

FINANCING
INFRASTRUCTURE PROJECTS
SUCH AS THE CITY LINK



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FINANCING INFRASTRUCTURE PROJECTS

SUCH AS THE CITY LINK



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DECLARATION

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projects such as the City
Link

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BY

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ABSTRACT

This project provides various points of view to determine whether the private sector can build-own-operate-transfer public infrastructure projects more efficiently than the public sector and will use as an example the building of the City Link Project. The project will argue the advantages of it being managed by the private or public sector. Some consideration will be given to the argument that the Victorian State Government simply does not have the capital or the expertise to complete a public infrastructure project the size of the City Link.

Arguments put forward will evaluate methods governments can use to determine whether or not to invite the private sector to participate in public infrastructure projects. The project will evaluate the efficiency of the private sector in comparison with the public sector in a number of government business activities and will explore international experiences, particularly where governments have contracted out services, and demonstrate the savings to the taxpayer.

A case will be built around the proposition that the City Link may not proceed unless it has private sector participation and will consider the reasons why the State Government has had to seek external resources in order to build City Link.

A number of funding options will be evaluated including direct and shadow tolls. Further discussion will take place on the financial risk and who should be responsible for this (i.e. the State Government or the private sector) with a brief comparison to the financial arrangements in relation to the World Congress Centre.

This project concludes that if the City Link Project is to proceed, it will need private sector involvement. It is clear on the evidence provided that the Victorian State Government could not afford the expected \$1.7 billion in capital works to complete the City Link Project. It is argued that the State Government is not in a financial position to repay the private sector through a shadow toll or from consolidated revenue. Therefore, the State Government should opt for a user pay or direct toll. This is concluded even after the experience of Victoria's first tolling effort on the Westgate Bridge which proved unpopular, with approximately 40% of motorists using alternative routes to avoid the toll.

CHAPTER ONE - THE PROBLEM AND METHODOLOGY

During the 1980s there was an attempt in Victoria to set up a private and public sector partnership with the building of the World Congress Centre. This did not work and proved embarrassing for the State Government of the day. This failed attempt, in particular, was motivation for the writer to explore more successful ways of financing infrastructure projects.

The writer has therefore chosen "Financing Infrastructure Projects such as the City Link" as an important area of study as there needs to be greater accountability of the use of taxpayer's dollars in public infrastructure projects.

In the past, private sector participation in public infrastructure projects has been seen as a poor investment with little incentive, basically shunned by the business and investment community. Projects such as the City Link, for example, have been talked about for many years, but have been stalled due to the substantial capital outlays required to complete such large infrastructure projects.¹

Public capital expenditure relative to gross domestic product has been declining in most overseas economies over the past decade. Australia has followed this international trend as a result of the deterioration in its' balance of payments and mounting public sector debt, and because of this there is now a tendency to look towards the private sector.² Infrastructure is essential for Australian industries to be internationally competitive. For

¹ Arbouw, John: "Rebuilding Australia", Australian Business Monthly, 21 August, 1991, p39

² Fray, Peter: "Planes, Trains and Private Pains", The Bulletin, 7 June, 1994, pp20-21

example, if a manufacturer can produce an item more cheaply than their overseas competitor, but the cost of transportation to the wharf is expensive due to poor or congested roads, then they could become uncompetitive. Capital expenditure by the public sector has continued to decline since the late 1980s, slumping to below 6% of gross domestic product for the first time since World War I³, which indicates that a greater proportion of the Federal Government's expenditure is being used for recurrent purposes rather than for new roads, schools, hospitals, telecommunications and airways. The private sector has played a dominant role in the provision of some transport services and is now moving to an expanded role in the provision of infrastructure generally. An example of this is Australian airports. Both Federal political parties are moving towards a policy of privatisation or at least corporatisation of Australian airports. It is anticipated that a future Federal Liberal Government will hasten this change.

The problems associated with the private sector purchasing public institutions on the grounds of efficiency and greater competition will be discussed at length throughout this major project. The writer will argue the case for and against the sale of public sector utilities such as the State Electricity Commission of Victoria, and the introduction of Optus into the telecommunications industry. Arguments will be based on efficiency, as well as the need to retire debt, and the need to reduce overall government sector debt.

The decline in capital expenditure undertaken by the public sector raises the question as to whether the current levels of spending on infrastructure are adequate.

³ Commonwealth Bank: "Strengthening The Economy's Backbone: Spending on Infrastructure", Economic Newsletter, August, 1991, p1

The Chief Economist for the Commonwealth Bank believes that a large part of the recent decline in infrastructure spending reflects shifts in demographic, social and economic patterns and anticipates further changes in the pattern of expenditure in future. Pressure to upgrade transport infrastructure on economic grounds has, in some instances, increased and capital expenditure on water and sewerage works may also rise in time influenced by increased population pressure and a shift towards improved environmental standards.⁴

Over recent years, the Federal Government has sought to raise the efficiency levels of industries as part of the microeconomic reform process. However, raising the efficiency of public enterprises requires additional capital expenditure to reduce the cost of infrastructure services to users.

There has been a reluctance by the private sector to invest in public sector infrastructure because of low returns, the size of funding required and a lack of underwriters. Doubt as to whether the Federal Government wishes to reform the tax laws to make infrastructure investment attractive to superannuation funds, is also a concern.

There is little doubt in the writer's mind that the Australian economy does need the private sector to invest in public infrastructure projects such as roads, ports, hospitals and other vital works.

⁴ Commonwealth Bank: "Strengthening The Economy's Backbone: Spending on Infrastructure", Economic Newsletter, August, 1991, p2

This view, however, is not supported by all. The H.V. Evatt Research Centre believes that governments should "meet the capital needs of public enterprises through an appropriate combination of dividend relief, budget financed injections over a five year period and relaxation of Loan Council and other borrowing restrictions".⁵

If the private sector is going to provide the infrastructure that is demanded by the consumers, then the projects have to be able to attract capital on a competitive basis commensurate with other investments.

The level and direction of public capital expenditure has been affected by changes in economic and social structures, for example:

- lower expenditure on education reflects the impact of demographic factors on school enrolments and the expanded role of the private sector in the provision of education services;
- the decline in capital expenditure on energy in recent years followed the emergence of excess capacity in electricity generation;
- the accelerated sale of assets accounts for around one quarter of the decline in the ratio of total public capital expenditure to GDP.⁶

According to Arbouw, it has been stated by senior members of the business community that it is becoming increasingly difficult to undertake new investment projects in

⁵ H.V. Evatt Research Centre: "The Capital Funding of Public Enterprises in Australia", Paper, Sydney, March, 1988, p(vi)

⁶ Commonwealth Bank: "Strengthening The Economy's Backbone: Spending on Infrastructure", Economic Newsletter, August, 1991, p2

Australia. This is due in part to some governmental decision making processes and the plethora of regulations and bureaucratic barriers.⁷ Osborne and Gaebler believe that the first task for a mission driven government is to scrape off the dead weight of accumulated rules, regulations and obsolete activities. Many people understand the need to deregulate the private sector but few apply the same thinking to the public sector. Osborne and Gaebler call this "scraping the barnacles off the Ship of State".⁸

Some critics believe that if public infrastructure projects need to rely on tax incentives or government handouts to be commercially viable then it is little wonder governments are slow to react. However, unless taxation treatment for infrastructure is at least on an equal footing with all other forms of investment, the private sector cannot be blamed for looking elsewhere.⁹

Private sector involvement allows major infrastructure projects to be provided and once provided, be operated in a manner that does not create a public sector borrowing liability. It can be argued that this involvement could also provide a more efficient service than would otherwise be able to be provided.

Financial institutions looking for investment opportunities and committing capital will assess a particular project on the basis of its risk, return and its liquidity. The difficulty of attracting investment to some infrastructure projects is the lack of liquidity or consistent revenue streams. If a project such as a tollway has a revenue ceiling because

⁷ Arbouw, John: "Rebuilding Australia", Australian Business Monthly, 21 August, 1991, p38

⁸ Osborne, David and Gaebler, Ted: Reinventing Government: How the Entrepreneurial Spirit is Transforming the Public Sector, Addison-Wesley, Reading, Mass., 1992, p114

⁹ Arbouw, John: "Rebuilding Australia", Australian Business Monthly, 21 August, 1991, p39

of social justice considerations it will make the investment less attractive. Infrastructure projects usually entail technical and financial risks that can limit their attractiveness for private investors. Governments need to minimise the extent of the community risk.

In financial terms, many infrastructure projects require a large capital expenditure relative to operating expenditure and have limited secondary markets and long pay back periods (i.e. the City Link Project will only have a single market and that is its reliance on traffic usage, therefore, the tunnel could not be used for any other purpose). Community interests that limit the ability of the private investor to set prices and determine modes of operation will affect profitability, and thus reduce the attractiveness to invest in such projects.

Therefore, to involve the private sector in public infrastructure requires that special consideration be given to minimising and sharing risks and maximising returns. The return to the investor needs to be competitive and commensurate with the risk. Where the potential community benefit is high, it may be appropriate to share the risks of the investor.¹⁰

However, there has also been strong reluctance from the public sector to work closely with the private sector, making an ideal partnership more difficult.

According to the NSW Public Accounts Committee, reluctance by the public sector for private investors to invest in public infrastructures is based on several grounds:

¹⁰ Victorian State Treasurer: "Public/Private Sector Partnership", Victorian Government Infrastructure Investment Guidelines for Victoria, Melbourne, May, 1991, p1

- 1) political interference might mean pork barrelling
- 2) accountability, probity and transparency might be compromised
- 3) the Government's exposure might be open ended
- 4) the structure of any such cooperation might be messy and over complicated
- 5) the management of any such cooperative structures might not be professional
- 6) any given public-private partnership might result in an inefficient allocation of resources
- 7) there could be difficulties with the Loan Council¹¹

However, in Victoria there is a change of culture by the public sector due mainly to a lack of finance, and, if public infrastructure works were to take place, there is general acceptance that private funding would be required. The Victorian Government has brought many private sector managers into the public sector to shift the culture.

Osborne and Gaebler believe that public sector employees enjoy competition, so long as they do not have to worry about job security. The compromise for this is not to guarantee the current job they hold, but a job somewhere in the public sector. Osborne and Gaebler quote John Cleveland, formerly of the Michigan Commerce Department, who claims that public sector employees find their work more exciting and work a lot harder when they are in a competitive situation.¹²

¹¹ Public Accounts Committee, Parliament of New South Wales: The Financing of Infrastructure Projects, Sydney, November, 1993, p9

¹² Osborne, David and Gaebler, Ted: Reinventing Government: How the Entrepreneurial Spirit is Transforming the Public Sector, Addison-Wesley, Reading, Mass., 1992, p84

Before this change of perceived culture by the public sector, the NSW State Government relied on six traditional sources of funding to finance infrastructure projects namely:

- (a) Retained earnings of authorities
- (b) Support from Consolidated Funds - using State taxes
- (c) Borrowing by the Government
- (d) Proceeds of assets sales
- (e) Commonwealth grants
- (f) Small scale contributions from the private sector, ie. three cent fuel levy¹³

The six sources do have limitations. As State taxes are needed to pay for other community needs such as health, education and public transport, the amount available for infrastructure work is decreasing.

Although the New South Wales State Government relied on the six sources of revenue, a seventh source could be large scale contributions from the private sector.

The fundamental principle for determining the appropriate type of government involvement in any build-own-operate or build-own-operate-transfer project is that each sector should carry the risk it is best equipped to bear. The most efficient outcome will be reached if the government and the private sector carry the risks that are appropriate for each one.

¹³ Public Accounts Committee, Parliament of New South Wales: The Financing of Infrastructure Projects, Sydney, November, 1993, p3

In Victoria the six traditional sources of funding have been on the decline over previous years. The world wide recession has seen property markets slump and demand for government assets fall to unacceptable levels. Victoria in particular, as a result of the previous Labor Government's gross financial mismanagement, has overseen its authorities amass huge debts. The State Government debt went from \$12 billion in 1982 to an incredible \$69.8 billion in 1992.¹⁴

Most authorities do not have huge amounts of retained earnings. In fact, there is a strong emphasis to reduce authorities' debt-equity ratios (for example, State Electricity Commission, Gas & Fuel). The State Opposition claims the only reason the Government is keen for the reduction of debt equity ratios is for ease of privatisation. This has been proved to be correct with the announcement of the privatisation of the State Electricity Commission and the subsequent sale of electricity distribution companies.

State taxes in Victoria are already the highest in Australia and the Government would be most reluctant to increase taxes to fund public infrastructure work. According to the Treasurer in the September 1995 budget, Victorian taxes remain too high and put Victoria at a competitive disadvantage.¹⁵

The State Government has a policy in place that it will not build infrastructure projects unless it has the funds available or a reliable revenue stream to pay for it. Consequently, the Government will not borrow to pay for public work.¹⁶

¹⁴ Victorian Commission of Audit: Towards Prosperity, Melbourne, June, 1993, p12

¹⁵ Stockdale, The Hon. Alan., Treasurer of Victoria: "Treasurer's Speech, 1995-96", Melbourne, 6 September, 1995, p2

¹⁶ Birrell, The Hon. Mark, Victorian Minister for Major Projects: "Revitalising Melbourne", Agenda 21 Quarterly, Melbourne, December, 1993, p3

The proceeds of asset sales in Victoria are being utilised to retire existing debts and it is anticipated this policy will continue. However, revenue such as the Casino licence (\$200 million) is being used for infrastructure projects under the Agenda 21 policy. The Agenda 21 policy is the Victorian Government's major infrastructure policy and outlines the Government's longer term infrastructure plans.

Although there are some Commonwealth grants for infrastructure projects, the longer term viability of this may be in doubt, particularly as net national debt approaches \$190 billion.

Governments should review private sector investment in public infrastructure with caution and a high degree of accountability.

