Overview of Public Private Partnerships in Australia: Financing, Regulation, Auditing and Proposed Improvements

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Abstract

The ideological demands for public authorities to concentrate on the perceived core competencies of their staff and to seek cost efficient operations has led to the emergence of a number of new philosophies which have appeared under various terms including the New Public Management, the public governance paradigm, public value model and the Best Value model (Talty, 2007). Public private partnerships (PPPs) are perceived to be one of the ways to achieve efficiencies in the provision of services to the public through outsourcing entire projects and their cost to private sector organisations. However, the lack of substantial and structured performance review, especially in the post-contracting stage, means that future PPP projects will not be able to systematically implement lessons learnt from past experiences. The overall conclusion from the literature suggests that the net benefits of PPPs are, so far, still subject to debate and uncertainty, and the absence of a coherent review process will limit improvement in their creation and management.

Introduction

Public private partnerships (PPPs) became fashionable on the international scene around 30 years ago (Bovaird, 2004) and since then have become one of the most interesting and controversial topics for theorists and practitioners to explore. However, a literature review of PPPs confirms that the concept is not new. Private capital and expertise in the provision of public services have been utilised for a long time. Different authors agree that many examples in history show that some cooperation between the private and the public sectors existed in the 18th and 19th centuries (Hodge, 2004; Hodge & Greve, 2007; Nisar, 2007). Indeed, an early example could be related to the arrangements that existed between the British Government and the privateers of the 17th Century (Talty, 2007) and as early as the Roman Empire (Callender, 2007). According to Noble and Jones (2006) the term PPP can be traced
back to the 1960s during which time they were established in the United States for urban renewal projects.

In Australia, which is a federal system, all states are in different stages of development of PPP initiative and have different experiences (English & Guthrie, 2003; Jones, 2003). New South Wales, Victoria and Queensland are leading in terms of the number and value of newly established PPPs (Jones, 2003), but examples can be found (and are widely published in the press) in each state.

The overall development and implementation of PPPs in Australia can be categorised into two periods: pre- and post-2000. One of the major characteristics of the pre-2000 period is the lack of specific PPP procurement policies and guidelines. In the post-2000 period we are witnessing a more structured approach towards PPP development and implementation with, for example, specific policies, procedures, guidelines, the establishment of government bodies and steering mechanisms (Teicher, Alam & Gramberg, 2006; English, 2007).

The term PPP can be defined in a number of ways. In Australia the operational definition of PPP is ‘that government has a business relationship, it is long term, with risks and returns being shared, and that private business becomes involved in financing, designing, constructing, owning, or operating public facilities or services’ (Teicher et al., 2006). However, according to English (2007), PPPs are defined as time and cost-specific agreements between the state and a private consortium for infrastructure-based service provision. The consortium is responsible for finance, design, construction and providing services and maintenance for the agreed term of the PPP.

According to Hodge and Greve (2007), for example, there are different definitions of the term PPP. For some it’s a governance tool, whereas for others it represents a new expression in the language of public management to replace the terms outsourcing, contracting out and privatisation. In Australia, however, there is a clear distinction. The argument favours the view that PPPs are completely separate from privatisation (Hodge & Greve, 2007; Teicher et al., 2007). In addition, some people see PPPs as a new way to handle infrastructure projects and others make no distinction between contracting and PPPs (Hodge & Greve, 2007). Finally, Private Finance Initiatives (PFIs), which mean ‘getting private sector consortia to finance government capital projects in return for a long-term contract to operate the facility’ (Euromoney Institutional Investor PLC, 2003a: 1), are another variation on the PPP theme.

This introduction would not be complete without summarising the different types of PPPs that currently exist in Australia and internationally. According to Hodge and Greve (2007) there are at least five families of PPP arrangements:

- institutional cooperation for joint production and risk sharing
- long-term infrastructure contracts that emphasise tight specification of outputs in long-term legal contracts
• public policy networks in which loose stakeholder relationships are emphasised
• civil society and community development in which partnership symbolism is adopted for cultural change
• urban renewal and development.

In Australia there are several different outcomes of PPP. Their specific characteristics are dependent on the particular needs of the project and in this sense they are unique. The most common types are: BOOT (Build, Own, Operate, Transfer), BOT (Build, Operate, Transfer), BOO (Build, Own, Operate) and DBFM (Design, Build, Finance, Maintain) (English & Guthrie, 2003). These variations do not change the underlying nature of a PPP, but rather reflect different roles attached to the job of the PPP providers.

