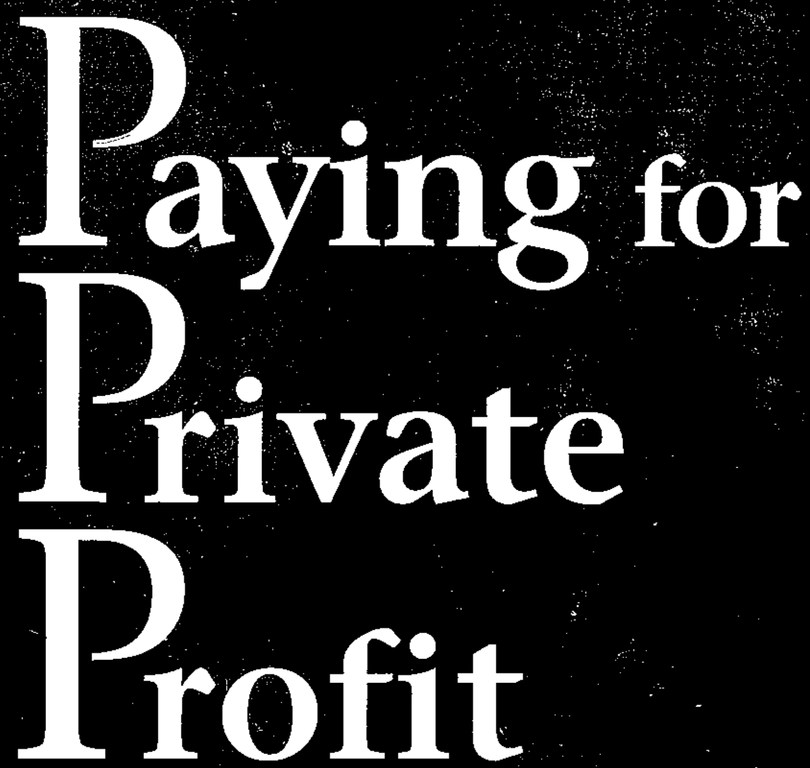

Paying for Private Profit

A review of the public private partnership model in the provision of community infrastructure and services

A union policy project of the
Rail, Tram & Bus Union
Australian Education Union
Australian Nursing Federation
Community and Public Sector Union - SPSF Group
Prepared by Strategic Economics August 2003

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Foreword

The Australian community has a rightful expectation that in a developed and modern economy like ours, governments both state and federal, will provide the quality services and infrastructure necessary to underpin a prosperous and decent society.

Traditionally many of these needs have been provided to the community directly by government.

More recently some governments have sought to utilise partnerships between the public and private sectors as a means of bringing more private capital into the provision of community infrastructure and services.

These arrangements are commonly known as public private partnerships or PPPs and there have been over 170 of them initiated in Australia over the past 20 years. In fact Australia leads the world in the number and complexity of these arrangements.

Ideally PPPs can work in certain circumstances. Given a robust policy framework community interests can be protected and vital infrastructure can be delivered.

But increasingly some of these arrangements are being recognised as potentially expensive, inefficient, inflexible and not necessarily in the best interest of the wider community.

A vibrant industry has developed in the private and public sectors to promote the use of PPPs, but what has not yet been developed is an adequate regime of contestability, accountability and transparency standards in the identification, tendering, assessment and evaluation of PPP projects.

It also needs to be recognised that even where PPPs are appropriately applied they do not substitute the overall key role of government in directly providing the infrastructure and services required for a dynamic, forward looking and fair Australian society.

To reach its full economic and human potential Australia needs governments that are willing to show strong leadership in the provision of community infrastructure and services.

This timely report makes an important contribution to the debate about the type of community we want Australia to be and how it can be funded.

It raises important questions about the roles and responsibilities that governments and the private sector have in protecting and advancing Australia's community and national interests.

Greg Combet
ACTU Secretary

Executive summary

Public private partnerships are the current 'policy rage' in Australia and elsewhere for providing major infrastructure and basic social services. But the Australian people have not been told that they will have to pay a premium for these PPP projects, and governments end up losing the capacity to direct state resources for the common good.

A central challenge for our society is how to provide for our infrastructure and their services in an effective manner. Infrastructure demands are growing, driven by the urgent need for increased investment – particularly better schools, health facilities and efficient and environmentally friendly transport systems. At the same time as demands for infrastructure are increasing, governments are becoming more reluctant to meet the cost of paying for them either through taxation or through debt financing.

Public private partnerships (PPPs) have been put forward as a panacea to overcome the unwillingness of governments to borrow or increase taxes.

PPPs are arrangements where negotiations between the public and private sector lead to a sharing of responsibility and risk for different combinations of design, construction, finance, ownership and / or the operation of infrastructure projects.

Australian state governments have embraced PPPs as an important mechanism to finance infrastructure requirements. An industry is developing around PPPs in Australia that strongly advocates the extension of PPPs into new areas of economic and social infrastructure projects. This includes sections of the government bureaucracy, large engineering and financial companies, super funds, special industry service providers and legal and management consultants. For the private sector, PPPs are very attractive because they provide for long term returns with manageable risks, because governments are committed to ensuring that PPPs work well and are prepared to underwrite many of the risks.

This report highlights many of the problems with PPPs and their long-term costs to society to counter the euphoria with which they are propagated by government.

A number of myths about PPPs are challenged, including:

- **By reducing the call on public funds the amount of funds available for other essential services is increased.**
- **Private sector investment accelerates the availability of community goods and services.**
- **The private sector is inherently better at providing services.**
- **Private sector involvement in the provision of goods and services is free from political interference.**
- **Private sector involvement reduces the level of financial risk to government.**
- **PPPs reduce taxation.**
- **The user pays principle is inherently a fairer way of paying for services.**
- **Private sector involvement can inject world best practice into service provision.**
- **The introduction of new players will increase employment and improve conditions.**
- **PPPs improve accountability.**

PPPs are plagued with escalating costs, conflict, high consultancy fees, poor services and secrecy. A major problem with PPPs is that they reduce accountability and transparency. Increasingly, public and private parties use "commercial-in-confidence" clauses to protect the private sector from public scrutiny. Many problems are emerging with PPPs because the private sector has better information and expertise to negotiate favourable deals. By offering attractive financial packages, the private sector is also luring public servants into the private sector.

Reliance on the private sector through PPPs to solve our emerging infrastructure crisis will be costly and risky. Future generations will be forced to pick up the bill. A seemingly universal belief that debt by its very nature is bad and that increased direct taxation is politically unacceptable has meant that both federal and state treasuries are now hamstrung as to their options in a way that is historically unprecedented. Debt in itself is not a problem. The issue is whether the debt is being used to invest in productive assets or recurrent expenditure. Although there are situations where the private sector does have a role to play, governments must be much more active in looking for innovative solutions to meet the growing demand for infrastructure.

The report puts forward a number of alternatives.

1: consideration should be given to establishing savings bonds as a way to increase community savings available for infrastructure projects. Savings bonds are quite common overseas and are fixed term and generally fixed return deposit instruments, usually guaranteed by government. This option means an increase in government borrowing.

2: community revolving loan funds are a useful way of raising funds for smaller infrastructure projects. The Canadian government has supported these funds, which encourage funds to be raised locally, and are blended with government and private funds. They make loans available that create or maintain jobs, enhance infrastructure and promote investment into local economies.

3: social venture funds aim to invest in social infrastructure and services by combining philanthropic, private and public funds to provide innovative solutions to community problems. Australia falls well behind in the number of philanthropic institutions compared to the US and most other OECD countries. Efforts to promote these entities could provide an effective alternative source of funding for much needed social infrastructure and services whilst at the same time encouraging greater community benefit.

4: the Pooled Development Fund program, through the provision of tax breaks, could be extended to include not just small and medium business ventures, but also infrastructure such as roads, hospitals and community facilities. This would be both consistent and tax effective as it aims to address the same problem, a lack of investment capital.

5: much of the funding for PPPs in Australia can be ultimately sourced to superannuation funds, usually through an intermediary such as a specialised infrastructure or property trust. There is no financial reason why governments could not establish investment opportunities for larger projects directly with the market rather than through an intermediary, thereby reducing the project costs. Superannuation funds in turn are looking for secure longer-term investments. There are some examples of Australian super funds developing such policies. The Local Authorities Super Fund in Victoria has a target of a percentage of its investment funds to be invested in regional infrastructure. The Construction and Building Unions Superannuation Fund (C+BUS) has pioneered an asset allocation policy directed towards the housing construction sector. Once again the facilitative role of government is crucial if these opportunities are to be realised, as government are the only body able to establish the framework within which these opportunities can be captured.