To strengthen the case relating to the lack of private sector participation in public infrastructure, critics of private sector involvement may point to the disastrous deal the former Victorian Labor Government negotiated in regard to the World Congress Centre. The construction of the World Congress Centre was the beginning of a new partnership between the State Government and the private sector.

In its Tourism Strategy of August 1984 entitled, "Victoria - The Best is Within Your Reach", the Victorian Labor Government announced as part of its Economic Strategy for the 1980s, that it was undertaking the construction of a 2,500 seat convention centre at the World Trade Centre site at a cost of about \$25 million. It was anticipated that the completion of this facility in 1987 would ensure that Melbourne could continue to compete for national and international conventions.

It was not until the 1990-91 Budget, that the extent of the Labor Government's financial involvement with the convention centre (later known as the World Congress Centre) came back into the public arena.¹⁷ However, for some of the reasons outlined below, the scheme was a failure and has been a costly mistake for the State Government. The Victorian Parliamentary Economic and Budget Review Committee published its report in May 1992, titled "Funding of the World Congress Centre."

This report highlights:

- * a possible 12-year funding cost approaching \$500 million;
- * non-inclusion of the Centre's \$148.8 million capital cost in Global Borrowing Limits that cover public sector projects such as the Congress Centre under Government control;
- * a 1990 interest swap arranged independently of earlier World Congress Centre funding structures, which is likely to add an extra \$45 million to World Congress Centre costs;
- * a possible Capital Gains Tax scenario, which may increase equity financing costs by up to \$36 million;
- * all-embracing Treasurer's Indemnities that remove all financial risk from the private sector, including make-up by the Government of \$30-\$40 million to the financiers for any loss of their tax deductions and the transaction's tax effectiveness;

¹⁷ Economic & Budget Review Committee Estimates Sub Committee, 4th Report to Parliament: "Funding of The World Congress Centre" Melbourne, May 1992, p1

- * likely assumption by the State Government of World Congress Centre ownership in 2002, after a high public auction reserve price drives the Treasurer to indemnify the Banks for their advances and to then re-finance the outstanding principal.¹⁸

The Committee in its findings points to the question of whether it would have been cheaper to have used conventional government borrowing, instead of involving private investors. In the case of the World Congress Centre, the Government carried all the financial risk, which meant that private sector competitive efficiencies could have been reduced because of the Government's comprehensive financial subsidies and guarantees. The World Congress Centre project became a Government embarrassment for several reasons.

Between 1987 and 1992, the Treasurer's accountability to the Parliament and the public on the World Congress Centre fell far short of any reasonably acceptable standard. This is supported by the Economic and Budget Review Committee's report which further highlighted:

- * Treasury failed to report on the World Congress Centre between 1987 and 1990;
- * Treasury were unwilling in February 1991 to confirm even the broad ambit of estimated costs;
- * Treasury made it difficult for the Auditor General's investigation;

¹⁸ Ibid, pxxviii

- * Treasury failed to disclose the crucial May 1990 interest swap involving an extra \$45 million in financing costs;
- * Treasury failed to disclose a possible Capital Gains Tax scenario involving at most an extra \$36 million in equity finance payments.¹⁹

The question that now begs an answer is why Treasury did not make the correct disclosures to Parliament. The uncertainties of a total funding cost approaching \$500 million over 12 years, with the possibility of no contribution from the World Congress Centre operating surpluses, may have contributed to this non-disclosure.

Treasury did not include the World Congress Centre capital cost of \$148.8 million in Global Borrowing Limits applicable to Victoria. The Government of the day was embarrassed over the misjudged interest swap that added an additional \$45 million to the final bill, and the possible make-up of \$30-40 million to the private financiers through the Government indemnity of any loss of their 1990-1997 tax deductions.

Future dealings by state governments with the private sector investing in public infrastructure must use the experience of the World Congress Centre to ensure past mistakes are not repeated.

Further problems faced in later discussions of private investment in public infrastructure involve conflicting evidence from overseas. Countries in the OECD treat the private sector differently and have different levels of involvement. For example, in Belgium toll

¹⁹ Ibid, pxxvii

roads do not exist. In Finland a recent study showed that the toll required to cover the cost of building a new freeway was the same price as a railway ticket for the same distance. This was not allowing for the operating costs of the car.²⁰

The writer believes there is a strong feeling within Victoria that the City Link Project would bring an enormous economic benefit to the State. The problem is how does the State finance such a project and how does the Government decide who should provide the capital and who should carry the financial risks?

The construction of a linkage between the Westgate Freeway and the South Eastern Freeway would provide direct links to the existing freeway system and the transportation facilities serving Melbourne and Victoria, including the major intermodal points such as the docklands, rail terminals and airports. The linkage would divert much of the potential heavy through traffic from the docklands development area, Southbank and the central activities district. Traffic congestion on major streets would also be reduced. The linkage would have considerable environmental benefits, with reduced fuel consumption and reduced noise and air pollution.

VicRoads favours the construction of twin three lane tunnels and anticipates that the tunnels would carry 100,000 vehicles per day. It is accepted that the tunnels would attract a high proportion of through traffic currently using Batman Avenue, Swan Street Bridge and Alexandra Avenue. Tunnelling techniques to be utilised in these areas are

²⁰ Manidis Roberts Consultants: "Private Participation in Infrastructure", A Research Paper, Surry Hills, NSW, July, 1989, p7 (not published)

of considerable concern with minimum construction and long term impacts being key criteria for evaluating proposals.²¹

The writer will address the following questions to ensure that private investment into public infrastructure is still a viable proposition to the Victorian taxpayer in constructing projects such as the City Link Project:

- (a) How does the State Government determine whether it is more efficient for the private sector to build-own-operate public infrastructure projects such as the City Link Project than for the State Government to perform this task?
- (b) Would infrastructure projects such as the City Link Project proceed if the private sector was excluded from the project?
- (c) If the private sector is to be involved in the building-owning-operating of the City Link Project what revenue stream could be applied to ensure this project is a success?
- (d) If, for example, the private sector is in a better position than the State Government to provide capital, financial risk and the benefits of their expertise in constructing public infrastructure, will this conflict with the State Government's Global Borrowing Limits?

²¹ VicRoads: Registration of Interest Brief to Build, Own and Operate the Western ByPass and Southern ByPass, Melbourne, January, 1997, p7

For the private sector to participate in the City Link Project and for it to be a viable proposition, it is necessary to make several assumptions. The assumptions made are:

1. There is a need for further public infrastructure projects.
2. Private investors will want to invest in public infrastructure projects, where there is an acceptable rate of return with acceptable financial risks.
3. State taxpayers believe it is more efficient for private investors to build and operate public infrastructure projects.
4. The State Government will establish an acceptable revenue stream to repay the private investor.
5. The value of the project will remain linked to current market prices and the original contracts between the State Government and the private investor will reflect this.

The remaining part of the major project will consist of three chapters.

Chapter Two will provide a review of relevant literature addressing the theoretical framework and international experience in private and public sector involvement in public infrastructure. This will include academic material based on the theory of the problems associated with private investment into public infrastructure and use examples of governments around the world who have privatised public trading enterprises, in order to create efficiency and better value for the taxpayer. Literature will include government reports and books relating to barriers preventing the private sector from investing in public infrastructure projects, whether they be financial or bureaucratic barriers.

Literature will include research into efficiencies of the private sector providing capital and finance compared to the public sector. A literature search has found a number of overseas papers on how foreign governments have tackled the problem of private sector involvement in public infrastructure. State Global Borrowing Limits and the effect of the private sector servicing a debt related to public infrastructure will be reviewed.

The third chapter will be an analysis and evaluation of the benefits of private investors building, owning and operating the City Link Project. This chapter will analyse financial and bureaucratic barriers the private sector needs to overcome in order to participate in the provision of public infrastructure projects. The chapter will review and evaluate revenue streams which may help entice the private sector to participate. This chapter will analyse and evaluate the question of public sector versus private sector efficiencies when it comes to building-owning-operating public infrastructure. Chapter Three will also look at other Victorian Government enterprises and how the Government is reviewing them in order of efficiencies and in some cases privatising them. These Victorian Government enterprises, together with the City Link Project, will constitute the Victorian case study.

The last chapter of the project will be a summary of the research and conclusions drawn. This final chapter will outline what the Government should do to ensure the City Link Project is a financial success. Recommendations will be made to ensure that future public infrastructure projects are eagerly sought by the private sector and that the Victorian taxpayer has confidence in such a system. This chapter will also indicate areas of future and additional research which may be explored.

METHODOLOGY

The methodology which is used in this major project will address the issue of whether infrastructure projects such as the City Link Project should be built-owned-operated by the private sector rather than the Government.


For the City Link Project to be a viable private sector project there needs to be a comparison between private and public sector financial management and this major project will build a case based on a number of arguments to support the fact that private investment in public infrastructure is necessary.

This major project will deal with the relationship between the public sector and the private sector in such areas as:

- (a) the cost of finance
- (b) correct accounting procedures
- (c) transferral of the risk of the project to the Government
- (d) establishment of acceptable revenue streams
- (e) possible privatisation at the completion of the project
- (f) the effect of Global Borrowing Limits
- (g) the benefit of private investment in public infrastructure projects

The methodology used to address this case study will take two forms, namely: literature search and review and unstructured interviews.

The literature review focuses on the following areas:

- (a) privatisation of public infrastructure projects
 - (b) cost benefit analysis - the advantages of private investors over the public sector investor into public infrastructure projects
 - (c) project decision making process, ie. when should a project get the go-ahead and how should the risks be borne if the private sector is involved
 - (d) private finances conflicting with State Government Global Borrowing Limits
- 

Unstructured interviews were used to address issues from a number of reports to which interviewees contributed, and their contributions have been linked back to this major project. Unstructured interviews were chosen to allow the writer greater flexibility in framing questions to better reflect the various areas of expertise of the individual interviewee. The interviewees were selected because of their direct involvement in the various committee reports which the writer used to form part of this major project.

With regard to the City Link Project and its proposed guidelines, unstructured interviews included officers of VicRoads and Government members of the Roads & Ports Bill Committees.

Copies of the original interviews are attached within the Appendices i-xxx.

Questionnaires are a formal mechanism and mean the research is carried out by remote control. The reasons for not choosing questionnaires are that they do not allow supplementary information such as how did the person feel when providing answers. Questionnaires dramatically collapse the amount of information supplied to perhaps one written line or even a tick in a box.²²

Further concerns regarding questionnaires are that they do not allow spontaneous, qualitative information to be gathered. Answers can often be ambiguous. Tightly structured questionnaires do not allow the person completing them to really express what they believe. Experience shows that questionnaires frequently mean that people "miss out" on what they really mean.²³

Further research shows that there is a world of difference between what people say and what they do, what they really mean and what is actually the case.²⁴

²² Wadsworth, Yoland: Do it yourself Social Research, Council of Social Service, Melbourne Family Care Organisation, Victoria 1984, p33

²³ Ibid, p34

²⁴ Ibid, p34

CHAPTER TWO - THEORETICAL ARGUMENTS AND INTERNATIONAL EXPERIENCES

This chapter will look at the theory of financing public infrastructure projects and look at interstate and overseas experiences.

The discussion on financing public infrastructure projects needs to be grounded on a review of public choice theory.

Public Choice Theory And Cost Benefit Analysis

According to the Palgrave Dictionary of Economics, public choice theory began in the 18th and 19th centuries when a number of mathematicians, Condorcet, Borden, Laplace and Lewis Carroll, became interested in the mathematics of the voting process. Duncan Black rediscovered it in the 1950s and is considered the father of modern public choice theory. Historically, economics dealt to a very large extent with the choice of government policies with respect to economic matters.²⁵

The public choice approach to the analysis of bureaucratic behaviour begins by drawing parallels between government departments and agents in the private sector in the economy. Both are responsible to ultimate decision makers, ie. legislators and shareholders, but enjoy some latitude in the way in which this responsibility is met. Piggott does not claim that there are no important differences between public and private

²⁵ Tullock, Gordon: The New Palgrave: A Dictionary of Economics. Edited by John Eatwell, Murray Milgate, Peter Newman, Macmillan, London, 1987, 4 vols. illus. Volume 3, p1040

sector agencies, but rather puts forward an argument to support the view that the economic analysis of bureaucratic behaviour may be fruitful.²⁶

An example of public choice theory is government allowing the choice of private and the public sector to supply roads. Generally speaking roads have been built by the public sector, although there is the trend towards more private sector involvement.

With the involvement of the private sector, the public will have the choice of using a public road or a private road. The public will make a choice as to which road to use based on time savings, fuel usage, toll costs and other reasons dependent on the user.

Governments use the cost benefit analysis tool to assess projects where the market mechanism does not provide an accurate indication of the costs and benefits to society.

Harris²⁷ examines the use of the cost benefit analysis by governments in deciding what process should be used to involve the private sector in the provision of public infrastructure. Harris points to the use of cost benefit analysis where there is no market price for outputs (e.g. the recreational benefits of national parks) or the market prices which do exist may not adequately measure society's valuation.

²⁶ Ibid, p114

²⁷ Harris, G. T.: "Cost Benefit Analysis: Its Limitations And Use in Fully Privatised Infrastructure Projects", Australian Journal of Public Administration, v.50, No. 4, December, 1991

Arguments To Justify Moving Functions From The Public Sector To The Private Sector

To demonstrate that it is more efficient to use the private sector to participate in public infrastructure, a literature search has been made in areas where governments have decided to privatise public trading utilities in order to achieve greater efficiencies.

Osborne and Gaebler²⁸ go to great lengths to show that successful governments are entrepreneurial and have no hesitation in removing restrictive rules and regulations.

In the area of privatisation, Osborne and Gaebler believe it is essential to promote and encourage competition rather than monopolies, especially in the public sector. They further believe people in our community who are career bureaucrats, who fear rotting or abuse with mission driven government should have faith in the institution of proper accountability measures that carefully monitor the outcome of programmes, rather than through a myriad of rules that simply use up resources to administer and observe.