The remainder of this paper comprises six sections. Following this introduction and a brief overview of the various types of PPPs, the key factors contributing to the emergence of PPPs are discussed and an analysis of the financial context of PPPs in Australia is described. PPP regulation and auditing are discussed in the next section and it is debated whether PPPs are a problem or a solution in the present public policy environment. The final section focuses on lessons learnt from the past and how these can be implemented to facilitate future PPP performance improvements.

Key Factors Contributing to the Emergence of Public Private Partnerships

One of the main drivers for the utilisation of PPPs has been the emergence of a number of new philosophies to describe the reform of public administration and enhance the provision of public services (English & Guthrie, 2003; Thai, 2005). Within this framework, PPPs are seen as an approach to making the most of scarce resources (often created by the reduction of taxes) and competencies, the best use of both the private and public sector, a means of exploring the potential of innovative mechanisms for public services provision (Bovaird, 2004; Teicher et al., 2006) and to harness the capabilities of the private sector. It is also envisaged that PPPs are able to solve a number of *wicked problems* in a society which seemingly cannot be resolved by government alone. The necessity to solve the wicked problems (Rittel & Webber, 1973) imposes a need for governments to work in cooperation with a wide range of organisations such as not-for-profit and the private sectors (Bovaird, 2004). According to Bovaird (2004) and Teicher et al. (2006), however, it has been demonstrated in practice that the New Public Management (NPM) governance model is far from perfect. Long-term partnerships, promoted by the NPM, are undermining competition between potential providers. Another criticism is that NPM is ignoring public opinion and focusing mainly on cost efficiencies. Therefore, a need has emerged for new governance models that consider public opinion and take into account equity and accountability.
The public value model is one of the ideologies that have emerged as a way to ensure citizens can participate in the decision-making process (Teicher et al., 2006). According to Bovaird (2004), the public governance paradigm which evolved during the 1990s significantly modifies many of the concepts that underpin NPM. A fundamental characteristic of the shift in paradigm is a new governance mechanism that aims to create trust, improve transparency, increase accountability, increase efficiency and allow greater citizen participation. Some of these attributes are seen to be essential in order to build upon the current knowledge in relation to PPPs (Bovaird, 2004; Teicher et al., 2006). Implementing these improvements within PPPs is expected to reduce the pressure on government budgets and achieve better value for money in the provision of public infrastructure and share risks (Teicher et al., 2006; Hodge & Greve, 2007).

Apart from the commitment to the contemporary NPM framework, other key factors that contribute to the development and implementation of PPPs are: the expectations of citizens for a high level of public services provision; an assumption that citizens are resistant to paying higher tax; public choice; the need to reduce public debt; commitment to reducing the role of government in the ownership of assets and direct delivery of services; and governments’ focus on core competencies and elimination of non-efficient operations (English & Guthrie, 2003; Thai, 2005; Teicher et al., 2006). Furthermore, the fact that governments struggle to deliver projects of high importance within planned budgets has also motivated government to explore the utilisation of emerging PPP concepts. Key players in this movement have been banks and private equity groups (Jones, 2005).

**The Financial Context of Public Private Partnerships in Australia**

Many of the major banks in Australia have established PPP teams and continue to develop their skill base despite the limited number of PPPs that have been established in this country (Euromoney Institutional Investor PLC, 2003b). ABN Amro, for example, has the biggest share in most of Australia’s PPPs to date. There are several reasons for this. One is the bank’s bond market experience and knowledge. Another is the apparent willingness of some banks to take 100 percent of the project equity (at least at the start) and to underwrite project bonds in their entirety, working in conjunction with private equity partners. Furthermore, governments are keen on the bank’s willingness to act as a one stop shop—as financier, equity provider and debt arranger (Euromoney Institutional Investor PLC, 2003b; Jones, 2005).

The main focus for governments is finding the best financing model for PPPs. In recent years there has been a shift in the financing of PPPs through the re-emergence of the traditional funding model. Additionally other alternatives have been proposed in financing PPPs such as a debt capital markets alternative and bank debt package. In one of the fairly new projects—the Long Bay Forensic and Prison Hospitals (NSW) project—there was no bank debt in the transaction and the financing model consists of inflation linked and nominal bonds (Jones, 2005; NSW Health, 2006). Furthermore,
a financial model is discussed by Keating (2004) promoting a hybrid PPP model and comprises a joint venture with contractors with equity underwritten 50-50. The major characteristic of this model is the equity ownership by both major parties so that they are each exposed for the long term. Even though a portion of the project may be sold, they still keep at least ten percent for the life of the project. Private equity has also featured in PPP financing and was promoted by ABN-Amro, although now much diminished.