In conclusion, the application of the PPP model is often inappropriate, poorly understood, and relatively expensive compared to other techniques. Over the life of the project, PPPs are full of significant risks to government and the community. If PPPs are to continue to be developed there is a clear need for a consistent national policy that is transparent, provides a better result than alternative methods, including direct government borrowings, and brings benefits to all Australians. In addition there is a need to develop a broader suite of alternative approaches to the funding of community infrastructure and service provision that reflects the changes in the financial and investment markets and which best suit the particular needs of the Australian community as a whole. The facilitation of alternative sources of and methodologies for funding that will channel additional resources into community infrastructure is only worthwhile if there are clear safeguards in place.

Changing Public Private Partnerships A union policy project

Background

The central question in the debate about public private partnerships is how do we meet society's requirements for the construction and operation of social and economic infrastructure. Infrastructure is concerned with assets that provide public services over a long period of time. The major infrastructure items are roads, railways, ports, schools and tertiary institutions, hospitals and health care facilities, energy, telecommunications, and housing. In both advanced and developing economies infrastructure and associated services have been traditionally a responsibility of government.

Over the past two decades the real capital expenditure on infrastructure has declined. This has resulted in unmet demand for infrastructure and their associated services. In land transport, for example, under-investment in rail infrastructure has resulted in poor freight services in many regions, increasing urban congestion and environmental problems due to over-dependence on road transport. Aging of the Australian population is increasing demand for health infrastructure such as hospitals and nursing homes and clinical services. The public education system requires an urgent injection of funds to bring facilities up to an international standard and to ensure that all young Australians are treated equitably in relation to educational opportunities.

The rationale for government involvement in infrastructure provision is well established in the economic literature. Large infrastructure projects simply don't happen unless government is involved. Government has historically funded the vast majority of major infrastructure in Australia. Because of the large scale of investment required and the need to ensure that the benefits of infrastructure services are equitably shared throughout the community, it has traditionally been a function of government to finance infrastructure through borrowings. The size of government and its influence over interest rates and budget policy gives it a unique capacity to raise large amounts of capital and to influence economic outcomes.

Governments are now promoting PPPs as an alternative to traditional government debt financing, where the government borrows up front and pays off the principal and interest over the life of the asset. PPPs were developed as a way of reducing government debt. Rather than the government borrowing up front, PPPs involve the private sector borrowing up front, and the government leasing or buying the infrastructure and services from the private sector over a long period of time.

Definitions of PPPs tend to be vague and not very helpful. Chris Sheil puts a compelling argument that the use of the term 'partnership' to describe contractual relationships between the public and private sector is misleading[1].

"Far from constituting partnerships in any meaningful sense, PPPs provide for the contracting parties to pursue their separate, diverse and potentially conflicting public and private interests".

For example, the NSW Government defines PPPs as any project "in which there is joint public and private sector participation". Such a definition could include projects ranging from a firm of architects contracted to government to design a new building through to the private ownership of a state electricity supply system. Public private partnerships are arrangements where negotiations between the public and private sector lead to a sharing of responsibility and risk for different combinations of design, construction, finance, ownership and/or the operation of infrastructure projects. PPPs, like privatisation, lead to a transfer of risks associated with infrastructure to the private sector from the public sector.

The actual delineation of responsibilities differs widely between countries and between projects. Public private partnerships reside somewhere between complete public sector ownership and control and full privatisation of infrastructure assets and their services. The difference between privatisation and PPPs is that the transfer of risk is moderated in the PPPs.

PPPs have been around for a long time. For example, in the US, tollways and expressways have been around for 50 years, where private companies have the authority to levy tolls from motorists for the use of public transport infrastructure. The Australian Council for Infrastructure Development has estimated that there have been more than 170 PPPs signed in Australia, worth more than $32 billion and stretching back 20 years. What is new is the speed with which PPPs have become central mechanisms for providing and managing infrastructure in a number of advanced economies, and in the provision of services in such sectors as education, health and transport.

The Blair Labour Government in the United Kingdom is at the forefront of using PPPs to provide for and finance infrastructure. Inheriting

1 Chris Sheil, PPPs, It's time to take the PIIS, Evatt Foundation 15 April 2002

antiquated social and economic infrastructure from the Thatcher-Major years, but sharing its predecessors' commitment to low taxation, the Blair Government saw PPPs as a mechanism to mobilise private sector resources to modernise the UK's infrastructure while at the same time limiting increases in public expenditure. Public private partnerships were central to the Blair Government's "third way"; somewhere between the extremes of Anglo-American neo-liberalism as espoused throughout the Thatcher-Reagan years and the European social democratic model of cooperation and consensus between business and unions.

The Blair Government created new organisational structures to promote PPPs. Partnerships UK grew directly out of the UK Government Treasury Taskforce established to develop the policy framework for PPP projects of the UK Government. Partnerships UK aims to assist government bodies to achieve better public / private partnerships. The UK government holds two seats on the private company, a minority shareholding and has funds available to kick-start and invest in new partnerships. The charter of Partnerships UK states: -

"It works with the government in the development of PPP policy and contract standardisation, helps with project evaluation and implementation and supports PPPs in difficulty."

Partnerships UK is headed by a combination of both former government and private sector officials. The principal historical reason for the creation of Partnerships UK was - to quote Hon Alan Milborn, the recently resigned transport and local government cabinet minister - "to get around the bureaucratic problems of government".

It is worth noting however that this same former cabinet minister in his resignation speech to Parliament stated "that the government needed to stop private companies from walking away from unprofitable contracts and forcing the public to pick up the tab"[2].

The report card from Britain on PPPs is poor. In Britain, PPPs come under the policy term "Private Finance Initiative (PFI)", which is designed to increase private sector involvement in the provision of public services. A critique by UNISON[3] of PFIs found that:

- They are a more costly way of financing public services than direct borrowing by the public sector.
- They tend to escalate both in scale and cost, leading to financial shortfalls which must be met from other parts of the public sector.
- Methods to measure the benefits of public compared to privately financed projects are "biased". The method is most often called the "public sector comparator".
- Despite some improvements in staff protection, privately financed projects tend to reduce terms and conditions for staff as well as jobs.
- Increasingly, the public sector loses control over assets and service provision.

2 *The Guardian* May 26,2003
3 UNISON, Challenging the private finance initiative, 2000

Latrobe Valley Base Hospital

In October 1995, the Victorian Government announced a new vision for hospital treatment and care for the residents of the Latrobe Valley and Gippsland communities.

The Minister for Health, Mrs Tehan, announced that a modern state of the art hospital serving a mix of public and private patients would be built and would be equipped to meet the medical challenges of the next century. Mrs Tehan stated that the current hospital facilities at Moe-Traralgon were unable to meet the needs of a growing population, new technology and enhanced medical practices.

Mrs Tehan said the private sector would be invited to build and manage the new hospital. The new facility would include a comprehensive range of general and speciality medical and surgical care, 24 hour emergency services, coronary care, intensive care, obstetrics, paediatrics, aged care and mental health services.

In 1996, a contract was signed between the Government and Australian Health Care Limited (AHC) for the provision of a 257 bed public hospital.

It was quickly apparent that the arrangement was to be a failure, both from the perspective of providing quality health care to the community, as well as making a profit.

The private facility lost the total support of the community ie. volunteer networks disappeared, donations from community groups and businesses stopped.

Services were lost through privatisation eg. ear, nose and throat and ophthalmology. Also paediatric services were reduced.

In January 2000 the AHC commenced Supreme Court action against the Victorian Government claiming that they were not being paid appropriately under the terms of the contract.

In October 2000, the AHC reached an agreement with the Victorian Government, whereby the government would assume responsibility for the Latrobe Regional Hospital, including AHC selling its $12.6M stake in the hospital building to the Government for $6.6 million.

The Victorian Minister for Health stated, at the time, that continuing losses incurred by AHC meant it could no longer guarantee appropriate levels of hospital care.

PPPs in Australia

State Labor governments in Australia have enthusiastically embraced PPPs. We have a growing list of public infrastructure projects that are developed as PPPs. Examples include road and rail infrastructure, tunnels, schools, hospitals, water and sewage projects, telecommunications and sporting facilities.