In another blow to supporters of the old bureaucratic public service, Osborne and Gaebler argue that most public sector agencies are funded by government and it is generally politicians and interest groups who are the focus of activity, rather than customers. Many public sector systems are designed more for the people who run them than for those they are intended to serve.

²⁸ Osborne, David and Gaebler, Ted: Reinventing Government: How the Entrepreneurial Spirit is Transforming the Public Sector, Addison-Wesley, Reading, Mass., 1992

Osborne and Gaebler believe that the culture of governments involves spending money rather than earning it. With people objecting to paying large amounts of tax, entrepreneurial governments have been forced to gain revenue from other sources and manage their resources more efficiently and effectively while eliminating waste.

The most common mechanism for raising money is the charging of fees for services provided, as already occurs in relation to various government utilities. Fees can be charged in full or be subsidised, either to ensure the provision of socially useful services like public transport for instance, or for reasons of equity.

Consistent with "steering rather than rowing", entrepreneurial governments increasingly operate as brokers and facilitators, rather than as direct service providers. These governments endeavour to use leverage and intervention in the market place to produce desired outcomes. An example of this is where the Commonwealth Government has used tax incentives rather than government initiated programmes to promote research and development in industry. Osborne and Gaebler regard this trend as representing a "third way"²⁹ coming between State controlled or State administered programmes and a completely laissez faire, free market approach.

There are many ways in which governments can seek to structure and influence the market place, apart from tax credits and user-pay fees.

²⁹ Ibid, p284

1. The establishment of rules, for example, Town Planning Regulations, to govern the market place;³⁰
2. the creating or influencing of demand for particular goods and services as happens in the subsidising of child care;³¹
3. the stimulation of private sector activity through a variety of means;³² (the Victorian Government provided a good example of this when it granted a Casino licence in exchange for a construction programme in a tourist precinct).

Osborne and Gaebler believe in market oriented government, although they acknowledge the importance of balancing markets and community. Markets, they argue, are only half the equation, especially if equity is a central concern. The other half of the equation is community empowerment. This, in turn, focuses on markets and community and is what they call "moving right and left at the same time".³³

Osborne and Gaebler³⁴ believe that successful governments, and especially the people who lead them, are behaving like successful business entrepreneurs. This entrepreneurial approach involves dispensing with arbitrary and restrictive rules and regulations, clearly identifying who the prime customers are and doing more with less. The authors believe that successful governments will take advantage of the vast scope that exists for them

³⁰ Ibid, p290

³¹ Ibid, p283

³² Ibid, p291

³³ Ibid, p305

³⁴ Osborne, David and Gaebler, Ted: Reinventing Government: How the Entrepreneurial Spirit is Transforming the Public Sector, Addison-Wesley, Reading, Mass., 1992

to operate more like client oriented businesses do, seizing opportunities as they emerge and continually striving to eliminate waste. Consequently, they would support the view that the City Link project being tendered to the private sector was correct based on their theories of government continually striving for efficiencies.

Governments over the years have been seen as tax collectors and service providers. Osborne and Gaebler believe in an alternative solution whereby the fundamental role of government should be "problem solving by catalysing action throughout the community".³⁵ Osborne and Gaebler have coined the phrase "steering, rather than rowing", in other words the government role becomes one of setting the direction, making policy, dispensing resources and evaluating the authorities, rather than engaging in direct service delivery.

Benefits Of Competition

As mentioned earlier, Osborne and Gaebler believe it is essential to promote and encourage competition rather than monopolies. The authors point to the essence of this principle, summed up by John Moffitt who said "The issue is not public versus private. It is competition versus monopoly".³⁶ This is because competition leads to a greater consciousness about costs and a better level of service delivery.

³⁵ Ibid, p28

³⁶ Ibid, p76

Osborne and Gaebler suggest that the advantages of increased competition are:

1. Greater efficiency and value for money; "more bang for the buck".³⁷
2. pressure on monopolies to consider and respond to customers' needs;³⁸
3. greater likelihood that innovation is valued and rewarded;³⁹
4. increased pride and morale of public sector employees.
(There is acknowledgment by the authors that job security needs to be maintained for this to occur).⁴⁰

Osborne and Gaebler point to E. S. Savas, Chairman of the Department of Management at City University of New York, and one of the United States' leading experts on competition in the public service. When Savas left the Government he convinced the National Science Foundation to fund a large scale comparison of public and private garbage collection. The results were quite striking and irrefutable, with private firms under contract being equally effective, equally responsive but vastly more efficient than government agencies. Further studies by Savas have shown that on average public service delivery is 35-95% more expensive than contracting, even when the costs of administering the contracts is included. Savas did admit that in a small number of cases

³⁷ Ibid, p80

³⁸ Ibid, p82

³⁹ Ibid, p83

⁴⁰ Ibid, p84

he has seen the public sector match the private sector, where the Government competes continually with the private sector.⁴¹

Osborne and Gaebler use an example by Roger Douglas, a former Labor Party Finance Minister in New Zealand, when arguing that competition forces public (or private) monopolies to respond to the needs of their customers. "Air New Zealand as a State-owned business had always done a first class job for customers on international routes because they were competing with Qantas, Pan Am and British Airways. However, domestically Air New Zealand was a disaster. Passengers trudged through the rain from the terminal to their aircraft and waited up to 20-30 minutes at the other end for their luggage. Nobody realised what they were missing until the New Zealand Government decided to allow Ansett to trade in New Zealand. Overnight, Air New Zealand upgraded their terminal, increased flights, reduced costs, provided better food, friendlier service and virtually a zero wait for luggage".⁴²

Some economists argue that high taxation rates discourage effort and productivity and drive resources away from highly taxed activities. At the same time social scientists with economists prominent among them had been paying increasing attention to public choice theory or the way in which governments make decisions. Many based their theories on the notion that politicians and bureaucrats are "economic men" who seek to maximise their own incomes and living standards subject to democratic restraints and a certain amount of personal idealism.⁴³ In 1986, a leading member of this school,

⁴¹ Ibid, p81

⁴² Ibid, p83

⁴³ Abelson, Peter (ed): "Privatisation: An Australian Perspective", Australian Professional Publications, Sydney, 1987, p8

Professor James Buchanan, was awarded the Nobel Prize for his contribution to economics. Like supply side economists, public choice theorists tend to conclude that the role of the public sector should be reduced.

To support Buchanan, leading Australian commentator Mr Paddy McGuinness wrote that the reason for this privatisation movement is the growing realisation that government owned enterprises have not performed satisfactorily; all too often they have been gigantic and powerful monopolies far more indifferent to the welfare of the community or the desires of their customers than private business. Monopolies like Telecom, Australia Post, the electricity industry, the railways and the water authorities have run their own policies and have blocked growth and structural change in the Australian economy.⁴⁴

Arguments For and Against Privatisation of Australian Monopolies

McGuinness⁴⁵ accuses large public monopolies of running their own policies and having deliberately blocked growth and structural changes in Australia. McGuinness, in particular, points to Telecom and Australia Post. This major project will use the argument of increasing competition to improve the efficiency of Telecom (now known as Telstra) to further justify the City Link project being built-owned-operated by the private sector.

⁴⁴ McGuinness, Paddy: "Efficient, responsible working should be focus of debate on privatisation", The Australian Financial Review, Sydney, 28 November, 1985, p12

⁴⁵ McGuinness, Paddy: "Efficient, responsible working should be focus of debate on privatisation", The Australian Financial Review, Sydney, 28 November, 1985, p12

Kenneth Davidson's views differ greatly from McGuinness'. Davidson argues that Telecom has been a champion of the broader nation. Davidson also argues that Telecom, which has been in public ownership, has provided Australia a telephone service throughout a continent larger than Western Europe at an average cost that compared more favourably with some much larger industrialised countries. He also argues that Telecom being in public ownership has allowed it to develop a world class telecommunication equipment industry that supplies 95% of the equipment for the network. If Telecom generates profits of \$2 billion, Davidson argues, how could the Federal Government be justified selling Telecom to the private sector?⁴⁶

In support of Davidson's views on Telecom, Don Greenless quotes the Federal Minister for Communications, Mr Lee, as ruling out the sale of Telecom's directory services and the mobile phone network.⁴⁷ Mr Lee believes that with Optus entering the telecommunications market, it is more important to have greater competition than debating who should own Telecom. The indication is that Telecom has become more efficient with the introduction of Optus resulting in the cost of telephone calls falling.

Domberger has a similar view to Davidson on the issue of Telecom, where he raises concerns over the introduction of a second telecommunications carrier and fears that this will bring about a reduction in standards for domestic carriers.

⁴⁶ Davidson, Kenneth: "National Sacrifice in Name of Competition", The Age Newspaper, Melbourne, 18 June, 1994, p18

⁴⁷ Greenless, Don: "Telecom Will Keep Key Assets", The Australian Newspaper, Sydney, 24 June, 1994, p15

The H. V. Evatt Research Centre believes Telecom should remain in public ownership. They argue that it is appropriate for the Government to protect Telecom which operates as a natural monopoly. This is necessary to prevent "cream skimming" in profitable areas, leaving less profitable areas and community service obligations to be borne by Telecom. In addition, where investment is "lumpy", protection of the natural monopoly is required - thus avoiding wasteful destabilising competition.⁴⁸

Earlier in this major project, Tullock⁴⁹ claimed as part of his theory that governments were essentially attempting to maximise some kind of welfare function for society.⁵⁰ Davidson argues that the sale of Tullamarine Airport will not benefit the community through privatisation.⁵¹ He further argues that the revenue loss from the sale of Tullamarine Airport will not be met by the interest savings on retiring the debt from the sale price. Consequently, Davidson argues that it is more efficient for Tullamarine to remain in public ownership.

Davidson refers to arguments by Professor Bob Walker to support the proposition that Tullamarine should not be sold to the private sector. Walker argues that the sale price of a public asset is supposed to go to repayment of debt or to reduce public sector deficits.⁵² However, according to Walker the reality is that governments use the sale price for recurrent expenditure in a single year. Walker also argues that public assets

⁴⁸ H. V. Evatt Research Centre: "The Capital Funding of Public Enterprise in Australia", Paper, Sydney, March, 1988, p148

⁴⁹ Tullock, Gordon: The New Palgrave: A Dictionary of Economics, Edited by John Eatwell, Murray Milgate, Peter Newman, Macmillan, London, 1987, 4 vols. illus. Volume 3, p1040

⁵⁰ Ibid, p1041

⁵¹ Davidson, Kenneth: "Community Will Lose if Tullamarine Goes Private", The Age Newspaper, Melbourne, 30 July, 1994, p17

⁵² Walker, Professor Bob: "The Ethical Question of Privatisation", New Accountant, 4 August, 1994

being considered for sale are financially attractive and are good earners. Walker, like Davidson earlier, argues that it is likely that savings from applying the proceeds of privatisation to debt-reduction are not likely to outweigh the loss of dividends and other receipts from the retention of a profitable government trading enterprise. Walker argues that in some cases public assets should remain in public ownership. For example, private sector purchasers of Government Trading Enterprises (GTEs) require a higher rate of return than lenders to National or State Government, while equity investors in listed or unlisted companies would expect a far higher return than that required by investors in government securities. Walker also points out that private sector firms must pay company taxes, sales taxes, payroll taxes and council rates.⁵³ Consequently, the maximum amount that a private sector purchaser could afford to pay to acquire an existing GTE, while ensuring an acceptable return to equity investors, will usually be significantly less than the retention value of the GTE to its current government owner.

Privatisation Of Government Agencies - Arguments For And Against

Arbouw refers to comments by State Premiers and their attitude to privatisation and infrastructure. Premier Kennett from Victoria states that he is "unashamedly pro private enterprise, pro business and pro growth". Premier Ray Groom from Tasmania states "we will vigorously apply the principle of strong commercial practice to all government business enterprises. All government agencies will be required to adopt those measures which will yield the best results in management of capital assets as well as financial and human resources". Queensland Premier Wayne Goss states that the "Queensland

⁵³ Ibid, p11

Government does not support a policy of privatisation of core public utilities and entities. At the same time, to ensure their efficient operation and secure the benefits for the Queensland economy of government-owned enterprises, the Queensland Government has begun a process of corporatisation to introduce appropriate accounting and management".⁵⁴

Every major financial institution, bank, construction company, state government and union, together with large conglomerates such as BHP and Boral, are now involved in one way or another in understanding, defining and developing the privatised infrastructure market. Infrastructure projects will make a huge call on the Australian capital market. In 1992 the market had raised \$18.5 billion in major share listings including the Woolworths, Channel 7 and Commonwealth Bank floats, thus diminishing the funds available in the capital markets.⁵⁵

Institutional involvement in infrastructure equity is an investment in the safe, constant cash flow that is produced by road tolls or by government-guaranteed take-or-pay arrangements in the case of water and electricity supply. Although infrastructure equity does not provide the same level of liquidity as other investments, it does give the institutions a guaranteed cash stream in a project with a life span of up to 20 years. In the case of the City Link Project the project life is expected to be 30-33 years.

⁵⁴ Arbouw, John: "Public Benefit Private Gain", Australian Business Monthly, November, 1992, p92

⁵⁵ Ibid, p92

A problem with private investment in public infrastructure projects is the reaction of the Australian public to possible overseas companies owning and operating, for example, road systems, sewerage works or water projects. This debate was particularly relevant in Victoria with the sale of the State Electricity Commission. However, the State Government is encouraging overseas companies to have local businesses or institutions as partners.

The H. V. Evatt Research Centre in its report⁵⁶ on capital funding of public infrastructure claims that "public enterprises are not invariably less efficient than their private sector counterparts and they have made a vital contribution to Australia's economic and social development throughout history".⁵⁷ The Evatt Research Centre argues that with adequate capitalisation the public enterprises can run as efficiently as the private sector.

