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Public Private Partnerships: An Introduction

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Public Private Partnerships: An Introduction

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Major Issues

The private sector has long provided goods and services to the public sector. However, a trend seems to be developing in a number of countries, notably the United Kingdom, towards increasing involvement of the private sector in the provision of goods and services traditionally provided by, and seen as a function of, the public sector. This entails a shift in the role of the public sector from supplying to buying services, with private firms designing, constructing, financing, operating and maintaining infrastructure, and the public sector paying for these services. Such arrangements are called public private partnerships (PPPs). Contracting out differs from PPPs in that the latter usually entail a combination of services (for example, design, construction and maintenance) whereas contracting out is usually for one or relatively simple services.

Key features of infrastructure PPPs include:

- the private sector invests in infrastructure and provides related services to the government
- the government retains responsibility for the delivery of core services, and
- arrangements between the government and the private sector are governed by long-term contract. It specifies the services the private sector has to deliver and to what standards. Payment depends on the private partner meeting these standards.

PPPs take many forms such as design, construct and maintain, and build, own, operate and transfer. The choice of form depends on factors such as the government's objectives, the nature of the project, the availability of finance, and the expertise that the private sector can bring. The main applications (by value) of PPPs in Australia and overseas are transport-related. However, PPPs are increasingly being used in social infrastructure such as hospitals and schools.

Governments are attracted to PPPs because they may provide value for money—at least in the short term. The ability to transfer risk to whichever of the public or private partner is better able to manage the risk is a source of value for money. PPPs often involve the private sector providing a 'bundle' of services. Bundling can provide value for money that contracting services separately cannot. PPPs can contain incentives for the private sector party to perform well. For example, under a contract to construct a road, the developer has an incentive to do the minimum necessary to meet the contract terms. However, under a design, construct and maintain arrangement, the developer has an incentive to build the road to the standard necessary to provide services for the period of the contract. For heavily indebted governments, an attraction of having the private sector finance infrastructure is that it obviates the need to borrow, and can allow projects to be brought forward. But even if the private sector finances a project, the government has to fund payments to the private partner for the services provided. Assessment of whether a PPP offers value for money entails the preparation of a 'public sector comparator'. This is an estimate of what the proposed project would cost if the public sector were to undertake it, based on 'best-practice' assumptions. The shift from supplying to buying services changes demands on the public service towards output specification and contract management including specification of the measures by which the performance of the private sector partner is assessed.

Advocates of private sector finance claim that it provides incentives for the private partner to deliver projects to time and budget, and operate infrastructure soundly. Critics of PPPs claim that public sector finance is cheaper than private sector finance and so the latter should not be used. But critics of this argument claim that the government's ability to borrow cheaply is a function of its capacity to levy taxes. They say that what determines the real cost of finance for a project is its risks. The private sector explicitly prices these risks into the cost of finance. When the public sector finances a project, taxpayers bear the risks and implicitly subsidise the cost of the project because the risks are not factored into the government borrowing rate.

Critics of PPPs claim that governments can use PPPs to understate debt by not recording in the balance sheet the total value of payments payable to private sector providers, that is, PPP obligations are 'off the balance sheet'. In the United Kingdom, the Accounting Standards Board argued that payments should be brought into the balance sheet. But subsequent UK Treasury guidelines allow most PPP transactions to be excluded from government borrowing on the grounds that they are operating and not finance leases. No Australian accounting standard deals with risk allocation issues associated with PPPs. Instead, agencies have adopted the accounting standards for leases. The Australian Accounting Standards Board, with heads of Treasury representation, has established a working group to determine how PPPs should be treated in government accounts.

The private sector sees the lack of accounting standards, transaction costs and taxation issues—especially the so-called leasing sections—51AD and Division 16D—of the *Income Tax Assessment Act 1936* as barriers to the greater use of PPPs. In certain situations, these sections deny to the private owner of an asset certain tax deductions related to the asset. The effect is to reduce the potential value of income from a project. In 1999, the Ralph Review of Business Taxation recommended that section 51AD be abolished and that Division 16D be replaced. Treasury is reviewing these sections and plans to introduce legislation in the autumn 2003 sittings of Parliament.

State governments are likely to be the main users of PPPs. The Commonwealth has not yet entered a privately financed project. As to the Government's position on the use of private finance, following Cabinet's rejection of using private finance for the patrol boats contract, the Minister for Finance and Administration was reported as saying that the Government sees few opportunities to use PPPs. The Minister for Revenue and Assistant Treasurer has since said that the Commonwealth will evaluate individual proposals on the basis of their ability to offer value for money.

Introduction

The private sector has long provided goods and services to the public sector. At the Federal government level, this role has expanded beyond relatively small-scale activities to the provision of so-called non-core activities such as corporate services. The Government is committed to competitive tendering and contracting, and market testing is mandated for most Federal agencies. The Government has also involved the private sector in the operation of publicly-owned assets. For example, beginning in 1997, the Government has granted long-term leases to private companies to operate the major Commonwealth-owned airports.

The expansion of private sector involvement in the provision of 'public services' is even more pronounced at the State level. An indicator of the magnitude of this involvement is that over ten years, the contribution of private sector funding to infrastructure provision in NSW was equivalent to about seven per cent of the State's capital budget.[1] An example of the increasing role of the private sector is roads. Whereas the public sector used to design, construct and maintain roads, private contractors are increasingly undertaking these activities.[2] A major departure from traditional practice has been the use of the private sector not only to construct infrastructure but finance and operate it as well. This is perhaps most evident in NSW and Victoria whose governments have used build, own, operate and transfer (BOOT) arrangements for toll roads in Sydney and Melbourne. Victoria and South Australia have also adopted franchise arrangements for some public transport services. While the focus of past private sector involvement has been economic infrastructure such as roads, an emerging trend seems to be towards private sector involvement in the provision of social infrastructure such as hospitals and schools. For example, the Port Macquarie Base Hospital is the first public hospital that a private firm manages on behalf of the NSW government, and a private company won the contract to design, build and operate the prison at Junee.

These developments are part of what seems to be a trend around the world—most notably in the United Kingdom—towards increased involvement of the private sector in the provision of goods and services traditionally provided by and seen as a function of the public sector. In particular, private firms have become increasingly involved in the design, financing, operation and maintenance as well as the more traditional construction of public infrastructure. Such activities are called public private partnerships (PPPs).[3] Contracting out differs from PPPs in that the latter usually entail a combination of services (for example, design, construction and maintenance) whereas contracting out is usually for one or relatively simple services.

This paper seeks to explain what PPPs are, why governments have used PPPs, some consequences of their use, and the debate surrounding their use. It also reviews some infrastructure taxation matters that some claim impede the greater use of PPPs. The paper does not examine the reasons for the alleged success or failure of individual PPPs.[4] There are several reason for this approach. First, as the Organisation for Economic Cooperation and Development noted of PPP projects in the United Kingdom:

> Unfortunately, there is a lack of systematic evaluations of the results from PPP projects … and … it is still too early to judge whether savings can be maintained in the long run as many contracts are still in their early stages. The potential for future savings could be undermined by the long time horizon of contracts.[5]

Second, it is difficult to assess the merits of claims and counter-claims about individual PPPs. Third, much of the discussion of the alleged success or failure of particular PPPs is indeterminate. For example, if the government decides to use a PPP, it may be difficult to determine whether public sector provision would have produced better outcomes. Finally, while noting that some governments may be attracted to PPPs for political reasons, the paper does enter the political debate about PPPs.

What are Public Private Partnerships?