All states have policies and special units established to promote PPPs. All of them set out criteria for assessing the provision of infrastructure through conventional debt financing compared to the use of PPPs. A major criterion is the "public sector comparator", which requires PPPs to demonstrate better value than the public sector financing alternatives. The NSW Government has produced guidelines for Privately Financed Projects (PFPs) which it sees as a sub-set of PPPs. The Victorian Government has established Partnerships Victoria, a group that facilitates interaction between the public sector and private sector consortia. Perhaps the most advanced, the Victorian policy was developed out of the current government's legacy of wholesale privatisations by the previous Kennett Government. The policy has three principle components:

1 Standardised processes of assessment
2 Risk allocation
3 A methodology for developing a risk-weighted public sector comparator.

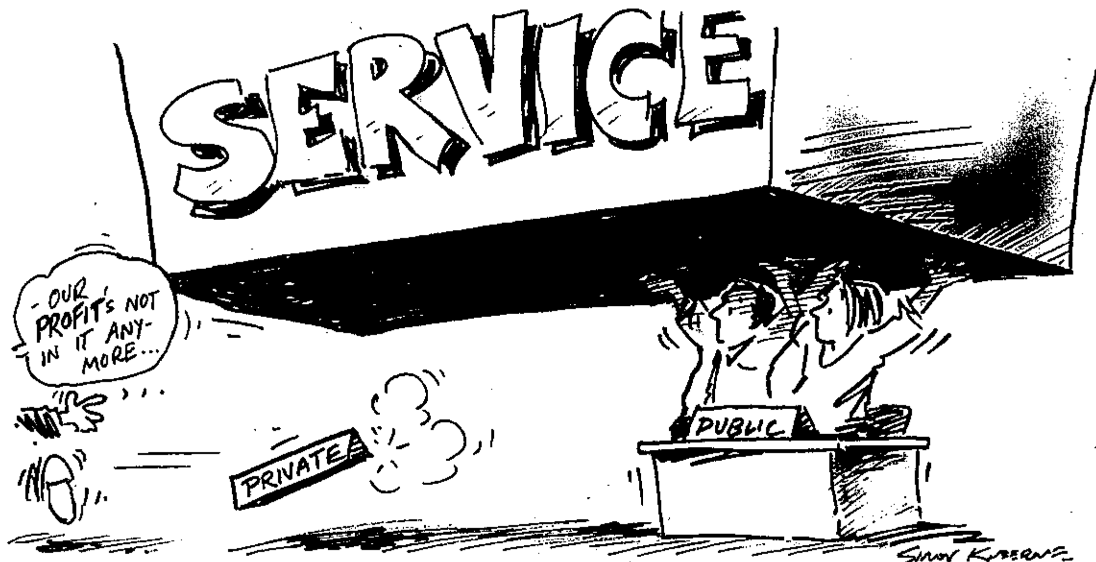
Western Australia, Queensland and South Australia have also released Public Private Partnership guidelines. There is no similar overarching federal government policy. Instead, some departments have set up PPP units mainly as a way of leveraging private sector funds for asset realisation. As the Australian Infrastructure Council states:

"The Commonwealth Government has been a largely silent party in this debate ... In general however, it seems fixated on asset financing rather than service provision - an important distinction not learned in the UK until after the Bates Review"[4].

An industry is developing around PPPs in Australia that strongly advocates the extension of PPPs into new areas of economic and social infrastructure projects. According to Professor Ken Wiltshire, around 10per cent of new infrastructure projects are currently designated as PPPs and this is forecast by him to rise to 50 per cent over the next five years[5].

The PPP "industry" straddles both public and private sector. Within government, specialist PPP units have been created within treasury. State governments have created infrastructure councils which are dominated by groups with a vested interest in pushing PPPs. Senior public servants, including treasury officials and bureaucrats from big spending agencies such as transport and health, provide a talent pool for private sector companies wanting to acquire expertise and knowledge of public sector processes and procedures.

4 Dr Raphael Arndt, Director - Policy, ACID, Oct 2001
5 *Australian Financial Review*, 23 May 2003.



On the private sector side, the industry includes a number of Australia's largest engineering and financial companies. The industry also includes a number of specialist service providers in areas as diverse as prisons, water, hospitals and age care facilities. Many of these are global corporates that have been involved in PPPs in the UK and North America and are actively pursuing new opportunities in the growing Australian market. Legal firms and management consultancies are actively engaged in the industry, earning healthy fees for financial advice and drawing up legal documents. They actively promote the PPP industry to government and throughout the broader community.

The small group of engineering companies that dominate the construction of large economic infrastructure projects are major players. Traditionally their profits came from successfully bidding to design and construct large infrastructure projects for government agencies. The major trend in PPPs is for engineering to link up with the large investment banks and service providers to bid, not only for the design and construction phases of a project, but increasingly in various aspects of ownership and operation of a project. PPPs are only suited to very large-scale projects, usually with a threshhold of about $100 million. This is because of the high costs of tendering and the transaction costs in establishing PPPs. Hence only a small group of Australian-based companies has the capacity to bid for projects.

The "PPP industry" is an attractive one to be in, particularly when large infrastructure projects are involved with a secure revenue base and government involvement in underpinning the risks. With the current volatility of share markets, offshore investment and property markets, major infrastructure projects structured as PPPs can provide long term, healthy and secure rates of return on investment.

There is a growing list of infrastructure projects in Australia that have been developed as PPPs. Recent examples include Sydney's Orbital road network, nine public schools in north-west Sydney, Queensland's Gateway Bridge and Motorway project, Sydney Airport Rail Link, Brisbane Airport Rail Link, Melbourne's Spencer St Station and the City Link motorway (TransUrban).

The Commonwealth Government wants the private sector to play a major role in funding the expansion and modernisation of the national land transport sector. The recent AUSLINK Green Paper[6] proposes that private sector investment be directed to projects that are commercially viable, while public infrastructure investment should go to projects that are less commercially attractive but offer broader community benefits.

6 Department of Transport and Regional Services, **AUSLINK Green Paper – Towards the National Land Transport Plan**, November 2002.

Port Macquarie Base Hospital

The Port Macquarie Base Hospital in northern New South Wales was the first public hospital in Australia to be constructed, owned and managed by the private sector. The New South Wales Government expected to save $46 million over 20 years by allowing the private sector to build and run one of its public hospitals.

One justification for entering into the arrangement with Health Care Australia (HCA) was the assertion that HCA could build a much needed new facility for about $15 million less than the public sector, and operate the hospital for 20 years for some $46 million less than the public sector.

In the year 2000 the New South Wales Auditor General estimated the cost to the public purse at actually around $143.6 million. And despite paying this amount the state would not end up owning the facility. Instead of saving $15M it is now estimated that the total deal will cost the people of New South Wales an additional $93 million.

The cost blowouts were detailed in a report of the independent New South Wales Audit Office in explaining that the government had agreed to pass the hospital, together with the land and licence, to the private sector when the government had paid out the finances in 20 years and stated: "This inexplicable grant is in addition to the significant fees paid by the government for the private sector provided hospital services. The government is, in effect, paying for the hospital twice and giving it away".

Whereas most hospital services are provided by doctors who are paid a salary or charge a sessional fee, the New South Wales Health Department pays a service charge for public patients at Port Macquarie based on the fee for service which is equivalent to the rebate for top cover private health insurance. The OECD has pointed to the fee for service system as one of the root causes of rising health expenditure.

A study of administrative costs in Australian hospitals suggests that overhead costs are 31per cent higher in private hospitals compared with public hospitals[7].

7 Queensland Government submission to the Senate Community Affairs Reference Committee (2000), **Submission No. 41**, Additional information P.2, Hansard 2000.

The rationale for PPPs

The growing importance of PPPs is associated with the rise of neo-liberalism as the primary model for running modern economies. The essence of neo-liberalism is the idea that government intervention in the economy impedes economic growth and efficiency. Conversely, neo-liberalism argues that markets are the most efficient mechanism for allocating resources in an economy and the private sector is best equipped to make assessments and take risks. Many consequences have flowed from the adoption of neo-liberal economic principles and policies.

Firstly, there has been a reduction in the role of government in managing economies. Tax minimisation policies for firms and households have reduced the relative resources available for public sector capital and recurrent expenditures.

