicited PPPs? Did they originate with you or somebody else?

Mrs COOMBES: It would be fair to say that I am formalising the needs and feelings of the community. In that sense, yes, they are solicited in that the community largely is driving the need for those improved services.

CHAIR: They came out of the consultation at the local or regional level?

Mrs COOMBES: That is right. SERTEC has been involved over many years with that public consultation and dialogue process, and remains so.

CHAIR: You have recommended that they should be a non-profit member-sponsored national body to promote PPPs. What do you see for that organisation? There must be some lack, in your opinion, to be met by this organisation. Is it only national, or could it be a State-based body?

Mrs COOMBES: Having spent 21 months in Australia looking at PPPs and three months before I arrived here looking at them from the outside, I believe that that which is here differs significantly from the PPPs with which I have been involved. There is tremendous capacity for a great approach to PPPs best explained in business terms. If you are running a business and you need to generate a new and additional income stream with which to fund its core assets, it is that growth approach to PPPs that I have been involved with that I have not yet seen strong examples of in New South Wales, Victoria and Queensland. My research in Victoria and Queensland has not been as large as the research in New South Wales, I must add.

Until we get that frank communication and the dialogue going between public and private sector parties as to what can be achieved, we are not allowing those opportunities to surface. Sitting with a private sector accountant's hat on, it comes very close to the bone of intellectual property when you are aware of tremendous opportunities that are out there that could generate significant income streams over a considerable period of time as well as deliver on the triple bottom line and thereby create funding for required and expressly stated infrastructural needs. It is a bit of a dilemma in extent to how much you put forward and how much you hold back or, in fact, create entirely within the private sector thereby removing the opportunity for a public sector funding to be added to.

CHAIR: Your area of expertise is more assisting on projects at the local government level. Have you looked at State PPPs like the cross-city tunnel and projects of that size?

Mrs COOMBES: I have looked at both and I have had meetings with the Minister for State and Regional Development in terms of a regional investment strategy which would certainly, I believe, be best supported from the State level. All of those would be within the South Coast of New South Wales.

The Hon. GREG PEARCE: The Victoria and Alfred waterfront, what was the extent of government involvement in that, was it the use of government land?

Mrs COOMBES: It is very interesting, the land is publicly held. More importantly the entire company is a 100 per cent subsidiary of the South African Government Pension Fund.

The Hon. GREG PEARCE: You mentioned a couple of projects on the South Coast that were both health projects. Where do you see the greatest potential for PPPs in regional areas? We are not going to see too many toll roads, except for the Pacific Highway.

Mrs COOMBES: No, not at all. That potential exists. By following a mixed use development model, we could create sufficient income stream to fund, shall we call it a non-profit or a non-income generating, even a loss-making, asset such as a hospital, or the redevelopment of approach roads within a local area. One needs to look at the need in rural and regional communities and that should be the starting point as it would if you were a private sector operator. And looking at it

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only from a private sector perspective, you would ask: What is the biggest need or demand that the market is expressing in this area?

The Hon. GREG PEARCE: I am to be convinced that in most regional areas you would get revenue streams sufficient to fund any size PPP, other than maybe a water and sewerage project or a toll road. What other ideas have you seen? How do you think PPPs would be modelled to work in regional areas?

Mrs COOMBES: The best way I could answer that would be to say that if you use a rough guide of 1:5, in other words for every \$50 million invested at an IRR of 23 per cent and above, which is where that type of funding becomes possible, you then have a 1:5 of asset which you can develop, which will not generate a profit without losing the interest of the private sector capital donors. The regional strategy that we have been working on for the South Coast contains seven projects and has a total estimated capital value of \$500 million. We are talking of a load factor of some \$80 million to \$100 million that could be expended on what we regard as societies' most important infrastructural needs in their areas.

The Hon. GREG PEARCE: You are trying to bundle up seven projects to make that work?

Mrs COOMBES: Most certainly. In order to create the regional market that is needed, because each individual market in its own right is too small, one would have to.

The Hon. GREG PEARCE: That was my question. Keep going.

Mrs COOMBES: Nonetheless each individual project needs to be sufficiently attractive to obtain that private sector capital interest.

Mr ANDREW CONSTANCE: One of the key points in your opening remarks was the recommendation of establishing a single partnership with Partnerships UK. Is that an indication that from the private enterprise perspective the Government is hard to deal with currently? It is difficult for business to be proactive in both dealing with local government and State government in terms of potential solutions to meeting community expectations.

Mrs COOMBES: Most certainly. When one looks at the hearings held by the Public Accounts Committee and your hearings here, as I read it, it is a uniform response that I seem to hear.

Mr ANDREW CONSTANCE: Do you think that with the expertise within bureaucracy, at both a council and State government level, business does not have that confidence at this stage?

