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# The Dissolution of Public Private Partnerships: An Australian Case Study of the Political Costs Involved

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*In a 2008 discussion paper, Infrastructure Australia, a statutory advisory council consisting of 12 members, noted that 'national infrastructure ...is the platform for future growth and prosperity'. In recent years, however, a number of PPPs engaged in building this national infrastructure have collapsed. With the creation of a 'Future Fund' by the current Australian government and a robust agenda envisioned for the technological advancement of Australian infrastructure through a 'National Broadband Network' this paper seeks to examine the non-economic political costs associated with the collapse of such PPPs. Although perhaps pessimistic, in that parties do not generally commit to a PPP expecting it to collapse, the costs associated with unsuccessful PPPs are indeed considerations that should at least be acknowledged at the outset of a venture in a robust risk profile. Even the most detailed risk profile, however, cannot account for the political costs that may be incurred by a government if a PPP collapses. Looking at the experience of the Australian state of New South Wales, this paper argues that transparency and astute political management are essential if the political costs associated with the demise of a PPP are to be minimised.*

## 1. Introduction

The purpose of this paper is to examine an aspect of public private partnerships (PPPs) that seldom features in the contemporary literature in this area. Whilst much has been written and said of the varied nature PPPs, their utility in creating public infrastructure (whilst limiting a governments debt financing liabilities) as well as operational aspects of PPPs, little attention has been paid to the less savoury aspects of PPPs. What happens when PPPs fail? What type of costs can one expect to face? And who is to bear the brunt of these costs? Given the vastly different types of PPPs around the world, there is no one size fits all approach to dealing with these problems. Some general considerations, however, can still be distilled and serve as guide posts to interested parties engaged in PPP projects in most if not all OECD jurisdictions.

Public funded initiatives (PFIs) in the United Kingdom (UK) paved the way for similar collaborations between the public and private sectors around the world. In Australia PPPs are relatively new forms of business models with a much narrower scope of operation than the UK. In the UK PFIs have been used to build schools, hospitals as well as larger scale transport infrastructure projects. In Australia, by contrast, PPPs have been predominately used only in relation to public transport infrastructure. In the Australian state of New South Wales (NSW) two high profile PPPs have recently

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failed exposing the government to significant political costs. This paper examines the experience of the NSW government and focuses on the nature and consequences of the political costs that may be encountered upon the unsuccessful ending of a PPP venture. Economic losses, to a large extent, depend on the individual circumstances of individual PPPs and as such this category does not lend itself to general principles. The focus this paper draws upon the political category of non-economic loss is perhaps more generic and open to a broader approach from which generally applicable principles and lessons can be extracted.

## 2. What are PPPs?

Some commentators continue to insist that PPPs are simply manifestations of privatisation under a different name. At its most essential, a PPP arrangement is a contractual transaction where one of the contracting parties is the government or a public authority. On this simple basis, costs involved in the dissolution of a PPP would include the usual legal costs associated with a commercial contract dispute and any associated litigation (Noble, 2006). This paper, however, seeks to expand the economic basis for the calculation of the costs of dissolving a PPP to include collateral costs not caught in the risk profile generated at the preliminary stages of a PPPs life cycle. PPPs come in all shapes and sizes and range from the public contracting of services associated with public service provisions (cleaning schools, maintaining roads, etc) to arrangements where the private sector is granted a greater role in constructing, operating and maintaining the public facilities in question. Around the world PPPs have been utilised by governments in many diverse sectors and in varying capacities.

Traditional asset procurement methods for the public sector usually involve a tendering process and the allocation of public capital towards the purchase of a specific public asset. The PPP process is less static and involves an ongoing relationship between the private and public sectors. Indeed, in a PPP context, the personal relationships between the negotiating teams representing the contracting parties, it has been argued, are of significant importance to the success or failure of a PPP (Noble, 2006). When comparing the traditional procurement method with the PPP business model several advantages and disadvantages can be seen. In terms of advantages, PPPs draw upon private sector expertise and efficiencies to provide purportedly cost effective outcomes to public sector requirements. PPPs, it is argued, also reflect a greater certainty in relation to the risk allocation characterising both parties exposure with the possibilities of periodically reassessing the risk profile schedule and adjusting the relationship accord with issues that may arise as a result of changing conditions. One major disadvantage of PPPs is that the design and functional specificity is not as well defined as with a traditional procurement method when tenders are submitted specifying all aspects of a projects life from the outset.