Secondly, government debt has been labeled as economic incompetence because it "crowds out" investment for private sector projects and exerts upward pressure on interest rates. The Loans Council has severely constrained the capacity of state governments to borrow. The Commonwealth Government has searched for ways to get out of the bond market altogether. Surplus budgets (or the absence of government debt) have become a

The raising of capital through PPPs is actually more expensive than if government directly borrows the necessary capital for a project because of the risk of financial failure by the proponent.

core indicator of the health of an economy. A core piece of legislation in NSW is the General Government Debt Elimination Act, which has set targets for government to ensure the state budget is in surplus. Credit rating agencies "punish" governments with high levels of debt by downgrading their creditworthiness. Whether this has an impact on how economies perform is debatable. The point is that PPPs may have little impact on how much is invested in infrastructure and the quality of services they provide. PPPs have more to do with reducing government debt and the public sector borrowing requirement.

Some financial analysts have seen merit in PPPs for Australia's equity and debt markets, arguing that the raising of private capital especially for large infrastructure projects provides a greater depth to those markets. Paradoxically the debt market has reduced principally because of the reluctance of government to borrow to raise capital. The raising of capital through PPPs is

Recent large scale corporate failures such as Ansett, Pasminco, HIH, and AMP clearly illustrate that the private sector per se has no monopoly on good management.

actually more expensive than if government directly borrows the necessary capital for a project because of the risk of financial failure by the proponent. Governments on the other hand are less exposed to risk due to their unique capacity to tax and their sheer size as financial entities. The raising of funds through selling shares or private sector borrowing simply transfers the risk from public to private hands at a greater commensurate cost to the community as a whole.

At the core of the neo-liberalism model is an ideology – an ideology that emphasises the inherent efficiency of the private sector, operating in a competitive environment, compared to the public sector. The private sector is "more innovative", "leaner", subject to "market discipline" and has "more expertise" than the public sector. There is little basis in fact in these assertions. Evidence of poorly-run government business enterprises can be countered with evidence of many innovations emanating from the public sector that spread to the private sector. The trend is for exaggerated claims of the benefits of PPPs such as cost savings and improved services to be scaled down dramatically once a PPP project gets underway. Recent large scale corporate failures such as Ansett, Pasminco, HIH, and AMP clearly illustrate that the private sector per se has no monopoly on good management.

Many economic reforms on the road to PPPs, such as competition reforms over the past decade, have required the public sector to behave much more like the private sector. There is no theoretical argument to suggest that the private sector is better at infrastructure service delivery than the public sector. The essential point is that they have different functions. The public sector must take account of broader social goals and objectives, such as providing universal access to health services, travel access and education. The private sector's strengths are in identifying, assessing and taking on commercially viable and potentially profitable projects.

While neo-liberalism results in a significant reduction in the role of government in infrastructure ownership and funding, it forces governments to attract private funding to make up the shortfall. In this it has been partially successful. The private sector share of national infrastructure construction activity almost doubled over the past decade, accounting for up to 44 per cent of the total[8].

An irony of PPPs is that they actually result in an increase in public sector intervention in the economy, not a decrease along the lines of the classic neo-liberal model. One reason for this is that privatisation of many government assets – the predecessor to PPPs - has brought about poor results in many sectors and reduced services to the community. The financial risks for the private sector are high, particularly when it is obliged to maintain a certain level of universal service to the public. When privatisation doesn't work, resulting in, for example, shortages of electricity, dramatic increases in water prices and revenues falling short of forecasts, the private sector can experience severe financial losses. But perhaps more significantly, governments must bear the significant political and economic risks of service failure. In the case of major blunders, governments can fall. The private sector will incessantly search to secure projects where it can maximise returns at a low level of risk, whereas governments of the neo-liberal persuasion will always be searching for ways to reduce government expenditure, taxes and budget deficits.

8 Ibid.

PPP for seven schools in Sydney's northwest

On January 28, 2001, the then NSW Minister for Education and Training, John Aquilina, announced that the private sector would fund the construction of two new high schools and seven primary schools in Sydney's northwest. This was subsequent to the release in November 2000 of the NSW Government's Green Paper *Private Financing of Infrastructure and Certain Government Services in NSW*.

In November 2001 the government issued Guidelines for Privately Financed Projects, which it defined as part of the broader spectrum of Public Private Partnerships.

Development of the schools project continued after John Watkins replaced John Aquilina as Minister.

Expenditure on capital works for NSW public education was cut severely over the past ten years, particularly in the years leading up to the Olympic Games.

It is the NSW Teachers Federation's view that the privatisers are prepared to co-operate with restrictions as a form of 'loss leadership', in the same way as supermarkets discount a few popular commodities.

The private financiers and corporations specialising in supplying outsourced services are looking to the longer term when they will not be so restricted. The security of an income stream from a stable government means there will be no risk to investors, and all the prospects of a bright future if these schemes become the norm, and the boundaries can be pushed even further.

Analysis of the myths of PPPs

A large body of government and private sector reports has been generated by the emergence of PPPs. Little of it is objective and it depends on the vested interest of the particular group. Many myths about PPPs need to be challenged.

Myth 1

By reducing the call on public funds the amount of funds available for other essential services is increased

A reason often stated for the adoption of PPP arrangements is that it frees up public funds that could be used in other essential services. This argument would have some validity if in practice these 'savings' were applied in this way. There is little evidence of this actually happening. Funds saved in this way have mostly been allocated to consolidated revenue to be used to retire debt and not used in the provision of better community services and infrastructure.

A number of commentators point to the higher cost of financing infrastructure through PPPs compared to traditional public sector debt financing. According to economics writer Ken Davidson[9], the private sector requires a rate of return of around nine per cent per year compared to 6per cent per year for the public sector. Davidson suggests that, using these rates, a project costing $4 billion through conventional public sector financing would cost $5.6 billion if financed through a PPP. The $1.6 billion difference could have been used to finance new schools or health services.

This impacts on government finance and the government's capacity to maintain and expand existing services.

9 Kenneth Davidson, Brumby ignores Labor and we pay the price, *The Age* 23 May 2002.

Myth 2

Private sector investment accelerates the availability of community goods and services

Another key argument put forward by advocates of PPPs is that the injection of private sector funds into community assets and services accelerates their creation. The argument is that without the injection of private investment much-needed goods and services would have to be deferred or not undertaken. While this has some short-term attraction it fails to recognise:

- the longer-term financial liabilities that accumulate with such a strategy,
- changes that will occur to the investment strategies of the partnering organisation over the life of the project due to a change of ownership or board direction; and,
- the asset allocation decision-making process that comes with the partnering which can see a partnering organisation remove itself or be wound up.

This latter issue is often not recognised but is important in terms of equity and is inherent in the nature of these projects.

Typically PPPs emerge when an investor or government identifies an opportunity. They are rarely developed out of any identified priority of need or, if they are, they are developed at a premium to government.

In NSW the Government has contracted a private sector consortium comprising ABN AMRO, St Hilliers, Hansen Yuncken and SSL Facilities Management (Spotless) to build, maintain and provide security in nine state schools, which the Government will lease back for 30 years.

Although this PPP was announced with much fanfare, the Government has acknowledged that, if

all goes well, the project will produce only a four per cent saving over 30 years to taxpayers. The benefit - according to the NSW Government - is that the schools can be built in 2005 rather than 2010 with the involvement of the private sector. This assumes that funds cannot be raised in other ways such as through traditional public sector debt financing.

PPP agreements can produce significant unforeseen outcomes and reduce the capacity of governments to provide adequate services.

In California the existence of a 'non-compete clause' in the state's franchise agreement with a private toll road operator has forced the Orange County Transportation Authority to buy back the 91 Express Lane Toll Road from its private operator. The County paid over US$380 million to allow much needed road upgrades in the area surrounding the private toll roads. Non-compete clauses are common in infrastructure PPPs where assumptions are made as to the level of patronage / toll that can be expected. Similar clauses exist in a number of tollways operating in Victoria and NSW.

Myth 3

The private sector is inherently better at providing services

Supporters of PPPs argue that the private sector is able to deliver services in a more effective and efficient manner than the public sector. Advocates of PPPs often argue that the introduction of PPPs into the provision of public sector goods and services will improve the provision of services through better management and systems. The private sector is motivated by bottom line profit, and hence it has an incentive to continually reduce costs and to improve delivery mechanisms. While this is superficially appealing it fails to recognise some of the distinct differences that exist between the two sectors and therefore the fallacy of such comparisons. The public sector has different responsibilities compared to the private sector. Not all services can be provided profitably. That is not to say that the public sector does not need to constantly improve its performance. However the criteria for comparing the two sectors often needs to be differentiated. Private sector failure is sufficiently well documented to demonstrate the fallacy of any 'inherent' argument.