Mrs COOMBES: I would have to be very careful in what I say. There have been people, particularly in the PAC hearings who have expressed that they were not unhappy with the level of expertise. Others have been quite open and felt that it could have been stronger. Personally I believe it would be unusual to find the type of expertise that the private sector develops and engages for this type of initiative within the public sector. I cannot imagine that that is a skill set that the public sector recruiting strategies would be asked to deliver on. It is not fair to expect that level of expertise to be part of some other group of skills. It is highly specialised, very advanced, and requires a sound understanding not only of politics and economics but essentially of financial mechanics.

Mr ANDREW CONSTANCE: In terms of the dedicated agency in the United Kingdom, how does it work with its private component? Obviously it was established by government.

Mrs COOMBES: I have not had any direct dealings with them. My knowledge of them is what I have been able to research in digging through research papers, et cetera. It is interesting that it is clearly a partnership with the majority stake held by the private sector. If you look at the equity holders, the public sector holders, one group of about 44 per cent, which is Treasury, and all of the others, which are 10 "board members" if you will, are coming from organisations such as SERCO, right through to the top accounting and consulting firms. If you think about the mechanics of managing a board, if you have one nominated member from the public sector agency and having to deal with 10 others from the private sector, clearly there will be a lot of private sector input.

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Mr ANDREW CONSTANCE: How does the private sector component deal with conflict of interest issues that might arise in terms of the advisory process?

Mrs COOMBES: Look, conflict of interest, when it is clear and has been stated, is relatively easily dealt with. In the areas where conflict of interest is much more difficult I believe that if government or public sector agencies were able to define and specify their triple bottom-line value indicators—in other words, for example, we need 80 kilometres of roads, we need social outcomes of A, B and C, and we need environmental like-for-like, eco-coined, exchange, one would then be in a position to say, "Put forward your proposals" without at the early stages actually sharing that which is commercially confident, provided that the proponents could actually specify their proposals within those three groups of value indicators.

Mr ANDREW CONSTANCE: Okay. However, if you are sitting on Partnerships UK from one of the large accounting bodies or large construction companies such as Leightons, how do you withdraw from that process?

Mrs COOMBES: That should be dealt with in sound directorial fiduciary duty. You should be excused and you should be required to be excused. Furthermore, one should not have to be pointed out that one needs to excuse oneself if a conflict of interest exists, potentially or not.

Mr ANDREW CONSTANCE: In Australia, given the size of our marketplace, most of the private sector companies who would be involved in such an advisory committee process would probably be happy to excuse themselves on that basis.

Mrs COOMBES: From time to time.

CHAIR: You have recommended that such a body be established, although you said that the establishment of these advisory groups, infrastructure advisory and infrastructure implementation, actively addresses this need. Does it completely address the need? You do not need a State or national body?

Mrs COOMBES: No.

CHAIR: You still need this?

Mrs COOMBES: Most definitely. I think more is required.

CHAIR: They are actually government bodies.

Mrs COOMBES: They are. They address the need of a dedicated public sector advisory consultative agency, which should be accessible to all agencies entering into or contemplating entering into PPPs.

CHAIR: Do you have a model for that? Are you suggesting that Partnerships UK is the model? Or is that just one approach? Have you devised a model or would you take that question on notice to supply the Committee with a suggested model, as a witness, without a fee?

Mrs COOMBES: I would certainly be prepared to do that, yes. It is important to draw on what Partnerships UK has done, but Australian context is clearly different. We need to make allowance for that. We have a lot of mechanisms already in place so it would be a case of building on that. I will happily do that.

CHAIR: Have you had contact with the Federal Government or any Federal agencies? You have talked about a national body.

Mrs COOMBES: I have not had contact with the Federal agencies or bodies regarding PPPs per se, yet we have had some broader discussions with certain Federal members.

CHAIR: Is there any support for a national body, or is that still confidential?

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Mrs COOMBES: The support is there. The need has been recognised and I think it is critical. It needs to be addressed, it is a national market, at the end of the day.

CHAIR: Some Federal Ministers, such as Dr Nelson, have talked about involving more private financing of skills and other things. It is probably on the agenda.

Mrs COOMBES: Absolutely. If you look at the speech by the Victorian Treasurer, and Minister for State and Regional Development at the Canadian Council's National Public-Private and Partnership Conference in October of last year, he quite clearly supports that notion and reinforces the need for a national approach, a national agency and a national market. One cannot get away from that. The national PPP forum has been established, so I think there are already moves afoot on which one could build.

CHAIR: The Canadian conference that you referred to, I assume it issued a report with recommendations. Is that accessible?

Mrs COOMBES: I have the Minister's speech with me, and it makes for some very interesting reading. As to the seminars and discussions that were held around it, I do not know what is available. Certainly his speech is available.

CHAIR: The speech by whom?

Mrs COOMBES: The Victorian Treasurer, which I think was the opening address at the Canadian national conference.

CHAIR: The Committee has received evidence from the Victorian Treasury, along the lines that you are speaking.

The Hon. AMANDA FAZIO: Could you identify some key differences between public-private partnerships of which you have had experience overseas and those in Australia to date?