The private equity funding model is variable as to the number of equity partners in the long-term plan. However, the financing model usually ensures that equity is provided by the members of a consortia and not just a single institution. Another difference, and just as important as the previous one, is that some of these sponsors intend to hold their stakes for the long term. Bankers argue that this characteristic makes the new financial options more competitive. On the other hand, ABN Amro usually sells its equity shortly after the financial close of the initial project. Nevertheless there is evidence that it is still gaining new projects. One of the successful PPPs has been the CBD Courts redevelopment project in Perth where ABN Amro was a partner in the winning consortium Western Liberty Group (Jones, 2005).

The shift to the new financing options means an increase in bank debt transactions. Bonds have been the cheaper solution in the PPP market to date. On the other hand bond issues in Australia are inflation linked and government has realised that it needs to take full account of the inflation risks that it is encountering. From recent examples it has been demonstrated that the government is willing to accept more interest rate risk in bank debt transactions than having costly hedges established (Jones, 2005). It appears that governments have a wider choice in funding PPPs and can make a decision depending on the specific requirements of the projects that are being undertaken. According to the literature review the two major players are bonds versus bank debt financing which are used according to the type of PPP and the goal that government wants to achieve. However, both types of financing raise questions about the regulation of aspects of PPP.

**Regulation and Auditing of Public Private Partnerships**

With three levels of government in Australia—local, state and federal—it is evident that PPPs operate in a complex and confusing context set by different governing rules and expectations (English & Guthrie, 2003). This makes auditing and evaluation of PPPs even more difficult for the players involved especially in the case of private companies.

In Australia PPPs operate within some or all of the following constitutional, legal and regulatory frameworks: two levels of government (federal government and state government), National Competition Policy, Australian Taxation Law and the overriding commitment to NPM. The main steering medium on federal level is, of course, the federal government with other steering groups also reporting including the
Loan Council, the Federal Department of Finance and Administration, and the Australian Accounting Standards Board. These produce legislation, regulations, reports, policies and guidelines that are categorised as steering mechanisms on a state level (English & Guthrie, 2003). In addition, state governments are steering PPPs at state level, usually represented by departments of treasury. At both federal and state levels, auditor-generals and parliamentary committees are also classified as steering media. They produce reports that are classified as *ex post* steering mechanisms. All these have contributed to the establishment of different steering mechanisms such as (English & Guthrie, 2003): macro-economic mechanisms, procurement steering mechanisms, mechanisms to achieve VFM (Public Sector Comparator and Public Interest Test) and monitoring mechanisms.

The PPPs’ steering media and mechanisms listed above have been established only recently. Keating (2004) finds that the New South Wales and Victorian Governments, which are the most adventurous in engaging PPPs, lacked specific PPP policies and guidelines until 2001–2. According to English and Guthrie (2003) only the federal and state governments have the power and responsibility to enter into PPPs. Local governments do not have specific guidelines or experience in relation to establishment of PPPs. As a result, some state governments could be reluctant to allow local governments to undertake PPPs (Jones, 2003), and may need to amend the requisite legislation. Nevertheless, Keating (2004) provides evidence that local governments are also commencing PPP establishment—a view supported by Jones (2005) and Teicher *et al.* (2006).

**Public Private Partnership Auditing**

The Australian performance audit literature finds that individual Auditors-General have adopted completely diverse interpretations of what performance audits are and how they should be conducted. Early performance audits were concentrated more on economy and efficiency and not on effectiveness (English, 2007). The audit criteria are set up because these are the benchmarks against which PPP performance is measured. The benchmarks are the basis of performance audits and focus on *effectiveness and good management* (English, 2007).

However, according to Bovaird (2004), when PPPs are attempting to solve *wicked problems* their success cannot be restricted only to achieved efficiency or improvised performance. Their main objective is quality of service improvement in areas of major significance to citizens and other users. Thus performance indicators, which measure the success of PPPs, should be associated to this objective. Another key measure of the achievement of the PPP objectives is whether the partnership itself is working successfully. The partnership may be endangered if each party has to account publicly as to whether it is getting more out of a partnership than it is putting in. English (2007) does not agree with this, believing that everything should be made public and audits should be based on the principle of open book. Parties are held responsible and accountable for the decisions they make and outcomes they deliver.
Research conducted by English (2007) analyses the extent, focus and characteristics of ten Australian high profile PPP performance audits. According to this research, the performance audits are separated into two broad groups: systems-based and substantive. The main characteristic of systems-based performance audits is checking for adherence to procedures mandated by audited bodies or to best practice frameworks set by Auditors-General. Substantive audits investigate the effectiveness of policy implementation in relation to core activities and the quality of service experienced by users against externally derived criteria. The substantive audits are costly both politically and in terms of time and labour necessary to conduct them.