Inherent within the debate over the introduction of PPPs into what has been traditional public sector service provision is that the private sector will bring better service delivery. Through the prescription, monitoring and measurement of service provision it is argued that a better service outcome can be achieved in the provision of community infrastructure and services. While it is generally true that any service can be delivered better where the outputs are clearly stated, this is true for both sectors and not an argument for or against the provision of services by the public or private sector. Secondly there is sufficient evidence of high quality service provision delivered by the public sector to illustrate the fallacy of this proposition.

A recent report on the private financing of health services in the UK concludes that there are serious problems with privately financed projects[10]. The report, compiled with a series of interviews with health care workers in nine hospitals involved in privately financed projects, identifies four major problems:

- All hospitals were desperately short of beds, putting pressure on hospital staff to get patients out as quickly as possible.
- All trusts running the hospitals were under severe financial pressure, partly as a result of the escalating costs associated with PFIs.
- There were concerns over poor quality of design of buildings, including poor ventilation, lack of space and inadequate fittings and materials.
- The quality of care had declined, with concerns about time spent with patients and the level of multi-skilling required.

10 John Lister, The PFI experience - Voices from the Frontline, A PFI report for UNISON, March 2003.

Myth 4

Private sector involvement in the provision of goods and services is free of political interference

Many advocates of both privatisation and PPPs argue that, by removing the provision of services from the public sector, the capacity for political interference is reduced. Political interference is seen as causing inefficiency, corruption and poor resource allocation. Such an argument fails to recognise that inefficiency, corruption and poor resource allocation can also exist in the private sector. In many instances, the growing inter-relationship between the public and private sector associated with PPPs increases political pressure for governments to endorse projects that may or may not be required.

Private sector companies are putting forward unsolicited proposals to government and then mobilising public opinion to support the project. The Very Fast Train is a good example. There have been various proposals over the past 15 years to construct a Very Fast Train link between Melbourne - Sydney, Sydney - Canberra and Melbourne - Brisbane. Despite intense private sector lobbying for these mega-projects, it was clear they required massive public subsidies and government would not take them on. The Inland Railway linking Melbourne and Brisbane was heralded by the Federal Government in many rural electorates during the 2001 national election campaign, only to be quietly downgraded after the election.

The public sector does not have a monopoly on corruption or interference in decision making. The HIH Royal Commission exposed a corporate culture of boards or senior executives interfering to secure rewards for themselves, demonstrating that 'political' interference can exist in any culture and is not removed just by the presence of private as against public sector management. What is important is robust governance processes whatever the ownership structure.

Myth 5

Private sector involvement reduces the level of financial risk to government

One reason for the introduction of PPPs in recent times is the desire of governments of all persuasion to reduce public sector financial risk. The argument is that by transferring debt and risks to the private sector, the public sector balance sheet is improved. This may be true in the short term.

However, the use of private funds as against public funds increases the level of contingent liability exposure when service contracts fail. As the Sydney Airport Rail Link contract (New Southern Railway) demonstrates, when essential services provided by the private sector fail, the public sector is forced to act as guarantor. The public sector risk can be greater as the ability to directly manage the risk is reduced.

The New Southern Railway linking central Sydney CBD with Kingsford Smith Airport shows that government must continue to underpin major infrastructure projects even if they are run by the private sector. Professor Bob Walker has estimated that in the case of the Sydney Airport Rail Link, the private sector stood to make a 23 per cent rate of return despite incurring minimal risks[11]. On the other hand, the NSW Government incurred construction and volume risks, contributed most funding, and may only break even after 23 years and at best earn only 2 per cent pa on its investment.

The public sector remains the provider of last resort. In cases where the private sector loses money and walks away from a contract the public sector must intervene to maintain services. After reporting a loss of $6.2 million in 1999, the 257-bed La Trobe Hospital, which had been owned and operated by private company Australia Health Care (AHC), was handed back to the Victorian Government[12].

There is currently no accredited accounting standard being applied by any government in Australia to quantify the contingent liabilities inherent in PPPs. What this means is that government accounts do not accurately reflect the risks they are carrying within their accounts, leaving them exposed to significant expenditure they have not made allowance for.

11 Bob Walker, **Privatisation, Infrastructure and Local Government**, address to the NSW State Assembly NSW Local Government and Shires Association, Sydney, 2001.

12 Allyson Pollock, Jean Shaoul, David Rowland and Stewart Player, **Public services and the private sector**, Catalyst Working Paper, November 2001.

Myth 6

PPPs reduce taxation

Advocates of PPPs argue that through the injection of private funds overall taxation rates can be reduced. Reduced government spending can mean reduction in the need for revenue. However, in practice, this is only true in the short term.

PPPs don't provide free goods and services. The public sector borrows funds to meet annual lease payments to the private sector over the life of project, normally in the order of 20-30 years. It simply passes the costs onto future generations. According to a UK paper on public services and the private sector[13], additional costs, problems and deficiencies will fall on future taxpayers and users.

With many infrastructure PPPs having an operational life of over 20 years the real cost and therefore tax liability could be significant. This is especially the case as replacement and refurbishment costs accumulate over the life of the project but the income stream is channelled to only one of the partners. To date, taxation has not been reduced but has increased through the application of user charges for example, freeway charges in effect are an indirect tax. Consumers and often the environment bear most of the costs of privatisation.

The costs of establishing and maintaining PPPs are high for governments. Governments pursuing PPPs have to create bureaucracies to administer and manage them. Transaction costs are high. This includes establishing guidelines, tendering procedures, legal documents and negotiating with the private sector.

13 Allyson Pollock, Jean Shaoul, David Rowlamnd and Stewart Player, **Public services and the private sector – a response to the IPPR**, A Catalyst Working Paper, November 2001.

Myth 7

The user pay principle is inherently a fairer way of paying for services

Inherent in the use of PPPs is that the end users of such services pay a fee to the PPP partners. Rather than the community paying through general taxation it is argued that the users of such services should pay, and that this is more equitable. However in practice this is difficult to demonstrate. As the application of rebates paid to users of motorways illustrate, the application of the user pay principle is not equitable as it charges a fixed fee to all users regardless of their ability to pay.

Motorists dependent on motorways are often lower income earners living long distances from workplaces at the centre of our major cities. To insure a reliable rate of return to the operators of such motorway schemes, governments have tended to enter exclusivity of supply agreements with the partnering developers, whereby alternative and pre-existing services are downgraded and in the case of some infrastructure removed, as a way of reducing competition.

The closure and incorporation of existing public infrastructure into new PPP motorways is a case in point.

Myth 8

Private sector involvement can inject world best practice into service provision

Some advocates of PPPs argue that the introduction of private sector partners can produce important and required organisational change through the introduction of new techniques and processes. While there is little doubt that partnership arrangements can lead to learning opportunities, PPPs do not inherently produce this result. Sometimes in practice the transfer of knowledge flows in the opposite direction, with the operating partner learning information of a critical nature that makes the relationship one of dependency rather than a real partnership. In addition, in practice there appears to be a tendency to transfer personnel from the purchaser partner to the provider partner, which can see a reduction in the skill base of the former.

PPPs can unnecessarily increase complexity. For example, under the PPP arrangement for London Underground, infrastructure companies maintain the tracks, stations and trains. The public authority London Underground manages the day-to-day operations of the network and has overall responsibility for the safe operation of the system. In April 2003, Tubeline Cleaners, one of the maintenance contractors undertook a cleaning project on the Central Line Station. In the process of cleaning, considerable dust residues were dislodged which in turn stuck to glue left by another contractor placing advertising hoarding at the station. This seemingly simple demarcation of responsibilities produced a fire within the system and the temporary closure of the line. Despite provision within the contract, no fines were demanded for lack of performance, essentially due to the difficulties of apportioning responsibility in such a complex arrangement.

In the case of British Rail privatisation, the rail sector was fragmented beyond recognition. Today there are 25 train-operating companies; six freight operators, three rolling stock operators, two infrastructure controllers and seven infrastructure maintenance contractors. Under this complex regime are some 1,500 subcontractors. A once integrated whole has become a patchwork of competing interests that have seen costs rise from $3.75 billion in 1999 to $12.5 billion in 2003. When responsibilities are split between a number of parties through contractual arrangements, responsibility is reduced. Contract competition has not led to overall savings. The problem has not been a lack of competition but a failure to invest properly in the maintenance and upgrading of the infrastructure.