Mrs COOMBES: For me the key difference is almost the rationale. I believe your political and economic definition drive the strategy and the financial definition drives the structure of the PPP. That political and economic definition is where I see the largest difference in that it would seem that the piece of infrastructure is the sole target, it is the issue, it is what the entire PPP is about. The PPPs that I have been involved in have said that there is a requirement for \$X million of infrastructure, we do not necessarily have those funds readily available so how hard do we go about creating an ongoing income stream that can fund that infrastructure. In a sense, the PPP which is delivered, or the infrastructure which is delivered, is almost the flip side of the coin of the other assets involved in the PPP.

The Hon. AMANDA FAZIO: In your submission you state that the establishment of both the infrastructure advisory group and infrastructure implementation group actively addresses this need, which is the need to develop expertise. Do you have any comments on the infrastructure implementation group in terms of a model to co-ordinate those sorts of public-private partnerships?

Mrs COOMBES: I think, for me, one of the most interesting things about that group is its position in that it reports to the Premier's office and, as I understand it, the implementation group is not a part of Treasury. Speaking with my internal audit or corporate governance hat on, I believe that that is crucial. There is often a bias or an overexaggeration of the importance of matters financial, and they really are only one aspect of the full package. I feel that should that type of group be housed solely within Treasury, there would be the potential for an overemphasis and an overaccentuation of the financial aspects. I think it is wonderful that currently it is housed within the Premier's office.

CHAIR: You have outlined your own background. I am just curious as to the structure of SERTEC itself. How many staff does it have in its own organisation?

Mrs COOMBES: SERTEC does a lot of group training, so I think one would have to distinguish between staff who are involved or who have been taken on as apprentices and for whom

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employment has been found and recorded core staff. I imagine that the core staff would be somewhere 35 and 50 staff members.

CHAIR: And then you have another division that is investigating this public private partnerships.

Mrs COOMBES: That is right. There is also the enterprise development part of the business which was taken over from the State and regional enterprise development group. It has currently been funded by SERTEC for some two to three years in an effort to address the need for economic development.

CHAIR: What does that compromise? There is obviously you, but are there others?

Mrs COOMBES: There is a manager, clearly. The chief executive officer is quite significantly involved from time to time and then the use of consultants on an ad hoc basis, as required.

CHAIR: If there are no other questions, I thank you very much. You have provided a very comprehensive set of information which we will now have to digest and see how we can apply to our situation. I thank you very much.

Mrs COOMBES: You are most welcome. Thank you.

(The witness withdrew)

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TERRENCE JAMES WHYTE, Project Director—Public Private Partnerships, Department of Education and Training, 35 Bridge Street, Sydney, and

GERRARD KENNETH SCHIPP, Deputy Commissioner—Corporate Services, Department of Corporate Services, Level 6, 20 Lee Street, Sydney, sworn and examined:

LINDSAY JAMES WASSON, Regional Director of Education—Western Sydney, Department of Education and Training, 2-10 O'Connell Street, Kingswood, and

PAUL ANTHONY CULSHAW, Director—Asset Management, Department of Education and Training, 35 Bridge Street, Sydney, affirmed and examined:

CHAIR: Thank you very much for agreeing to appear before our inquiry. We thank you for your attendance. Mr Whyte, are you conversant with the terms of reference for this inquiry?

Mr WHYTE: Yes, I am.

CHAIR: Mr Schipp, are you conversant with the terms of reference for this inquiry?

Mr SCHIPP: Yes.

CHAIR: Mr Wasson, are you conversant with the terms of reference for this inquiry?

Mr WASSON: Not intimately, but I understand the nature of the inquiry.

CHAIR: This particular one is into public-private partnerships.

Mr WASSON: Yes, I understand that.

CHAIR: Mr Culshaw, are you conversant with the terms of reference for this inquiry?

Mr CULSHAW: Yes, I am.

CHAIR: For the information of all witnesses, if you should consider at any stage that evidence you may wish to give or documents you may wish to tender should be seen or heard only the Committee, please indicate that fact and the Committee will consider your request. Do any of the witnesses wish to make an opening statement?

Mr WHYTE: No.

Mr SCHIPP: No.

CHAIR: This question is perhaps best addressed to the representative of the Department of Education and Training. How many more schools are being planned as public-private partnerships?

Mr CULSHAW: The answer is to that is that the department has just entered into a contract with Axiom to deliver another 10 schools as part of the second new schools PPP project.

CHAIR: What allowances have been made for future demographic changes? Do the long term PPP arrangements with the schools' operators mean that the Government could be locked into making payment for a school that has fewer students than anticipated?

Mr CULSHAW: I might ask my colleague, Mr Whyte, to answer that.