Some of the competing influences bearing upon the PPP context include the balancing of high quality public service provision with value for money (VFM). From a fiscal standpoint, PPP projects have the benefit of being funded by private sector capital reducing the requirement for public debt expansion. The risks of capital market fluctuations are thus shifted from the public accounts onto the books of private consortiums as part of a larger risk allocation matrix (including insurers and underwriters). When examined closely, PPPs are at their core innovative financing tools. Granted they may also result in quality and efficiency benefits but the cost saving benefits to public authorities seem to be the overriding consideration driving the growth in PPP adoption around the world (along with the recent proliferation of Private Equity firms). Public authorities, however, are not commercial enterprises and as such a whole different set of pressures and expectations are evident in relation to government actions and undertakings. Diluting the public accountability of government by mixing it in with commercial pressures in a PPP venture makes it somewhat difficult to measure the entire spectrum of costs incurred in the event of a PPP being wound up.

Political institutions built on government accountability to the public (such as elections) are the greatest safeguard liberal democratic societies have against oppressive, incompetent or fiscally profligate government. The lesson that is currently being learnt by constituents in the Australian state of New South Wales is that accountability in the context of failed PPPs is difficult to measure, and in terms of political costs, such confusion in responsibility is itself proving to be a significant liability to the incumbent government.

## 3. A Brief Overview of PPPs in Australia

PPPs in Australia have largely been used in the infrastructure sectors to supplement public expenditure and expertise. Worldwide, it is believed that 60% of PPPs are in the transport infrastructure sector (Cook, 2007). The traditional forms of fund procurement on the part of public authorities have been replaced by a belief that PPPs will provide the desired Value For Money (VFM) without the need for immediate government outlay. Furthermore in non-PPP projects worldwide cost overruns occur in approximately 73% of cases whilst in PPP projects this figure stands at only 22% (Cook, 2007). Time delays were also more prevalent in non-PPP cases further strengthening the case for private involvement in the provision of public amenities, services and infrastructure from a VFM perspective. The criticisms of this movement towards PPP adoption have been varied and range from accusations that the public is funding private profits (Shaoul, 2005) to private sector investors complaining that the government is imposing undue restrictions upon arrangements when constructions begins and circumstances change making PPPs a less attractive option than ‘going it alone’. Amid the discourse, the Australian Research Council

(ARC) has recently funded academic investigation into the post-performance evaluation of public private partnerships (English, 2006).

Linda English has noted that in the Australian experience PPPs can be separated into two discreet periods - pre-2000 and post-2000. The adoption by Victoria, an Australian State, of the term 'PPP' in 2000 to cover a range of hybrid public private models was a 'watershed' in PPP developments in Australia. Prior to 2000 the various models that characterised the PPP experience were the 'BOO' model (Build, Own, Operate) and the BOOT model (Build, Own, Operate and Transfer). The Victorian Government, in particular, had used a privately operated service model to fund a range of traditionally publicly funded operations including hospitals and corrective services. An alternative model is the Design, Build, Finance and Operate (DBFO) approach. In 2000 the practice of having these services provided exclusively by private enterprises was shifted such that the public now had a greater role. This movement, it is here argued, can only be understood on a political level. In 1999 a new Victorian Labor government was elected after 7 years of Conservative (Liberal National Party) rule. The shift from out right privatisation of traditionally government provided services towards the PPP model could thus be seen and understood as a shift from right wing economic polices back towards the centre left.

The approach adopted by the Victorian government was based on the UK models developed to facilitate that country's Private Finance Initiative (PFI). In 2005 other Australian states and the federal government agreed to harmonise PPP implementation measures. By the end of 2005, however, the federal government had yet to be party to any PPP projects. As of 2006, there were 127 PPP projects worth $AU 35 billion that had been undertaken in Australia (English, 2006). PPPs were most utilised in Victoria accounting for 38.6% of the overall total. New South Wales came in second with 29.7%. In New South Wales the annual expenditure on PPPs as a percentage of overall capital works budget is 11% and is expected to remain between 10-15% (Phibbs, 2007). Again the political angle is important to consider in appreciating these statistics. For much of the early part of the 21$^{st}$ century all Australian state governments were Labor with the federal government being the sole conservative administration in the country. In 2007 the Labor party won federal office on a platform of 'rebuilding the nation' with massive policy commitments to renew and initiate Australian economic infrastructure for the new digital age. One of the largest policy commitment's, which has subsequently been commenced in the form of a PPP, is the ambitious National Broadband Network (NBN). The federal government has registered a company (NBN Co Ltd) with a massive government commitment of $43billion over the life of the project. It is hoped that this project will provide superfast broadband Internet to 90% of homes and business in Australia.