There is no hard and fast definition of PPPs. One definition is:

> … partnerships between the public sector and the private sector for the purposes of designing, planning, financing, constructing and/or operating projects which would be regarded traditionally as falling within the remit of the public sector. Infrastructural projects such as roads and bridges are prime examples.[6]

A project does not have to contain all these features to be called a PPP because, as discussed below, PPPs can take a number of forms.

PPPs entail a sharing of responsibility between government and the private sector:

> For example, the private sector contributes design, construction, operation, maintenance, finance and risk management skills while the government is responsible for strategic planning and industry structure, obtaining permits, some customer interface issues, regulation, community service obligations and (sometimes) payment on behalf of the service users.[7]

The key features of infrastructure PPPs have been identified as:

- a private partner investing in public infrastructure, and providing related non-core services to the government or to the community on the government's behalf

- the government retaining responsibility for the delivery of core services such as teaching and clinical services, and

- the government and private party working together under long-term arrangements, whereby the payments to the private sector party depend upon its continuing to deliver the specified services to the agreed performance standards. Failure to meet these standards results in the private partner not being paid.[8]

In the United Kingdom, the main form of PPP is the Private Finance Initiative (PFI). The main features of PFI have been described as follows:

> *Considerable capital expenditure by the contractor*. The contractor is usually expected to invest heavily in productive assets such as buildings, roads or other physical infrastructure or IT-systems. These investments are financed by private sources involving the issuing of equity and debt securities.
>
> *The bundling of different operational tasks within a partnership*. Rather than outsourcing each activity separately (like cleaning, heating or maintenance), PFI combines several or most operations that together constitute a package of services within one long-term contract, thus enabling the contractor to seek innovative solutions for cost reductions within a longer planning horizon.
>
> *Performance-based payment schemes*. Both classical outsourcing and PFIs normally rely on competitive tendering. However, unlike classical outsourcing, PFI contracts make payments during the contract period dependent on a set of performance measures evaluated at regular time intervals. Moreover, PFI contracts typically set requirements regarding the quality of outcomes (rather than quantity of input or output) and leave the contractor freedom as to how to meet them.[9]

PPPs take many forms. Examples are design, construct and maintain (DCM); build, own operate (BOO); and build, own, operate and transfer (BOOT). (Appendix One contains definitions of some forms of infrastructure PPPs). PPPs can be thought of as falling along a spectrum of different combinations of public and private arrangements:[10]

> The spectrum of possible PPPs … extends from businesses almost entirely controlled by the private sector, at one end, to those almost entirely controlled by the public sector, at the other. Outside the United Kingdom, there are PPP businesses jointly owned by the public and private sectors, but with the majority ownership held by the public sector. Examples include water utility companies within continental Europe.[11]

Partnerships Victoria—the Victorian Government's policy towards and guidance for PPPs—identifies models ranging from maximum to minimum retention of service delivery by government.[12] PPPs generally do not, however, involve privatisation, that is, the sale of equity in public enterprises with the public sector no longer participating in their operation.[13]

The choice of form depends on factors such as the government's objectives, the nature of the project, the availability of finance, and the expertise that the private sector can bring. *Partnerships Victoria* lists three considerations in determining the preferred form:

-whether any part of the proposed service should be delivered by government itself;

-whether involvement of the private sector will deliver value for money and, if so, how to optimise that value; and

-whether the project will satisfy the pubic interest criteria which form part of the *Partnerships Victoria* policy.[14]

Some forms of PPP are more suited than others for a particular task. For example, with respect to the use of BOOT schemes, the Private Infrastructure Task Force Report opined:

> In the broad, BOOT-type structures are likely to be least beneficial for road and urban rail projects. They are advantageous for long distance rail and for utility services such as electricity and water. But for utility services it is possible that privatisation of networks might offer even greater gains. This is particularly so if competition can be introduced through, for example, breaking up generation or distribution.[15]

Role and Responsibility of Government

The use of PPPs entails changes to the role of government. This often entails a shift from being the supplier to the buyer of services:

> The PFI transforms Government Departments and Agencies from being owners and operators of assets into purchasers of services from the private sector.[16]

Nonetheless, governments retain overall responsibility for service delivery:

> … within a Private Finance Initiative project, the public sector pays for services on behalf of the general public and retains ultimate responsibility for their delivery, whereas the private sector's role is limited to that of providing an improved delivery mechanism for the services.[17]

The use of PPPs has important consequences for the public service. The key shift is from the role of supplying services to buying them:

> The essential role of the public sector in all PPPs … is to define the scope of business; specify priorities, targets and outputs; and set the performance regime by which management of the PPP is given incentives to deliver–and, in the case of PFI projects, also to pay for–the services.[18]

The consequences of PPPs for the public sector are thus similar to those resulting from contracting out. But because PPPs are usually more comprehensive in scope than contracting out, PPP place even greater demands on the public service.

Applications

State governments have been the main users of PPPs in Australia. This is likely to remain the case since the States bear primary responsibility for providing economic and social infrastructure. The main applications (by value) of PPPs in Australia and overseas are transport-related. The largest PPP in the United Kingdom—the Channel Tunnel Rail Link—was valued at £4178 million (almost $12 billion).[19] However, PPPs are increasingly being used for social infrastructure such as the hospitals and schools. The NSW green paper on PPPs listed 23 projects involving private sector funding of infrastructure including toll roads, hospitals, water and sewerage infrastructure, and Olympic venues.[20] In the UK, the application of PPPs has extended to hospitals, schools, prisons and defence projects.[21]

Still, PPPs account for a relatively small proportion of capital expenditure with NSW, Victoria and Queensland collectively accounting for around only nine per cent.[22]

Why do Governments use Public Private Partnerships?

There are a number of reasons governments are attracted to PPPs. They include the potential for value for money, early project delivery, gains from innovation, obviating the need to borrow to finance infrastructure investment, and access to improved services. The relevant government agency is responsible for assessing whether a project offers value for money compared with the most efficient form of public delivery. To do this, the agency uses a 'public sector comparator' (discussed below). Some governments might find PPPs politically attractive in that PPPs entail private sector partners supplying 'public' services.

PPPs operate at the boundary of the public and private sectors, being neither nationalized nor privatized assets and services. Thus, politically, they represent a *third way* in which governments may deliver some public services.

Value for Money

The underlying rationale for PPPs is that they may offer value for money:[23]

> … the [NSW and Victorian] policies require that privately financed options demonstrate superior value-for-money to the Government and community compared to conventional, publicly funded approaches to infrastructure provision. This is the sole reason for considering private financing and delivery—with both States having low debt levels, off-balance sheet borrowing is not an attraction in its own right.[24]

The forms that value for money can take include:

> … lower construction costs, lower operating costs and perhaps more efficient maintenance in the long run, than comparable public sector projects.[25]

With respect to construction costs, UK evidence on PPP projects is mixed with some projects coming in under cost and others incurring cost overruns.[26]

PPPs often involve the private sector partner providing a 'bundle' of services such as the design, construction and maintenance of a road. Bundling thus differs from traditional contracting out whereby separate contracts are let for each service. Bundling can provide value for money that cannot be obtained by contracting services separately:

> Integration of design, operation and maintenance over the life of an asset, within a single-project finance package … improves performance and reduces whole-of-life costs.[27]

For example, there may be economies in construction when a road is built as a single project rather than in stages as funding becomes available.[28]

The sources of value for money ('drivers') have been described as follows:

> At the heart of all PPPs is the deployment of private sector capital. Within a PPP framework, this can result in greatly improved value for money for the government in terms of the risks transferred to the private sector (in cases where the latter is better able to assess the risks) and powerful private sector incentives for the long-term delivery of reliable public services.[29]