Mr WHYTE: The department of education's demographic data is based on live birth trends, current school area population statistics. Projections are prepared after consultation with the Department of Planning. New schools are placed in urban release areas. Existing neighbourhood schools that are already full or have excess students get catered for in temporary accommodation. New

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schools are built under the core plus principle. This means a number of permanent classrooms are restricted to the expected long-term stable enrolments. Peak enrolments are therefore catered for in relocatable buildings which can be brought on site and removed as demand increases or decreases. So, for example, a new school, built for around a peak of 450 students will have permanent classrooms for around 300 students. Payments therefore to the operator are modified based on usage. Already a number of primary schools in the PPP-1 schools are using all their permanent accommodation, and some have relocatable accommodation already on site. The first lot of high schools restrict their enrolments to the initial years in order to manage subject offerings for each year and so are predicted to grow to their full capacity over five to six years. This pattern has been tried and proved for school delivery since the early 1980s under traditional delivery models, and the system is the same for the PPP model. If enrolments therefore are less, the number of relocatable buildings will be less and the payment will be less.

CHAIR: Currently the staff of these schools are departmental employees. Was any consideration given by the department to include the delivery of services in the PPP agreement?

Mr WHYTE: The PPP arrangement was considered as a capital works procurement vehicle in order to gain economies in building, quality, fast delivery and single facilities management. The facilities management includes maintenance, cleaning, security and utilities. These are separate contracts in our existing standard schools and they are the only service delivery contracts considered for inclusion in the PPP contract for schools. For replacement schools, existing contract staff were given the first option for jobs in these schools.

CHAIR: I am just wondering whether you may have information available—if not, take it on notice—to give us a list of the schools where there are PPP arrangements?

Mr WHYTE: We have not got them here but we can give you a list of the first round of schools and we can give you the four announced ones in the second round of 10, but the remainder have not yet been announced by the Government.

CHAIR: Would you take that on notice?

Mr WHYTE: Yes.

CHAIR: I appreciate that. Are there any other questions you would like to ask the departmental people? Then we will go on to corrective services.

The Hon. GREG PEARCE: I thought it was most appropriate that we had corrective services and schools on at the same time.

CHAIR: Continue on then. It is the same exercise.

The Hon. AMANDA FAZIO: He thinks he is a comedian, but we do not.

CHAIR: I have a question for corrective services and then all witnesses will be questioned together. What is the Department of Corrective Services' involvement in the PPPs?

Mr SCHIPP: Currently in the Department of Corrective Services there is a joint partnership along with Justice Health and the Department of Health in the prison forensic hospital project, which is a \$130 million redevelopment of the existing prison hospital at Long Bay.

CHAIR: Can you explain why the most recent correctional centres were not delivered as PPPs? When and why was that decision made?

Mr SCHIPP: Perhaps if I could answer that with a question. If you are referring to Wellington as the most recent correctional centre under construction, it was considered as an opportunity for a PPP but the decision was taken in April 2004 by Cabinet that it should be a publicly delivered project following a demonstration of greater value for money in delivering the project as a public procurement and as a public operation following a new set of work arrangements that had been negotiated with the unions for the delivery of custodial services at the Kempsey prison.

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CHAIR: So there had been some problems in the previous PPP. It seems that there was a change of policy.

Mr SCHIPP: In terms of the actual delivery of custodial services, there was never any consideration because it is outside of the Government's current core service delivery policy. So what was considered at Wellington was the delivery of the capital works component with some what is termed soft facilities management services as a PPP. So the actual correctional services was not considered as part of the scope of works for the PPP. When the feasibility study was undertaken to look at whether or not Wellington should be delivered as a PPP, it was demonstrated that it was not as effective or as cost effective as delivering it as a publicly provided facility.

CHAIR: So that is different from the suggestion of what you call a privately run prison?

Mr SCHIPP: Yes. The department pays the GEO Corporation to run the Junee prison. The Junee prison was built as a build/operate facility back in, I think it was 1993. The definition of the PPP, as we know it today, or as defined by the Government's current policy, does not include the privatisation or the private operations of core services—what is defined as core services.

In our context, what we define as core services includes the custodial operations, the provision of educational and health services to the prisoners and a raft of security services. They would be outside the scope of a privately provided project and the privately provided project would be limited to the capital and the construction side of things. The construction of jails is invariably contracted out to the private sector. The Government does not employ builders to build prisons. The custodial operations were never included as part of that.

The Hon. GREG PEARCE: The Auditor-General's report on the schools was fairly complimentary in most respects, particularly the second contract. There were one or two criticisms. He mentioned that particularly in the first contract he thought the department was perhaps a little overly prescriptive in defining schools with the result that there might have been less innovation from the private sector. Can you comment on that?

Mr WHYTE: Innovation in school design has been ongoing for us since the early 1980s when we introduced the core-plus model. Then in the mid 1990s we reviewed the secondary school facilities standards. We have a research group that looks at innovation in building materials and design, and anything that is required as far as educational outcomes are concerned. Most of the things that the companies came up with in regard to school design had already been tried or looked at. There was not a lot that they were able to innovate that was not more costly than the current delivery model, which was producing educational outcomes.

In the second round they were able to look at some small changes to design and some improvements in how they could distribute the electrical supply and a few things like that. The major innovation they came up with in the first round was to look at providing complementary childcare services on the site.

The Hon. GREG PEARCE: I have not had a look at the tender documents, but what do you do if you do not give them the locations of schools?