Myth 9

The introduction of new players will increase employment and improve conditions

The claimed capacity of PPPs to accelerate investment is said to increase new employment opportunities. While new investment in infrastructure and services will create new jobs, it may not increase overall employment. Experience suggests that if the PPP takes over an existing project, the net employment in the post-construction phase will reduce as a means of reducing costs. Where a new project is created, net employment may increase. In the case of a competitive market, cost competition may see a reduction in employment. Unlike most commercial transactions, PPPs rarely allow for an increase in charges to occur, therefore operators have little choice but to reduce outlays if their shareholders' interests are to be protected.

British health workers are concerned about the transfer of staff from public to privately financed projects[14]. Unions representing health workers rejected the UK Government offer of "retention of employment" rights to blue collar workers such as cleaners and porters because it excluded 200,000 staff, including clerical staff, receptionists, building maintenance workers and patient transport vehicle drivers. A two-tiered workforce has emerged in the UK with workers remaining with an existing but privatised entity remaining with public sector wage parity, but with workers recruited after the privatisation being recruited at lower levels of pay and conditions.

...there are 25 train-operating companies; six freight operators, three rolling stock operators, two infrastructure controllers and seven infrastructure maintenance contractors. A once integrated whole has become a patchwork of competing interests that have seen costs rise from $3.75 billion to $12.5 billion.

14 Patrick Butler, Government faces union challenge on NHS staff rights, *Guardian Weekly*, Tuesday March 26, 2002

Myth 10

PPPs improve accountability

Proponents of PPPs argue that through the use of performance contracts, transparency is created and therefore greater levels of performance accountability can be achieved. While it is true that greater specificity can lead to greater accountability of performance, such arrangements presuppose strong contract administration skills and capacity. Performance indicators often depend on data provided by the service provider, and many mechanisms can be used to inflate or deflate statistics. Strongly prescribed performance contracts have led to increased costs in terms of accountability regimes and contract variations made during the life of the contract, often at a high cost to the community.

Because of the cost, complexity and time involved in setting up PPP contracts, governments are reluctant to break a contract with a private sector partner once a project is up and running.

The use of performance contracts with measurable outputs is a key characteristic of PPPs. However they are not unique to PPPs and the use of PPPs is not the only way to ensure robust performance. There are significant risks in establishing fixed outputs in service contracts that can span a number of years over a period of uncertainty.

Because of the cost, complexity and time involved in setting up PPP contracts, governments are reluctant to break a contract with a private sector partner once a project is up and running. Once a private sector partner has been awarded a project the government is "locked-in" and will seek to re-negotiate rather than terminate a contract. There is a tendency for costs to escalate once projects are up and running, with public and private sector partners sitting down to accommodate cost increases. Higher prices to sustain profitability is normally a better option than terminating a private sector partner, because the costs of bringing in a new private sector partner or getting the public sector to take over the project is too high in both practical and political terms as well as financial terms.

Sydney Airport Rail Link

The contract to build the Sydney Airport Rail Link was negotiated by the Greiner Coalition Government, signed in the dying days of the Fahey Coalition Government, and accepted by the incoming Carr Labor Government in 1995. Greiner and Fahey had repeatedly promised that the 'New Southern Railway' would not cost the taxpayers a cent.

When the tunnel between Central Station and the Illawarra line was complete, the NSW Government invested over $700 million and the private sector consortium 'invested' $125 million. The private consortium had the right to set the fare for stops at the four new underground stations and to operate these stations – for 30 years.

All the trains would be provided by the government through CityRail.

Under the contract, the private consortium would charge a premium over the basic CityRail fare, and this revenue would be shared in such a way that the consortium would receive a real rate of return to the consortium of 23 per cent for 30 years.

The NSW Government would not break even for 23 years, and would earn a two per cent rate of return on its much bigger investment over the 30 years.

What happened?

The new line was opened in April 2000, in the lead up to the Olympics. The public looked at the $10 fare for the journey from the airport to Central and took a taxi or a private car, or the bus. Patronage was so low that the consortium went into receivership in November 2000.

The NSW Government immediately began to make payments to keep the consortium going, and the consortium took legal action against the Government. The legal issues remain unresolved at the time of publication.

More Problems with PPPs

Transparency and accountability

A major concern in the development of PPPs is the reduction in transparency and accountability inherent in such arrangements. 'Commercial in confidence' arrangements are the norm in such partnerships, to protect the commercial arrangements that exist between the parties. While this is critical in many cases to the private sector partner, it has the undesirable affect of reducing and in many cases eliminating public accountability. Increasingly incoming governments have discovered the costly legacy left to them by previous governments that were not revealed to the parliament, or in some cases not made privy to even Auditor-Generals. The UK House of Commons Public Accounts Committee stated in 2002 that more than half of public bodies that have used PPPs have been forced to renegotiate contracts and that two out of three public bodies have had to penalise contractors for failing to meet performance contracts[15].

The common use of partnership entities often separately incorporated means that the levels of reporting and therefore accountability are reduced from those which the public would normally expect of such major projects.

Expertise

An examination of many PPP arrangements has demonstrated the differing capacity of each party to identify potential difficulties and negotiate amenable terms. This is not surprising, as the level of experience of each party is often unequal. Investment banks such as Macquarie Bank, a major PPP player in infrastructure projects, have more than a decade of experience in developing PPPs. Despite the creation of specialist PPP management units in some state and federal jurisdictions, the experience and expertise has often been demonstrated to be uneven.

The Altcourse prison situated in Fazakerley, Liverpool, was the first prison to be built under the UK Government's Private Finance Initiative. PFIs are the Blair Government's principal method of attracting private finance and operators into the provision of community infrastructure. The profits generated from the Altcourse prison have enabled the operators (Group 4 Securitas and Tarmac Constructions, subsequently purchased by Carillon Plc) to recover all of their costs within the first two years of operations. This leaves the operators with a rate of return of 39 per cent per year for the remainder of the 23 years of the contract. The arrangement has been widely condemned, with the UK Commons Public Accounts Committee issuing a scathing report that revealed that the construction cost was reduced by $3 million but annual operating costs tripled. Sir David Omond, the permanent head of the Department of Home Affairs, which commissioned the prison, admitted to the Committee of enquiry:

"At the time this contract was novel, contentious and extremely risky. There was no guarantee that a marketplace would emerge for private sector prisons."

In other words the public sector's expertise was not up to the task of such an arrangement. It is therefore essential that a system of public accountability is established and open to review.

Equity considerations

For PPPs to work effectively, costs must be borne by the users of the services offered by the PPP. This means that the public sector contributes real assets, cash or a license to operate what was a public asset. Project assessments must therefore include a consideration of equity issues. The transfer of limited and valuable community assets and/or rights is an issue affecting the whole community and not just the beneficiaries of the asset or service. Despite this, there is a history of analysing the viability of a project only in terms of its immediate impact rather than the impact on the total community.

Public consultation

From a public policy point of view, significant criticism has been levelled at the use of 'commercial in confidence' arrangements to effectively avoid any process of public scrutiny. Often 'commercial in confidence' clauses have been used by both private and public sector to avoid criticism of poorly put together agreements or the awarding of unjustifiable terms and conditions. Clearly there is a need for robust public scrutiny mechanisms that meet the following criteria:

1. Be able to expertly review complex contracts in a way that is both commercially competent and publicly defensible.

15 R Hattersley - Private Obsession Public Grief. *The Guardian* 30 September 2002

Increasingly project partners have realised there are more profits in the provision of consulting fees than in the actual operation of the service.

2. Be subject to the Auditor-Generals Act within each appropriate jurisdiction, including the reporting of the costs of not undertaking projects.
3. Involve where appropriate the commissioning of project specific consultative mechanisms with affected stakeholders in the development.
4. The development of sophisticated triple bottom line reporting systems over the life of the project that evaluate the project not just in terms of its financial performance, but against the claims made on behalf of the project proponents (both government and private sector). There is a need to report on the environmental and social impacts of the project including employment issues as well as a fuller report on the financial performance.
5. Public reporting on the progress of the project to Parliament.

Public benefit

In the consideration of any reuse of public assets, there is a strong requirement that the asset is used in the most beneficial manner. This is especially true in the case of PPPs where public assets may be alienated for considerable periods of time. There is a need for a public benefit test that goes beyond a project appraisal to encompass a broader analysis beyond the expertise of one government department. The establishment of PPP units within whole of government portfolios such as Premiers Department could assist in this process.

Trends in the operation & ownership of PPPs

Whilst PPPs are a relatively recent innovation in the funding of public infrastructure and services, worrying trends are emerging in the development of PPPs.

