Driving Privately Financed Projects in Australia: what makes them tick?

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Abstract
This paper documents the growing dependence of Australian governments on the use of private funding to provide infrastructure and related services to the public. Using a Habermasian framework proposed by Broadbent and Laughlin (1999) we examine their second research question: “What is the nature of PFI and who is regulating their application?” to frame our analysis of the complex relationships between steering media and steering mechanisms in determining the operation of privately financed projects (PFP) in Australia.

A secondary, but related concern, is to explore the linkages between the macro economic policy debates that gave rise to PFP and their implications for the micro organisational control issues. The debate about whether or not PFP are a response by governments to macro economic pressures remains unresolved. Similarly, there is evidence that governments are not as successful as private-sector consortia at identifying and shifting risk and, therefore, at achieving value-for-money (VFM). Ultimate PFP outcomes depend on two factors: broad policy parameters established by governments (steering mechanisms) either discreetly, or through other appointed steering media; and execution at the micro or organisational level, that is, on the decisions and actions taken by a variety of actors interfacing with PFP.

Keywords: Australia, Publicly Financed Projects, Public Private Partnerships, New Public Management, Public Finance Initiatives, Steering media, Steering mechanisms

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1. Introduction: setting the research agenda

Internationally, the past two decades have seen considerable changes in the management and control of public-sector organisations and in the mechanisms adopted by governments to deliver services to the public. The emergence of new public management (NPM) has been characterised by a growing partnership between the public and private sectors to provide services that, in the past, were exclusively supplied by the public sector. This paper focuses on one aspect of the evolving partnership between the sectors. Specifically, we review the growing dependence of Australian governments on private-sector consortia, using finance raised through capital markets, to provide infrastructure and related services to the public. In doing so, we make use of one aspect of the research agenda proposed by Broadbent and Laughlin (1999) to guide our examination of the nature and regulation of Privately Financed Projects (PFP)\(^1\) in Australia.

In a review of partnerships between the public and private sectors to construct and operate infrastructure in the UK, Broadbent and Laughlin (1999) point to a lack of scholarly work analysing the outworking of the Private Finance Initiative (PFI)\(^2\) over time in particular locations. In that paper, Broadbent and Laughlin pose five research questions, the second of which is relevant to this paper. That question concerns the nature of PFI and who is regulating its application.

Following Broadbent and Laughlin, we adopt the Habermasian worldview to frame our analysis. We identify the key ‘steering media’ and the ‘steering mechanisms’ that have been put in place to regulate and operationalise PFP in Australia. Steering media include institutions whose role it is, in this instance, to guide the organisational systems that provide public services in particular ways. The process of steering is undertaken in part through the use of particular steering mechanisms, for instance, the

\(^{1}\) In Australia PFP are also known as public private partnerships (PPP). However, we prefer to use the nomenclature adopted in New South Wales because we believe, as indicated in Figure 1, that there are numerous ‘partnerships’ between the private and public sectors; PFP are merely one subset of that evolving partnership.

\(^{2}\) In the context of their 1999 paper, Broadbent and Laughlin focus specifically on the UK context and particularly on PFI, the UK variant of PPP. In this paper we use PFI to refer specifically to the arguments presented in the Broadbent and Laughlin (1999) paper from which we take our research questions
laws, regulations, and other pronouncements that define and operationalise PFP. Thus, in identifying steering media and steering mechanisms our focus is at both the overall contextual level and also at the organisational level.

In the paper Broadbent and Laughlin analyse the linkages between the macro economic policy debates that gave rise to PFI, and their implications for the micro organisational control issues. At the macro level the central issue appears to be the tension between the need to provide infrastructure-based services on the one hand, and a strong philosophical commitment to minimal levels of government debt, and to a NPM reform agenda on the other. One of the debates centres around the notion that a drive to maintain low government debt levels was, initially at least, at the heart of the PFI and their execution, because PFI presents government with the opportunity to remove debt from balance sheets and budget papers. Accordingly, much of the recent debate in the UK has been about the nature of PFI. If PFI is a financing arrangement for public sector capital procurement, then the related asset and liability must be recognised and accounted for in the public accounts. If, the primary purpose of PFI is the procurement of services, then the related asset and liability remain unreported. This issue remains unresolved in the UK.

However, Broadbent and Laughlin argue that ultimate PFI outcomes depend not only on the macro issues, but also on how a PFI is executed at the micro or organisational level, that is, in the decisions and actions taken by a variety of actors interfacing with PFI. They (1999: 102) explore the interface between the macro and micro levels through two interconnected themes: the accounting treatment of PFI; and the achievement of value-for-money (VFM) and risk transfer. Their proposed research agenda is grounded in the “need to consider whether and how the context of the macro economic and other requirements impinges upon the expression of PFI at the micro (organisational) level” (1999: 105-6).

The paper is structured as follows. Section 2 establishes the institutional context, and places PFP within the context of public-sector service delivery options. Section 3 explores the central research question of this paper: namely, the nature and regulation of PFP in Australia, including who is regulating their application and how the regulation is operationalised at the micro level. Section 4 addresses the two issues
identified by Broadbent and Laughlin (1999) as central to the nature and regulation of
PFP. First, are PFP a response by Australian governments to macro economic
pressures? Second, how effective are governments at ensuring that risk is transferred
to the private sector? The final section provides our conclusions.

2. PFP within the context of public-sector change in Australia

*Establishing the institutional framework*

Australia is a federation of six states and two federal territories and includes three
levels of government - federal, state and local. At the first level of government, the
Federal Parliament’s authority includes, *inter alia*: national economic management;
corporate and securities industry regulation; trade and commerce; international
relations; defence; telephone and postal services; social welfare; education; and
hospital services.

