

AUSTRALIAN INVOLVEMENT IN PUBLIC PRIVATE PARTNERSHIPS IN THE ASIA-PACIFIC REGION

MICHAEL REGAN*

I INTRODUCTION

The Asia-Pacific region first introduced public private partnerships ('PPPs') in the mid 1990s. These were isolated transactions often negotiated from unsolicited bids and the results were mixed – few projects survived in their original form and many either failed or were renegotiated. Early PPPs were encouraged by national governments and development agencies as a substitute for scarce state capital. They aimed to expand the pool of infrastructure capital, improve the efficiency of utilities and extend the reach of markets into non-core public service delivery. Many PPPs required state guarantees, output-based subsidies and other forms of fiscal support.¹ Early PPPs in Malaysia, Indonesia and Hong Kong were 'build, own, operate and transfer' ('BOOT') transactions for the construction of tollways. In subsequent years, franchises were used for other transport assets such as ports and railways, and pilot projects in the health sector.

The region is now experiencing a second wave of interest in PPPs and many countries have introduced new PPP guidelines including China, Hong Kong, India, Indonesia, Japan, Korea, Malaysia, the Philippines, Singapore, Taiwan and Thailand. In contrast with the 1990s, however, the objectives of contemporary PPP programs are different. There is a focus on private sector expertise and efficiency in the operation of networked infrastructure and lower cost procurement. The challenge facing Asian governments is to learn from past mistakes and address the structural adjustments that are necessary to achieve best practice standards and deliver value for money ('VFM') outcomes similar to the levels being achieved in developed economies.

Australia has been successfully engaged in the Asia-Pacific for over 30 years providing development assistance, contracting and a variety of professional

* Dr Michael Regan is Associate Professor of Infrastructure in the School of Sustainable Development, Bond University. He provides consulting services and training programs in public private partnerships to state agencies in Asia and the Pacific.

1 Antonio Vives, *Private Infrastructure: Ten Commandments for Sustainability* (1997) Department of Sustainable Development, Inter-American Development Bank <<http://www.iadb.org/sds/doc/ifm%2D303e.pdf>> at 24 October 2006.

services. Although the States had used off-balance sheet asset financing of public transport, motor vehicle fleets and some built assets, in the 1980s, the first Australian PPP was a BOOT transaction for the Sydney Harbour Tunnel. In the mid to late 1990s, Victoria and New South Wales implemented comprehensive PPP programs. For example, in 1994, the Victorian Government released its Infrastructure Investment Policy that favoured private sector participation for the delivery of public services. Policy guidelines for the Commonwealth and other states followed. The most comprehensive PPP program is the Partnerships Victoria model which established international best practice standards for PPPs. The State's transactional experience is also extensive and includes tollways; hospitals; corrective services; film production studios; public buildings; water treatment works; law courts; public transport nodes; showgrounds; wholesale produce markets; a convention centre; and communication facilities. PPP style transactions are also entered into by public agencies outside conventional PPP frameworks and include the franchising of Melbourne's rail and tram services, office buildings, university research and accommodation facilities.

As well as local experience, Australian firms are engaged in PPPs in North America, the European Community and throughout the Asia-Pacific region providing contracting and multi-disciplinary professional services. Additionally, the Victorian Department of Treasury and Finance and development agencies such as the Commonwealth Secretariat, AusAID, the World Bank and the Asian Development Bank provide technical assistance to governments in the region with the design of PPP policy frameworks. Australian firms are well equipped to continue to play a key role in future PPP programs across the region.

This article examines how Asian countries can draw on Australian expertise and experience to aid them in developing effective PPP policies and practices.

II THE EARLY EXPERIENCE AND LESSONS LEARNT

A Policy Frameworks – An Articulated Approach

Most Asian PPP transactions in the 1990s were negotiated without clear government policies or guidelines to assist agencies select projects, determine priorities, evaluate the procurement options and run a public tender process. Many of the early transport projects were negotiated without the preparation of a Public Sector Comparator ('PSC'), a risk-weighted model of traditional procurement. This occurred with toll road projects in Indonesia and Malaysia, and energy and water plants in Pakistan and Bangladesh. This made it nearly impossible to identify whether or not the PPP generated a better VFM outcome than other procurement methods.²

Another consequence of the absence of transparent PPP policies was that Asian governments were criticised for lack of disclosure and governance. Many

2 Chiaki Kuranami, 'Review of Recent Toll Road Experiences in Selected Countries' (Paper presented at Seminar Proceedings on Asian Toll Road Development in an Era of Financial Crises, Tokyo, 9–11 March 1999) <http://worldbank.org/transport/toll_sem/vol1/vone_s4.doc> at 1 November 2006; Ashoka Mody and Michael Walton, 'Building on East Asia's Infrastructure Foundations' (1998) 35(2) *Finance & Development* 22.

early PPPs were unsolicited bids and deals were struck without a competitive bid process. Another concern was the lack of disclosure with renegotiated deals including the reallocation of risk between the state and consortia. Moreover, these PPPs failed to isolate agency project development from political intervention.