Partnerships Victoria lists four major 'drivers': risk transfer, whole-of-life costing, innovation and asset utilisation.[30]

Risk Transfer

As noted, the transfer of risk is a driver of value for money. Risk can take many forms including those relating to construction, the size of the market (demand risk), the cost of operations and maintenance, declarations of force majeure, and changes to the law and regulations.[31] Whatever the nature of the risk, the principle of optimal risk transfer is:

> … that the risk should be allocated to whoever from the public or private sector is able to manage it at least cost.[32]

The nature of risk allocation has been described as follows:

> The essence of a public-private partnership arrangement is the sharing of risks. Central to any successful public-private partnership initiative is the identification of risk associated with each component of the project and the allocation of that risk factor to either the public sector, the private sector or perhaps a sharing by both. Thus, the desired balance to ensure best value (for money) is based on an allocation of risk factors to the participants who are best able to manage those risks and thus minimize costs while improving performance.[33]

Partnerships Victoria, in the Risk Allocation and Contractual Issues guide, classifies major project risks into ten categories and recommends a government-preferred position on allocating each of the risks. In practice, the allocation of risk has not always been appropriate, and the government has had to assume risks that were initially transferred to the private party. An example is the Sydney airport rail link, which the NSW Government took over after the company that built and operated the link failed to meet scheduled payments to creditors.

Incentives

PPPs can contain incentives for the private sector party to perform well in order to earn a profit:

> Much of the improved value for money comes from the fact that when private sector capital is deployed and is at risk—to, for example, the long-term performance of public service delivery—the right commercial decisions are made about design, operating regime, human resource planning, whole-life-of-asset costings, and so on.[34]

For example, under a contract to construct a road, the developer has an incentive to do the minimum necessary to meet the contract terms. However, under a design, construct and maintain arrangement, the developer has an incentive to minimise whole-of-life costs[35] and so construct the road to the standard that will minimise those costs. This incentive is reinforced by the fact that payment under PPPs depends on the developer meeting agreed maintenance standards.

PPPs can contain negative incentives for the public sector. Where the contract specifies that the asset is to be returned to the public sector at the end of the contract period, the private partner has an incentive to run the asset down especially in the later years of the contract. However, contracts typically specify that the government has a right to review the asset's condition before it is returned to ensure that the condition is acceptable. A third party sometimes conducts this review. Further, if running down the asset results in standards lower than those specified in the contract, the private sector partner will not be paid.

Public Sector Comparator

Assessment of whether it offers value of money is an essential part of a PPP process. This entails comparing the proposed PPP with the cost of the public sector undertaking the project. This requires the preparation of a public sector comparator (PSC):

> In most cases, value for money will need to be demonstrated by comparison of private sector PFI bids with a detailed public sector comparator (PSC). The PSC describes the option as to what it would cost the public sector to provide the outputs it is requesting from the private sector by a non-PFI route.[36]

The comparator is based on 'best practice' assumptions. The Department of Finance and Administration has issued guidelines requiring that agencies prepare a PSC in certain circumstances.[37]

However, governments consider other factors as well as the comparator.[38] NSW and Victorian policies specifically include a public interest test:

> … P[rivately] F[inanced] P[rojects]/PPPs are assessed against public interest criteria including effectiveness, impact on key shareholders, accountability and transparency, public access and equity, consumer rights, security, and privacy. This assessment takes place before the project is put to the market.[39]

Political Attraction

Some governments might find PPPs politically attractive:

> PPPs operate at the boundary of the public and private sectors, being neither nationalized nor privatized assets and services. Thus, politically, they represent a *third way* in which governments may deliver some public services. Moreover, in a practical sense, PPPs represent a form of collaboration under contract by which public and private sectors, acting together, can achieve what each acting alone cannot.[40]

Budget Constraints

How a PPP is paid for depends on whether it is self-financing. When a project is self-financing—for example, when the private sector finances, constructs, and operates roads and recovers costs through direct tolls on road users—the government does not have to borrow or levy taxes to finance the project because it is paid for by direct user charges. When the project is not self-financing the government has to levy taxes to meet payments to the private sector provider. This does not necessarily mean that the government has to raise taxes since the project could be financed from within the existing tax framework. A third category of project combines cost recovery and government subsidy. Many social infrastructure projects are not self-financing.

In the UK, PFIs were introduced to circumvent constraints on public sector borrowing. The main alternative to PPPs with private sector finance is for the government to borrow through the issue of debt such as bonds. For governments with large debts and hence reluctant to borrow more, having the private sector finance infrastructure obviates the need to borrow. An example of where the use of PPPs is being considered mainly because national government funding will not cover the cost, is the proposed Trans-European Network for Transport.

Private sector financing can allow governments to bring forward projects that might otherwise be delayed because of budget constraints. Delaying projects can have adverse consequences:

> … the public sector will often find it difficult to provide dedicated funding for large projects out of annual budgets. In the past, this has resulted in lengthy delays before projects proceed and/or projects proceeding incrementally over a number of years. Delayed access to necessary infrastructure is costly to the community. Also, budget constraints can lead to sub optimal project forms. For example, government agencies may opt for lower up front cost infrastructure with much higher maintenance costs or a shorter life.[41]

On the other hand, given that political considerations often drive the timing of projects, bringing forward projects may not result in the optimal timing of investment in that economic benefits may not be maximised. For example, benefit-cost analyses of toll roads in Norway indicate that delaying projects would have resulted in increased net benefits.[42]

The NSW and Victorian Governments deny that borrowing constraints are the reason they consider using PPPs. Rather:

> … with both States having AAA balance sheets, it is these ongoing availability and performance payments (or depreciation and debt servicing), which are more important constraints on governments.[43]

When a project is not self-financing, regardless of whether the public sector or the private sector under a PPP finances investment, governments have to fund payments to meet future costs:

> Even though social infrastructure may be financed by the private sector, the government, through payments made during the contract's life, will ultimately fund it through payments for the services provided. These payments commitments are as real as those associated with servicing balance-sheet debt and, in the context of a government's fiscal strategy, need to be considered in a similar manner.[44]

Issues in PPPs

Public Versus Private Finance[45]

The case for using private sector finance in PPPs has been put as follows:

> The importance of the finance element of privately provided infrastructure lies in the incentive it can provide for the performance of the infrastructure, and the disciplines external financiers can provide on the delivery of project to time and budget. It is difficult to replicate the strength of these incentives and disciplines within a conventional funding process where all the risks of delivery reside with the government.[46]

Critics have claimed that PPPs involving private sector finance should not be used because public sector finance is cheaper. The Department of Finance and Administration's policy principles for the use of private financing state:

> … it is generally more expensive for the private sector to raise capital through private capital markets, than for the Commonwealth to do so directly.[47]

However, critics of the argument that public sector finance is cheaper claim:

> It's a myth that governments have access to 'cheaper' finance to undertake projects: a government's ability to borrow more cheaply is purely a function of its capacity to levy taxes to repay borrowings. But, when it comes to raising finance for a project, it's the risk of the individual project that determines the real cost of finance. The difference between the private and public sectors is that private-sector capital markets explicitly price in the risk of the project into the sources of finances. In the public sector, taxpayers implicitly subsidise the cost of a project by bearing the risk of cost overruns, time delays or performance failures, which are not priced into the government borrowing rate.[48]

It has been claimed that when risks are factored into the cost of government debt, the differential between the cost of government debt and private debt in the case of a project with a 'guaranteed' revenue stream from government is only 15 basis points.[49] If so, it is difficult to use the 'higher cost of funds' argument especially if the benefits of risk transfer outweigh the additional cost of private finance.