1. There is pressure on governments to reduce the cost of the transaction to potential partners in the areas of bidding, submission development and assessment, project documentation and contract negotiation. While cost reduction in itself is a desirable objective, concern has been raised at the level of probity, disclosure and detail it takes to remain in the arrangement arrived at.
2. Refinancing of PPPs during the life of the arrangement is becoming a major issue in older projects as circumstances change and partner investment strategies change. A major concern here is that contractual arrangements put in place at previous times may be altered to the advantage of the exiting or entering party due to changed circumstances. If yields are known to be less than that projected by the originating partner, any new partner is able to leverage a more favourable arrangement from the remaining partner. In addition, concern has been raised as to the difficulties in maintaining the projects quality of service during the renegotiations.
3. Governments grant approvals to projects that do not meet their own planning, environmental or service standards. This can arise due to the inherent conflict of interest that can arise through government being both a partner and a consenting authority, especially in circumstances where there is potential or actual partnership failure.
4. Private sector partners often build in open-ended fee and penalty structures within the contract from which project profits can be derived separate from the actual project service provision. Increasingly many project partners have realised that there are more profits to be made from the provision of consulting fees to the partnership entity than in the actual operation of the service. Exclusivity agreements for the provision of such services are becoming increasingly common within PPP contracts and memoranda of agreement. This has lead to increasing concern about the phenomena of the 'captive partner' which can lead to narrow advice, self-interested advice and uncontested pricing of such services.
5. Service providers rely on service costs reducing over the life of the project. Called 'back end loading', this business principle assumes that costs can be reduced over time. The major risk in this arrangement is the operator may not have a strong understanding of the services or the precise implications of the service level agreements. This is particularly true in the case of service components of PPP where increasingly private sector partners are seeking to gain a profit. It is also why concerns have been raised by unions regarding a deterioration of salaries and conditions.

Alternatives to PPPs

Opportunities for funding
- the case for a new approach for infrastructure development

The development of new means of funding has always followed a process that recognises the changing nature of need, opportunities and the techniques that can meet those needs.

For example, the development of a Futures Exchange as a means of funding commodity trading and reducing the level of risk to participants was only made possible by the growth of transnational trade and the ability to communicate in real time about a standardised product. In the same way the reinvigoration of funding for community infrastructure and services needs to be seen as a problem needing a solution rather than simply a problem. PPPs are one attempt to resolve the problem of insufficient public funding for needed public infrastructure and services. However, they are only one way, and as can be seen, they bear potentially high risks and costs.

In developing strategies to provide for our future infrastructure needs, we need a broader context in order to consider policy options and not just rely, as proponents of PPPs do, on ideological assumptions about the wonders of the private sector.

As the environment changes so do the opportunities for innovation. Significant changes have occurred and will continue to occur in the Australian community that will impact upon the financial market and therefore the methods of raising funds for much needed infrastructure investment. Most notable of these are:

1. Unprecedented inter-generational wealth transfer fuelled by property inheritance and income growth.
2. The exponential growth of superannuation funds seeking new investment opportunities.
3. Continuing expectations for higher quality services and infrastructure.
4. A continuing reluctance by government to increase levels of general taxation in line with international benchmarks and the increasing adoption of user pay systems of revenue raising.
5. Growing disparities between levels of service and amenity for different communities across the country.
6. A more informed and financially sophisticated community that will increasingly require more accountability as their participation rates increase in the investment market.
7. A reduced proportion of the population who are working supporting a growing proportion of the population that are aging, who require high levels of care and amenity. In response to these and other changes, new financial products will emerge and some existing products will disappear.

Governments in Australia have failed to innovate sufficiently to meet the financial needs of their community. A seemingly universal belief that debt by its very nature is bad and that increased direct taxation is politically unacceptable has meant that both federal and state treasuries are now hamstrung as to their options in a way that is historically unprecedented. Debt in itself is not a problem. It is the nature of the debt and whether the debt is being used to invest in productive assets or recurrent expenditure.

Historically, Australia's major infrastructure has been provided through the raising of public sector debt. Most PPPs involve the raising of debt by the private sector partner. Whether the debt is raised by government or private sector participants from external sources, it adds to the national debt, which has always been relatively high in Australia's case. This fact is not surprising or particularly problematic for Australia, as the need to expand infrastructure quickly in a growing economy has proven itself an economically desirable strategy. The raising of debt to fund economically productive assets therefore represents a good investment if it is done efficiently, in a cost-effective manner and with an understanding of the financial risks involved. A central question about the PPP model is not the raising of debt as such, but who raises the debt and at what cost. According to a major player in the provision of PPP finance, Macquarie Infrastructure Group, a ten percent premium above the ten year bond rate can be expected from such projects as the Eastern distributor and the Western Sydney Orbital[16]. In other words the community is paying 17 percent for funding through an intermediary that could have cost seven percent if funds were raised directly by government.

Governments will need to change their approach to the funding of community assets and services in

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...where shares are sold, there is considerable risk that, when profits do not meet market expectations, service standards may be put in jeopardy to reduce costs and maintain profit forecasts.

line with these changes or increasingly see their capacity to provide, guide and regulate the provision of both public and private goods and services in Australia decline. One can only steer the boat if you maintain the necessary authority of captaincy. As authority is diluted so too is capacity to make decisions about the direction and speed of travel. PPPs dilute government's capacity to determine the direction, location and speed of development. Generally, PPPs require that governments will remain responsible for all of the outcomes beyond the specified outputs of the contract and private partners remain the recipients of all of the residual income. PPPs are one option, but not necessarily the best option, available.

The critical financial question facing governments in Australia is how to meet the increasing demand for better infrastructure and services when their revenue streams are stagnant or in real terms in decline. PPPs are principally being used to access private funding sources that would be more efficiently accessed directly by government. Treasury departments are attempting to reduce the level of reported public sector borrowings without accurately accounting for the risks, liabilities and costs of these transactions. Unlike the UK, no accounting standard has been developed to accurately report the real costs of PPPs in Australian public sector accounts. Governments are using this sleight of hand to meet the political agenda of better services and infrastructure without accounting for the real costs of the exercise.

In the end consumers are paying the premium embedded in these arrangements in a number of ways:

- private sector finance costs much more than government finance,
- user pay charges impose additional taxes on the community,
- PPPs are exposing future generations to significant contingent liabilities that have not been allowed for.

The Commonwealth Department of Finance and Administration policy on the use of private financing states:

"It is generally more expensive for the private sector to raise capital through private capital markets than the Commonwealth to do so directly".

In real terms this initial financial premium is approximately double that which would be paid if government had borrowed the funds. Even where the private sector raises finance by selling shares rather than borrowing, higher rates of return are required by private investors. They want a rate of return similar to other investment options, and to cover the level of contingent risk of dealing through a commercial intermediary structure and not with the government directly. In addition where shares are sold, there is considerable risk that, when profits do not meet market expectations, service standards may be put in jeopardy to reduce costs and maintain profit forecasts.

Under PPPs, the government effectively grants an exclusive license to a private corporation to collect tax from its citizens for the period of the contract. It rarely benefits from the income flows generated by the project, therefore reducing the future capacity of governments to replace the project assets or generate cash flows that can be used to service the costs of other projects.

From a financial point of view, PPPs are effectively channelling private investment through an intermediary structure at additional expense that could otherwise have been directly sourced by government at a lower cost. The challenge for PPPs is to realise authentic measurable public benefits that would not have come through sole public participation.

As a recent Community and Public Sector Union - State Public Services Federation (CPSU-SPSF) - Evatt Foundation study concluded[17]:

"To the extent that pro-privatisation policy makers argue that governments can regulate the behaviour of private firms to prevent gaming without distorting incentives they are effectively making a case for governments continuing to manage the function directly."

17 CPSU-SPSF Group- Evatt Foundation Privatisation and the Public Good, 2002, p14.

Non-PPP options to finance infrastructure and services

Any alternative strategy to direct additional funds into public infrastructure and services must be:

1. cost competitive
2. able to meet service standard requirements
3. able to transparently show the total cost of the transaction over the life of the project
4. economically sustainable.

Savings bonds

Saving bonds are fixed term and generally fixed return deposit instruments usually guaranteed by government. They are extremely common throughout Europe, the USA and Canada as a way of providing investors a secure means of increasing their levels of private savings. Governments in turn have been able to utilise such savings to finance infrastructure and initiate expanded services where appropriate. Increasingly Australians will need access to this type of investment as they seek to balance their investment portfolios either directly, or indirectly through superannuation. From a public policy point of view, any innovation that increases the attractiveness of saving over speculation must be welcome as one way of addressing Australia's historically low rate of savings and subsequent high levels of foreign-sourced debt.