Mr WHYTE: We have nominated potential locations in the growth areas of Sydney, the Central Coast and the Illawarra region. The contract allows for a school potentially to be moved. Because we have similar designs we are able to say that if the growth area does not progress as quickly in one area of the north-west sector, for example, but is greater in another area of the north-west sector, we have the potential in the contract to move the school to the faster growth area before construction starts. That is why they have not yet been announced.

Mr CULSHAW: That occurred in the first PPP. One school was substituted for another because of delays in the development of a particular area.

CHAIR: Are they built on departmental land?

Mr WHYTE: They are built on departmental land.

CHAIR: You know where the land is where you wish to have the school?

Mr WHYTE: Yes. There are school sites on LEPs in all growth areas. For example, if a school was to go in the south-west sector, we have maybe three sites indicated in that area and it would depend on where the development first occurs as to which one of those sites would get the first of the schools.

The Hon. GREG PEARCE: So you get it down to a module that is almost interchangeable?

Mr WHYTE: Yes, they can price the aboveground buildings because the buildings are pretty standard in primary schools and high schools. It is just how you place them on the site, depending on the site contours, streets and so on. They can give us a set price for building a standard high school or primary school. The only variation to the price would be site conditions, slope of land and conditions peculiar to the site we are looking at.

The Hon. GREG PEARCE: Then they give you a schedule of rates?

Mr WHYTE: Yes, for the rest.

CHAIR: Does that mean there will not be any permanent buildings as such?

Mr WHYTE: No, they are permanent buildings.

CHAIR: You said they could be moved.

Mr WHYTE: I meant that the project can be moved to the other site should that be developed quicker.

CHAIR: I know there are a lot of module buildings, like temporary classrooms.

Mr WHYTE: No, the intent of the answer was that the whole school, the permanent building accommodation, would be looked at and re-priced on the next site, should that be needed.

CHAIR: I was a bit worried in case you were going to have temporary schools.

Mr WHYTE: That was not the intent.

The Hon. GREG PEARCE: You actually replaced a school that burnt down, didn't you?

Mr WHYTE: We intend to replace a school that burnt down, not necessarily under PPP.

The Hon. GREG PEARCE: How do you make a decision as to whether one of the schools is done under a PPP contract or funded through your normal capital expenditure?

Mr CULSHAW: We do all new schools on a greenfields site as PPP.

The Hon. GREG PEARCE: The expertise you have built up, the unit, will roll on and do more of these in the future?

Mr CULSHAW: Yes. It is not something we do every year; it is about every three years with the current demographic demands and changes.

Mr WHYTE: The current projection is for schools that we expect to be delivered up to the beginning of 2009 so we would not expect another contract to come into play until after that, should there be one, or preparation for it, probably in the year before.

Mr ANDREW CONSTANCE: Is there any scope to include accommodation blocks as part of PPPs in future if a school is expanding rapidly?

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Mr CULSHAW: Accommodation blocks? Do you mean additional classrooms?

Mr ANDREW CONSTANCE: Yes.

Mr CULSHAW: I think Terry answered that question with the core-plus design. Enrolments peak and then taper off for a long term, so we design for the core facilities to cater for the peak enrolment and then we add temporary demountables in the primary schools to take care of that. They are taken out after a period of time. Indeed, some of the PPP(I) schools have demountables now. They are going into their peak enrolment and they will come out over time.

Mr WHYTE: We have not yet looked at the question you raised about putting a full block under PPP because this is both a building and a maintenance contract. You would then have two lots of maintenance contractors on the same site, which is a little more complicated. So we have not looked into doing half and half on the site.

Mr CULSHAW: Are you talking about a brownfields site?

Mr ANDREW CONSTANCE: Yes.

CHAIR: You mentioned the 10 schools that have been announced. Do you tend to have one contractor, one company that will handle the 10 schools, or are there separate companies for each school?

Mr CULSHAW: One consortium has responsibility for delivery and maintenance of all 10 schools, but they use two builders, Hanson Yuncken and St Hillier's. The company that provides all the facilities maintenance—grounds, building maintenance, security, pest control, etcetera, is Spotless.

CHAIR: These companies are getting the experience and winning these contracts. There must be more than one company tendering.

Mr CULSHAW: Yes.

CHAIR: How many companies are able to tender?

Mr WHYTE: Five or six applied under the EOI for this round, three were taken through to more detailed proposals and the final contractor was chosen from those three.

Mr CULSHAW: If you look at the standard Department of Commerce procurement list, you will see a very large number of builders and maintenance companies can align themselves in a consortium to tender for this work. There is a fair depth of experience and competency out there.

Mr PAUL McLEAY: When you short-listed the groups was it mainly on price or were you looking at anything else?

Mr WHYTE: A whole range of criteria was used in the evaluation.

Mr PAUL McLEAY: If the schools are pretty standard in design what were the extra criteria?