The Bureau of Transport and Communications Economics observed that:

> The transfer of financial risk from lenders to taxpayers provides no obvious benefit to society. The interest rate differential [between government and private sector borrowings] is therefore no indication that public ownership reduces the cost of capital to society.[50]

Accounting for Public Private Partnerships

From a government budget perspective, PPPs involving the government buying services move spending from the capital to the recurrent budget or, to put it another way, today's capital investment by the private sector becomes tomorrow's current spending by the government. However, an issue is how governments should account for PPP payments and, in particular, whether they should be brought into the government's balance sheet as debt. When the government issues debt, it has to repay the interest and principal to debt holders. The government records the total outstanding debt as a liability in its balance sheet. Repayments of principal are recorded as reductions in outstanding debt. Critics of PPPs claim that governments can use PPPs to understate debt by not recording in the balance sheet the total value of payments. In other words, PPP obligations are 'off the balance sheet'.

Accounting for PPPs is an issue in the UK:

> In September 1998, the [UK] Accounting Standards Board (ASB) stated that the capital value of P[rivate] F[inance] I[nitiative] schemes should appear on the Government's "balance sheet". However, following negotiations between the ASB and the [UK] treasury, in June 1999 the treasury issued a new version of their note *How to account for*

> *PFI transactions* which allowed most PFI transactions to be excluded from Government borrowing figures on the grounds that they were "operating leases", not "finance leases" ... The ASB has said that the revised accounting guidance is to be kept under review and updated as necessary in the light of developments in the PFI …[51]

The Accounting Standards Board standard referred to above (FRS 5) deals with 'reporting the substance of transactions':

> FRS5 addresses the problem of what is commonly referred to as 'off balance sheet financing'. One of the main aims of such arrangements is to finance a company's assets and operations in such a way that the finance is not shown as a liability in the company's balance sheet. A further effect is that the assets being financed are excluded from the accounts, with the result that both the resources of the entity and its financing are understated.
>
> FRS 5 requires that the substance of an entity's transactions is reported in its financial statements. This requires that the commercial effect of a transaction and any resulting assets, liabilities, gains and losses are shown and that the accounts do not merely report the legal form of a transaction. For example, a company may sell (ie transfer legal title to) an asset and enter into a concurrent agreement to repurchase the asset at the sales price plus interest. The asset may remain on the premises of the 'seller' and continue to be used in its business. In such a case, the company continues to enjoy the economic benefit of the asset and to be exposed to the principal risks inherent in those benefits. FRS 5 requires that the asset continues to be reported as an asset of the seller, notwithstanding the transfer of legal title, and that a liability is recognised for the 'seller's' obligation to repay the sales price plus interest.[52]

In its publication How to Account for PFI Transactions, the UK Treasury draws a distinction between finance and operating leases. No Australian accounting standard deals with risk allocation issues associated with PPPs. Accounting Standard AAS17, which deals with leases, is relied on to classify PPP arrangements. But this Standard does not deal adequately with the unique nature of PPPs. The Australian Accounting Standards Board, with Heads of Treasury representation, has establish a working group to determine how these issues should be treated in government accounts.

The treatment of a lease depends on whether it is a finance or operating lease. A finance lease is one where substantially all of the leased asset effectively passes from the lessor to the lessee. For such a lease, the lessee must, at the beginning of the lease, recognise an asset and liability equal to the 'present value'[53] of the minimum lease payments. The leased asset must be written off over the period in which it is expected benefits will be consumed. Minimum lease payments must be apportioned between interest expense and a reduction in the lease liability. An operating lease, on the other hand, is one where substantially all the risks and benefits incidental to the ownership of the asset remain with the lessor. For such a lease, the minimum lease payments are an expense.

The NSW and Victorian Governments acknowledge the need for accounting standards:

> A recognised Australian Accounting Standard capable of addressing the complex risk allocations issues in a PFP/PPP transaction does not exist, and the existing standard on accounting for operating and finance leases has tended to be adopted by some parties as a default. An inter-jurisdictional group has been working actively to develop proposals for a better accounting treatment of these transactions, to ensure that they are appropriately reported within a State's accounts.[54]

Transaction Costs

The process of defining and bidding for PPPs is costly for the private sector and the government. The Australian Council for Infrastructure Development has described these 'transaction costs' as follows:

> Bidding for complex PPPs is time consuming and expensive. Unless tendering processes are well run it is possible that the benefits of using a PPP for delivering the project may be outweighed by the tendering costs. For this reason it is essential for the government to prepare good processes with a common approach across the whole-of government … Transaction costs can also be reduced by following the UK's example and developing standard risk allocations and conditions of contract[55]

The often short-term focus of government budgeting decisions and delays in making decisions are particular difficulties for private firms. Standardisation of some contract documentation, procedures and definitions[56] can reduce bid costs and accelerate project timetables.[57] But the fact that each project is different limits the scope for contract standardisation.

Other Issues

The traditional contracting out of activities to the private sector means that some of the benefits of private sector involvement in the provision of public goods and services have already been obtained. PPPs potentially may offer additional value for money especially if services are bundled to incorporate design, build, and lifetime operation and maintenance of assets, and through appropriate risk transfer. And the use of comparators and other considerations helps to ensure that PPPs offer value for money.

However, PPPs are potentially fraught with difficulty. The design and implementation of PPPs are usually very complicated. The essence of the business relationship between the public and private sectors is contractual. This requires that the services to be delivered have to be specified in great detail. Assessment of whether a PPP would offer value for money is often difficult to determine. Some risks are difficult to identify let alone quantify, and it is difficult to assess to what extent the transfer of risk is deemed optimal.[58]

These considerations have been summarised as follows:

> In areas like infrastructure, where large-scale investment is needed, so-called public private partnerships (PPP) may be an option, where private investors design, build, own,

> maintain and operate facilities like highways under long-term contracts. By deferring payment and by making it contingent on facilities being operable through the contract period, PPP contracts transfer investment risks to the private investors, such as those arising from delays in construction projects, and ensure a life-cycle perspective on costs. Private contractors may be better equipped than government for managing construction projects, especially where there is considerable scope for reducing maintenance and operation costs through innovative design. However, PPP usually entails a higher cost of capital than if the risks were carried by the general government budget and investment were financed via public lending. Moreover, complex financial contracts, involving commitments to future payments, may reduce transparency, requiring strong institutional checks. And while PPP contracts shift investments off the government's balance sheet, the commitments to pay for future service-flows have largely the same macroeconomic effects as public debt. Most importantly, the inherent long-term character and complexity of PPP contracts may pose a number of problems. It may have adverse effects on the effectiveness of competition, as fewer firms are able to make a bid, and contracts must be able to accommodate changes in future need which are inherently difficult to foresee. As far as large-scale infrastructure is concerned, achieving co-ordination among alternative routes and means of transport is crucial and having a range of different private owners may entail complicated and costly negotiations to accommodate changes. Furthermore, insofar as the government may ultimately be held responsible for outcomes, the transfer of risks to private contractors may be partial, with the government having to step in if something goes wrong.[59]

Note that this summary seems to accept the claim that government finance is cheaper than private finance.