These issues demonstrate the need for a comprehensive policy framework before entering into PPP transactions to ensure clarity and certainty in bid markets and public confidence. The implementation of these policies will continue to pose a major challenge for successful PPP regimes in Asia over the next decade.

The Australian experience may be helpful in informing the type of policy that is needed. The Partnerships Victoria Guidelines, for example, provide state agencies and private firms with certainty about the PPP process, and can be used as model guidelines in other countries. In addition, the Victorian Department of Treasury and Finance assists governments in the region with the development of PPP policy and guidance materials in areas such as risk analysis and management, best practice standards for tendering and bid evaluation.

B Building Capacity and Project Evaluation

In transition economies, early PPPs were negotiated without systematic evaluation or ranking of projects. Several of the early tollway PPPs were entered into without public tender by companies with strong political connections.³ Mistakes in patronage forecasts by bidders were underwritten by full or partial state guarantees, which removed the incentive for bidders and their financiers to get their patronage forecasts right and maintain efficient management practices. In many Asian countries, the first tollway projects, such as the North South Expressway in Malaysia, left the state holding significant revenue risk. State agencies lacked the skill and training to negotiate effectively with the consortium. Another common failure was the negotiated tender method of procurement used extensively in Asia that involves negotiation of the franchise with only one consortium. A further limiting factor is benign regulatory frameworks which do not adequately protect the public interest. As a result, the failure rate of early PPP transactions in Asia was high and a large number of early PPP projects in Asia and South America were renegotiated in the early post-commissioning period.⁴

During renegotiation, governments could either limit or increase their risk. If governments attempted to withdraw or limit their guarantees, renegotiation often resulted in their granting long extensions to the franchise term. However, attempts to cap toll increases or impose new regulatory interventions resulted in high compensation payments to consortia. Either way, renegotiation came at a high cost to the state.

3 Xueging Zhang, 'Concessionaire Selection: Methods and Criteria' (2004) 130 *Journal of Construction Engineering and Management* 235.

4 Paulina Beato, *Road Concessions: Lessons Learned from the Experience of Four Countries* (1997) Department of Sustainable Development, Inter-American Development Bank
<<http://www.iadb.org/sds/doc/1205eng.pdf>> at 24 October 2006; Kuranami, above n 2.

It is, therefore, important for Asian countries to build their capacity for dealing with PPPs. This is because line agencies need to acquire the knowledge and skill to identify projects, undertake the development of a business case and rigorous analysis of project risk, and continue monitoring of the franchisee's performance against specification and contract administration after the commissioning of the project.

Australian governments can help in this endeavour by assisting state agencies in Asian countries to build capacity through training, case study workshops and sponsorship of postgraduate PPP education courses. Australian universities also have a role in offering specialist PPP programs in conjunction with local universities in the Asia-Pacific region. These courses address the specific training needs of line agency and central government staff, and include:

- business case development;
- probity, governance and process management;
- financial modelling;
- risk analysis, allocation and pricing; and
- contract administration.

C Inter-Government Coordination and Liaison

Early PPPs were implemented with insufficient coordination and communication between line agencies and provincial governments.⁵ Most PPP deals were negotiated by central government rather than line agencies that were closer to problems such as transport congestion, route selection, land tenure, local community concerns and operational matters. This resulted in widespread provincial opposition to PPPs and operational problems for the consortia. This adversely affected connectivity with complementary infrastructures which is so necessary with networked supply chains in the water, energy and transport sectors.

State participation in infrastructure and PPP conferences and related forums is one way of addressing this problem because it opens lines of communication between the different stakeholders. The opportunity exists for Australian firms to partner locally with information sharing platforms for both state and private stakeholders.

D Value for Money

Many countries undertook PPP projects in the late 1990s mainly in the form of input specification BOOTs. Under these arrangements, the consortium constructs assets to a full state specification for both the service and the form of the asset to be provided. In contrast, modern PPPs are designed around an output specification. Evidence from a number of Asian case studies suggests that PPPs involving large and complex projects achieve better VFM where the private

5 See Kuranami, above n 2.

bidder is accepting significant project risk, introducing new technology and innovation or offering a distinctive expertise in asset management.⁶ An example is the Metro Manila Skyway in the Philippines where the contractor was appointed because of its expertise in concrete box girder technology.

VFM requires systematic evaluation and unless guidance frameworks are in place, there is no way of ascertaining whether this has been achieved.

E Public Failure and Project Effectiveness

Connectivity to supporting networks is also important in the context of supply chain planning. PPPs often provide a single link in complex supply chains where both access and service pricing are an input to transport and industry production costs. Many early PPPs were negotiated without reference to broader supply chain strategies or integration with long-term infrastructure plans. This is critical to the efficiency of investment in networked industry sectors such as electricity generation, gas and water distribution.

A key lesson for Asian governments, therefore, is the importance of central planning as a key preliminary step to a PPP program. New motorways must be supported by complimentary improvements to supporting road networks for ease of access and exit. Similarly, new transport infrastructure should connect to major transport nodes such as railway stations, ports and airports, and support the government's strategic logistics plan. Failure to observe network factors can have a significant impact on investment economics.⁷ A PPP accounts for a relatively isolated link in an infrastructure network and its contribution to regional development is limited to the extent that it is not integrated into supply chains.