Each state has its own parliament, executive government, and judiciary, and has the
power to set laws on matters relating to the state. This is the second level of
government. The state government plays a direct role in the delivery of education,
health care, transport, water, policing and social services. The federal government
also plays roles either directly in these areas at a macro level, or indirectly through the
terms and conditions it applies to funding grants to support such activities.

The third level of government is local government at the city, town, municipal or shire
levels. Key areas of local government authority include town planning, local road
systems, and community and recreation facilities.

Only the commonwealth and state and territory governments have the necessary
powers and responsibilities to commission infrastructure developments and their
related services that are of interest to this paper. However, as explained later in the
paper, all PFP initiatives in Australia so far have been state-based.

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3 In this paper we use the terms ‘federal’ and commonwealth’ interchangeably to indicate that we are
referring to the first level of government.
Defining PFP in the Australian public sector service-delivery context

Figure 1 locates PFP within the more general context of the partnership\(^4\) between governments and private-sector service providers that have been a key feature of recent NPM reforms in the western world.

[INSERT FIGURE 1 ABOUT HERE]

The term ‘conventional procurement’ is used to indicate traditional, and now almost defunct, delivery mechanisms in which governments control all aspects of infrastructure development, maintenance and delivery. In this option there is no private sector involvement, for instance, in the construction and maintenance of rail track by government-owned organisations, and the delivery of rail services by a government authority.

‘Outsourcing’ and privatisation are at the other end of the spectrum. Outsourcing can involve two different types of activities: the procurement of services from the private sector without the utilisation of publicly owned infrastructure, or service provision by the private sector that coincidently utilises publicly owned infrastructure. In this latter option there is little public-sector involvement other than the provision of infrastructure and the setting of policy parameters. This includes, for instance, the engagement of private-sector management companies to deliver detention, and the provision of maintenance services within publicly owned detention centres. The discussion of outsourcing options is beyond the scope of this paper.

Privatisation involves the sale of government infrastructure assets, and their associated revenue streams, to private-sector corporations. Privatisation frequently involves some regulation of the services provided and prices charged by the private-sector operator of previously publicly-owned enterprises.

Between these extremes lie PFP. These large-scale infrastructure development projects are unique in that private finance is utilised to construct, maintain and operate the infrastructure, which after many years reverts back to public ownership. Typically,

\(^4\) The partnership between the private sector and governments straddles a variety of service delivery options, and has been a feature of the political landscape since the late 19\(^{th}\) century (NSWAG, 1994a).
governments retain ownership of the land on which these projects are built. PFP are attractive to governments because they provide for the construction of the essential infrastructure without direct capital outlay, and the delivery of related services without the need for the public-sector employees to maintain and operate infrastructure projects.5

Our model, as represented in Figure 1, is necessarily oversimplified. We recognise that any government project could involve a mixture of the service delivery options described in Figure 1. As is indicated in the figure, PFP initiatives in the Australian context can take a number of forms, many of which are unique to a given project, and whose features are determined in response to the specifications of the particular project, changing macro economic conditions, and also to political fallout arising from unintended consequences from earlier projects (Walker, 2002; NSWAG, 1994a, b, c). We can conclude that no two PFP are identical because their specification and commissioning is essentially an iterative and not a static process. In addition, changing macro economic conditions such as interest rates, growth and inflation will influence the response of different private consortia to PFP proposals.

The state of Victoria has been the driving force behind PFP developments in Australia (O’Neill, 2002; WWG, 2001a), and has used PFP more aggressively than any other state to develop its infrastructure. The first PFP in Victoria occurred in 1993. Currently Victoria has almost 9 billion dollars of investment in PFP, out of a total of $A17 billion in commitments to investment in PFP projects made by different Australian states (AusCID, 2002). Victoria’s projects include the construction and operation of prisons, hospitals, county courts, transport, tourism, waste systems and water projects.

PFP in Victoria are defined in government policy documents as “a contract for a private party to deliver public infrastructure-based services” (VDTF, 2001: 3). However, under this local definition, PFP explicitly exclude “outsourcing or other service delivery arrangements where no capital investment [by the government] is required” (VDTF, 2001: 4).

5 The timing and number of these projects depend on the ability of capital markets to raise the necessary finance (WWG 2000: 16)
In New South Wales, the majority of the five billion dollars worth of PFP have been joint ventures, with roads, tourism, water, and waste facilities being the most likely infrastructure to be developed in conjunction with private-sector participation. However, the move towards PFP in NSW did not gain momentum until the latter half of the 1990s. NSW recently moved towards the provision of ‘social infrastructure’ with the signing of a $133 million contract to build and maintain nine public schools over the next 30 years, before handing them back to the government (Hepworth, *AFR*, 4 December 2002, p.9).

In all states a distinction is made between economic and social infrastructure. Economic infrastructure is generally funded by user charges or dedicated taxes and includes roads, railways, power generation and water supply. Social infrastructure is normally funded from general revenue and includes schools, hospitals and police stations. Economic infrastructure has a cash revenue stream that can be used to finance investment (WWG, 2001a). All governments have also made a distinction between ‘core’ and ‘non-core’ functions, and a commitment to preclude ‘core’ functions such as the provision of public health and education from PFP projects (DFA, 2002; VDTF, 2001; SADTF, 2002; WADTF, 2002; QDSD, 2002; TDTF, 2000; WWG, 2001). There currently appears to be no intention in Australia of including the delivery of clinical or full educational services in PFP contracts, although it is arguable that such sensitive services have already been outsourced to private operators in some areas, notably in the running of the country’s asylum seeker detention centres, which cannot strictly be classified as PFP.