Mr WHYTE: The extra criteria were things such as experience, ability to design on site—they had to submit designs and their understanding of educational layouts because there is interaction between buildings, particularly in a high school where you have to work out logical movements of students between buildings. So there is a design criterion that is quite important. Obviously price is a criterion, as is the potential for innovation. There are a number of technical criteria as well.

Mr ANDREW CONSTANCE: How will the public-private partnership work with the forensic hospital?

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Mr SCHIPP: The forensic hospital will be part of the Justice-Health section of the Department of Health's side of the public department's joint venture. Corrective Services' responsibility will be the prison hospital. There are two hospitals involved in the project, the forensic hospital and the prison hospital. The forensic hospital will be on the site of the current prison hospital, which will be de-gazetted as a prison facility and re-gazetted as a health facility. The Department of Corrective Services will have no involvement at all in the operation of that facility. It is possibly better for someone from the Department of Health to respond to how the facility will be operated.

In respect of the prison hospital, however, the core services will be provided by the Department of Corrective Services. We will be providing prison officers, Justice Health will be providing the health services, and the consortium that is providing the PPP will provide the finance, build the facility and provide the soft facilities maintenance, essentially the maintenance utilities, garbage removal and collection, those sorts of services.

Mr ANDREW CONSTANCE: Do you see any scope for the new jail probably to be built at Nowra to be a public-private partnership?

Mr SCHIPP: A decision has not been made as to where it will be built. We are currently funding it as part of our capital works program for an additional 1,000 beds over the coming four years. Part of that thousand-bed program is a 500-bed new facility and two 250-bed expansions at Lithgow and Cessnock. We are developing our procurement strategy for those three facilities and no decision has been made as to whether or not any of the three projects will be procured as a PPP rather than as a traditional public provision.

The sorts of issues we are considering are whether the three facilities are delivered as a single contract or three different contracts, given the different locations of the facilities. It may be that some parts of each of the three projects are delivered as a separate contract. For example, it may be that security is provided across the three projects under one contract rather than under separate contracts. As I said, that is part of our procurement strategy and we are developing that as we speak.

Ms LEE RHIANNON: I would like to go back to the DET representatives. I am interested in how you handle problems that you run into with contractors you have engaged. An example is what happened with the out-of-school care. I understand that ABC Learning Centres childcare was doing the out-of-school care for the original nine schools and then there were complaints, and I am not sure whether it was Peppercorn or ABC that went. Could you run us through how you handled those problems and why you decided to let a contractor go?

Mr WHYTE: Neither of us was there for that part of the contract. I have come on board just recently for the second contract, but my understanding is there were complaints from some of the schools about the quality of provision of the out-of-school hours care. That care is done in the school facilities themselves—the halls and the playgrounds—usually with students from the school or neighbouring schools. They felt that was not suitable. It was run in the school halls and there were concerns about the quality of care and being able to get in contact with the operators. It appears that was discussed with Axiom. They felt that the program was not particularly a success on their behalf either and so it was mutually agreed that it would not be continued.

Ms LEE RHIANNON: Was the problem with lack of equipment or the student supervision ratio? What was the problem?

Mr WHYTE: I am not sure what the student-teacher ratio was. I have not heard about the equipment side, so I cannot not comment.

Ms LEE RHIANNON: Was it ABC or Peppercorn that was let go?

Mr WHYTE: Initially it was Peppercorn. I think it was then bought out by ABC. However, the problems were brought up during the time that Peppercorn was doing it. We have a structure in our contract that should we wish to stop that service, which we ultimately did, we must give six months' notice. Axiom was happy for it to cease, so it was ceased mutually with the required six months' notice.

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Ms LEE RHIANNON: Does that mean there was no cost to the public?

Mr WHYTE: No, there was no cost to the public. Some of the schools have decided to operate their own out-of-school-hours [OOSH] services, and the traditional delivery schools have that option.

Ms LEE RHIANNON: Does that mean it does not come under Axiom?

Mr WHYTE: No, the current ones no longer come under Axiom.

Ms LEE RHIANNON: Do new providers come under Axiom?

Mr WHYTE: No, Axiom is not interested in providing OOSH care after that experiment.

Ms LEE RHIANNON: Is the department going with an OOSH care provider or will that be left up to the schools?

Mr WHYTE: Once again, there was no offer from any of the three final providers, including Axiom. So it will be up to the schools to organise out-of-school-hours care should they find that it is a viable option.

Ms LEE RHIANNON: Comments were made about the Auditor-General's March report in discussions with Treasury officers. There were some interesting comments about the public sector comparator. Is that something you have taken on board, and are you making any adjustments before you go into the next round?

Mr CULSHAW: We prepare a public sector comparator for each PPP. The adjustment will be worked up at the end.

Ms LEE RHIANNON: In light of the Auditor General's comments? I thought they were severe criticisms given that we know that this form of statistical analysis clearly must be robust. If small changes are to have such a big impact, obviously the public sector comparator is starting to become questionable. Are they the sorts of things that you have taken on board?

Mr CULSHAW: Yes, we will take them on board. They were not questioning the outcomes; they wanted a bit more rigour on a few more options.