Australian firms are well positioned to provide advice to central government in the areas of infrastructure planning and coordination; network and supply chain strategy; and output specification of public services.⁸

F Institutional Infrastructures

In Asian economies, recent evidence points to better VFM outcomes from private investment in infrastructure when there is strong supporting institutional infrastructure. PPPs are a highly developed form of 'contracting out' that work best with:

- an enabling environment that includes stable and developed institutional frameworks such as the rule of law, access to mediation and protection of property rights;
- access to capital markets;

6 Peter Fitzgerald, *Review of Partnerships Victoria Provided Infrastructure – Final Report to the Treasurer* (2004) <<http://www.gsg.com.au/pdf/PPPReview.pdf>> at 1 November 2006.

7 Michael Regan, *Infrastructure: A New Asset Class in Australia* (PhD Thesis, University of Queensland, 2005).

8 A review of case studies for early Asian PPP toll road projects was conducted for the World Bank and Ministry of Construction, Japan: see Seminar Proceedings on Asian Toll Road Development in an Era of Financial Crises – Volume II: Appendices A through F, Tokyo, 9–11 March 1999 <http://worldbank.org/transport/toll_sem/vol2_toc.htm> at 1 November 2006.

- liberalised foreign investment regimes, capital mobility and access to foreign exchange; and
- national infrastructure policies.

A problem for Australian firms operating in the region is the disparity between legal and regulatory requirements in areas such as franchise law, taxation, repatriation of dividends, long-term leasehold interests, access to mediation services and the court system. This is also a problem in South America and Africa.⁹

G Cultural Factors

PPPs encountered strong resistance when they were progressively implemented in developed economies from the early 1990s. A combination of many of the factors mentioned above – poor policy frameworks, lack of transparency, a public service conditioned by traditional procurement practices and a critical media – put a brake on the hasty expansion of PPP programs. Nevertheless, policy was developed to improve the model and the VFM outcomes. In developed economies, new public management changed the culture of the public service in the early 1990s. Line managers on short-term contracts were given authority to manage policy implementation. They became accountable for procurement outcomes and cost reduction became the objective for investment in big ticket infrastructure items. In Victoria, the Department of Treasury and Finance invested in clear and comprehensive guidelines, and assisted line agencies to develop inhouse capabilities to run PPP projects. These were significant changes to the culture of public service delivery.

Similar reforms are lagging in many Asian countries and many line agencies retain top-down administrative structures. This is especially the case with social infrastructure in areas such as health services and education. This is an impediment to the introduction of comprehensive and innovative PPP frameworks and a proactive approach to capacity building within government. Improvement in the quality of services in these areas will require public service reforms along the lines of the managerial approach employed in developed economies over the past 15 years.

I Bid Markets

Experience internationally points to the need for depth in bid markets and deal flow. In the United Kingdom, for example, this is achieved with partial reimbursement of bid costs for losing bidders. Bid markets must be competitive and the state should endeavour to minimise bid costs in order to maintain bidder interest.¹⁰ Deal flow or the systematic release of PPP transactions ensures the retention of skills in local markets, permits concurrent projects and ensures a

9 Beato, above n 4.

10 Jean-Etienne de Bettignies and Thomas W Ross, 'The Economics of Public-Private Partnerships' (2004) 30 *Canadian Public Policy – Analyse De Politiques* 135.

strong bid market. Awareness of bid markets and the systematic release of projects are important policy considerations for Asian PPP programs.

Transaction size is also important to maintain a healthy bid market and this may require the bundling of smaller like projects such as schools, police stations, local courts and public buildings.

J Documenting the Lessons Learnt

Evidence from previous transactions assists governments to document, evaluate and review the ex post performance of PPP transactions. PPPs are an evolving procurement model and continuous program development is required to establish and improve best practice standards, document the lessons learnt and modify policy settings and guidelines with the benefit of transactional experience within the country and internationally. The broad national and international experience of Australian contractors and professional firms provides them with a unique opportunity to play an important role in the further development of successful PPP programs in the Asia-Pacific region.

III THE IMPORTANCE OF PPPs TO ASIAN-PACIFIC ECONOMIES

PPPs add to the pool of capital available for infrastructure development. Infrastructure investment is associated with an economy's output capacity, growth and performance.¹¹ PPPs can also lower procurement cost and improve the delivery of major capital works.

The rigour applied to PPPs is leading to improvements of existing traditional procurement methods. The Gateway programs implemented in the United Kingdom and Victoria employ the first seven steps of the PPP program, which includes a systematic approach to project selection, business case development, risk analysis and measurement and a rigorous review process. The program has led to improvements in traditional procurement approaching PPP performance benchmarks. This represents a big saving for the 90 per cent of capital expenditure incurred using traditional procurement methods.

Finally, high levels of user satisfaction and improved service delivery outcomes of PPPs are well documented in the United Kingdom.

11 Regan, above n 7.