### 3. The nature and regulation of Australian PFP

According to the NSW government (WWG, 2001a), there are a number of factors to consider in investment in infrastructure. These include the size of the Australian continent relative to its population; the expectations of citizens for excellence in public service provision; the ideological predisposition of governments towards implementing a NPM reform agenda; and the general resistance of citizens to paying more tax. Therefore the construction of many large infrastructure projects is made extremely expensive and inherently risky for governments in terms of cost recovery.
In addition, all Australian governments have imposed restrictions on their own ability to make significant new borrowings to fund new infrastructure, and all state governments have official policies to encourage the private sector to participate in the joint provision of infrastructure. Alongside these circumstantial and environmental factors, other advantages that give PFP their current appeal include the potential for achieving cost efficiencies (VFM), early project delivery, achieving gains from innovation, transferring some project and finance risk to the private sector, and creating and accessing improved services for citizens (Webb and Pulle, 2002).

This section considers the contexts in which PFP operate in Australia. Specifically we investigate which institutions are actually regulating PFP (the ‘steering media’) and how the ‘steering mechanisms’ they establish affect the nature of PFP.

The context within which steering media and steering mechanisms operate

Because Australia has a federal system of government, there is a nested and complex evolving hierarchical relationship between steering media and the steering mechanisms they establish. At the apex is the commonwealth government and parliament, both of which can be classified as steering media. The government is the primary steering medium because of its domination of parliamentary legislative activity, and its ability to steer at the broad contextual level through its control of the economy and commercial activity, and its control of the commonwealth public sector. Between them, these two steering media have established other steering media that report to them such as the commonwealth Department of Finance and Administration, the commonwealth Auditor-General, various parliamentary committees, and the Financial Reporting Council, which in turn steers the Australian Accounting Standards Board (AASB). All of these steering media produce legislation, regulations, reports, policies and guidelines that can be classified as steering mechanisms.

At the state level similar complexity arises. State governments and parliaments, as steering media, in turn establish secondary steering media whose activities effect the outworking of PFP. These include state auditors-general and parliamentary committees whose reports (steering mechanisms) can influence aspects of PFP. It is, however, at both state and commonwealth levels, the powerful departments of
treasury and finance\textsuperscript{6} which are largely responsible, through the policy documents - steering mechanisms - they produce, for determining the context within which PFP are operationalised at the organisational level.

Thus, it can be seen that the context in which PFP are operationalised is extremely fluid because of the circularity of rule setting, with more rule setting resulting from changes in the external environment, including in steering mechanisms that may directly or indirectly impinge on PFP. In addition, distinctions between steering mechanisms at the ‘federal’ level and the ‘state’ level cannot easily be made because of the growing tendency for policy that originates at federal level to be adopted at state level, and vice versa. This occurs either formally through legislation or other formal agreements, or informally through a shared commitment to the implementation of similar policies. In the latter case, it will be shown that that despite the lack of formal mechanisms to ensure uniform adoption of one PFP policy Australia-wide, documents reveal that steering mechanisms regulating the introduction and conduct of PFP are remarkably similar at commonwealth and state levels.

Accordingly, because of the complexity of the Australian institutional arrangements, we proceed by identifying critical steering mechanisms and then discuss both the mechanism and the responsible steering media.

\textit{The Loan Council}

All Australian governments are committed to operate within global borrowing limits controlled by the commonwealth government through the Loan Council, which places limits on on borrowing by public organisations, including governments. Until 1993, BOOT (Build, Own, Operate, Transfer) projects were either counted as a government borrowing or as outside global borrowing limits by the Loan Council. Accordingly, the Loan Council determined whether BOOT projects could be entered into and, if so, how they were to be accounted for. These restrictions resulted in private-sector consortia designing elaborate financing arrangements to keep PFP outside Loan Council criteria (WWG, 2001a; Walker, 2002), and in substantial lobbying to change

\textsuperscript{6} At the commonwealth level and in all states except Queensland, it is the departments of treasury and finance that determine PFP policies. In Queensland, the Department of State Development determines such policies but this makes no essential difference to the policy outcomes.
Loan Council decision criteria. In response, in 1996 the Loan Council revised the assessment of private sector infrastructure projects from the previous risk-weighted approach to an assessment of a government’s contingent exposure based on termination conditions in the PFP contract, virtually removing PFP from the ambit of global borrowing limits. The Loan Council also agreed in principle that these exposures would be reported only as a footnote to a jurisdiction’s Loan Council Allocation. As a result, the Loan Council has ceased to be a major steering medium and determinant of whether a PFP should or should not proceed.

**Legislation to reduce government debt**

Changes to the Loan Council’s criteria relating to defining global borrowings coincided with governments in Australia pledging to contain and eliminate public debt under their commitment to implementing NPM. For instance, at commonwealth level, the *Charter of Budget Honesty Act 1998* provides a framework for the conduct of fiscal policy. The purpose of the Act is to improve fiscal policy outcomes by requiring fiscal strategy to be based on principles of sound fiscal management and by facilitating public scrutiny of fiscal policy and performance (s1). The Act defines sound fiscal management as maintaining commonwealth general government debt at prudent levels (s5(1)). In addition, the *Financial Management and Accountability Act 1997* sets out the financial management, accountability and audit obligations on agencies for managing public resources efficiently, effectively and ethically.

Similar steering mechanisms exist at state level. For instance, in NSW the *General Government Debt Elimination Act 1995* commits the government to adhering to responsible fiscal targets, including the repayment of debt, balancing budgets and containing borrowings. The current position is that PFP projects, provided they are not regarded as finance leases, are not classified as debt on government balance sheets, and accordingly do not increase public debt levels.