Socialists argue that privatisation is a threat and that it is a comprehensive strategy for permanently restricting the welfare State and public services in the interests of capital. The socialists argue that for workers and users, privatisation means job losses, wage cuts, working harder for longer hours under worse conditions. It means paying more for poorer services. Profitability, they believe, will dictate the provisions of services and that Tory propaganda about more choice, greater flexibility and increased efficiency hides the stark reality of third rate health care, third rate education and third rate social services for working class people.⁵⁸

⁵⁶ H. V. Evatt Research Centre: "The Capital Funding of Public Enterprise in Australia", Paper, Sydney, March, 1988

⁵⁷ Ibid, pV

⁵⁸ Whitfield, Dexter: Arguments for Socialism Making it Public: Evidence and Action Against Privatisation, Pluto Press, London, 1983, p2

It is easier to evaluate the impact of privatisation based on public trading enterprises. These organisations are geared to production and trade, their output can be measured and sold and the performance of managers is assessed at least in part by profits and losses generated. These features provide a comparison with private sector performance, are more manageable and facilitate the process of transfer from the public to the private sector. The economic analysis of bureaucratic behaviour is still relatively underdeveloped. Even in its present form, however, it strongly suggests that the potential production efficiency gains from privatising bureaucratic agencies may be greater than the gains available from privatising public trading enterprises.⁵⁹

Two important features of the public agency's environment which differentiate it from its private sector counterpart, are that it is typically a monopolistic supplier and that its services are likely to be of a non-market nature. Frequently an organisation's performance can be measured only in terms of its activities, rather than in terms of output which is of ultimate benefit to the consumer. Piggott raises the argument that if an agencies output is not measurable and if there is no competing organisation with which to compare costs, how can the efficiency of a bureaucracy's performance be monitored?

Piggott refers to Niskanen's view that where bureaucracy's performance cannot be monitored these circumstances "give the bureaucrat considerable freedom to pursue his own objectives which may include salary, perquisites of the office, public reputation,

⁵⁹ Piggott, John: "Privatisation and Public Economics - Some Neglected Issues (in Abelson, Peter (ed)) *Privatisation an Australian Perspective*", Australian Professional Publications, Sydney, 1987, p109

power, patronage, output of the bureau, ease of making changes and ease in managing the bureau".⁶⁰

Hartley⁶¹ adds further support to Piggott's views and argues that the owner-manager has an incentive to maximise the present value of his assets and generally reduce the cost of production.

Niskanen's model of bureaucrats maximising their own budgets so they pursue their own objectives can be monitored with appropriate accounting systems. Further arguments against Niskanen's model ignore many bureaucrats who are individually dedicated to the public service and the public good and have chosen a career in the public service because of their attitude. Niskanen's model also suggests that bureaucracies are likely to be less productively efficient than private enterprises and this in turn suggests that there may be greater gains to be reaped from privatising government agencies charged with administering non-marketable services than there are from selling off a public enterprise.

Piggott argues against Niskanen for the need to privatise bureaucratic agencies because their output is non-market and the Government may not wish to relinquish control of this particular function. Piggott uses the example of a health department and the wish of the Government to maintain this under government control. According to Piggott there is considerable scope for improving the efficiency of the services by contracting them out

⁶⁰ Niskanen, W. A., Jr: Bureaucracy and Representative Government, Aldine & Atherton, Chicago, 1971, p38

⁶¹ Hartley, Peter: "Privatisation Lessons From Public Utilities", Australian Institute for Public Policy, 1986

to the private sector. His argument is based on the high proportion of public sector expenditure and also the substantial degree of operating inefficiency that is likely to be present in the public sector operation.

Deane⁶² puts forward some conceptual issues, that economic activity is primarily about transactions between different parties, and at the heart of the interrelationship is the need for information and the cost of obtaining that information to facilitate decisions about the transactions undertaken by the different parties.⁶³ This argument by Dean is critical for the successful City Link Project bidder when they are dealing with the various bureaucracies, but also when managing construction costs over a five year period and toll setting for a project which will not be operational for five years.

Steel and Heald⁶⁴ argue that privatising public enterprises through a policy of denationalisation can generate proceeds for Treasury through asset sales and reduce public expenditure. However, there are longer term implications which are difficult to estimate. If, for example, denationalisation were to lead to the more rapid contraction of a declining industry, there would be second round effects in the form of additional public expenditure on redundancy payments, social security benefits, infrastructural adjustments and industrial promotion.⁶⁵

⁶² Deane, Roderick: "Reflections on Privatisation", Occasional Papers, The Centre for Independent Studies, March, 1991

⁶³ Ibid, p4

⁶⁴ Steel, David and Heald, David: "Privatising Public Enterprises", Royal Institute of Public Administration, London, 1984

⁶⁵ Ibid, p22

Some critics believe that the recession in Australia has forced big spending government departments and private companies to look for ways to cut costs and gain efficiencies, with the result that more of their non-core operations are being contracted out. As the public and private sectors realise that some outside companies are more efficient than their own internal divisions, small business will be given many new contracts. Union objections have so far proved the biggest stumbling block to contracting out much government business.⁶⁶

The Federal Government's early attempt at contracting out government functions was the business migration scheme. Private consultants based overseas were used to select candidates. Unfortunately, the scheme was criticised for its lack of regulations and its potential for criminal abuse and was put on hold.⁶⁷

The NSW Government is looking to the private sector to provide funding and to operate part of the hospital system, due to the shortage of government funding. The NSW Government is paying out \$300 million a year on hospital maintenance⁶⁸ and believes efficiencies within the private sector can shift the cost burden from the government to the private sector.

Forde and Malley⁶⁹ believe that it is essential not to confuse privatisation with commercialisation, where governments contract in, or contract out, particular services

⁶⁶ Gilchrist, Michelle: "Contracts Prove The Recessions Windfall", Business Review Weekly, 23 August, 1991

⁶⁷ Ibid, p89

⁶⁸ Hannaford, John: "Putting Profit Into Public Hospitals", Directions in Government, April, 1992, p21

⁶⁹ Forde, Kevin and Malley, Alex: "Widening The Privatisation Debate Hospital Cost Cure", Directions in Government, May, 1992

with the private sector. For example, contracting with a private company to provide linen or catering services to a hospital is commercialisation. Advocates of privatisation see the benefits in the hospital system, saving the community money as the private sector will manage the assets more efficiently; the privatised business is free from government funding restrictions, enabling it to expand according to consumer demands and the profitability of the proposal; it frees up government resources for other activities or reduces government debt; it provides more competition thereby encouraging the public sector to become more efficient; it will improve the overall efficiency of resource allocation by redressing the current imbalance between an over-utilised public hospital system and an under-utilised private hospital sector.⁷⁰

Disincentives For Private Sector Involvement In Public Infrastructure

With funding for infrastructure works becoming scarcer, governments are looking to the private sector to build-own-operate public infrastructure projects. However, the private sector involvement in infrastructure projects in Australia is being held back by red tape and bureaucracy, forcing many companies to look overseas for investment opportunities.⁷¹

Stolarek suggests that infrastructure projects will be attractive to the private sector provided that the key investment criteria are satisfied; the project must carry an adequate investment return for the investor; a high quality credit rating may be achievable by

⁷⁰ Ibid, p18

⁷¹ Stolarek, Tony: "Structuring for Infrastructure", Building Owner and Manager, May, 1994, p25

appropriately balancing the risks between the various investors and liquidity is required to give investment flexibility to the investor.⁷²

The Business Council of Australia believes taxation impediments and disincentives are especially significant in impeding infrastructure investment.⁷³ The Council believes that existing taxation anti-avoidance provisions should be redrafted to define more precisely the circumstances where deductions are to be denied so that legitimate infrastructure investments are not put at risk.⁷⁴

Arbouw⁷⁵ further supports the view that there is justification for private investment in public infrastructure. He claims that Australia badly needs public infrastructure work done and discusses ways of encouraging the private sector to invest in such projects. However, Arbouw does make the point that if "projects need to rely on tax incentives or government handouts to be commercially viable, then it is little wonder governments are slow to react".⁷⁶ In another article by Arbouw,⁷⁷ he makes the point that the privatised infrastructure industry has had some good results with recent toll road projects, but if the market is to develop further, the commercial and legal framework which provides the checks and balances on the private sector will have to be extended to the public sector.⁷⁸

⁷² Ibid, p25

⁷³ Business Council of Australia: "Impediments to Private Sector Infrastructure Involvement", Submission by BCA to the Economic Planning Advisory Commission on 21 February, 1995, Business Council Bulletin, April, 1995, p30

⁷⁴ Ibid, p30

⁷⁵ Arbouw, John: "Rebuilding Australia", Australian Business Monthly, 21 August, 1991

⁷⁶ Ibid, p38

⁷⁷ Arbouw, John: "Public Benefit Private Gain", Australian Business Monthly, November, 1992

⁷⁸ Ibid, p94

Like Arbouw, Kirwan⁷⁹ believes there is a need to decrease reliance on public borrowing by shifting public sector recovery from recurrent charges to capital levies. Kirwan's article includes the transfer of responsibility for capital works to the private sector, with it taking two forms: provision of infrastructure in kind, followed by immediate asset transferral to the public sector or continuing the responsibility of maintaining the project and not transferring the residual assets to the public sector. Kirwan's point will be explored further when discussing the building of the City Link Project in relation to what should happen to the asset at the end of the contract.

Financing Problems Associated With Public Infrastructure

Previous writers have commented on the Government's capital funding shortfall in public infrastructure projects. Fray⁸⁰ points to the Australian Bureau of Statistics figures that show total government spending on capital infrastructure has dropped from 7.5% of GDP to about 4.4% of GDP this financial year (1994).⁸¹ Based on 1992/93 figures this represents a fall of \$3 billion, which Fray claims the private sector has been unable, or unwilling, to fill. Fray believes that the shortfall in funding is due to either direct Commonwealth cutbacks, or the drop of Federal payments to States which fell from 7.6% of GDP in 1982-83 to 4.9% in 1994-95.⁸²

⁷⁹ Kirwan, Richard: "Infrastructure Finance: Aims, Attitudes and Approaches", Urban Policy and Research, Vol 8, No. 4

⁸⁰ Fray, Peter: "Planes, Trains and Private Pains", The Bulletin, 7 June, 1994, pp20-21

⁸¹ Ibid, p20

⁸² Ibid, p20

The Commonwealth Bank⁸³ makes a similar point to Fray, in that the reduction of Government expenditure in the area of infrastructure has been in a steady decline. The Commonwealth Bank claims that infrastructure represents the backbone of the economy, providing the form within which other economic activities take place. Efficient infrastructure, they claim, is vital to Australia's economic prospects, having a direct bearing upon the competitiveness of domestic industry and the scope for future living standards.

There is a strong desirability to increase the involvement of the private sector in sponsoring and financing economic infrastructure development and this is supported by the significant constraints and limitations under which governments must function.⁸⁴ Governments fail to separate capital expenditure on economic infrastructure from recurrent expenditure in their reporting and control procedures, and this added to financial constraints allows a window of opportunity for the private sector to participate in infrastructure projects. Dixon believes superannuation funds could provide an ideal and very substantial funding source for the provision of economic infrastructure over the next decade; however, there needs to be modifications made to the Income Tax Assessment Act, sections 51AD and 16D and 16E.⁸⁵ This is needed to give greater financial incentives to investors who wish to invest in public infrastructure (i.e. a different tax rate for superannuation funds).

⁸³ Commonwealth Bank: "Strengthening The Economy's Backbone: Spending on Infrastructure", Economic Newsletter, August, 1991

⁸⁴ Dixon, John: "Private Sector Provision of Public Infrastructure", Canberra Bulletin of Public Administration, No. 65, Canberra, July, 1991, p132

⁸⁵ Ibid, p132

Richard Kirwan⁸⁶ refers to the need to devise new methods of financing infrastructure, and to decrease reliance on public borrowing by shifting public sector cost recovery from recurrent charges to capital levies. Public sector pricing of infrastructure should aim to reflect long run marginal cost and, where possible, its impact should accord with principles of social justice. Kirwan states that it is an important role for the private sector to provide some categories of infrastructure, but it is not as important as the development of a system of public sector cost recovery.

Kirwan refers to conventional pricing which can be adjusted to meet these criteria at least in the cases where earmarked revenue streams are well established. The need to avoid, or minimise borrowing, dictates that levies should cover the cost of capital investment.

Within the classification of networked infrastructure costs, there are at least three distinct types of costs: connection, consumption and capacity charges. Connection and consumption are straight forward, because the price of connection is a realised cost and consumption can be estimated based on past experience. However, the capacity charge is more difficult.

In pricing theory, a capacity charge aims to identify variable capital costs and to price it on a marginal cost basis. Variable capital costs are those associated with serving peak or variable demands, which would be avoided if the demand remained stable. In the case of the City Link Project, demand would increase with peak hour traffic and slow

⁸⁶ Kirwan, Richard: "Infrastructure Finance: Aims, Attitudes and Approaches", Urban Policy and Research, Vol 8, No. 4

during the late night-early morning periods. A capacity charge in Kirwan's pricing policy is not relevant as the City Link Project is a 'fixed supply asset' and, regardless of increased demand, it cannot increase supply. However, if the revenue stream for cars entering the City Link Project is based on a toll and this is set at a dollar rate based on 'peak' and 'off peak' rates (i.e. two different rates), this may make demand for the City Link Project consistent. This may also reduce traffic during peak hour and improve traffic flow.

Kirwan discusses The Interstate Commission's report which has recommended the so-called PAYGO approach. Under this method the aim of the measure would be in effect to recoup from vehicle users total road and vehicle-related outlays in each year.⁸⁷

Kirwan believes that a desirable pricing policy would base the capital component of recurrent charges on a real rate of return on current replacement costs. The Commission also ignored land costs as they were difficult to determine.