PPPs could have adverse effects on competition. As noted, the potential for savings from PPPs could be undermined by the long time periods of contracts. Moreover:

> … the specificity of assets (such as a hospital building or an IT-system) implies that the private and public partners become mutually dependent in a way that may stifle competition. When the contract expires, other potential contractors may be reluctant to undertake the effort necessary to make a bid in a renewed tender process, knowing that the incumbent will have a considerable cost advantage—other things being equal.[60]

INGREDIENTS FOR A SUCCESSFUL PPP

The UK National Audit Office (NAO) in a report titled Managing the Relationship to Secure A Successful Partnership in PFI Projects found that most (81 per cent) public bodies involved in PFI projects believed that they are achieving satisfactory or better value for money from their PFI contracts. Feedback from service users was generally positive. Over 70 per cent of authorities and contractors viewed their relationship as being good or very good with only four per cent of contractors feeling their relationship with authorities was poor.

The NAO report identified the following necessary ingredients for a successful PPP:

- As PFI projects are long-term arrangements, a successful outcome is best achieved by authorities and contractors balancing both contractual and relationship issues to approach projects in a spirit of partnership. Authorities and contractors should seek to understand each others' businesses and should have a common vision of how they will work together to achieve a mutually successful outcome to the project. Authorities should regularly reassess their relationships with contractors and the value for money their projects are delivering, to identify ways in which relationships can be improved.
- The long-term nature of PFI projects means that some contractual changes are likely to be necessary during the life of the project. The report found that although most PFI projects are still at an early stage, around half of the contracts surveyed had been changed since they were entered into. Changes related to the specification, new services, additional building work or design changes and performance measurement arrangements. Appropriate procedures for dealing with change should be built into the contract. This includes procedures to ensure that value for money is maintained when contract changes occur.
- Having staff with the right skills is critical to good contract management, yet there is considerable variation in the extent of training provided in contract management skills, with some authorities providing little or none. Attention needs to be given early in the procurement process to staffing, training and contract management issues, and how the relationship between authority and contractor will be developed.

The Channel Tunnel Rail Link (Link) is the largest (by value) PFI undertaken in the United Kingdom. However, the project almost collapsed partly because of overly optimistic forecasts for the company responsible for operating the UK section of the train service. As a result, the project was refinanced and risks redistributed among the various parties. The NAO examined the reasons for the near collapse of the arrangements in a report titled the Channel Tunnel Rail Link. The NAO concluded that the lessons learned from this experience are relevant to other PPPs. These lessons include:

- make sure that bidders for a PFI deal are not encouraged to be over-optimistic
- if a deal goes wrong, private sector partners should bear their share of the risk
- substantial risks arise if public sector assets are transferred in advance
- the proportion of equity capital in a PFI project should reflect the risks involved
- the Department [of the Environment, Transport and the Regions] should monitor the expected benefits from the Link
- government guarantees of project debts are unlikely to be costless, and
- if a project requires public funding, give careful consideration to the most cost-effective route.

Government Policy Towards Public Private Partnerships

To date, the Commonwealth has not entered into a privately financed project. But a number of agencies have been preparing for the possible use of private financing. In December 1998, the Department of Defence undertook:

> … a review of options for the greater use of private financing of its procurement requirements ... The Defence Executive decided that Private Financing be considered for proposals requiring investment of Defence resources ...[61]

On 20 May 2002, the Department issued a Private Financing Manual. This is a guide to the use of private finance in major capital equipment and infrastructure projects. The Department rejected using private finance for the patrol boats contract.[62]

The Private Financing Unit has been established in the Department of Finance and Administration:

> … [to] work collaboratively with Commonwealth agencies and their advisers to assist with assessing the relative merits and viability of private financing proposals.[63]

The Unit has released an issues paper titled Taxation and Private Financing Initiatives for comment. The paper deals, among other things, with the definition and measurement of tax advantage, and relevant provisions of the *Income Tax Assessment Act 1936*. In October 2001, the former Minister for Finance and Administration, the Hon. John Fahey, issued a paper titled Commonwealth Policy Principles For The Use Of Private Financing. This paper:

> … establishes policy principles and processes for the use of private financing by Commonwealth departments and agencies subject to the *Financial Management and Accountability Act 1997* ('agencies').

The Department of Transport and Regional Services has been investigating the use of PPPs to develop roads.[64] The Government's AusLink proposal may entail the use of PPPs (see the quote below). The proposed Western Sydney Orbital Road to which the Commonwealth is contributing funds may be the first stretch of the National Highway to be largely privately-funded. However, the NSW government will be primarily responsible for developing the PPP for the Orbital Road.

As to the Government's position of the use of private finance, following Cabinet's rejection of private financing of the patrol boats contract,[65] the Minister for Finance and Administration, the Hon. N. Minchin, is reported as saying that the Commonwealth Government sees few opportunities to use PPPs.[66] The Minister for Revenue and Assistant Treasurer, Senator the Hon. Helen Coonan, has since stated:

> The Minister for Finance and Administration recently indicated that there currently appear to be limited opportunities for the use of private financing at the Commonwealth level. However in saying that, it is important to emphasise that individual proposals will continue to be evaluated on the basis of their ability to offer value for money to the Commonwealth. As my colleague, the Minister for Industry, Tourism and Resources outlined yesterday, in May 2002, the Minister for Transport and Regional Services indicated that the Government will be developing a new transport infrastructure plan - Auslink. This is a plan to reform Australia's land transport arrangements. The Government will be releasing a discussion paper - a Green paper - in relation to AusLink later this year. It will establish the basis for developing a formal statement of Government policy in May 2003. Under the proposed AusLink plan the Minister emphasised that proposals for PPP arrangements would be given equal treatment with other project bids to advance the plan's strategic land transport infrastructure priorities.[67]

To date, State governments have been the main users of PPPs in Australia. This is likely to remain the case since the States bear primary responsibility for providing economic and social infrastructure, and several States have issued guidelines for the use of PPPs. A risk is that each State will 'go its own way'. However, steps are being taken to try to ensure consistency in approach across the States and Commonwealth:

> In a small country like Australia, the existence of separate state-based P[rivately]F[inanced]P[rojects]/PPP markets is unsustainable, and can only contribute to the (often significant) transaction costs associated with getting projects up and running. Accordingly, all states, the territories and the Commonwealth have been working through the Heads of Treasuries forum to promote consistent approaches.[68]

Conclusions

The development of PPPs is an on-going process. Shortcomings of early PPPs have been recognised and the lessons learned incorporated into subsequent projects. For example, it has been recognised that:

> Early in both States' [NSW and Victoria] experience the temptation was for maximum transfer of risk, and inevitably risks were sometimes transferred that ultimately came back to Government.[69]

It is also recognised that the 'one size fits all' approach doesn't work. For example, whereas BOOT schemes have been the preferred form of PPP for urban roads, design, construct and maintain arrangements might be better suited to rural roads.

Despite the difficulties that PPPs have encountered, it seems likely that more and more countries will use them and for increasingly varied purposes. One person involved in PPPs has predicted 'explosive growth' in PPP programs internationally over the next few years and expects the following developments:

> More diversity in PPP models – Design Build Finance Operate contracts will always be important, but so too is the need for flexibility and closer alignment of the private sector with public sector objectives.
>
> Structural changes in the private sector – Consortia will give way to genuine operator companies, a trend already being seen in the UK. Corporate finance will become as important as project finance in supporting PPP investment.
>
> Structural changes in the public sector - Aside from the need for changes to initially facilitate PPP programmes, new structures will develop.
>
> More focus on the workforce involved in PPPs – Internationally, there is growing concern about the impact on public sector employees transferring to the private sector where much greater 'efficiencies' are being promised.
>
> Increasing internationalisation – Many of the players in PPPs are still domestically focussed, but will follow international opportunities where they have competitive advantage from past experience.[70]

Appendix One: Forms of Public-Private Involvement in Infrastructure

Traditional Design and Construction (TDC)

The Government, as principal, prepares a brief setting out project requirements before inviting tenders for the design and construction of the project. Private sector contractors undertake to design the project in accordance with the brief, and construct it for an agreed sum, which may be fixed or subject to escalation.