**The commitment by Australian governments to adopt NPM reform**

Associated with the philosophy of expenditure restriction, has been the desire, since the mid 1980s, by federal and state governments to revise and pursue more efficient and effective systems of managing public resources via ‘improved’ public-sector management systems (English and Guthrie, 2001). In general, reform of the
Australian Public Service (APS) has followed the largely familiar pattern identified as NPM (Hood, 1995).

NPM reform in the APS has been consistently grounded in, and developed and applied, on the basis of institutional economic theory, inspired by the rhetoric of ‘rationalising’ public-sector activities and driven by the treasury and finance departments (English and Guthrie, 2001). Agency theory and the theory of the firm provide the blueprint to reshape governance structures to minimise transaction and contracting costs. Public choice theory suggests the rationale for applying conventional economic behavioural postulates to collective decision-making. Modern competition policy provides the impetus for replicating competitive markets in the public sector. Broadly, the reform program is based on key principles derived from the work of Osborne and Gaebler (1993): separation of the contracting of services from service delivery; funding based on results (outputs and outcomes) as opposed to inputs in an environment permitting private-sector suppliers to determine the most effective and innovative ways to produce contracted services; and a commitment to reducing the role of government in the direct provision of services. NPM implementation is steered by copious legislation, regulation and policy documentation at both the commonwealth and state levels of government. Consideration of the NPM regulatory framework is beyond the ambit of this paper.

The use of private finance to fund the construction of infrastructure and the provision of services derives from the philosophies outlined above. Thus, as recognised by Broadbent and Laughlin (1999), and others (Dunleavy and Hood, 1994; Hood, 1995; Zifcak, 1994; English, Guthrie and Parker, forthcoming), it is apparent at one level that PFP have been embraced by governments as a logical extension of their continuing commitment to implementing a NPM reform agenda, as is made clear in extant Australian policy documentation (DFA, 2002; VDTF, 2001; SADTF, 2002; WADTF, 2002; QDSD, 2002; TDTF, 2000; WWG, 2001).

**National Competition Policy**

In 1995 all Australian governments reached agreement on a National Competition Policy which committed governments to apply to public-sector activities the competitive norms and rules applying in the private sector (English, 2003).
Competition policy is supported by the Competition Principles Agreement, also agreed to by all governments in 1996, which requires competitive neutrality; that is that publicly owned business activities do not enjoy net competitive advantages over their private-sector competitors simply by virtue of public-sector ownership. Under this policy adjustments are made to the costs of a government business to ensure that relevant costs and margins that apply in the private sector also apply to the relevant government business. These steering mechanisms are designed to level the playing field between the public and private sectors. However, some would argue that they provide net competitive advantages for the private-sector consortia by effectively undercutting the competitiveness of the public sector.

**Australian taxation law**

Section 51AD and Division 16D of the *Income Tax Assessment Act 1936* can deny certain tax deductions to the owners of infrastructure - that is to one or more of the private-sector partners in any PFP arrangement. The effect is to reduce the potential value of income from a project. An infrastructure project consortium will incur significant early income tax losses as interest accrues on the debt prior to the project generating assessable income. However, in the post construction stage the consortium may be unable to deduct depreciation, building and development allowances and business expenses. Effectively, s51AD applies where a federal or state government - as a tax-exempt entity - is deemed to effectively control the use of the asset and its output. For this reason the allocation of commercial risks to the private-sector consortium is crucial.

Division 16D of the Act relates to non-leverage leases which could be used by a tax-exempt entity for providing the assets. The effect of Division 16D is to treat leases and similar arrangements as loans. The owner of the plant or equipment is prevented from obtaining depreciation and other ownership benefits. Prior to proceeding with an infrastructure development project, most state governments approach the Australian Taxation Office (ATO) for a ruling as to the likely applicability of Section 51AD and Division 16 for that particular project, and will not proceed to the final contract stage without a binding ruling from the ATO (WWG, 2000). The Ralph Review of the Australian taxation system (another potential steering mechanism), charged with removing impediments to commercial activity and unnecessary duplication and
complication in taxation laws, has recommended the abolition of Section 51AD and the modification of Division 16.\(^7\)

However, if the tax savings from depreciation allowances and certain expenditures can be shifted to the private financier of the PFP, state governments benefit because the cost savings will be factored into the price, helping to make the PFP option cheaper than the equivalent ‘in house’ option.

Commonwealth government documentation makes clear how relevant its own taxation law is to state governments’ decisions to embrace PFP, and its own reluctance to do so. Its policy principles document (DFA, 2002: 9), states:

\[\text{An important issue in the whole-of-government assessment of private financing proposals is consideration of the practical implications for tax revenue flowing from the use of private financing arrangements. There is a potential for the Commonwealth to face hidden costs through revenue forgone resulting from the use by the private-sector of tax effective arrangements.}\]

**Accounting standards and practices**

Unlike in the UK, where the Accounting Standards Board (ASB) has attempted to regulate PFI, resulting in a fundamental disagreement ensued between the ASB and HM Treasury over whether PFI arrangements should appear in the balance sheet (Broadbent and Laughlin, 1999; 2002), the Australian Accounting Standards Board (AASB) has not issued any pronouncements relating directly or indirectly to PFP.

Accounting for PFP has been largely steered at state level. In response to reports by the NSW Auditor-General (NSWAG, 1994a, b, c) and the NSW Parliamentary Accounts Committee (PAC, 2001a; 2000) departments of treasuries and finance have moved to head off controversy by establishing criteria to determine how PFP should be accounted for in public-sector financial statements.