The United Kingdom Experience With Privatisation

Vickers and Yarrow⁸⁸ analyse the process of public ownership and its move to private ownership. In the United Kingdom there has been a radical transformation from public ownership to private sector involvement in business enterprises formerly owned by government, especially when Prime Minister Thatcher came to power in 1979. The total

⁸⁷ Kirwan, Richard: "Infrastructure Finance: Aims, Attitudes and Approaches", Urban Policy and Research, Vol 8, No. 4: 'The Interstate Commission (1990) Road Use Charges and Vehicle Registration: A National Scheme (GPS, Canberra), p188

⁸⁸ Vickers, John and Yarrow, George: Privatization, An Economic Analysis. The MIT Press, Cambridge, Mass. 1988

number of private shareholders in Britain roughly trebled⁸⁹ under Mrs Thatcher's privatisation programme.

Looking at the United Kingdom experience, a rise in public expenditure as a share of the national income is the so-called "relative price effect". Since the scope for raising productivity in many parts of the public sector is quite limited, the price of public sector output rises, at any given inflation rate, relative to the price of private sector output. This will result in a rising ratio of public expenditure at current prices even if in real terms the share of the public sector remains the same.⁹⁰ Owen points to the fact that increases in public sector financing require an increase in taxes thereby inhibiting investment and growth. In recent years this has led to vigorous efforts by most industrialised governments to cut back public sector expenditure. Owen also claims that "the public sector, per se, is becoming the victim of an ideological political debate about privatisation or nationalisation in which the criteria of improving standards and cost effectiveness have become secondary to dogmatic assertions of the supposed superiority in all instances of private or State ownership".⁹¹

Pryke, like Owen, also reviews the public sector in the United Kingdom and concentrates on its productivity over the years.⁹² Pryke points out that the output per worker in the public sector has improved in such areas as electricity, coal, public enterprise sector and nationalised buses. However, some of these figures may be disputed because of the substitution of capital for labour.

⁸⁹ Ibid, p1

⁹⁰ Owen, David: A Future That Will Work: Competitiveness and Compassion, Penguin Books, Great Britain, 1984, p48

⁹¹ Ibid, p58

⁹² Pryke, Richard: Public Enterprise in Practice, McGibbon & Kee, London, 1971, p36

It is claimed that competitive tendering of services provided in the private sector offers very large financial savings and efficiency improvements to government. Domberger and Hall believe that public sector management is now closely linked to the renewed interest in benchmarking evident in many large private sector companies.⁹³ All levels of government use the tendering out process to the private sector in order to receive lower prices. In the United Kingdom, the National Audit Office in 1987 reported a total of £945,000 savings from the contracting out of domestic catering and laundry services in the National Health Service. Savings ranged from 13-62% for domestic service contracts, 5-19% for catering contracts and 6-26% for laundry contracts.⁹⁴

Other World Experiences With Privatisation

At an international gathering of senior government officials in 1989, the Minister of Finance of a socialist country was heard to say that the only way to ensure the future of socialism is to increase the rate of privatisation. He believed that privatisation can serve a variety of objectives, from reducing budget deficits to restructuring industries to compete in the European Common Market. Despite a wide variance in political motivations, the results from privatisation tend to be similar across nations: higher productivity, a smaller public sector and savings for the taxpayer.⁹⁵

⁹³ Domberger, Simon and Hall, Christine: "Competitive Tendering and Contracting: Are Cost Reductions Compatible With Quality of Service?", Business Council Bulletin, No. 82, December, 1991, p29

⁹⁴ Ibid, p29

⁹⁵ MacAvoy, Paul W., Stanbury, W.T., Yarrow, George and Zeckhauser, Richard J. (Eds): Privatization and State-Owned Enterprises, (Lessons from the United States, Great Britain and Canada), Kluwer Academic Publishers, Boston, 1989, p1

Wolf⁹⁶ argues that there is a worldwide trend away from the public sector delivering goods and services towards the private sector, and uses the World Bank to support his arguments. The World Bank believes that improved efficiency by privatising public utilities could increase GDP by \$55 billion in developing countries.⁹⁷

Zeckhauser believes that State-owned enterprises are different from private firms and are created to meet redistributive objectives, for example, to favour certain consumers, regions, domestic suppliers or employees. Moreover, various groups can pressure the enterprise to meet possibly conflicting objectives, and effective compromises may lead to inefficiencies.⁹⁸

Collignon⁹⁹ describes how California increased its infrastructure funding by allowing for financial incentives to those who participate, through tax breaks which reduce their financial risk.¹⁰⁰ Also using a United States experience, Koelmay¹⁰¹ believes a national infrastructure corporation would be needed to support infrastructure projects which can guarantee an acceptable return. His article points to the use of pension funds in the United States and how this could be tapped into for infrastructure projects.¹⁰²

⁹⁶ Wolf, Martin: "Sell Offs Redefine Role of The State", The Australian Newspaper, Sydney, 21 June, 1994, p49

⁹⁷ Ibid, p49

⁹⁸ Ibid, p14

⁹⁹ Collignon, Frederick C: "Where's The Money Coming From?: Any Lessons for Australia from the California Experience?", Australian Planner, v.29, No. 3, September, 1991

¹⁰⁰ Ibid, p116

¹⁰¹ Koelmay, Douglas: "To Bank or Not to Bank: Finding Money For Infrastructure", Governing, Vol. 6, No. 1, October, 1993

¹⁰² Ibid, p54

New South Wales Private Roads Experience

Arbouw¹⁰³ points to the example where if the New South Wales government upgraded the Pacific Highway to a dual carriageway it would cost taxpayers \$2.4 billion, take 25 years to build and a dual carriageway between Grafton and Bangalow would still be needed. However, if the Government used a part of its road allocation as equity in a private sector company which would build Motorway Pacific, the project could be completed in 10 years at a cost of approximately \$5.5 billion. The tolls are estimated at \$1.40 to \$2.00 for every 20 kms and would be collected through an Automatic Vehicle Indicator or petrol levy¹⁰⁴

Arbouw believes that the private sector is reluctant to assume traffic volume risks for roads extending beyond the inner city network. The Commonwealth Bank of Australia and Westpac, both involved in the three Sydney toll roads, are comfortable with traffic volatility involving inner city traffic, but they are not prepared to venture beyond city limits without guaranteed revenue streams.¹⁰⁵ This situation was again experienced in the closing stages of the City Link Project negotiations, when the Banks did not want to participate because the Victorian Government would not guarantee traffic flows.

The M2 Motorway in Sydney, NSW, costing \$650 million, is the first infrastructure project in the world to be publicly listed on a stock exchange. It is also the first Australian infrastructure project to bypass corporate investors and tap directly into the

¹⁰³ Arbouw, John: "For Whom The Road Tolls", Australian Business Monthly, June, 1993

¹⁰⁴ Ibid, p28

¹⁰⁵ Ibid, p28

institutional debt and equity markets. Ferguson¹⁰⁶ investigated the M2 prospectus issued November, 1994 and found that it guarantees investors a tax free distribution of 10¢ a unit per year, payable quarterly in arrears, for the first three years. This puts investors on a guaranteed cash yield of 10% for three years based on an issue price of \$1.00, placing a person on a marginal tax rate of 48% on an 18.5% yield.¹⁰⁷

However, Maclean's¹⁰⁸ assessment of the NSW experience is quite different, stating that the Sydney Harbour Tunnel built by the private sector will leave taxpayers with a \$4 billion bill over the next 30 years. This has been revealed by the Auditor General who also argues that the \$2.00 toll should have only been \$1.45. The Auditor General believed that the Government was exposed to too much of the financial risk and has ordered an overhaul of financial arrangements between the NSW Government and companies contracted to build big public works.¹⁰⁹

Looking for direction from overseas interviews and literature gives conflicting opinions and views.

The South Africa Private Roads Experience

The South Africans believe toll roads have worked very successfully. In fact, in the recent past all new national roads have been funded by a user pay principle. Dr

¹⁰⁶ Ferguson, Adele: "Motorway Float Runs Into Trouble", Business Review Weekly, 21 November, 1994

¹⁰⁷ Ibid, p30

¹⁰⁸ Maclean, Sheena: "The NSW Experience - Hidden Costs of Private Roads", The Age Newspaper, Melbourne, 19 November, 1994, p13

¹⁰⁹ Ibid, p13

Mitchell, the Deputy Director-General, Department of Transport¹¹⁰ in South Africa, explained in an interview with the writer that the Government organises the finance and the toll collected is used to repay the loan. In some cases the loan has been re-adjusted where vehicle estimates have been too conservative or too generous.

What was startling about the Mitchell interview was the revelation that the South African Government has tolled existing roads on two previous occasions. This is particularly relevant with the current debate on the possibility of tolling the South Eastern Freeway or the Tullamarine Freeway as existing components of the planned City Link. (The significance of this will be explained in greater detail in chapter three). The South African motorists were outraged when the toll was introduced on existing roads with ugly scenes and attempts by the public to pull down the tolling booths. One of the most common arguments put forward by the public was that previously paid taxes have already paid for the roads. Mitchell staunchly defends the push for tolling existing roads because research shows that the construction of a road represents about one third of the total costs in the life of a road. The other two thirds of total costs represent maintenance and upgrading.

The South African Western Province Minister for Roads and Public Works,¹¹¹ said that looking for revenue raising for road construction was limited, although an increase in car registration was an option. The Minister was particularly interested in the Victorian Government's three cent fuel levy. Fuel in South Africa is 165 cents per litre (\$A0.66¢)

¹¹⁰ Mitchell, Dr Malcolm, Deputy Director-General, Department of Transport, South Africa, Interview, 20 January, 1995

¹¹¹ Ramatlakane, Leonard, Minister of Roads, Transport and Public Works, Province of Western Cape, Cape Town, Interview, 13 January, 1995

and the thought of an extra three cents should not be too difficult, in terms of political impact.

The Japanese Private Roads Experience

The Japanese Government does not agree with the South African way of doing business when it comes to building roads. In an interview with Mr Hayakawa and Mr Nakane,¹¹² they stated they would never contemplate tolling an existing road. However, all newly built national roads will be toll roads, with overall plans to build 14,000 kms of national roads, Japan has only built 5,500 kms so far. Japanese motorists are prepared to pay tolls because they want the existing congestion reduced. The Japanese believe that to toll an existing road would be to disadvantage current motorists, so any upgrading or maintenance on a toll free road will be done at "no cost to the current motorist".¹¹³

Other World Private Roads Experiences

Manidis Roberts Consultants¹¹⁴ conclude that "there is no conclusive evidence that financing roads through tolls is better than user fees such as licence fees and petrol taxes".¹¹⁵ They believe that most countries have resorted to toll roads where there have been no alternatives, ie., they were unable to extend existing sources of finance. Furthermore, the "advantages of toll roads are that they enable governments to raise

¹¹² Hayakawa, Katsunori, Director, Trunk Road Office, Roads Division, O.P.G. and Nakane, Shinji, Senior Staff, Trunk Roads Office, Roads Division, O.P.G., Interview, March, 1995

¹¹³ Ibid

¹¹⁴ Manidis Roberts Consultants: "Private Participation in Infrastructure", A Research Paper, Surry Hills, NSW, July, 1989 (unpublished)

¹¹⁵ Ibid, p(i)

more funding than would have been possible through ordinary public financing, they are usually built sooner and toll facilities are generally better maintained compared with other roads".¹¹⁶

In Finland, a 100 km toll road was proposed with twin two-lane carriageways, however, when it was discovered that the toll would be the same as the price of a railway ticket for the same distance, it was decided that it would not be acceptable in addition to vehicle operating costs.¹¹⁷

Loan Council Limitations - Private Sector Involvement In Public Infrastructure

The issue of financial risk and provision of capital is crucial when the private sector is participating in public infrastructure and it is essential that the Government has tight financial control over these two areas.

Talbot¹¹⁸ argues that the Loan Council guidelines are too restrictive, and this has allowed the private sector an opportunity to become involved in the building of infrastructure projects. Talbot specifically discusses toll roads and traffic volumes and states: "it is fair to say that the market is reluctant to assume traffic volume without reservation or some kind of protection".¹¹⁹ Talbot finds support from Wilmoth,¹²⁰ who argues that global

¹¹⁶ Ibid, p(i)

¹¹⁷ Ibid, p7

¹¹⁸ Talbot, John: "Paying For Public Infrastructure", Directions in Government, v.5, No.1, February, 1991

¹¹⁹ Ibid, p26

¹²⁰ Wilmoth, David: "Urban Infrastructure Finance Issues in Australia", Urban Policy and Research, v.8, No. 4, December, 1990

limits on States restrict business activities and local governments are unable to grow because of the State's borrowing limits.¹²¹

The first report by the NSW Public Accounts Committee¹²² highlighted many of the problems associated with the Loan Council guidelines.¹²³ The report makes the point that the guidelines are confusing and discourage private sector participation, especially where there is a joint venture between a private company and the Government.¹²⁴

The Federal Treasurer, in 1992/93,¹²⁵ announced that borrowing limits would increase by 10%, and acknowledged the need for greater flexibility to ensure microeconomic reforms were to take place.¹²⁶ He also discussed the need to include operating leases within the global limits from 1993/94. The Loan Council,¹²⁷ allows for an increase in the level of global limits to include operating leases.