The literature suggests that most performance audits are systems-based. Another observation that emerged from English’s study is that the least audited projects are those that involve large government funding commitments (PFI-type PPPs). The achievement of VFM and risk transfer does not seem to have been investigated by Auditors-General. Also, English found that not one Auditor-General conducted an audit of a PPP on a regular basis and had not, consequently, established audit methodology (English, 2007). The focus is on the pre-contracting stage as opposed to the post-contracting stage as the development of PPPs is long and complex (English, 2005).

The following benchmarks are used extensively in the pre-contracting stage of the PPP to determine the achievement of VFM: Public Sector Comparator (PSC) and Public Interest Test (PIT). PSC is used to determine the costs and benefits of a project if it was completed by the government alone. In addition, PIT is used to evaluate the non-economic costs and benefits such as privacy, security, the impact on key stakeholders and consumer rights (English & Guthrie, 2003; Tarrant, 2007). In the literature there are arguments about the appropriateness of the use of PSC as a benchmark (English, 2005; Clifton & Duffield, 2006; Tarrant, 2007).

It appears that since 2000, Australia’s Auditors-General have failed to provide adequate independent external performance audit of PPP projects. Many examples show that Australia’s parliaments are providing more substantive external review of PPPs than the Auditor-General (English, 2007). Furthermore, post-contracting evaluation of PPPs has not been addressed at all, partly because these projects have not yet concluded. Consequently, future PPP projects will not be able to implement lessons learnt from past experience. In order to address this issue, a project is underway for development of a generic post-contracting evaluation model for PPPs in Australia (English, 2005).

Public Private Partnerships: A Problem or a Solution?

In the literature review, it was found that a number of authors have analysed both the positive and negative aspects of PPPs. For example, Noble and Jones (2006) reported that managers involved in the PPP projects were found to hold differing views on the success of the project. Some managers had no concerns about loss of
personal control or organisational autonomy, possessed no preconceived views of a negative nature about the opposing sector, and accepted the level of risk involved. These managers tended to focus on the positive aspects of the potential PPP and believed in its success. On the other hand, some perceive PPPs to be a threat and these managers tended to harbour fears of loss of personal and/or organisational autonomy, possessed preconceived negative views of the opposing sector, and perceived high levels of risk.

According to Bovaird (2004) a major problem of a partnership approach to public issues is that it brings fragmentation of structures and processes, which in turn leads to a blurring of the responsibilities and of accountability as the partnership is itself the accountable body and there is no mechanism by which the partners can be held accountable. In addition, recent evidence suggests that the lack of accountability leads to difficulty in learning from past experiences (Hodge & Greve, 2007). As noted by Callender (2007), the use of proprietary or private companies as the legal entity accepting and managing private sector involvement in a PPP has limited reporting requirements. This forces government to use powers inherent in the Audit Act of the State or Commonwealth to investigate the success (or otherwise) of the financial outcomes of the PPP.

According to Bovaird (2004) the key stakeholders have expressed diverse opinions about their involvement in PPPs. Staff feared losing their jobs or experiencing worse conditions of employment after being transferred from the public to the private sector. However, on the other side of the coin, some staff experienced a perceived improvement in employment conditions. Politicians generally fear losing control over policy making and service delivery management. However, some have grasped the new opportunities that arise with PPPs and have been able to further their own vision of how public services should be delivered. Service users and citizens feared becoming objects of a profit making partnership rather than a public service ethos. From the public surveys, however, the following conclusion has been made: many service users are unaware or uninterested in the legal ground of the organisation which provides the services as long as the services are up to an appropriate standard.

Tarrant (2007) agrees that controversy surrounds PPPs. Over the past decade the media coverage of PPPs suggests that they are mad, bad and dangerous to be involved in. However, they are also responsible for some of the most cost- and time-saving and effective developments which, on many occasions, have not been recognised. Recent studies in UK found that PPPs run over budget less often and are delivered behind schedule less often compared to similar government operated projects (Hodge & Greve, 2007; Tarrant, 2007).

There are several factors that limit the development of PPPs in Australia: high bidding cost, limited national market and lack of contract standardisation. Additionally, the overall scope of the projects is reduced because the government is reluctant to include service delivery in the PPPs. As a result, there is a reduced likelihood that the
private sector will acquire a fair share in the Australian PPP market (Euromoney
Institutional Investor PLC, 2003a, 2003b; Keating, 2004). Authors are united in the
belief that the experience with development and implementation of PPPs has been,
thus far, mixed. The overall conclusion is that the economic and financial benefits of
PPPs are still subject to debate and uncertainty (Hodge & Greve, 2007).