For instance, NSW practice was established in the Working with Government document released in 2001 (WWG, 2001a), and has been adopted in all other jurisdictions. This document defines the contribution of land to a BOOT arrangement

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\(^7\) For a more complete discussion of the implications of Section 51AD and Division 16, see, Webb and Pufle (2002).
as an operating lease; treated the infrastructure constructed on government-owned land as a leasehold improvement, to be transferred to the government at the cessation of the land operating lease term; and, finally, recognises the government’s right to future ownership of the infrastructure on an emerging basis.

One unintended AASB steering mechanism is a little-used accounting standard which has been aggressively employed by at least one Australian infrastructure investor to increase its reported revenue and to show a handsome paper profit. AASB Standard 1030 *Application of Accounting Standards to Financial Year Accounts and Consolidated Accounts of Disclosing Entities other than Companies* permits, in the case of some PFP infrastructure projects utilising a unit trust structure, the recognition of increases in asset valuations as revenue from operating activities in its profit and loss statement, permitting the payment of distributions to unit holders from capital - from money paid by unit holders, not from the profits of the business (*ABR*, 2003). Naturally, provided they can adopt the appropriate structure, this opportunity provides an incentive for private consortia to invest in infrastructure projects.

**Monitoring mechanisms**
At both commonwealth and state levels of government, auditors-general appear to have sufficient power to enable them to audit underlying PFP documentation (NSWAG 1994a, b, c). In addition, parliamentary accounts committees have powers to review and report on PFP activity.

In relation to PFP, NSW has in place the most publicly visible accountability-related steering mechanisms of all the states. For instance, the NSW Auditor-General produced a comprehensive report into three road projects undertaken by the Roads and Traffic Authority (RTA) (NSWAG, 1994a, b, c). The report into arrangements surrounding the Sydney Harbour tunnel and the M5 motorway (NSWAG 1994a, b) is in two volumes and runs to almost 500 pages excluding copious appendices. The auditor-general’s chief concerns related to the nature of the PFP and their accounting treatments, inadequate risk assessment and disclosure, lack of formal internal guidelines or policy for progression of BOOT contracts that build on general government policy, and instances of a close association between former politicians
and public servants and the private consortia building and operating the Sydney Harbour Tunnel\textsuperscript{8}. As a direct result of these audits the NSW government (followed by other jurisdictions) clarified and justified the accounting treatments of PFP, as discussed above.

However, a review of auditors-general websites indicates a relative lack of reports into PFP. This could be because PFP are still relatively new phenomena in Australia. It could also reflect a lack of disclosure early in PFP lifecycles, which makes audit scrutiny extremely difficult. Anecdotal evidence suggests that auditors-general and public accounts committees in Australia question the effectiveness of accountability mechanisms relating to PFP (Barrett, 2003).

In response to the 1994 audit reports, the NSW Parliamentary Accounts Committee (NSWPAC) conducted an extensive inquiry into urban infrastructure financing that resulted in four reports (NSWPAC, 1994a, b). Since 2000, the NSWPAC has issued an additional four reports into PFP (NSWPAC, 2000; 2001a, b; 2002). In Victoria the Parliamentary Accounts and Estimates Committee (VPAEC) has recently convened an Inquiry into Private Sector Investment in Public Infrastructure (VPAEC, 2003).

Other accountability mechanisms in place include the requirement in Victoria and NSW that a contract summary is be made available to the Auditor-General within 30 days of the PFP contract becoming effective. This is tabled in parliament by the responsible minister, and is thereafter available for public scrutiny via the internet. Contract summaries must disclose such matters as the full identity and relationship of the partners; service delivery and quality requirements; the terms of the contract; what assets are to be transferred by the public sector to the consortium, and when; all maintenance provisions; the price to be paid by the public and the basis for future changes in this price; provisions for renegotiation; results of cost-benefit analyses; risk sharing in the construction and operation phases; and evidence of significant guarantees or undertakings by the government. Disclosure of the following is not required: the private sector’s cost structure or profit margin; and matters relating to

\textsuperscript{8}The auditor-general applied the substance over form test to disallow the off-balance sheet treatment of the Sydney Harbour Tunnel on the RTA’s balance sheet, but allowed that treatment for the M4 and M5 toll ways.
intellectual property or any matters where ‘disclosure would put the contractor at a commercial disadvantage with its competitors’ (WWG, 2001a).

At first glance these requirements suggest unprecedented transparency and public access to critical documentation. However, in reality, sensitive contractual details are invariably hidden from the public. Furthermore, details of arrangements between the government and private consortia are complex and not easily unravelled. Profitability forecasts and break-even points are not disclosed.

It is also important to note that auditors-general only receive the right to scrutinise documentation after the relevant contract is signed – too late to alert parliament or citizens to guarantees or other clauses that may require significant taxpayer-funded injections of capital, or to suggest changes that may protect the public interest. As Walker (2002: 18) notes, the extent of potential profits to be enjoyed by the private-sector participants is not often discussed and is not incorporated in the ‘contract summaries’ made available to the public. In a review of the NSW experience with contract summaries, Walker (2002: 14) states that audit examination is limited to the procedures specified in the condition of the engagement by the government agencies concerned. Accordingly, state audit of contract summaries, as perhaps was intended, provide no substantive information about PFP contracts or the risks assumed by parties.