Operation and Maintenance Contract (O&M)

These projects involve the private sector operating a publicly-owned facility under contract with the Government.

Lease - Develop - Operate (LDO)

This type of project involves a private developer being given a long-term lease to operate and expand an existing facility. The private developer agrees to invest in facility improvements and can recover the investment plus a reasonable return over the term of the lease.

Build - Own - Maintain (BOM)

This type of arrangement involves the private sector developer building, owning and maintaining a facility. The Government leases the facility and operates it using public sector staff.

Build - Own - Operate - Transfer (BOOT)

Projects of the Build-Own-Operate-Transfer (BOOT) type involve a private developer financing, building, owning and operating a facility for a specified period. At the expiration of the specified period, the facility is returned to the Government.

Build - Own - Operate (BOO)

The Build-Own-Operate (BOO) project operates similarly to a BOOT project, except that the private sector owns the facility in perpetuity. The developer may be subject to regulatory constraints on operations and, in some cases, pricing. The long term right to operate the facility provides the developer with significant financial incentive for the capital investment in the facility.

Source: Tasmanian Department of Treasury and Finance, Guiding Principles for Private Sector Participation in Public Infrastructure Provision

Appendix Two: Effects of Section 51AD and Division 16D of the *Income Tax Assessment Act 1936* on Public Private Partnerships

Introduction

The so-called leasing sections—51AD and Division 16D—of the *Income Tax Assessment Act 1936* (ITAA 1936) apply to many PPPs. In certain circumstances, these sections deny to the owner of an asset (the private sector) certain tax deductions related to the asset. The effect is to reduce the potential value of income from a project. In 1999, the Ralph Review of Business Taxation recommended that section 51AD be abolished and that Division 16D be replaced. Treasury is reviewing these sections and plans to introduce legislation in the autumn 2003 sittings of Parliament. Consultation with the States and industry indicates support for proposed amendments. The following examines the issues surrounding the leasing sections.

What Exactly Do These Two Provisions of the ITAA 1936 Do?

Section 51AD—Deductions Not Allowable in Respect of Property Used Under Certain Leveraged Transactions

To claim deductions relating to the ownership of property (e.g., for depreciation or repairs) it is normally necessary for the taxpayer to show that the property was used for the purpose of producing assessable income or in carrying on a business for that purpose. Such deductions are therefore normally not available to tax-exempt bodies such as public authorities or non-resident bodies operating exclusively overseas because, in neither case, is the body producing assessable income.

Section 51AD is an anti-avoidance provision and applies to property acquired by a taxpayer under a contract entered into after 1 pm on 24 June 1982, or constructed by a taxpayer where construction commenced after that time. Where the conditions specified in section 51AD apply, subsection 51AD(10) operates to treat the owner of the property as not having used it for the purpose of producing assessable income or in carrying on a business for that purpose. The effect is that the owner is denied deductions attributable to the ownership of the property, including depreciation, repairs and interest on borrowings.

By the operation of subsection 51AD(8), section 51AD will not apply unless the cost of the acquisition or construction of the property by the taxpayer is wholly or predominantly financed by non-recourse debt, that is, where the rights of the creditor in the event of default by the taxpayer, are predominantly limited to rights against the property itself, or against the income, goods or services generated by the property, or to rights in respect of a security over the property. A debt is also a non-recourse debt if the creditor would not have access to all the unsecured assets of the taxpayer in a recovery action.

Where the conditions relating to time of acquisition and non-recourse debt are satisfied, section 51AD applies to property in either of two broad sets of circumstances. The first is where the property is leased and:

- the lessee (or sub-lessee) is not a resident of Australia and the property is, or is to be, used wholly or principally outside Australia
- the property is, or is to be, used otherwise than solely for producing assessable income, or
- the property was owned and used, or held for use, by the lessee or sub-lessee before the taxpayer acquired it.

The second circumstance in which section 51AD can apply concerns property that is owned by a taxpayer but the use of which in the production, supply, carriage, transmission or delivery of goods or the provision of services is effectively controlled by another person. Section 51AD will apply if that other person (called the 'end-user'):

- is not a resident of Australia and the property is, or is to be, used wholly or principally outside Australia
- uses the goods or services produced by means of the property otherwise than solely for the purpose of producing assessable income
- derives no income, or derives income that is wholly or partially exempt, in providing those goods or services, or
- owned and used the property, or held it for use, before the taxpayer acquired it.

Taxation Ruling TR 96/22 discusses the application and interpretation of section 51AD. It provides a general overview of the provision. In particular, it deals with the following matters:

- tax-exempt end users
- the nature of non-recourse finance
- the meaning of 'predominant'
- how non-recourse finance is affected by assurances, guarantees, put or call options and the release of securities
- the Commissioner's discretion to treat a debt as if it were not non-recourse debt, and considerations affecting its exercise
- the meaning of 'use'

- the meaning of 'control of use', and
- the consequences of section 51AD applying to property in relation to a taxpayer.

What is a Leveraged Lease Transaction?

A leveraged lease transaction is generally one in which a partnership of companies or other taxpayers acquires plant, which it leases for a term of years to a lessee and where, by reason of the 'leverage' obtained from the borrowing of a substantial non-recourse loan (or a similar arrangement), the members of the partnership are not effectively at risk for any more than a relatively small part of the funds used to acquire the plant. The lenders' security for the substantial amounts lent to acquire the plant is limited to the subject plant or to the rentals payable by the lessee.

Taxation Ruling IT 2051 sets out the basic views of the Australian Taxation Office on the minimum standards with which leveraged lease transactions must comply if they are to be accepted under the income tax law.

What is a Non-Recourse Debt?

Broadly, a non-recourse debt is one where the lender's rights against the borrower in the case of default in repayment are effectively limited to rights against the property, or against income generated or goods produced by the property. Generally, this test is satisfied either by a contractual limitation of the rights of the creditor against the assets of the borrower or by the fact that the borrower has insufficient assets, to satisfy the claims of the creditors in the event of a default. In other words the lender would not have the usual rights of access to the general assets of the taxpayer in any action for recovery of the debt. Taxation Ruling TR 96/22 discusses the nature of non-recourse finance.

Division 16D—Certain Arrangements Relating to the Use of Property

Division 16D of Part III of the ITAA 1936 treats certain non-leveraged finance leases and similar arrangements as if they were loan arrangements. Arrangements to which the Division applies are, broadly, those under which all, or substantially all, the risks and benefits associated with the ownership of the property that is the subject of the arrangement are transferred by the owner to the lessee or user. In general, where an arrangement covered by Division 16D exists, relevant deductions will be denied if the use of the property, or the effective control of its use, is in the hands of either:

- a government or tax-exempt government authority and the arrangement was entered into after 5 pm on 15 May 1984, or

- a person who uses the property outside Australia for the purpose of producing income which is exempt from tax in Australia and the arrangement was entered into after 5 pm on 16 December 1984.

Why are Sections 51AD and Division 16D Considered to be Impediments to PPPs?

PPPs are basically partnerships between public authorities and private sector companies. As sections 51AD and Division 16D disallow certain deductions for tax purposes because of the involvement of tax-exempt public authorities in the partnerships, these sections make it less attractive for the use of assets owned by public authorities in partnership with private sector companies. These provisions adversely impact on infrastructure development where assets owned by public authorities are involved.