The Loan Council in June, 1993¹²⁸ started to investigate the need for individual jurisdiction, and the need to allow greater flexibility to achieve better use of resources. The literature shows that the Loan Council's report was intended to improve reporting procedures and to help the markets and communities obtain accurate and transparent information regarding net borrowings.¹²⁹

¹²¹ Ibid, p164

¹²² Public Accounts Committee, Parliament of New South Wales: Government and Business in Partnership: Private Funding of Public Infrastructure, Sydney, March, 1993

¹²³ Ibid, p5

¹²⁴ Ibid, p5

¹²⁵ Dawkins, John, Federal Treasurer: "Premiers Conference/Loan Council Outcome for 1992/93", Press Release, Canberra, 12 June, 1992

¹²⁶ Ibid

¹²⁷ Loan Council: "Treatment of Operating Leases", Report by Commonwealth, State and Territory Officers, 5 July, 1993

¹²⁸ Loan Council: "Future Arrangements for Loan Council Monitoring and Reporting", 5 July, 1993,

¹²⁹ Ibid, p3

The NSW Parliament Public Accounts Committee¹³⁰ emphasises the frustration and anger at the delays, deficiencies and expenses¹³¹ that are being incurred by the private sector when trying to understand the Loan Council guidelines.¹³²

The Premier of NSW¹³³ agreed with the Committee's findings, when he addressed a Senate inquiry saying that millions of dollars worth of important public projects had been delayed or even stopped by the way in which the States' borrowing rules had been applied.

The second volume of the Public Accounts Committee's report was released in February, 1994¹³⁴ and it concentrates once again on the difficulties with the private sector entering into infrastructure projects because of Loan Council guidelines.

The current situation relating to Global Borrowing Limits means that individual projects will be reflected in Loan Council allocations only to the extent of public sector exposure. The Committee supports this view and believes it is a flexible and a sensible development.¹³⁵

¹³⁰ Public Accounts Committee, Parliament of New South Wales: Infrastructure Management and Financing in New South Wales, Volume 1: From Concept to Contract - Management of Infrastructure Projects, Sydney, July, 1993

¹³¹ Ibid, p(x)

¹³² Ibid, p(xv)

¹³³ Megalogenis, George: "Borrowing Rules Hurt Public Works: Greiner", The Australian Newspaper, Sydney, 28 July, 1993, p5

¹³⁴ Public Accounts Committee, Parliament of New South Wales: Infrastructure Management and Financing in New South Wales, Volume 2: Public-Private Partnerships - Risk and Return in Infrastructure Financing, Sydney, February, 1994

¹³⁵ Ibid, p17

One of the recommendations in this report is that "in conformity with the new flexible Loan Council guidelines, the Government's existing policy of requiring the private sector to bear the majority of the risk in all cases be relaxed".¹³⁶

The NSW Public Accounts Committee¹³⁷ when handing down its fourth report claims that the alteration to the Loan Council guidelines for global borrowing eliminates much of the confusion, secrecy and illogical characteristics of the old. "The new guidelines open the way for much more rational analysis of projects with regard to risk weighting and allocation between the Government and the private sector".¹³⁸

The new system of risk weighting will enable the Government to assess their risk exposure to projects for Loan Council purposes. Hogan¹³⁹ claims that the Commonwealth and the State Governments have broken more new ground with a proposal for innovative guidelines on the use of private funding for public infrastructure. The new guidelines make it easier to decide whether a project falls within or out of Loan Council global borrowing guidelines.

Mr Andrew Tinks, Chairman of the NSW Public Accounts Committee, believes the Government should consider the bond market as a source of financing public infrastructure projects. Chong¹⁴⁰ writes that public infrastructure needs will only be met

¹³⁶ Ibid, p17

¹³⁷ Public Accounts Committee, Parliament of New South Wales: The Financing of Infrastructure Projects, Sydney, November 1993

¹³⁸ Ibid, p36

¹³⁹ Hogan, Robert: "Canberra, States Agree on Project Guidelines", The Australian Financial Review, Sydney, 21 October, 1993, p28

¹⁴⁰ Chong, Florence: "NSW Urged to Build With Bonds", The Australian Newspaper, Sydney, 1 March, 1994, p48

by the private sector, and infrastructure funds need to be established to allow for a finance source. Similarly, Bitá¹⁴¹ believes the NSW Government should set up a company to raise money for infrastructure works in light of the Sydney Olympics in the year 2000.

¹⁴¹ Bitá, Natasha: "Shares Plan to Raise Cash for States", The Australian Newspaper, Sydney, 23 November, 1993, p4

CHAPTER THREE - THE VICTORIAN CASE STUDY

The State Government is on schedule to deliver ongoing Current Account savings of \$1.2 billion per year. The Government is meeting the targets set in its pre-election promise by delivering a sustainable Current Account surplus by no later than 1995-96 financial year. In order to keep the budget within its limits, the State Government could not afford the capital outlay for major public infrastructure, with the additional interest burden attached to it, and would need to look towards private investors.

The privatisation of the City Link Project is consistent with the State Government's recent privatisation of the State Electricity Commission and outsourcing of a number of functions within some Government agencies.

The concept of linking eastern Melbourne with western Melbourne has been a talking point for over sixty years. Until recently the link was known as the Southern and Western Bypasses, but it is now referred to as the Melbourne City Link Project.

What Is The City Link Project?

The Melbourne City Link Project will connect three of Melbourne's major freeways - the Tullamarine, Westgate and South-Eastern, as well as significantly upgrading two of them in a project with a total cost of approximately \$1.7 billion.

The Southern Link will create a six lane road of freeway standard connecting the Westgate Freeway east of Kings Way to the South-Eastern Freeway. This connection

will be achieved in part by two tunnels passing under the Kings Domain and the Yarra River. The tunnels will have a common portal in Grant Street South Melbourne, but will diverge under the Domain.

The 3.4 km "Burnley Tunnel" will carry east bound traffic to link up with the South Eastern Freeway near Barkly Avenue in Burnley. West bound traffic will be provided with three lanes on the South Eastern Freeway from Burnley to enter the 1.6 km "City Link Project" near the former Army Depot in Batman Avenue on the city side of Punt Road, Richmond. The section of the Freeway between Punt Road and Burnley will incorporate two east-bound lanes from Punt Road.

The Southern Link will also involve the upgrading and widening of the South-Eastern Freeway to six lanes from Toorak Road to Burnley.

The Western Link will be made up of three sections:

- * the upgrading of the Tullamarine Freeway and the creation of a "Gateway to Melbourne" at Flemington Road for visitors travelling from the Airport. The freeway will be widened to eight lanes from the Flemington Road interchange to near Bulla Road, including peak-period express lanes in each direction for public transport (buses and taxis).
- * a six-lane road of freeway standard between the city end of the Tullamarine Freeway and Footscray Road, generally following the alignment of the Moonee Ponds Creek.

- * continuation of the six-lane road from Footscray Road to join the Westgate Freeway near Graham Street, Port Melbourne, via a new bridge over the Yarra River.

In aggregate, these three parts will constitute a freeway link of at least six lanes between Bulla Road and the Westgate Freeway.¹⁴²

Why Build The City Link?

1. The Government has determined that decisive action is essential to overcome major traffic problems in and near the Central Activities District of Melbourne.
2. The Southern and Western Links will also deliver major industry and micro economic reform benefits and community and environmental benefits.
3. Traffic will be able to travel around the Central Activities District, and the Link will also provide travel movements to the CAD itself and to adjacent facilities (e.g. the Arts Centre, Exhibition Centre, sporting facilities, the Casino).
4. The Project will remove through traffic from sensitive areas such as inner city streets, Kings Domain, Alexandra Avenue and residential areas; and reduce traffic volumes on parallel routes such as Boundary Road, Swan Street, Toorak Road, Dryburgh Street, King Street and Spencer Street.
5. The Link is estimated to reduce travel time, typically as follows (especially during business hours):

- * between Melbourne Airport and the city by up to 15 minutes

¹⁴² Melbourne City Link Authority: "Melbourne City Link Project", Information Paper, Melbourne, July 1995

- * from Dandenong to the city by up to 20 minutes
- * for freight from Dandenong to the port or rail terminal by up to 30 minutes

6. When completed the City Link will mean that road travellers, and in particular trucks, will be able to travel without encountering a traffic light from Dandenong to the Melbourne Airport or to the outskirts of Geelong. Not only does this mean that business operates more efficiently but it is also a major environmental initiative with:

- * reduced petrol consumption;
- * reduced noise levels as trucks will not be required to brake and accelerate at each traffic light; and
- * reduced emissions.¹⁴³

The current Victorian Government's views are consistent with Tullock's theory which was explained in Chapter One and states that competition can be brought about by contracting out government activities and transferring activities to the market. The City Link Project is the prime example of transferring a "usual" government function to the private sector.

The cost of the City Link Project as mentioned earlier is estimated at \$1.7 billion and it is to be built over a five year period. Prior to 1992, the current account deficit was approaching \$3 billion per year with overall government debt set at an estimated \$67

¹⁴³ Melbourne City Link Authority: "Why Build the Melbourne City Link", Information Paper, Melbourne, May, 1995, Section A(i)

billion.¹⁴⁴ Consequently, the ability for the incoming Government to begin taxpayer funded projects was limited. To make the Government's position more difficult, the credit rating of the State had been downgraded a number of ratings points which was pushing up the cost of borrowings. Clearly, the choice the Government had was to put the City Link Project out to the market or wait until the State fully recovered from its financial woes and allow the State to build it. Considering the project has been on the drawing boards for many years, the Government decided the time to act was now.

How Does The Government Encourage Private Sector Involvement In the City Link Project?

Infrastructure projects are normally very expensive and have a long return time on the investment. The Government must then be prepared to make these types of projects attractive to the private sector. To encourage the private sector to invest in Victorian Government projects, the Premier has set up in his department a "one stop shop", which allows the private sector to become involved in investment in Government infrastructure works. This department cuts through the bureaucracy and 'fast tracks projects' which is a direct incentive to private investors.¹⁴⁵

The Public Accounts & Estimates Committee, in 1993, listed the reasons why it is in the interest of the State Government to include the private sector. The Committee found

¹⁴⁴ Victorian Commission of Audit: Towards Prosperity, Melbourne, June, 1993, p12

¹⁴⁵ Burke, Craig, former Senior Research Officer of the Estimates Sub-Committee, Interview 25 March, 1993

that possible objectives for the utilisation of private investment in the provision of public infrastructure can include:

- * to offset reductions in Government spending on new and existing public infrastructure;
- * to enable a project to proceed when the Government may otherwise be unable or unwilling to provide the funds;
- * to allow legal ownership of the infrastructure asset to rest with private sector bodies and so improve the flexibility of the Government's available capital and recurrent funds;
- * to avoid Global Borrowing Limit restrictions on public borrowings;
- * to qualify for available taxation benefits;
- * to exploit private sector competitive efficiencies;
- * to share financial risks and benefits between public and private partners;
- * to accelerate the start of a project, but at an overall cost which is comparable to conventional public sector borrowings;
- * to create a profitable investment for the private sector, with secure cash flows and attractive rates of return (with direct or indirect user charges or Government subsidies);
- * as a means of introducing market discipline in the construction and operation of public infrastructure;
- * to allow those groups best placed to contribute, on a user pays basis, for certain infrastructure; and

- * to lessen the transparency of a Government's future financial obligations.¹⁴⁶

These objectives set out by the Public Accounts and Estimates Committee allow the State Government greater justification when arguing for the acceptance of Transurban's bid to build the City Link Project. The Hon. Graeme Weideman, Chairman of the Public Accounts and Estimates Committees, argued that the objectives set out above allow the Parliament, Government and the Premier, a basis upon which to lay the foundation to discuss and debate with the Prime Minister what should or should not be included in Loan Council guidelines when it comes to private investment in the public infrastructure.¹⁴⁷

It is difficult to estimate at what cost the public sector could build-own-operate the City Link Project. This matter will be discussed further in this chapter, but the notion that the public sector should not be involved in public infrastructure projects is further supported by Professor James Buchanan. Buchanan is a leading member of the school of thought that believes that government tends to grow too big. Like supply-siders, public choice theorists tend to conclude that the role of the public sector should be reduced.¹⁴⁸

¹⁴⁶ Victorian Public Accounts and Estimates Committee "Private Investment in the Provision of Public Infrastructure" 1st Report to Parliament, Melbourne, November 1993, p34

¹⁴⁷ Weideman, Graeme, M.P. Chairman of Public Accounts and Estimates Committee, Interview, 26 April, 1994

¹⁴⁸ Abelson, Peter (ed): "Privatisation: An Australian Perspective", Australian Professional Publications, Sydney, 1987, p8

Some years ago, VicRoads and its past bodies were seen as a large bureaucracy, with overstaffing problems and costly road construction. However, with the contracting out of many activities many would now see VicRoads as being a more professional and leaner operation. This raises the question later on in this chapter as to how VicRoads may have compared to Transurban in the building of the City Link Project in terms of costs and efficiency.