**PFP policy documentation**

The policy documents and implementation guidelines produced by departments of treasury and finance are the observable steering mechanisms guiding the implementation of PFP at commonwealth (DFA, 2002) and state government levels (VDTF, 2001; SADTF, 2002; WADTF, 2002; QDSD, 2002; TDTF, 2000; WWG, 2001). With regard to PFP, the Victorian Department of Treasury and Finance (VDTF) documentation has been adopted virtually wholesale by other jurisdictions (WWG, 2001a; O’Neill, 2002). Given the complexities of PFP and the projects they involve, these publicly available documents are relatively bland and read like motherhood statements of intent.
The key Victorian policy document, Partnerships Victoria (VDTF, 2000: 1), states that the government is not constrained by any expectation that public-private relationships will fit a common mould:

*The government is committed to maximising the level of infrastructure spending through a responsible use of the resources of both the public and private sectors. The choice between public and private provision of infrastructure will be made on practical grounds. Such choices will be based on an assessment of the needs of each project and will be tested against a rigorous public interest test that will examine the potential impact upon privacy, security, consumer rights, public access and equity (VDTF 2000: 3)*

From this policy declaration flow the following broad principles (VDTF, 2000: 3):

- the ultimate decision relating to project delivery will be made on the ‘merit’ and ‘outcomes’ judged in terms of public benefit, which are linked to project efficiency and effectiveness;
- a full cost-benefit analysis to be undertaken prior to a decision in principle to commit to a major infrastructure project. The cost-benefit analysis must take into account the value of public land committed to the project and independent verification of financing arrangements and full assessment of risk;
- a rigorous system of public tendering;
- the public interest in any infrastructure project is to be protected by ensuring there are clear and enforceable performance standards, including public release of tender specifications, disclosure of financial risks, and oversight by the auditor-general;
- community rights to be assured through due process planning and appeals mechanisms;
- the achievement of VFM by utilising innovative capabilities and skills to deliver performance improvements and efficiency savings;
- VFM to be determined by the Public Sector Comparator (PSC) which estimates the cost of the most efficient form of public-sector delivery; and
- efficient risk transfer to the party most able to manage it at least cost with the value of risks transferred to be estimated and included in the PSC.

Similar sentiments are to be found in Commonwealth (DFA, 2002) and state (DFA, 2002; VDTF, 2001; SADTF, 2002; WADTF, 2002; QDSD, 2002; TDTF, 2000; WWG, 2001) documentation. However, despite having adopted uniform PFP policies,
there is evidence that each PFP project is essentially unique in its structure and outcomes (NSWAG, 1994a, b, c) as steering media respond to a changing political and economic environment within an implementation philosophy that emphasises outcomes.

**The Public Interest Test (PIT)**

Three Australian states (Victoria, NSW and Queensland) use the steering mechanism of the ‘public interest test’ (PIT) to ascertain the effectiveness (defined as meeting government objectives) of proposed PFP (WWG, 2001a: 57); its impact on key stakeholders; public access and equity; consumer rights; security; privacy; and other associated non-economic costs and benefits (WWG, 2001a; VDTF, 2000; QDSD, 2002). Being a qualitative tool, the PIT is much more difficult to cost than the PSC. Similar concerns have to be considered at commonwealth level (DFA, 2002: 7-11), and in the remaining states.

**The public sector comparator (PSC)**

One important steering mechanism implemented by all governments is the public-sector comparator (PSC). The PSC is used to determine whether or not a proposed PFP will deliver VFM. Before any contract is finally entered into, PFP cost effectiveness is tested by comparing the outputs and costs of the PFP project against a purportedly neutral benchmark called the PSC, which provides an estimate of the costs and outputs of a similar project if it were kept entirely in government hands (the ‘in house’ option) (WWG, 2000). However, the problem with the PSC model is that it is based on ‘best practice’ assumptions and its application also requires the use of a considerable number of other assumptions.

In theory, the PSC can be characterised as follows. First, it is based on the method to define output currently available to the public sector. Second, it takes into account the potential impact of risks on the costs and revenues associated with the proposal over its entire lifetime. Third, it is expressed in terms of the net present cost (i.e. benefit) to government over the life of the proposed concession. Finally, it is defined and costed so as to provide the same level and quality of service expected of the private sector (WWG, 2001a: 45).
In order to function effectively the PSC should also include qualitative considerations of the underlying assumptions. Qualitative considerations would include the identification of risks not easily or confidently quantified, information about the bidder, and the identification of positive (or negative) social and environmental consequences (the public interest test). PSCs are prepared on a risk-adjusted basis. A key and controversial characteristic of PSCs is the selection of what is considered to be an appropriate discount rate to compute the net present value of the payment streams under each option. VFM is assessed on a whole-of-life and whole-of-government basis. As it is generally considered to be more expensive for the private sector to raise capital through private capital markets than for governments to raise funds from bond markets, there has been considerable criticism of the discount rates used in PSC modelling (Walker, 2002; Barton, 2002).

However, Officer (1999; 2002) argues that the value of a project equals the discounted value of the expected net future benefits, where the discount rate is the investor’s opportunity cost of the capital tied up in the investment. In other words, the appropriate cost of capital is dependent on the definition of the net cash flows. Officer claims that critics of discount rates employed by governments in PSC calculations (who argue that the rate is too high) often use inconsistent definitions of the cost of capital and associated net cash flows. The most frequent error is to assume that, because governments pay no tax, net benefits should also be higher, that is, interest rates are lower; in other words that assets held by governments are worth more than equivalent assets held in private hands. Officer (1999: 10) writes:

*The fallacy in the proposition is that it fails to recognise that, although the net benefits are higher because there is no tax, the cost of capital is also equivalently higher because the opportunity cost of capital is also without tax.*

In other words, the cost of capital to the community [i.e. to government] is the opportunity cost of capital to the private sector because the two sectors are actually competing for capital.