End-users in Partnerships

According to the explanatory memorandum to the *Income Tax Amendment Bill (No. 5) 1983*, subsection 13 allows proportionate deductions in cases where the end-user is a partnership 'and some but not all of the partners are tax-exempt organisations or the partners are not deriving wholly assessable income from the partnership's use of the property'. The application of the subsection raises difficulties, especially in relation to subparagraph (4)(a)(ii), and it is not clear that the explanation is completely correct. It may be possible to rely on subsection (11) to obtain a partial deduction where a partnership of lessees uses property only partly for the purpose of producing assessable income.

In deciding, for the purposes of subsection (13), the extent to which a taxpayer is to be regarded as having used the property for business purposes, the Commissioner has regard to the respective interests of the 'taxable' partners in the net partnership income or loss and the extent to which any of the other partners have used the property in deriving assessable income: subsection (14).

None of the foregoing applies, however, where there are two or more lessees of property caught by subparagraph (4)(a)(ii) and one is a company whose income is ordinarily exempt from tax, if that company effectively controls the property and uses it in the company's tax-exempt activities. In these circumstances, the property is treated as not being used by the owner for the purpose of producing assessable income and no deductions at all are allowable: subsection (15).

The Ralph Review in its report A New Tax System Redesigned at page 392, referred to below, in recommending the repeal of section 51AD emphasised the adverse impact on infrastructure providers as the main reason for this recommendation. It stated:

> Section 51AD has a severe impact where it applies because all deductions are denied to the taxpayer but the associated income is still assessable. It has been continually

> criticised by State Governments and infrastructure providers for its severe impact where it applies and the uncertainty it creates. Section 51AD has become even more problematical in recent years because of increased levels of privatisation and outsourcing of government services which were not contemplated when it was first conceived.

The basis for this view was set out in Discussion Paper 2 Volume 1 titled A Platform For Consultation issued by the Review of Business Taxation in February 1999. Chapters 8, 9 and 10 dealt with taxation of leases and rights. Paragraphs 8.29 to 8.37, which summarise the impact of sections 51AD and Division 16D on tax exempt leasing, are set out below.

Tax exempt leasing

- 8.29 The ability of tax exempt entities to engage in leasing and similar arrangements is restricted by section 51AD and Division 16D, which operate to deny tax benefits to those who provide property to tax exempt entities, such as public utilities.
- 8.30 These provisions were introduced to prevent tax exempt entities from accessing tax preferences by entering into contracts with taxable entities for the use of assets.
- 8.31 Section 51AD applies to property predominantly financed by non-recourse debt which is leased to, or 'effectively controlled' by, an end user which:

  is a tax exempt entity;

  is a non-resident and uses the property outside Australia; or

  previously owned the asset (for example, sale and lease back).
- 8.32 In applying section 51AD, non-recourse debt is broadly defined as debt where the creditor's rights against the debtor in the event of default are legally or effectively limited to the financed property.
- 8.33 Section 51AD is severe in its application, because it disallows completely deductions relating to the property, while all the income remains taxable. It applies to arrangements which have features of both operating and finance leases.
- 8.34 While always criticised for its severe impact, section 51AD has become more problematic because of privatisation and outsourcing of government functions that were not contemplated when it was first conceived.
- 8.35 Division 16D applies in respect of a 'qualifying arrangement' where section 51AD does not apply and where there is 'use or effective control' by an end user who is:

  a tax exempt public body; or

a person who uses the property outside Australia to produce income not subject to Australian tax.

- 8.36 Division 16D denies capital allowances to the owner of the property and treats lease payments as repayments of principal and payments of interest. Division 16D does not apply to other tax exempt entities, such as certain clubs or businesses operated by charities. A Division 16D qualifying arrangement is broadly similar to a finance lease.

- 8.37 Both section 51AD and Division 16D are complex in their application, in that the operation of the 'effective control' test necessarily requires a degree of judgment on the part of the tax authorities, especially in relation to arrangements where the tax exempt remains involved to a greater or lesser extent in decisions relating to the arrangement. However, section 51AD is more controversial because the complexity is exacerbated by the severity of its application.

Has the Repeal of Sections 51AD and Division 16D been Canvassed Previously?

The Ralph Review

The repeal of sections 51AD and Division 16D was urged in submissions to the Review of Business Taxation (the Ralph Review) which was chaired by Mr John Ralph in 1998–99. The Review in its report (July 1999) A New Tax System Redesigned (the Ralph Review) made the following recommendations that will impact on infrastructure investment.

- abolition of section 51 AD (Recommendation 10.9, page 392), and

- replacing Division 16D under recommended removal of accelerated depreciation (Recommendation 10.10—page 393).

Shaping Regional Australia's Future

The House of Representatives Standing Committee on Primary Industries and Regional Affairs inquired into infrastructure and the development of Australia's regional areas and submitted its report Time Running Out: Shaping Regional Australia's Future in May 2001.

The Australian Council of Infrastructure Development (AusCID) had urged the repeal of section 51AD as it unnecessarily delayed projects, added significant costs and reduced community benefit from major private sector investment in infrastructure. The comments in Chapter 4 of this report are set out below.

Sections 51 AD and Division 16D

Other taxation considerations closely bound up with the accelerated depreciation provisions include Sections 51AD and Division 16D of the Income Tax Assessment Act

1936. These provisions were the subject of much representation during the inquiry with the former, according to AusCID, 'the most significant hurdle which is constraining increased private investment in public infrastructure'.[71] Removal of Section 51AD was essential because it unnecessarily delayed projects, added significant costs and reduced community benefit from major private sector investment in infrastructure. Similar sentiments were expressed by other parties:

> By private sector provision, the value of depreciation and other concessions are potentially available to State Governments. In a new environment of much greater cooperation on Federal State finances the regulations prohibiting tax benefit transfer are an anachronism. The abolition of section 51AD and the reform of Division 16D should be priority outcomes from the review of business taxation.[72]

A comprehensive statement of the problems associated with these provisions was set out in AusCID's submission to the Ralph review. In brief, Section 51AD was devised to prevent government control of privately financed infrastructure in 'an era where there was no private ownership and little private management of infrastructure in Australia'. Furthermore, 'its application was too broad and the consequences of its breach to severe'.

Government Response

On 14 May 2002 the Minister for Revenue and Assistant Treasurer, Senator Helen Coonan, in announcing the Government's programme for delivering the next stage of business tax reform measures foreshadowed that legislation for replacing section 51AD and the associated Division 16D provisions will be introduced in the Autumn 2003 sittings.[73] However, the Minister indicated that while there is broad agreement with the States and private sector on a framework to replace the existing section 51AD and the associated Division 16D provisions, significant boundary and implementation issues remain to be resolved. Further consultation on these issues will be undertaken through the course of 2002-03.

Endnotes

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2. Bureau of Transport and Communications Economics, *Benefits of Private Sector Involvement in Road Provision: A Look at the Evidence*, Working Paper 33, June 1997, p. 1.
3. In NSW, PPPs are called Privately Financed Projects (PFPs).
4. For readers interested in a (generally positive) assessment of PPPs in the UK, see PricewaterhouseCoopers at

http://www.pwcglobal.com/Extweb/service.nsf/docid/953520E1B107D60B85256BDD00329852

5. OECD, *OECD Economic Surveys: United Kingdom*, OECD, Paris 2002, pp. 120 and 121.

6. See McCann FitzGerald legal briefing.

7. Australian Council for Infrastructure Development, *What are Public Private Partnerships?*, at http://auscid.candela.com.au/uploads/WhatarePPPs.PDF.