Ms LEE RHIANNON: What sort of changes are you making?

Mr CULSHAW: We have not considered that yet.

Ms LEE RHIANNON: The point is made about how biased it is towards the private sector. The Auditor-General said that it made it unlikely that the public sector comparator would ever be lower than the private sector bid. That means the decision is known before we even go into it if it is not substantially changed. That is why I am interested in the changes you are making.

Mr WHYTE: One of the things that is misinterpreted—not necessarily by the Auditor-General, but by people reading into it—is that the public sector comparator was based on how we as a department traditionally delivered schools. We traditionally deliver new schools as single contracts. We do not have the option of going to Treasury and getting three years worth of forward capital works for new schools and packaging up those three years worth of nine schools. Under the traditional model we could only ever afford to put a couple of new schools on line each year. They were done through the Department of Commerce. If there is a public sector comparator that uses single contracts, it is not a comparison directly to a single contract for nine schools in which there is economy of scale and single contract letting. I think the criticism was intended to say, "Well, maybe you should have compared how you would do that if you were able to deliver that through the Department of Commerce as a package of nine." But the opportunity never presents itself.

Ms LEE RHIANNON: Is that because the funding or the willingness is not there?

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Mr WHYTE: The funding is based over a number of years. We cannot let contracts if we do not have the money to deliver that many schools in one hit.

CHAIR: That is one of the big advantages of the PPP.

Mr WHYTE: It certainly is.

CHAIR: You can now deliver 10 schools that it would have taken five years to provide in the past.

Mr WHYTE: Involving a series of contracts that had to be let to individual groups.

The Hon. AMANDA FAZIO: You said earlier that if, for example, three sites are identified for a new school in a local area environment plan and you come up with a standard price contract to build a school, the only variable might be in relation to specific site costs. What mechanism do you use to reach an agreed price on those site costs?

Mr WHYTE: The proponents that bid give us quantity amounts for site costs, so we can do a comparison when we are looking at the bid.

The Hon. AMANDA FAZIO: So the costs for all three sites would be known at the outset and you take that into account?

Mr WHYTE: They are not actually known because they give a quantity rate for, say, the removal of soil. It is not clear until we know, based on the slope of the land, how much cut and fill will be done. Then, because they put in a bid, we can get our quantity surveyors to confirm that they are quoting an appropriate amount for that site based on the square metre rate.

The Hon. AMANDA FAZIO: Mr Schipp, we have heard a lot—not particularly in this inquiry, but in the media and elsewhere—about the problems experienced in the Victorian privately run gaols. Were they set up as PPPs or contracts to build and operate as private enterprise deals?

Mr SCHIPP: The two or three gaols under construction in Victoria have been established as PPPs. So they are being financed and built by the private sector. Once again, the core services are being provided by the public provider and the non-core services—the soft FM and maintenance—are being provided by the PPP provider. I do not think any of those are operating as yet. Perhaps some of the problems that have been publicly reported have occurred in the publicly built but privately operated gaols. Some of those may have a boot scheme—that is, they were built and are owned and operated privately, but at some point in the future they will transfer from the private sector back to the public sector.

Mr MATT BROWN: In the electorate of Kiama I have seen the benefits of one of the new PPP schools at Shell Cove. Before that was built there was much scepticism in the community and teaching profession about how it would operate. However, the speed at which the school was delivered and students were transferred have made it a success. On the ground, it seems that it is a positive thing. As far as the balance sheet for the State goes, if you are bringing all these schools forward and building them so much more quickly, is that costing much more in servicing these contract debts each year?

Mr WHYTE: It is actually saving money in that the arrangement with Treasury—it was probably mentioned this morning—is that it withdraws a set amount out of our capital works budget for the capital works component over a number of years. Therefore, we are not disadvantaged in any year. Treasury has supported the model. The funding is withdrawn so that there is no disadvantage to the DET budget. Because the service delivery is a set maintenance contract over 30 years, there is a cost saving compared to traditional service and facilities management.

Mr CULSHAW: If the traditional procurement were over five years and we delivered it in three, Treasury would draw our capital budget over five years.

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Mr MATT BROWN: Has this arrangement of contracts and these builders doing these privately financed schools generated any change in culture? Have your standing contracts changed somewhat within the department, or have new levels of competence and cost effectiveness been seen in some of the more traditional contracts that you are still letting out?

Mr WHYTE: There was an influence from the PPP contracts for facilities management that was taken over into the new maintenance contracts. The former director, who has since retired, was heavily involved in the set up of the PPP Schools 1 project, and with the information he had he was able to steer the new maintenance contracts into a new regime.

Mr CULSHAW: We are trialling a facility maintenance contract as part of our overall school maintenance in two locations—Central Coast and Riverina—at the moment as a spin-off from that.

Mr MATT BROWN: How much innovation encouragement do you give the tenderers for these projects? Do you simply allow them to run a school, or can they set up, for example, a camping ground on the site for non-school periods?