In the case of PFP, the opportunity costs of risks that are transferred to the private sector are added to the discount rate in PSC modelling. Wynne (2002) claims that completion risk and cost overruns are frequently overestimated in the UK, making the discount rate used by the government ‘too high’ and, consequently, PFP the more
attractive option. Adding these risks is consistent with Officer’s arguments about equivalent definitions of risk and cash flows, and the appropriate cost of capital for governments is the equivalent private sector cost of capital (appropriately adjusted for risk).

Whatever the relative merits of these arguments, according to DFA (2002: 14) documentation, the Competition Principles Agreement Policy (which applies to all state governments) requires that public business activities do not enjoy net competitive advantages over private-sector competitors simply by virtue of public-sector ownership. Under the policy, competitive neutrality adjustments are made to the costs of government business to ensure that relevant costs and margins that apply in the private-sector also apply to the relevant public business. This is, in effect, a direction from the government that private-sector costs (including cost of capital) should be used in PSC calculations.

In all jurisdictions (federal and state) the achievement of VFM is essential to determining whether PFP should proceed. VFM is demonstrated when the public-sector procurement option, costed using the PSC, is shown to be more costly than the option using private finance and private-sector involvement. According to government documents, optimal risk sharing between the government and private consortia is the basis of the achievement of VFM.

The purpose of this section is to consider the key steering media and the role played by steering mechanisms in the Australian context. As indicated, the nature and regulation of PFP are influenced by contextual factors at both federal and state government levels. Using Broadbent and Laughlin’s (1999) terminonomy, we now consider the interface between the macro and micro levels through two interconnected themes: the accounting treatment of PFI; and the achievement of VFM and risk transfer.

4. The interface between the macro and micro contexts in which PFP operate

Relevant to this paper are two contentious issues relating to the nature and regulation of PFP. The first is a consideration of whether PFP are driven by macro economic pressures to contain government borrowings, and hence to ensure that PFP are not
recognised on balance sheets or budget papers. There is a commitment at all levels of
government in Australia to minimise borrowings, but is there evidence that this
commitment is a driving force behind PFP adoption in Australia?

Second, the achievement of VFM, supposedly through effective risk sharing, is
crucial to the cost effectiveness of PFP. What evidence is there that risk sharing and
VFM have actually been achieved?

Are reporting and disclosure issues driving PFP in Australia?
Most Australian governments publicly state that the recognition or non-recognition of
infrastructure projects on government balance sheets is not a primary driver of the use
of PFP to finance infrastructure projects. For example, with respect to NSW and
Victorian PFP policies, the NSW Treasury (TOFM, 2002: 2) has stated:

...the policies require that privately financed options demonstrate superior
value-for-money to the Government and community compared to
conventional, publicly funded approaches to infrastructure provision. This is
the sole reason for considering private financing and delivery – with both
States having low debt levels, off-balance sheet borrowing is not an attraction
in its own right.

Some states (VDTF, 2001; SADTF, 2002) make explicit that the efficient
procurement of services is the primary purpose of PFP. Others emphasise the need to
deliver better value to citizens, which is described as the achievement of better VFM
through improved risk sharing, innovation, better asset utilisation and the adoption of
commercial production and management practices (DFA, 2002; QDSD, 2002).
However, the commonwealth policy document (DFA, 2002: 9) does suggest
that ”beneficial risk transfer will be reflected in … little dependency on direct or
implied Commonwealth commitments other than the commercial obligation to pay the
agreed price for services”.

Notwithstanding the rhetoric, there are suggestions that PFP are driven by the desire
to contain debt. The NSW Government states that efficient procurement at minimum
risk is the driving force behind PFP. Yet the key NSW guidelines paper (WWG,
2001a: 15) somewhat paradoxically states that:

Delivering capital projects that do not appear on the Government’s sheet is
financially beneficial to the State. However, service delivery, value for money
and optimal balance of risk are the driving forces. Projects in which capital raising is considered a liability on the Government’s balance sheet could still proceed, but only if the delivery agency is able to bear the capital cost within its budget [emphasis added].

The State of Western Australia makes the macro link between levels of government debt and the use of PFP more explicit. The WA policies and guidelines documentation (WADTF, 2002: 1) states:

*The Western Australian approach to infrastructure is to give priority to projects which can demonstrate strong economic and social returns. Affordability is also a crucial factor. The Government is mindful of keeping within the limits of the State’s financial targets, and will always look to the most cost effective means of providing infrastructure.*

Tasmania, like Western Australia, openly states that there is a macro economic agenda behind the use of PFP. Its policy document (TDTF, 2000: 3) states:

*The Government is committed to a responsible medium term fiscal strategy. Key elements of the strategy include:*

- *the Government will not borrow to balance the Budget;*
- *the general government sector will also be maintained in surplus; and*
- *net debt will not be increased.*

*Given the above, the Government, under normal circumstances, will not be in a position to finance infrastructure projects by way of borrowings.*

Thus we can conclude from these public documents that, notwithstanding an era of historically low interest rates, the containment of government debt is a significant contributing factor to the deployment of PFP. However, we should not discount the level of commitment to NPM, shared by all Australian governments, irrespective of their political persuasion, as a key macro driver of PFP.