To assist private investors investing in public sector infrastructure, Treasury Victoria has published guidelines to set down ground rules. These rules enable the Government to analyse the process which is required for the private sector to become involved in public infrastructure works.¹⁴⁹ The current Victorian Government is keen to increase the private sector involvement in public infrastructure¹⁵⁰ and through Treasury Victoria's guidelines it is hoped that the Government's policy objective of securing increased private sector involvement in public infrastructure will be reached. The infrastructure guidelines work on the belief that increased private participation will expand the asset base of Victoria and increase the skills, expertise and opportunities for direct investment of private sector resources in infrastructure needed by the Victorian community.¹⁵¹

¹⁴⁹ Victorian State Treasurer, "Public/Private Sector Partnership", Victorian Government Infrastructure Investment Guidelines for Victoria, Melbourne, 22 April, 1993

¹⁵⁰ Birrell, The Hon. Mark, Victorian Minister for Major Projects: "Major Infrastructure Projects in Victoria", Paper presented to the 1995 Project and Infrastructure Conference, Melbourne, Tuesday, 21 February, 1995

¹⁵¹ Victorian State Treasurer, "Public/Private Sector Partnership", Victorian Government Infrastructure Investment Guidelines for Victoria, Melbourne, May, 1991

Justification For Private Sector Involvement

For the Victorian Government to choose a process of deciding between the private and public sector participating in a public infrastructure such as the City Link Project, it may wish to use a cost benefit analysis method. This tool is used by governments to assess projects where the market mechanism does not provide an indication of the costs and benefits to society. Cost benefit analysis attempts to measure all benefits and costs, including those which do not involve cash flow and also "externalities" which affect people or groups other than those directly involved in the project.¹⁵² Harris points to the suggestion that cost benefit analysis is the best available means to ensure efficient economic use of capital funds and to increase the chances of implementation on schedule. In the case of road building, Harris uses the analogy that the main losers will be those whose homes are acquired for the project, or who face greater pollution of various kinds as a result of the new road. Harris has argued that since inner city dwellers are mainly lower income households whose ability and therefore willingness to pay is less than that of the middle income commuters who will benefit most from the road, the net benefit to the society will be positive.¹⁵³

A limitation with the cost benefit analysis arises with certain assumptions that could have been made in regard to the City Link Project. For Government to decide that the project has a net benefit to the society, was the entire population of Victoria included in this assumption or was it restricted to motorists in Melbourne? Harris uses the

¹⁵² Harris, G. T.: "Cost Benefit Analysis: Its Limitations And Use In Fully Privatised Infrastructure Projects", Australian Journal of Public Administration, v.50, No. 4, December, 1991, p526

¹⁵³ Ibid, p526

Sydney Harbour Tunnel example to further describe the cost benefit analysis. The benefits argument put forward by the Government was elimination of traffic congestion on and surrounding the Sydney Harbour Bridge and Sydney's traffic problems generally. The first argument means increasing road space, whereas the second means better urban planning, better public transport and pricing initiatives.¹⁵⁴ Harris argues that the cost side in this cost benefit analysis of the Sydney Harbour Tunnel included a better public transport system, rather than an increase in the use of private motor vehicles. Further arguments put forward in the equation suggest that there has been no competition within the private sector to build and operate the tunnel and that no significant risks falls on the private sector.¹⁵⁵

The Victorian Government when deciding on what process to use when considering whether to include the private sector in the City Link Project, can analyse the Sydney Harbour Tunnel project as well as the World Congress Centre. Both of these projects included the private sector but the relevant State Governments exposed themselves to the private sectors financial risk. The other compounding factor which questions the viability of the private sector in both projects was the lack of competition among the private companies bidding to win the contract.

The process used in selecting the private sector to participate in building the City Link Project differs from the Sydney Harbour Tunnel. VicRoads invited a number of potential bidders to register an expression of interest to build-own-operate the Western

¹⁵⁴ Ibid, p533

¹⁵⁵ Ibid, p534

ByPass and the Southern ByPass.¹⁵⁶ After an evaluation of interested bidders the list was reduced to two - Chart Roads and Transurban. The winning bidder was Transurban. Consequently, the competition among private sector bidders ensured that the process of selection and participation by the private sector was fair and reasonable.

Who Should Accept The Financial Risk For The City Link Project?

An important difference between the Sydney Harbour Tunnel and the City Link Project is that the Victorian Government is exposed to minimal financial risk, which is unlike the New South Wales experience, where the Government was exposed to the private contractors' financial risks.

The Victorian Public Accounts and Estimates Committee produced its first report to the Parliament in November, 1993.¹⁵⁷ This report looks at the process the Government should use to determine the viability of private sector involvement. Coincidentally, the report is a continuation of an earlier report which investigated the funding of Melbourne's World Congress Centre, and included the issue of financial risk.¹⁵⁸

The process used to select the private sector involvement in the World Congress Centre failed. The construction of the World Congress Centre was the beginning of a new partnership between the State Government and the private sector. However, the process

¹⁵⁶ VicRoads: Registration of Interest Brief to Build, Own and Operate the Western ByPass and the Southern ByPass, Melbourne, January, 1992

¹⁵⁷ Victorian Public Accounts and Estimates Committee "Private Investment in the Provision of Public Infrastructure" 1st Report to Parliament, Melbourne, November 1993

¹⁵⁸ Economic & Budget Review Committee Estimates Sub Committee, 4th Report to Parliament "Funding of the World Congress Centre", Melbourne, May 1992

used to select the private sector involvement in the World Congress Centre meant that a \$25 million project ballooned out to approximately \$500 million. Further, similar to the NSW Auditor General's comments relating to the Sydney Harbour Tunnel¹⁵⁹, the report into the World Congress Centre found "all-embracing Treasurer's indemnities that remove all financial risk from the private sector including make-up by the Government of \$30-40 million to the financiers for any loss of their tax deductions and the transaction's tax effectiveness".¹⁶⁰ Consequently, the financial risk in both projects (the Sydney Harbour Tunnel and the World Congress Centre) was with the Government, rather than being shared with the private sector.

The Government, when deciding the process of involving the private sector in a public infrastructure project such as the City Link Project, needs to be aware of the perceived additional costs to be borne by the private sector, namely higher gross borrowing costs; additional professional fees (e.g. legal and accounting advisers); costs of creating and maintaining complex company and legal structures; profit requirements and Commonwealth and State taxes and municipal rates and charges from which the public sector is exempt.¹⁶¹

The decision by the Victorian Government not to accept any financial risk in the City Link process will ensure the Victorian taxpayer is not liable for construction and operating cost overruns, under-utilisation, increased financing costs, tax and other

¹⁵⁹ Maclean, Sheena: "The NSW Experience - Hidden Costs of Private Roads", The Age Newspaper, Melbourne, 19 November, 1994, p13

¹⁶⁰ Economic & Budget Review Committee Estimates Sub Committee, 4th Report to Parliament "Funding of the World Congress Centre", Melbourne, May 1992, pxxviii

¹⁶¹ Victorian Public Accounts and Estimates Committee "Private Investment in the Provision of Public Infrastructure" 1st Report to Parliament, Melbourne, November 1993, pxxi

legislative charges, inadequate investment returns and asset depreciation and delayed availability.¹⁶²

Is It More Efficient For The Private Sector To Build The City Link Project Rather Than The Public Sector?

There is a perception within the community that the private sector is more efficient than the public sector and that it would be more efficient for the private sector to build-own-operate the City Link Project.

According to the Victorian Government, the privatisation of government utilities must proceed to ensure greater competition and efficiencies, but equally important to repay debt. This major project has evaluated the arguments put forward by both sides of the debate on whether it is more efficient to privatise public trading enterprises. The major project uses these arguments to demonstrate whether or not it is more efficient to use the private sector in the building-owning-operating of the City Link Project.

The tendering out of the City Link Project ensured that the lowest cost was achieved and that expertise that the public sector (namely VicRoads) did not have, could be introduced by the private sector. Osborne and Gaebler suggest that competition can be achieved by encouraging competition between different public sector providers. Even if other State's public sector building organisations wanted to compete, none of them would have the necessary capital or expertise to realistically compete for the City Link project.

¹⁶² Ibid, pxii

Osborne and Gaebler argue that while government should promote competition, governments also need to ensure that all segments of the market are adequately served and contractors are operating fairly and in accord with valued social goals such as equal opportunity.

Osborne and Gaebler believe that governments need to "scrape off the barnacles", to ensure that rules and regulations are kept up to date and are efficient. With the private sector building the City Link project, a new Act of Parliament has been introduced to ensure that old rules and costly work practices do not hinder the project. Consequently, planning laws, acquisition of properties and other government restraints have been circumvented to ensure the project progresses smoothly. If the public sector were to build the project, it would be held to the current government guidelines and restrictions. Furthermore, with the private sector building the project, it can control its own budget without outside interference. If VicRoads were to build the project, senior bureaucrats would be required to keep within tight budgetary guidelines and report to the Minister constantly. The private sector can employ whoever it wishes and pay them whatever it likes to ensure the very best quality people are employed to build the City Link project. VicRoads simply would not have this flexibility and would be bound by public service pay guidelines. This would mean that the best people are simply not interested in applying for positions where the salary package is not attractive.

Competition between managers and more particularly transferability of ownership will limit the divergence between the aims of managers and shareholders. Furthermore, it will be in the private interests of those first establishing the enterprise to set up effective low cost mechanisms by which the shareholders can monitor the behaviour of managers.

Only then will the value of shares in the enterprise be maximised.¹⁶³ Transurban, the winning City Link Project bidder, would strongly support Hartley's¹⁶⁴ view, because they would also argue that they have huge incentives to reduce construction costs and operating costs in order to increase profit and, consequently, maximise shareholders wealth.

Transurban would be aware of the conceptual issues as put forward by Deane¹⁶⁵ for a number of reasons. Firstly, the transactions between them and all Government departments, and the ongoing cost of dealing with the bureaucracy; secondly, the need for Transurban to predict costs over the next five years of construction, which is critical because they are solely responsible for all financial risk. However, more importantly, is the need for the toll to be set at a realistic rate. The toll per section has been set at 80¢ (in 1995 prices) and if this is too high, motorists will use alternative routes. If it is too low there may be massive road congestion or Transurban may be in a position where they are not recovering costs.¹⁶⁶

Earlier in chapter two, it was stated that Tullock¹⁶⁷ believes pressure should be placed on Government to reform, and competition can be brought about by contracting out government activities or transferring the activity to the market.

¹⁶³ Ibid, p19

¹⁶⁴ Hartley, Peter: "Privatisation Lessons From Public Utilities", Australian Institute for Public Policy, 1986, p27

¹⁶⁵ Deane, Roderick: "Reflections on Privatisation", "Occasional Papers", The Centre for Independent Studies, March, 1991

¹⁶⁶ Ibid, p4

¹⁶⁷ Tullock, Gordon: The New Palgrave: A Dictionary of Economics, Edited by John Eatwell, Murray Milgate, Peter Newman, Macmillan, London, 4 vols. illus. Volume 3, p1040

The current Victorian State Government believes that private operators are able to run projects more efficiently than the public sector and evidence of this is the contracting out of Government services and privatisation of Government bodies. This was the general feeling prior to the building of the World Congress Centre, consequently the Victorian State Government wanted a partnership between the public and private sectors to get the project off the ground.

In the opinion of Dr Alf Smith it would be more efficient for the private sector to build-own-operate the City Link Project than for the State Government, and there are a number of reasons why the State Government would not build the City Link Project by itself. One reason is the lack of engineering expertise in building a tunnel of the magnitude of the proposed City Link Project. Building tunnels of this size would require huge and expensive capital equipment, something the State Government lacks. Consequently, the efficiencies of construction would be more likely with the private sector.¹⁶⁸

Another reason is the huge capital outlay which during hard economic times, the Government would feel reluctant to do, especially if it goes beyond Global Borrowing Limits.

The Government, when handing down its Autumn Economic Statement on 26 April, 1994, made it clear that its long term aims were:

¹⁶⁸ Smith, Dr Alf, Senior Public Servant - Ministry of Major Projects, Interview 22 June, 1993

- to "provide the framework in which Victorians can grasp the opportunities opened by our resources and talents";
- to deliver affordable, high quality services directed to the needs of Victorian businesses and households; and
- to reduce the call of Government on the resources of the Victorian community.¹⁶⁹

The State Government has a number of objectives to be met from private sector involvement in the City Link Project and Western ByPass:

- use of private sector expertise, particularly in tunnelling
- harnessing private sector efficiencies, particularly in construction and operation
- transfer of major risks associated with the ByPasses to the private sector
- minimise the impact on Victorian debt levels and Loan Council bids¹⁷⁰

Many people think that Governments can borrow money more cheaply than the private sector because of the sheer size and ability to repay financial obligations. In the case of Victoria and Australia this is generally true. However, the downgrading of Victoria's credit rating in 1992 made State Government borrowings more expensive than in

¹⁶⁹ Stockdale, The Hon. Alan, Treasurer of Victoria: "Autumn Economic Statement", Melbourne, 26 April, 1994, p1

¹⁷⁰ Melbourne City Link Authority: "Melbourne City Link Project", Information Paper, Melbourne, July, 1995

previous years. Large companies such as BHP could probably borrow at the same rate as the State Government.

Dr Alf Smith, Senior Public Servant - Ministry of Major Projects, makes the point that a company which wins the tender to build the City Link Project would have to be a sizeable organisation. The building of the City Link Project would require costly capital equipment, a large work force and the ability to finance a large debt. The financing of the large debt would depend on how the contract for the "payment for works" is structured.

However, this aside, if the projected cost of the City Link Project is between \$500 million and \$1,000 million, the company would have to be responsible for carrying large amounts of debt (figure later revised to \$1.7 billion).¹⁷¹ If the State Government did not build and operate the City Link Project, it would mean that the Government would only have to be concerned about the revenue stream and building and planning guidelines. The actual planning and construction works would be the responsibility of the winning tenderer. If the winning tenderer was going to build and operate the City Link Project itself, they might pay particular attention to detail to ensure the project lasts for the long term, with low maintenance costs.

The operation of the City Link Project remains the sole responsibility of the successful tenderer, which many have assumed could run it more efficiently than the State Government. By having a private operator build-own-operate the City Link Project, the

¹⁷¹ Smith, Dr Alf, Senior Public Servant - Ministry of Major Projects, Interview, 22 June, 1993

State Government would be protected from any short cuts the builder may opt for, creating problems later in the way of greater maintenance. The consortium building and operating the project may choose to increase their building costs (i.e. more expensive components) in order to reduce their operating and maintenance costs.¹⁷²

Dr Smith, in an interview, pointed to the fact that the private sector is better suited to completing the City Link Project in a given time than the public sector. For example, if the State Government wanted the project completed on January 1st, 2000, then part of the contract could state that they would pay the operator a financial incentive. The private operator will realise that as soon as the City Link Project is open, they will be able to start charging the toll and establish the revenue stream.

Consequently, as previously stated, the private sector may wish to increase its building costs in order to finish the project earlier and to reduce its running costs.¹⁷³

Despite domestic and overseas examples that the private sector is more efficient and that the State Government is justified in using the private sector to build the City Link project, the approach is definitely not supported by the H. V. Evatt Research Centre.