The application of such debt to productive infrastructure, such as capital works in the transport, road and housing sectors, makes such an instrument a low risk, low cost innovation.

By comparison, private consortia operating in a PPP will always seek to purchase the benefit of a secure income stream similar to a government security, but with higher rates of return than those available from investing in government securities.

Community revolving loan funds

Many of the goods and services required within the community, which are not being met, are not large scale or commercially attractive due to their size. Most PPP partners believe that projects under $100 million are not worth the effort in arranging. However there still remains a gap in the access to finance for projects of a lesser size.

CRLFs can provide an effective mechanism for the provision of debt funds to such activities as small businesses, community health facilities, tourism infrastructure etc. While there are a number of such funds in Australia, they operate in isolation and without any or little government support.

The Canadian Government over the last twenty years has recognised the effectiveness of such mechanisms, especially in disadvantaged areas, and consequently operates a program to assist the establishment of such funds. Acting as autonomous agencies, they are able to raise funds locally, blend with government and private funds, and make loans available that create or maintain jobs, enhance infrastructure and promote investment into local economies. Unlike PPPs, they are both the raiser of capital through government-backed bonds and the manager of the local project. The benefits remain in the community. Some 300 government accredited CRLFs successfully operate throughout Canada.

Social venture funds

Social venture funds aim to invest in social infrastructure and services by combining philanthropic, private and public funds to provide innovative solutions to community problems.

Despite recent small tax changes announced by the Federal Government aimed at encouraging greater levels of corporate and private philanthropy, Australia falls well behind in the number of philanthropic institutions compared to the US and most other OECD countries. Efforts to promote these entities could provide an effective alternative source of funding for much needed social infrastructure and services whilst at the same time encouraging greater community benefit.

Pooled development funds

The Pooled Development Fund program was established by the Federal Government to address the scarcity of funding available for small to medium sized business. Through the provision of tax breaks, registered venture capital firms act as intermediary structures between investors and small to medium sized businesses. An extension of the PDF program to include not just businesses but infrastructure such as roads, hospitals and community facilities would be both consistent and tax effective as it aims to address the same problem, a lack of investment capital.

Superannuation funds

One of the most significant changes to occur in the financial and investment markets in Australia over recent times has been the growth of superannuation funds. Superannuation funds are estimated to hold over $400 billion in investments. A recurring issue for these funds is the need to create a balanced portfolio of investments through a diversified selection of investments. Much of the funding for PPPs in Australia can be ultimately sourced to superannuation funds usually through an intermediary such as a specialised infrastructure or property trust. There is no financial reason why governments could not establish investment opportunities for larger projects directly with the market rather than through an intermediary, thereby reducing the project costs.

Superannuation funds in turn are looking for secure longer-term investments. There are some examples of Australian super funds developing such policies. The Local Authorities Super Fund in Victoria has a target of a percentage of its investment funds to be invested in regional infrastructure. The Construction and Building Unions Superannuation Fund (C+BUS) has pioneered an asset allocation policy directed towards the housing construction sector. Once again the facilitative role of government is crucial if these opportunities are to be realised, as government are the only body able to establish the framework within which these opportunities can be captured.

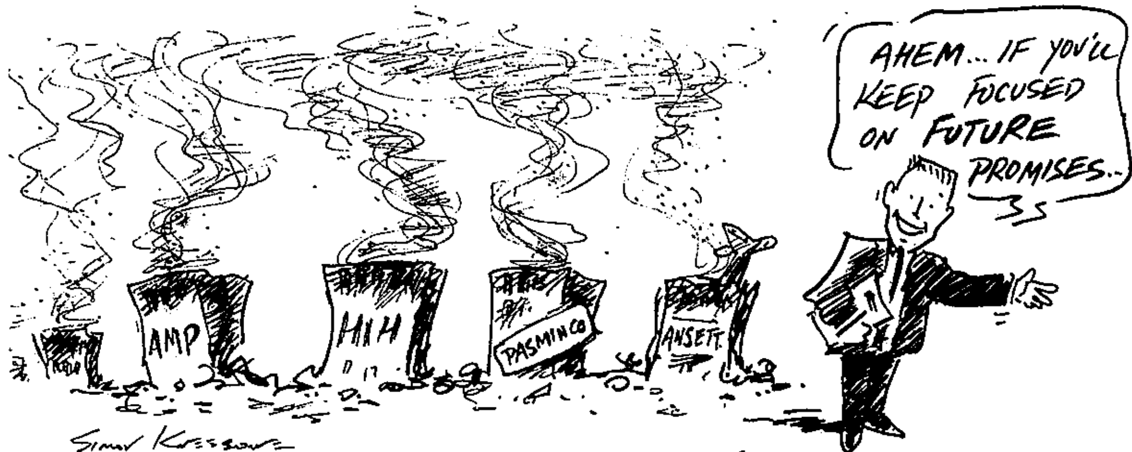
Conclusion

PPPs are one way of increasing the amount of funds available for much needed community infrastructure. However at present the application of the PPP model is often inappropriate, poorly understood, relatively expensive to other techniques and over the life of the project full of significant risks to government and the community.

If PPPs are to continue to be developed there is a clear need for a consistent national policy that brings benefits to all Australians.

If PPPs are to continue to be developed there is a clear need for a consistent national policy that is transparent, demonstrates positive comparability with alternative methodologies including direct government borrowings and bring benefits to all Australians. In addition there is a need to develop a broader suite of alternative approaches to the funding of community infrastructure and service provision that reflects the changes in the financial and investment markets and which best suit the particular needs of the Australian community as a whole.

The facilitation of alternative sources of and methodologies for funding that will channel additional resources into community infrastructure is only worthwhile if there are clear safeguards in place.



Glossary of terms

Asset allocation

The prioritisation of investment according to the nature of the asset to be invested in

Budget deficit

The expenditure of funds in excess of income received over a defined period

Commercial in confidence

A requirement that aspects of a document or whole documents remain confidential to specified parties due to the perceived commercial sensitivity of the information eg the costing of a service which could be considered valuable to a competitor

Consenting authority

The public authority legally authorised to ensure that a project meets all of the necessary legal requirements

Contingent liabilities

Losses that may occur over the life of the project but which at the beginning of the project are not current. They may be foreseen eg. replacement costs, or unforeseen eg. new technologies

Contracting out

The bundling together of defined services in a form that can be provided by an external agency

Debt financing

The raising of funds through loans

Debt markets

A shorthand term to describe financial institutions involved in providing debt to government, companies and individuals

Equity markets

A shorthand term to describe those institutions involved in the raising, exchange and sales of shares

Ideology

An internally coherent set of values and ideas

Investment banks

Financial institutions that unlike retail banks earn their income through their investment in and often management of business enterprises

Loan council

A joint federal and state government instrumentality that establishes an annual level of acceptable levels of debt which all levels of government must not exceed

Neo-liberalism

A reformulation of the doctrine of laissez faire capitalism that the free market should be the arbitrator of need

Non compete clause

A clause within a PPP contract which disallows governments approving potentially competing projects which may negatively impact upon the PPPs income stream

PPP

A contractual arrangement involving the partnering of both public and private sector assets, expertise and resources to achieve the development of goods and services

Performance contracts

Service contracts that specify performance contract benchmarks that must be achieved if payments are to be forthcoming

Private Finance Initiative - PFI

The UK Blair Government's term to describe a range of public and private partnerships

Privatisation

The sale of publicly owned assets to private interests

Probity

Arrangements put in place to ensure fair and equitable access to all parties in a process eg. all tendering parties receiving the same information at the same time.

Public sector capital requirements

Funds required by the state to build and maintain fixed infrastructure

Public sector comparator

A test employed by some governments to assess whether the private financing of a project produces a better result than direct public funding

Recurrent expenditure

Funds required to generate projects on annual or recurring basis eg. wages

Revenue base

The income generated by the project eg. road tolls

Risk allocation

The defining of the level of risk of the project collapsing

Transparency

The processes of negotiation, implementation and review that enable external parties to assess the probity and appropriateness of a decision

Triple bottom line

An increasingly popular method of describing a multi-dimensional reporting regime beyond a traditional financial report. Typically such reporting includes environmental and community impact statements alongside financial statements

Uncontested pricing

Prices developed without the knowledge of a competitor's pricing

Underwriting

The practice of insuring the risks of a venture through a third party

Universal access

The provision of a community service or goods to anyone requiring that service regardless of their income or status

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