**Can risk be effectively transferred to the private sector?**

A critical, and the most problematic, VFM option is the transfer of risk to the private sector. However attractive the idea of risk-sharing may seem, the reality is that identifying, costing and allocating risks is an extremely difficult procedure, especially as it is subject to ongoing negotiations between the parties during the tender process (see several state government policy documents: WWG, 2001a; DTF, 2001; QDSD, 2002; DFA, 2002).
Walker’s (2002: 19) analysis of the Sydney Airport BOOT Scheme indicates the difficulties faced by those wanting information about specific PFP, and the discrepancies that can occur between a government’s public comments about the risks involved and the cost of projected risks assumed by the government as contained in their own documentation. Differences between the rhetoric and reality were dramatically illustrated in the case of the construction of a rail link between the city and the airport prior to Sydney’s Olympic Games in 2000. Walker’s analysis of projections, revealed in the feasibility study for the project, suggested that the private consortium would need between three and four years in order for its investment to be repaid in full. The same report suggested that the NSW government would not break even on its investment for 23 years. Actual traffic volumes on the rail link were less than forecast. The consortium defaulted on borrowings and the state government was reported to have been liable under guarantees for some $A 400 million. Despite the publication of the contract summary, the guarantee had not previously been made public. Furthermore, the responsible minister had earlier claimed that the project “will not require one cent of Government money” (Editorial, SMH, 5 August 1994).

Usually it is not until something goes wrong that the public and parliament become aware of onerous conditions embedded in contracts. It is clear from extant audit reports into PFP that understanding each unique arrangement requires a considerable investment of time, energy and perseverance, in addition to the ability to comprehend the ramifications of contractual arrangements. Through audit review of PFP, it is unlikely to be routine. Evidence suggests it occurs infrequently, is ex post, and is likely a response of controversy (NSWAG, 1994a, b, c).

However, the great imponderable for governments is the cost of ‘political risk’, because governments are ultimately unable to transfer public accountability to the private sector (English, 2003; Funnell, 2001). As ex post analyses (for instance, Walker, 2002; NSWAG, 1994a, b) of PFP projects in Australia illustrate, the basis on which many governments enter such projects makes little economic sense for the public sector, but a great deal of economic sense for private-sector consortia. It seems that not only is the private sector more skilled at estimating and allocating risk than is the public sector, but also that many of the decisions to embrace infrastructure construction projects are based on political as opposed to economic considerations.
This rationale is rarely openly acknowledged, and it skews decision-making in favour of accepting a project that may be uneconomic.

5. Summary and conclusion

The stated aim of this paper was to use the Broadbent and Laughlin (1999) Habermasian framework to examine their second research question: What is the nature of PFI, and who is regulating them?

In conclusion, when reviewing PFP steering media and steering mechanisms, most striking is the complex nature of the relationships existing between commonwealth and state steering mechanisms because of Australia’s federal system of government; and the number of steering mechanisms that have been identified. As a principal steering medium, the commonwealth government, through the steering media it has established, largely sets the broad environment within which state governments operate. State governments are the agenda setters when it comes to the implementation of PFP at the micro or organisational level, and as such have influenced commonwealth policy on PFP.

Equally striking is the fact that, currently, state governments are the sole agenda setters, rule makers, implementers, benefactors, regulators and evaluators of the PFP they enter into. Despite their powers, auditors-general and parliamentary committees have played a relatively insignificant monitoring and steering role. The complexity of supporting documentation, commercial in-confidence clauses, and the reluctance of governments to make crucial aspects of their dealings transparent, make real-time accountability problematic. It seems that the best that can be hoped for is that lessons are learnt from past failures.

As for drawing conclusions about the nature and regulation of PFP in Australia, the diversity of locations and of PFP projects is likely to result in varying implementation of PFP despite each state having similar PFP policies and guidelines. Thus, to use Broadbent and Laughlin’s terms, the Australian experience suggests that despite uniformity in steering media and steering mechanisms – government policies and implementation of guidelines – there is diversity in how PFP are operationalised or
implemented at the local level. This diversification is likely to be greater than it may otherwise be in a country like the UK or New Zealand, both of which have only two levels of government. In Australia’s case, each state has its own parliament and auditor-general as well as its own bureaucracy and unique political concerns. In addition, the economic and political climate within which governments operate is constantly changing. Accordingly, we anticipate that different states will handle similar PFP such as road transport solutions differently, and consortia will influence the actual PFP contracts and outcomes differently over time as well.

A secondary concern was to provide evidence as to whether PFP are driven by macro economic pressures to contain government borrowings, and hence to ensure that PFP are not recognised on balance sheets or government budgets. Although there is evidence to suggest that the nature of PFP are determined by macro economic issues and that debt containment potentially underlies the adoption of PFP projects, we can conclude that the development and use of PFP in the Australian context appears to be driven by three factors: macro economic considerations relating to containing government borrowings; a commitment to the philosophical underpinnings of NPM; and the desire to procure infrastructure and related services in the most cost-effective manner, and at minimal risk. These concepts have been defined and operationalised through a multitude of steering mechanisms established for the purpose. Our review suggests that both governments and private consortia have become increasingly practised at optimising VFM and risk sharing to drive down project costs and remove PFP from public-sector balance sheets and budget papers. However, we also note that the private consortia continue to be more adept at identifying and minimising risk. There is evidence that governments are more swayed by political than economic considerations, despite the rhetoric to maximise VFM through risk sharing.

The primary purpose of this paper has been to provide a ‘stocktaking’ of the complex steering media and steering mechanisms operating in the Australian context. We have not attempted to document the connections between them. However, tracing connections between them could fruitfully be the next stage in PFP research in Australia.
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List of Figures
Figure 1: Public service delivery spectrum

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Public Private Partnerships

Government Service delivery

Private service delivery

Increasing private sector participation

Conventional Procurement

Privately Financed Initiatives

Outsourcing

Privatisation

D&C (Design & Construct)
DCM (Design, Construct,

BOOT (Build, Own, Operate, Transfer)
BOT (Build, Operate, Transfer)
BOO (Build, Own, Operate)
DBFM (Design, Build, Finance, Maintain)

(Adapted from Figure 1.1 WWG, 2001a: 2)