From the Victorian and Federal contexts in Australia, it is apparent that the PPP issue seems to be related to party politics. The centre left in Australian politics seems to be more inclined to have government involvement in the PPP context whilst the centre right is more inclined for full privatisation. As such, one of the key costs associated with the dissolution of PPPs in Australia that this paper seeks to focus upon is the political cost. When a relationship between private investors and the government sour in the context of PPPs, political ramifications for both the incumbent government and the consortia involved does not seem to feature in pre project risk profiling and indeed the question must be asked, can such a risk even be calculated and accounted for?

## 4. Dissolution of PPPs

As noted above, at the initial negotiation stages of a PPP project, representatives from all stakeholders contribute to producing a contractual relationship where risks and rewards are clearly allocated in a risk profile. Risks such as time delays due to *force majeure*, cost overruns within and outside the control of the parties are allocated to insurers, contractors and the relevant public authority. When responsibilities and exposure is clearly catalogued, the economic consequences of a fraying relationship are much more manageable. The financial and non-financial costs associated with performance failure under a PPP arrangement should usually be included in the calculations of the Public Sector Comparator (PSC) – which is a commercial mechanism used to measure the desirability of a private investment compared to the public providing that same investment (Grimsey and Lewis, 2006). Even the PSC, however, does not seem to completely account for the nature and extent of the political costs involved in the dissolution of a PPP.

## 5. Economic Costs

The economic costs associated with a breakdown in a PPP arrangement are relatively predictable. They may include legal costs to facilitate the proverbial contractual ‘clean up’ as well as other transaction costs related to confirming the conclusion, continued maintenance and or ongoing operation of the public utility in question. In some PPP contractual arrangements the public authority actually guarantees the private partner a minimum level of profit for a set period of time. Depending on the jurisdictions, such undertakings can result in massive public liability in the event that a PPP fails. Commitments are easy to make and provide great leverage in this context in that they can attract a greater spectrum of investors yet their consequences may be very serious in the final calculation of liability upon the dissolution of a PPP. Diligent preparation of a comprehensive risk profile renders the economic costs associated with the dissolution of a PPP a less problematic concern compared to the non-economic costs.

## 6. Non-Economic costs

The non-economic costs that may arise upon the dissolution of a PPP are somewhat more difficult to calculate. The identification of such costs is possible, but assigning a monetary amount to such identified issues is not always possible. The non-economic costs can be seen from the perspective of both the private sector partners and the public authority involved in the project. A common cost associated with both sides is the damage to reputation suffered when a commercial relationship concludes on unamicable terms. When a PPP venture does not turn out according to expectations both parties seek to save not only their economic bottom line but also, quite importantly, parties also seek to save 'face' or reputation. The certainty associated with a long-term public contract is a desirable investment for any private firm. The building up of a strong track record and a 'public partnership brand' is thus an important consideration if a private consortium is seeking to establish itself as a dependable counterpart to the implementation of public projects. Likewise, if a government is seeking to market itself as an attractive prospect for private investment and thus reap the benefits of private funding, reputation is also a key factor.

The reputational factors influencing the government are also relevant in the context of the 'public eye'. A commercial dispute with a private sector investor may be damaging to a governments commercial reputation in the investment community, but if this very same dispute was to translate into public objection and concern, such an injury to a government's reputation may be fatal to the longevity of an Administration's tenure. It is this non-economic political cost that this paper seeks to highlight in the context of the New South Wales Labor government and several recent high profile PPP failures in that state.

## 7. The NSW Experience: Cross City Tunnel and Lane Cove Tunnel

Two recent high profile PPP failures in New South Wales have reflected the importance of political costs evident upon the failure of a PPP. The Cross City Tunnel (CCT) was a transport infrastructure project connecting the western side of the Sydney CBD to Sydney's eastern suburbs by means of a 2.1km tunnel. In 2003 the New South Wales Labor government announced it was awarding *Cross City Motorways* the contract to build own and operate a tunnel that was to connect he western fringes of the Sydney CBD and east-west road arteries leading into the city to the eastern side of the city. In April 2005 the Cross-City Tunnel opened for operation at a building costs of $AU 680 million - by late 2006 the venture had debts of $AU 500 million dollars and was insolvent. In 2007 the venture was sold for $AU 700 million to a consortium making it now completely privately owned and privately operated. The tunnel will revert to public ownership in 2030. The Cross City Tunnel was the first road PPP to go into receivership in Australia. The paper presented by

Peter Phibbs at the State of Australian Cities conference 2007 provides a detailed insight into the Cross City Tunnel PPP based on primary contractual documents tabled in New South Wales Parliament and Auditor General Reports (Phibbs, 2007).