Mr WHYTE: I am not aware that any have followed that line. However, the potential is there because there is a third-party use clause. Most of these schools are heavily involved in third-party use. I have not heard of the camping ground experience, but I have heard of church groups using the schools on the weekends and the usual types of third-party use, such as karate groups and so on. I was at a post-occupancy evaluation for the second tranche of the first schools project last Thursday and the principals reported a strong interest in outside use of school facilities. It is encouraging to see that happening.

The Hon. AMANDA FAZIO: If that happens, who gets the money, the people operating the school or the school body itself?

Mr WHYTE: If the third-party users approach the school to use them, the school gets the fee less the operating costs. The additional operating, cleaning and maintenance costs are worked out and paid back to the consortium, because it is its responsibility to do that.

Mr MATT BROWN: Mr Schipp, we have only one privately run gaol in New South Wales. Would you call that a PPP?

Mr SCHIPP: No, it is more the contracting out of the management of the gaol. A PPP typically includes other services, be they the financing costs, the construction or the actual risk associated with the delivery of the service rather than a fee being paid to the operator. In the context of PPPs as they are described in policy documents, I would not include Junee as a PPP.

Mr MATT BROWN: Who built the Junee prison?

Mr SCHIPP: The consortium that included the predecessor to the current operator built it. However, there was a separate contract for the construction and then subsequently the operation of the facility. It was constructed about 15 years ago. There was little risk on the part of the constructing authority—the consortia—in terms of what the outcomes of the operations of the facility might have been. Basically, they were paid to construct it and operate it, with very little risk associated with the ongoing operations of the facility.

Mr MATT BROWN: Since they were paid to construct it in a contract separate from running the gaol there are obviously ongoing maintenance costs. Is all the money lumped in together or do you pay them a separate maintenance amount as well as for the running costs of the gaol?

Mr SCHIPP: We pay them an all-up management fee that incorporates the cost of maintenance and also some extended periodic maintenance, which may include the replacement of certain assets over the life of the contract. We incorporate as part of the performance indicators and the performance-linked fee for that contract certain obligations in relation to maintenance to comply with the standards that we, as a department, have for all our facilities, along with certain obligations to

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replace those assets that I mentioned. But it is incorporated as part of the overall fee that is paid to them.

The Hon. AMANDA FAZIO: I have a question for Mr Wasson. It seems to me that you are the person from the education department who has the most contact with principals, teachers and local school communities. We heard earlier that there was some dissatisfaction with the contracted-out before and after school care services. Apart from that, generally how have teaching staff and parents at the PPP schools responded to being given one of these schools?

Mr WASSON: The response has been overwhelmingly positive. There are five PPP schools in the Western Sydney region, all in the north-west sector. In short, I surveyed those principals and visited those schools last year and this year and the overwhelming response was extraordinarily positive. Principals noted several things that I think are critical here. One of them is the quality of the buildings. Given the fact that the consortium needs to maintain those schools, there is a vested interest in making sure that the quality is built in from the very beginning. So the standard is extremely high. Principals also note the efficiency of a one-stop shop for all maintenance and other issues associated with any ongoing site issues. There is obviously an efficiency built into that but it also frees them from a lot of the site management issues that take principals away from the core business of educational leadership and the improvement of learning outcomes. One of the very powerful responses that I hear—and it is not only principals but also staff within the schools—is that there is a real sense that the school can focus on what it is there to do, which is to teach kids rather than having time diverted from that to issues around maintenance and other management issues that might well take people away from their core business. Would you like me to continue?

The Hon. AMANDA FAZIO: When my kids attended the local primary school they would come home with notes that read, "Working bee this weekend to trim trees or scrub this and that". Does that mean that there is less impost on parents' time doing that sort of work in these schools?

Mr WASSON: I cannot answer categorically but my sense is most definitely yes, although principals may wish to do particular site enhancements and school communities may wish to do that as part of their presentation to the local community of the school itself. But the general effect of the PPP management system is that the school is able to concentrate on what it is there to do. The management of the site is therefore given over to the consortium and I have had extremely positive reports about the efficiency, responsiveness and effectiveness of that management regime.

The Hon. AMANDA FAZIO: To follow on, you said earlier that as a result of your experience with PPP schools you are able to improve the maintenance contracts for all schools generally. Do you think those sorts of efficiencies might flow on to schools that are not in the PPP program as a result of changes to the maintenance contracts?

Mr WASSON: I think I had better let Paul answer that.

Mr CULSHAW: As I said before, we are trialling the facilities management-type arrangement where you bundle up all the different types of services that are normally provided—cleaning, waste, security—into one. We are trialling that in a couple of areas now as a follow-up from PPP1. So we will audit that and see how it goes over the next period of time. I think the cleaning contracts have been informed by better outcomes from PPP1. We are picking it up wherever we can and taking it forward.

CHAIR: That is very good. We do not want the other schools to be poor cousins, with no maintenance. Thank you very much for appearing before the Committee and for the valuable information that you have provided. We wish you all the best in what you are doing. It is very encouraging.

(The witnesses withdrew)

(The Committee adjourned at 5.06 p.m.)