8. J. Pierce and I. Little, 'Taxpayers need value from partnerships', *Australian Financial Review*, 8 April 2002.

9. OECD, op. cit., pp. 117 and 119.

10. E. S. Savas, *Privatization and Public–Private Partnerships*, Seven Bridges Press, New York 2000, p. 241.

11. Michael B. Gerrard, 'Public-Private Partnerships', *Finance and Development*, vol. 38, no. 3, September 2001.

12. Partnerships Victoria, *Risk Allocation and Contractual Issues* at http://www.partnerships.vic.gov.au/domino/web_notes/PartVic/PVSite.nsf/Frameset/PV?OpenDocument, p. 7.

13. See UK Treasury, About Public Enterprise Partnerships.

14. Partnerships Victoria, op. cit., *Overview*, p. 7.

15. Economic Planning Advisory Commission, *Private Infrastructure Task Force Report*, AGPS, September 1995, p. xii.

16. UK Treasury Private Finance Initiative Taskforce (web site no longer available). The Taskforce became Partnerships UK, which is now partly privately owned.

17. Michael B. Gerrard, op. cit.

18. ibid.

19. Grahame Allen, *The Private Finance Initiative (PFI)*, House of Commons Library Research Paper 01/117, 18 December 2001, p. 22 at: http://www.Parliament.uk/commons/lib/research/rp2001/rp01-117.pdf.

20. NSW Government, op. cit.

21. See UK Treasury at http://www.hm-treasury.gov.uk/Documents/Enterprise_and_Productivity/Public_Enterprise_Partnerships/ent_pep_index.cfm.

22. Australian Council for Infrastructure Development, personal communication.

23. For a comprehensive discussion of procedures for determining whether PPPs offer value for money, see UK National Audit Office, *Examining the value for money of deals under the Private Finance Initiative*, 13 August 1999 at http://www.nao.gov.uk/publications/nao_reports/9899739.pdf.

24. NSW Treasury, *Private Provision of Public Infrastructure and Services*, Research and Information Paper, April 2002, p. 2 at http://www.treasury.nsw.gov.au/pubs/trp02_3/trp02_3.pdf.

25. Grahame Allen, op. cit., p. 25.

26. ibid., pp. 25-6.

27. J. Pierce and I. Little, op. cit.

28. Industry Commission, *Private Investment in Urban Roads*, IC Information Papers, October 1997, p. xi at http://www.pc.gov.au/ic/research/information/urbroads/index.html.

29. Michael B. Gerrard, op. cit.

30. For an analysis of the drivers of value for money, see *Value for Money Drivers in the Private Finance Initiative: A Report* by Arthur Andersen and Enterprise LSE, commissioned by the UK Treasury Taskforce, London, 2000.

31. For definitions of these and other terms, see for example, the Victorian Government's Guidance Material on *Risk Allocation and Contractual Issues* at http://www.partnerships.vic.gov.au/domino/web_notes/PartVic/PVSite.nsf/Frameset/PV?OpenDocument and the Tasmanian Department of Treasury and Finance, *Guiding Principles for Private Sector Participation in Public Infrastructure Provision* at http://www.partnerships.vic.gov.au/domino/web_notes/PartVic/PVSite.nsf/Frameset/PV?OpenDocument

32. UK Treasury Private Finance Initiative Taskforce, op. cit.

33. Province of New Brunswick, 'Public-private Partnerships', at http://www.gnb.ca/0158/reports/protocol/protocol.htm.

34. Michael B. Gerrard, op. cit.

35. Bureau of Transport and Communications Economics, op. cit., p. 7.

36. UK Treasury Private Finance Initiative Taskforce, op. cit.

37. *Commonwealth Policy Principles for the Use of Private Financing*. Paper issued by the Hon. John Fahey, Minister for Finance and Administration, October 2001, p. 11 at http://www.finance.gov.au/budgetgroup/Commonwealth_Budget_-_Overview/pf_principles.html.

38. For additional information, see http://www.partnerships.vic.gov.au/domino/web_notes/PartVic/PVSite.nsf/Frameset/PV?OpenDocument.

39. NSW Treasury, op. cit., p. 2.

40. Michael B. Gerrard, op. cit.

41. EPAC, *EPAC Private Infrastructure Task Force Final Report*, AGPS, September 1995, p. 42.

42. Bureau of Transport and Communications Economics, op. cit., p. 9.

43. NSW Treasury, op. cit., p. 4.

44. J. Pierce and I. Little, op. cit.

45. The debate about the relative merits of public and private finance is complicated and unresolved. The following does not enter this debate but merely seeks to set out the different viewpoints.

46. NSW Treasury, op.cit., p. 4.

47. *Commonwealth Policy Principles for the Use of Private Financing*. Paper issued by the Hon. John Fahey, Minister for Finance and Administration, October 2001, p. 5 at http://www.finance.gov.au/budgetgroup/Commonwealth_Budget_-_Overview/pf_principles.html. Some argue that the ability of government to pool risks means that there is no need for the public sector to be risk averse.

48. J. Pierce and I. Little, op. cit.

49. Jim Longley, Head of Government Finance, Commonwealth Bank of Australia, speech given to the National Infrastructure Summit, Melbourne, 15 August 2002.

50. Bureau of Transport and Communications Economics, op. cit., p. 10.

51. Grahame Allen, op. cit., p. 22.

52. Accounting Standards Board at http://www.asb.org.uk/publications/publication140.html.

53. Present value is the worth in today's dollars of a future stream of returns or costs. To obtain present value, a discount rate is used to discount these future returns and costs.

54. NSW Treasury, op.cit., p. 9.

55. Australian Council for Infrastructure Development, *Australia at a Crossroads—Public/Private partnerships or Perish?*, at: http://auscid.candela.com.au/cgi-bin/auscid.pl?A=Papers.

56. For example, adopting a standard definition of force majeure in contracts involving hospitals.

57. See PPP Forum at http://www.pppforum.com/faq.html.

58. Grahame Allen, op. cit., p.30.

59. Jens Lundsgaard, 'Competition and Efficiency in Publicly Funded Services' OECD Economics Department Working Paper no. 331, 6 June 2002 at http://appli1.oecd.org/olis/2002doc.nsf/linkto/eco-wkp(2002)17/$FILE/JT00127672.PDF.

60. OECD op. cit., p. 121.

61. See Department of Defence at http://www.defence.gov.au/cfo/privfin/index.htm.

62. See Minister for Defence, press release 316/2002, 28 June 2002, at http://www.minister.defence.gov.au/relindex.htm.

63. See Department of Finance and Administration at http://www.finance.gov.au/budgetgroup/docs/Commonwealth_PF_Principles_October_2001.pdf.

64. Department of Transport and Regional Services at http://www.dotars.gov.au/transprog/govt%5Flinks/ppp.htm.
65. The patrol boats proposal involved uninsurable risk that stemmed from the fact that the boats could be used for defence purposes.
66. L. Taylor and L. Allen, 'Minchin won't commit to PPPs', *Australian Financial Review*, 11 July 2002, p. 3.
67. Speech to the Australian Financial Review Infrastructure Summit, 15 August 2002, at http://assistant.treasurer.gov.au/atr/content/speeches/2002/014.asp.
68. J. Pierce and I. Little, op. cit.
69. NSW Treasury, op. cit., p. 3.
70. N Middleton, Developments in public private partnerships, published in the PPP Global Directory by the International Project Finance
71. Australian Council for Infrastructure Development, Submission no. 215, p. 7.
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73. Minister for Revenue and the Assistant Treasurer, 'Maintaining the Momentum of Business Tax Reform', Press Release, 14 May 2002.