The second similar failure in New South Wales in recent years is the collapse of the Lane Cove Tunnel (LCT) PPP which was estimated to have cost $AU 1.1 billion to construct. The tunnel is 3.6km long and was one of the final parts of the Sydney Orbital – a freeway network system that encircles the greater Sydney metropolitan area. The tunnel was opened in 2007 and the company that designed, built and was set to operate the tunnel until 2037 (Connector Motorways) went into receivership in January 2010. In both the context of the CCT and the LCT, political considerations have dominated the circumstances surrounding the collapse of each respective PPP. Although the political fallout from the LCT is yet to be felt, if the political furore that surrounded the CCT PPP collapse is any indication, the New South Wales government will most likely face a difficult time winning next years election (a prospect that was unlikely anyway). The collapse of the CCT project resulted in a New South Wales parliamentary investigation by a joint select committee. The completed parliamentary report gives unique insights into the world of transport related PPPs in New South Wales (Report, 2006). At the heart of many of the recommendations of the report were considerations of political importance to public sector officials similarly operating in the field of transport orientated PPPs.

Some of the most glaring omissions and mistakes committed by the New South Wales government in the context of the CCT include: A lack of public transparency, a disregard for commercial warnings related to project viability and an ill managed public relation operation. With respect to the transparency shortcoming, the NSW government, as part of its contractual arrangements with the CCT consortium, agreed to commit to CBD road closures upon the opening of the CCT to ‘direct’ traffic into the tunnel. There was an immediate public backlash against this undertaking and it was not until the government capitulated to political pressure that these contractual terms were publicised upon tabling in parliament. The traffic arrangements were difficult for the public to understand and this created some popular discomfort. The real sting for the public, however, was the lack of transparency which many members of the public understood to be arrogance on the part of the government and plainly insulting. Quite cynically people have come to unfortunately expect a lack of transparency or accountability from the private sector, but the brazenness of the NSW governments actions created significant disaffection amongst the voting public.

The parliamentary report completed in relation to the problems with the CCT was completed in 2006 and publicised the drastic miscalculation or over estimation of traffic volumes underpinning the figures upon which the viability of the entire project was premised. Several commentators have noted this point, but have yet to point out the inconsistency of the government approving proposals for a project in which it has a vested political interest. Indeed, in the context of the LCT, it is widely believed that the NSW government delayed the opening of the tunnel such that it would coincide with the 2007 state election and provide maximum political capital (at the cost of $25 million to the taxpayers). When a government vests its political capital in the success or popularity of a PPP to this extent, the costs associated with its demise are considerably greater.

The CCT episode was particularly important in a political sense to the NSW government in that 2007 was an election year. If not for the lack of a viable alternative government, the CCT debacle and the media interest it generated may have cost the Labor party office. The breakdown of the CCT project even degenerated into a personal conflict between the Premier of NSW at the time, Morris Iemma, and the head of the CCT consortium chief, Graeme Mulligam, with both parties exchanging insults in a public display of public private disunity (Noble, 2006).
The political situation faced by the NSW Labor government, as noted above, was made worse when it became public knowledge that in order to attract private investors, the government agreed to certain CBD road closures to 'direct' cars into the tunnel. Furthermore, the toll that was to be levied on motorists by the toll ways operators was also relatively high ranging from $1.87 - $6.75 (depending on which way a motorist is travelling, the type of vehicle, the particular exit taken and whether the motorist is registered for an e-tag (an electronic toll device attached to the windscreen of a vehicle)). Whilst the transport minister at the time requested from the private operators that the toll be reduced to lessen the political pressure that was building on the government, it was conceded that there was no legal way in which to force such a reduction short of command economy style price controls. After it became public knowledge that the government had agreed to the road closures that subsequently caused traffic chaos in Sydney, the NSW government preferred to breach its contractual arrangements with the CCT consortium rather than pay the higher non-economic cost of a severe public backlash. The toll operators, however, voluntarily agreed to toll-free period to attract road users and eventually reduced the toll to stimulate interest and demand. Ultimately both efforts failed in turning the project into a long-term profit making enterprise.