Lessons Learnt – Performance Improvement

Even though the reviews of the benefits of the PPP in the literature vary, there is
certainly room for improvement in their planning and execution. The improvements
can be facilitated using different governance models as well as lessons learnt from
numerous previous and recently-established PPPs. A major issue that arises is that of
risk allocation between partners.

One of the proposed mechanisms for future improvements of PPPs is alliance
contracting which is defined as ‘an agreement between parties to work cooperatively to
achieve agreed outcomes on the basis of sharing risks and rewards’ (Clifton & Duffield
2006: 4). The following key alliance principles can add to the concept of VFM if
implemented in PPPs: risk transfer, innovation and management skills (Clifton &
Duffield, 2006). Clifton and Duffield (2006) also found that the key alliance principles
and techniques have been used in the PPP projects in the past without implementing a
full alliance. Similarly, from a survey distributed to 15 leading PFI/PPP procurers in
Australia, it has been concluded that a number of alliance principles have been utilised
in the projects they undertook even though they were not identified as alliance
contracts in the project brief. However, there are two issues that need to be addressed
before managers consider utilising the alliance contracting techniques on PPP projects:
availability of suitable projects and financiers’ willingness to open-ended financial
exposure.

There are many discussions and analyses from different authors with regard to
improvement of risk allocation in PPPs and how this can affect their success. In
several case studies and surveys it has been found that the finance market is currently
unwilling to accept the risk profile of a full alliance regime (Clifton & Duffield, 2006).
On the other hand, risk allocation policies have an objective to allocate the risk to the
party that is best able to manage it for the least cost (Hodge, 2004; Clifton & Duffield,
2006; Nisar, 2007). These policies need to be adhered to especially in the case of major
infrastructure projects (Johnston & Gudergan, 2007). However, according to Teicher et
al. (2006), there is an expectation that partnerships would shift risk to the private
sector while public agencies would gain knowledge, new management skills and
innovative best practices. In addition to this, there are numerous case studies which
suggest that the cost savings achieved in PPPs were attributable to risk being
transferred (not shared) from the public to the private sector (Hodge, 2004; Nisar,
2007).
Noble and Jones (2006) define PPPs as ‘a commitment ... of some durability, in which partners develop products together and share risks, costs and revenues which are associated with these products’ (p. 892). One of the key phrases in this definition is *share risks*. Despite the fact that sharing of risk between the partners is an important aspect of the PPP success, Australian PPP examples confirm that the risk is usually shifted to the private sector (Keating, 2004; Jones, 2005). PFI/PPP projects transfer as much risk as possible to the private partner in an endeavour to gain budget surety and sometimes overlook the maxim ‘place the risk with the party best able to manage it’ (Clifton & Duffield, 2006).

The need to develop project relationships has been recognised by PPP/PFI patrons and financiers, and the next step is for them to recognise the need to change the risk management approach and develop a more appropriate scheme for risk allocation and sharing. Furthermore, some authors argue that the financial consequences of the company should be capped at certain levels (Jones, 2005). If an effective risk allocation is not achieved in the future PPPs, suppliers may stop bidding for PPPs or they may incorporate higher risk premiums in the bid, therefore increasing the overall project costs (Hodge, 2004; Keating, 2004; Clifton & Duffield, 2006).

**Conclusion**

When the public has increased expectations for timely and high standard service delivery, the onus is on the government to find innovative approaches to meet those expectations. Entering into a partnership with the private sector for major public capital projects is one of them. PPPs are being established not only to provide finance for public infrastructure, but also to explore the private sector’s management, commercial and creative skills. Only when the strengths of the public and the private sectors are combined will these major public capital projects be delivered on time and on budget and the government will achieve ‘value for money’ (Nisar, 2007).

Governments have several challenges to overcome before they consider PPPs as the preferred method to deliver high standard services to the public. One of the challenges is greater stakeholder involvement in the decision making process when the partnership is being established (Teicher et al., 2006). Risk allocation is another area that needs to improve. The literature suggests that the party that is in the best position to manage the risk at the lowest cost should be responsible for it (Jones, 2005; Nisar, 2007).

The potential benefits of PPPs are significant. In order for these benefits to be accomplished the concept needs to be modified to embrace the principles of enhanced partnership models such as alliance contracting. In addition to this, the focus should be placed on learning from previous experience and implementing changes on a regular basis due to the fact that economic conditions constantly change. To achieve this, evaluation and auditing of PPPs should be improved substantially (Hodge & Greve, 2007; Johnston & Gudergan, 2007).
References