The final parliamentary report into the CCT confirms the fact that the initial viability of the CCT project was based on exorbitant estimates of traffic volumes that were approximately 50% greater than the traffic volumes that were realised. An early viability study into the project also made it clear that upon a realistic estimate of traffic volumes the CCT project would only be commercially profitable if it included car parks and a shopping complex underground (Phibbs, 2007). The politics surrounding the LCT project failure in early 2010 were not as immediate as the fallout from the CCT episode - perhaps demonstrating that the same NSW government has learnt from its political mistakes. That is not to say the LCT opening

and initial operations were flawless, far from it in fact. When first opened, the LCT operators also demanded road closures from the government in order to direct traffic onto the toll way. Such actions again created some resentment, although the resentment quickly turned to anger when it was realised that the NSW government was collecting massive fines from motorists who were early adopters of the toll way and did not realise there was a 10km/h speed reduction at the start of the 3.1km tunnel and were caught on a strategically placed speeding camera. The fines resulted in an economic windfall for the government but a political near catastrophe. When news of the disproportionate number of fines appeared in the media, the government was pressured into refunding the fines and changing the speed limit at the entrance of the tunnel to match the roadways leading into the tunnel at 80km/h.
Whilst it is true that the city of Sydney now has two new useful, if not vital, pieces of infrastructure and that the private sector has born most of the cost, this has not translated into praise or political benefit for the government. Indeed the opposite is true. The dissolution of the CCT and the LCT PPPs has in fact inflicted significant political costs on the government despite ostensibly the tunnels being built on time and at minimal direct costs to the taxpayer. It appears that one of the most significant costs to a government in the context of PPPs (and in particular in relation to their dissolution) is the political cost. Although this cost is unpredictable it is manageable. Managing political benefits and costs requires an astute political strategy that balances fiscal considerations with reputational threats and opportunities. Whilst the private sector may have to make important decisions as to how much economic capital it will invest in a PPP, governments need to be weary of how much political capital they themselves invest.

## 8. Conclusion

PPPs have grown in significance and prevalence in the last 10-15 years as both a funding alternative and an alternative procurement model for public authorities across the world. In the Australian context, PPPs have played into the politics of government intervention at both the state and federal level. In the state of Victoria, the use of PPPs was refined and expanded after the election of the Bracks Labor government in 1999 following a prolonged period of Conservative rule. Despite some of the existing literature claiming that PPPs are just privatisation by another name, in the context of Victoria, the increased use of PPPs actually represented a winding back of the explicit privatisation of public services that had taken place during the 1990s. At the federal level of Australian government, the Conservative Howard government (1996-2007) made little if any use of the PPPs during its tenure. It was not until the election of the Rudd Labor government in 2007 that PPPs began to feature in a big way in the policy agenda of the federal government, particularly in relation to the nation building platform upon which the Labor government campaigned and was elected.

In the Australian context there is significant political capital invested in the success or failure of a PPP – perhaps more so than in any other OECD country. The experiences of the NSW government in the past 3 years in relation to the failure of the CCT and LCT PPPs will in all likelihood lead to the Labor party losing office at the 2011 state election. Although there are several other issues that have damaged the public's confidence in Labor (including factional infighting and various political scandals) the PPP failure issue has proven to be one of the most politically damaging issues undermining the credibility of the government. Issues such as competence, value for money, putting the interests of private contracting parties ahead of the public have all fed into an image of an out of touch and commercially incompetent government – even if in reality such a negative reputation is not entirely warranted.

What can be learnt from this Australian case study is that transparency is vital to minimising the political costs associated with a PPP failure. There is a populist strand that is immune to the tribulations of a private sector failure, but at the same time, is quite sensitive to public involvement in such a failure. Even if the public is left with a new piece of infrastructure at minimal cost to the taxpayer, the disingenuousness of the government will mean that any positive political gains will be magnified into a serious political cost. Political considerations, however, must not cloud Value for Money evaluations or the calculation of the Public Sector Comparator (PSC). Furthermore, even the most detailed risk profile cannot account for the consequences a government is liable to suffer if the dissolution of the PPP is not managed professionally and transparently. In a sense, the government is ultimately exposed to a greater extent than the private sector if the building and operation of the PPP project is not carried out in a manner that is acceptable to the public. So called 'buck passing' cannot be realised when a government invests its political capital into a project to the extent that the NSW government did in relation to both the CCT and the LCT.

The investment in a PPP by a consortium or private equity firm under the guise of a newly created entity somewhat shields the private counterparties from the political fallout from any failed venture. A government, on the other hand, has a much more enduring reputation to uphold. This places the private contracting party at a significant bargaining advantage in the context of dissolutions. If certain matters remain to be resolved at the final dying stages of a PPPs life, the threat of 'creating a scene' and making the dissolution as politically painful as possible for the government, gives the private contracting party a stronger hand in negotiations. Alternatively, if the government is able to play up the populist political perspective and emphasis and communicate to the public that the private sector is somehow trying to make the taxpayers pay for its own corporate mismanagement and failure, the government can carve out a certain degree of political immunity. Taking account of the political costs associated with the dissolution of a PPP is an important consideration for all sides involved in this hybrid form of public procurement and investment from day one of any such venture.

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