The H. V. Evatt Research Centre believes that part or partial privatisation of public enterprises would mean an irreversible shift in economic power from the community as a whole to the owners of capital. The Centre claims that it would inevitably increase the ability of overseas capital to influence our economic development, consequently,

¹⁷² Ibid

¹⁷³ Smith, Dr Alf, Senior Public Servant - Ministry of Major Projects, Interview 17 May, 1994

privatisation should be opposed.¹⁷⁴ The report also indicates that "it provides a sound foundation for calling on the Government to meet the capital needs of public enterprises through an appropriate combination of dividend relief, budget financed injections over a five year period and relaxation of Loan Council and other borrowing restrictions".¹⁷⁵

To justify this, the H. V. Evatt Foundation claim that if public enterprises do not have adequate capital funding and solutions cannot be found, then the broader programme of building robust and dynamic public enterprises would be jeopardised.¹⁷⁶ Consequently, they would argue that if VicRoads was properly funded then they should be in a position to provide the capital for the City Link project. Opponents would argue, however, that with the private sector building the City Link it is not costing the Victorian taxpayers a cent, although Victorian motorists will be asked to pay tolls, ie. "a user pays system".

Financing The City Link Project

As stated earlier in this chapter, the private sector needs to be reassured that the project has a safe, reliable return with low risk. Consequently, the State Government needs to ensure a quality revenue stream to ensure investors are willing to participate in Government infrastructure projects.

For the State Government to estimate a revenue stream for the City Link Project, it would be beneficial to look at Melbourne's Westgate Bridge and the experience it had

¹⁷⁴ H. V. Evatt Research Centre: "The Capital Funding of Public Enterprise in Australia", Sydney, March, 1988, p(v)

¹⁷⁵ Ibid, p(vi)

¹⁷⁶ Ibid, p(xv)

with tolls. Setting tolls on a facility to achieve optimum utilisation and return on investment, particularly where alternative routes are available, is somewhat risky. The toll on the Westgate Bridge was removed in November, 1985 and, as a direct result, an increase of approximately 45% in traffic volume was observed. Since the Westgate Bridge was completed, the volume of traffic using it has been considerably less than predicted, in fact, 25% less, based on 1968 predictions.¹⁷⁷ Although the usage of the bridge enjoyed steady growth in its first three years, volume levels were fairly constant in 1984 and 1985. In August, 1982, a major increase in tolls resulted in a noticeable decline in volume.

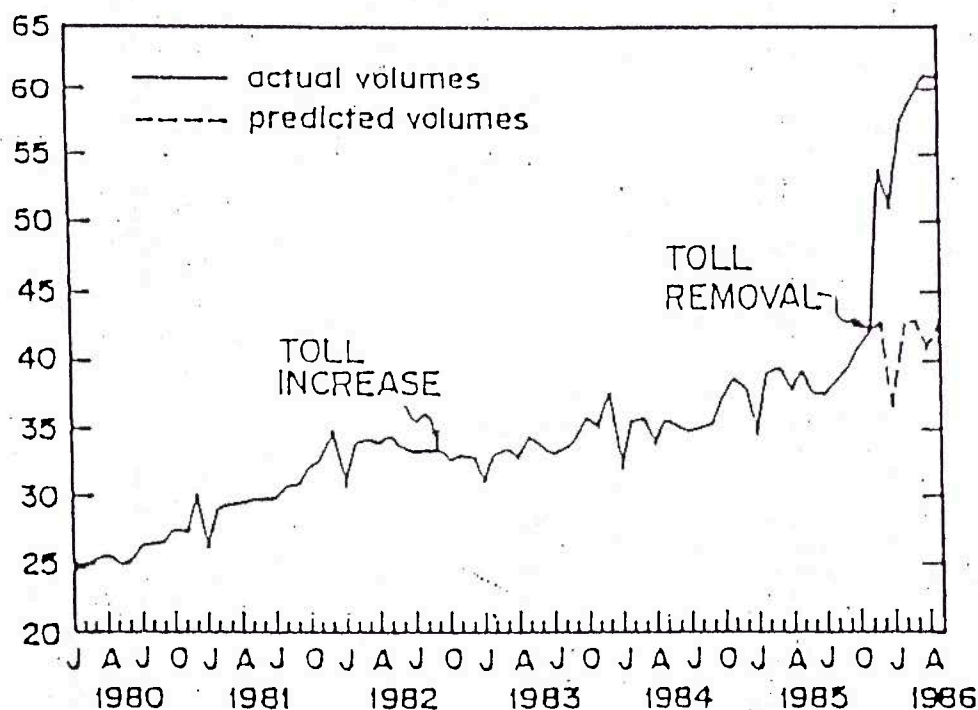
The consistently lower than predicted volume levels using the bridge could be attributable to a number of factors. These included the slowing down of the economy and the lack of predicted growth in Melbourne's western suburbs, together with the inconvenience of the connecting road network to the bridge. However, these reasons seem insignificant compared to the alternative routes which were improved by substantial investments in the Charles Grimes Bridge and the upgrading of Footscray Road, rendering alternative routes very competitive. The presence of a toll (being the only one in Victoria) seemed to be a major deterrent to traffic using the Bridge. This was largely evident from the substantial increase in volume after the toll removal.¹⁷⁸

¹⁷⁷ Thompson, R.G. and Vincent, E.N.: "Assessing the Traffic and Economic Impacts of the Westgate Bridge Toll Removal", Proceedings 14th ARRB Conference, Part 3, p168

¹⁷⁸ Ibid, p168

TABLE ONE

AVERAGE WEEKDAY TRAFFIC VOLUMES



Average Weekday Traffic Westgate Bridge, all classes 1980-1986

Source: Thompson, R.G. and Vincent, E.N.: "Assessing the Traffic and Economic Impacts of the Westgate Bridge Toll Removal", Proceedings 14th ARRB Conference Canberra, Vol. 14, No. 3, Melbourne, 1988, p169

An economic assessment of the toll removal was performed to identify the overall community costs and benefits of the toll removal. The benefits of the toll removal generally came from the reduction in travel distances, travel time of new users of the bridge and elimination of toll collection costs. Other benefits such as reductions in congestion and pollution on the alternative routes were identified, but no attempt was made to quantify them. The cost of collecting the toll on the Westgate Bridge was about 24% of revenue collected.

TABLE TWO
TOLL COLLECTION REVENUE AND COSTS

(Millions)	78/79	79/80	80/81	81/82	82/83	83/84	84/85
	\$	\$	\$	\$	\$	\$	\$
Toll Collection (Bridge Operations & Marketing)	1.0	1.4	1.4	1.8	1.7	2.0	2.2
Toll Revenue	2.9	5.1	5.8	6.7	7.8	9.3	9.9
Percentage	34.5	27.5	24.1	26.9	21.8	21.5	22.2

Source: Thompson, R.G. and Vincent, E.N.: "Assessing the Traffic and Economic Impacts of the Westgate Bridge Toll Removal", Proceedings 14th ARRB Conference Canberra, Vol. 14, No. 3, Melbourne, 1988, p171

Statistics derived from studies by R. G. Thompson and E. N. Vincent in 'Assessing the Traffic and Economic Impacts of the Westgate Bridge Toll Removal' in relation to travel time, car accidents and other related costs, show that with more people using the bridge, the community had a net benefit (see Table Three). The toll removal resulted in a net cost to the community. However, significant benefits to the community occurred with the reduction in accidents and travel time.

TABLE THREE
SUMMARY OF COSTS AND BENEFITS

	\$/day (1986 prices)
<u>Costs:</u>	
Toll (Revenue Less Collection Costs)	21,200
Vehicle Operating Cost increase	15,600
	<hr/>
TOTAL COSTS	36,800
 <u>Benefits:</u>	
Accident Reductions	1,800
Travel Time Reduction	24,000
	<hr/>
TOTAL BENEFITS	25,800

Source: Thompson, R.G. and Vincent, E.N.: "Assessing the Traffic and Economic Impacts of the Westgate Bridge Toll Removal", Proceedings 14th ARRB Conference Canberra, Vol. 14, No. 3, Melbourne, 1988, p174

Tolls are usually placed on facilities in the first years of operation, when traffic is low. Once the facility has paid for itself, the toll is removed, but this is usually at the time the facility becomes congested. If tolls are to be introduced, they should be set very low or not at all in the early years and increase when congestion increases. A viable tollway could be applied when there appears to be a lack of competing routes, sound projections of demand and accurate estimates of economic parameters. The Westgate Bridge did not exhibit all of these characteristics, whereas by contrast the Sydney Harbour Bridge and the Gateway Bridge in Brisbane did.

The collapse of the Westgate Bridge during construction added to the costs of the bridge, increasing them from \$30 million to \$200 million. This was reflected in the toll price, further discouraging motorists.

In relation to the City Link Project and in an earlier interview, there was a reluctance by Dr Alf Smith, Senior Public Servant - Ministry of Major Projects, to accept the concept of a direct toll. He believes that the City Link Project would only raise \$20 - \$30 million (net of collection). Mr Smith points to the Westgate Bridge example where the amount of toll collected was not significant, and when the toll was removed, the amount of people using the bridge increased significantly.¹⁷⁹

The City Link Project is primarily being built for traffic efficiency, pollution control, time savings and a reduction in road congestion. If a toll was placed on the City Link Project, some motorists may find alternative roadways to avoid paying the toll. The tunnel will be an expensive project and the State Government will want to ensure maximum usage in order to justify the financial outlay.

Mr Smith points to the fact that if the City Link Project is going to cost \$1 billion (later increased to \$1.7 billion), and the toll collected is going to be between \$20 - \$30 million, then the tunnel would clearly not be paying for itself

¹⁷⁹ Smith, Dr Alf, Senior Public Servant - Ministry of Major Projects, Interview 22 June, 1993

General assumptions:

\$1 billion x 10% interest rate	
Interest expense per year	\$100 million
Toll collected	\$ 30 million
<hr/>	
Loss	\$ 70 million

It is claimed by the RACV¹⁸⁰ that there are a number of methods by which the City Link Project could be built by private operators and paid for by the community. One suggestion is by means of a direct toll.

According to the RACV, if a toll was to be used for the City Link Project, toll facilities should allow for:

- a) a high standard of design for traffic flow and safety which will result in savings in road users' time, traffic accidents and running costs which are greater than the toll paid;
- b) any alternative "free" facility alongside or in close proximity to the proposed toll facility to be retained and adequately maintained

¹⁸⁰ RACV: "Private Sector Investment in the Provision of Public Infrastructure", Submission to the Estimates Sub-Committee of the Economic and Budget Review Committee of the Parliament of Victoria, Melbourne, 10 April, 1992, p6

- depending upon road user demand relative to maintenance costs;
- c) after allowing for the recovery of capital costs, such toll facilities should revert to public ownership and be free.¹⁸¹

The RACV also claims that the imposition of tolls should be seen as a last resort for financing major improvements to the road system, which cannot be financed from existing road funds due to the impact such funding would have on other priorities.

A second method of paying for the private development of roads is by the use of a shadow toll. This is an amount that the Government would pay the developer for every vehicle that uses the new road facility. It could be considered as similar to repaying a loan and, therefore, this type of funding arrangement may conflict with Federal Government Loan Council global limits on State Government loans. However, shadow tolls could be attractive because they do not have to outlay the very high level of capital necessary to build facilities.¹⁸²

Another alternative could be that the consortium charges the State Government for lane availability. The Government would insist that all lanes are open in peak hour. The contract between the consortium and the Government could have penalty clauses if a lane was closed during peak hour. This would ensure the operator had a significant incentive to keep the lanes open.

¹⁸¹ Ibid, p6

¹⁸² Ibid, p6

There are a number of ways a government could finance a shadow toll. It could be financed from general revenue, through the imposition of a fuel levy, or possibly from the introduction of a cordon toll around the central area. A cordon toll is a levy on motorists entering a particular area such as a central activities district.

As suggested by the RACV, the other financial source to pay for private sector financing of major road projects could be a shadow toll, possibly through a fuel levy. Part of a continuing dedicated fuel levy could be used for this purpose. However, in reality through later developments the State Government has already introduced a three cent levy in the 'Better Roads Programme'. None of this money is dedicated to the City Link Project and it is unlikely the Victorian motorist would accept a six cent fuel levy. There would obviously be strong opposition from country motorists, who rarely visit Melbourne and more specifically the City Link Project, who may find it unfair that they were contributing to such a project.

The third method put forward by the RACV¹⁸³ is by means of land redevelopment. This method could be used by the Government to help pay for private sector road development by allowing the private sector to redevelop adjacent publicly owned property. Such property could be land already in public ownership, or it could be compulsorily acquired property that is partially needed for the development of the road. An arrangement could even be considered involving the redevelopment of land in a different location.

¹⁸³ Ibid, p7

It would be unlikely that the entire cost of the provision of a new major road facility could be offset by profits made through property redevelopment. It is more likely that this method of payment could be used for smaller road projects.

The RACV¹⁸⁴ takes the position that the use of private enterprise for the financing, design and/or construction of road facilities is supported provided that:

- * the facility results in total savings in road users' time, accidents and running costs greater than the cost of the facility;
- * adequate standards for design, construction and operation are set and enforced by the appropriate road authority;
- * any liability arising from the deterioration of the facility be covered by a sinking fund which should be transferred to the public sector when the ownership of the facility reverts to the public.¹⁸⁵

In conclusion, the RACV supports the use of the private sector to finance and develop major road facilities. Private sector investment in road infrastructure should be additional to current Government borrowings, otherwise the Government could raise the necessary finance itself.¹⁸⁶

¹⁸⁴ Ibid, p7

¹⁸⁵ Ibid, p7

¹⁸⁶ Ibid, p9

Kirwan refers to public sector pricing policy reflecting long run marginal costs and states that, where possible, its impact should accord with the principles of social justice. He believes that conventional pricing can be adjusted to meet these criteria at least in the cases where earmarked revenue streams are well established and that the need to avoid, or minimise borrowing, dictates that levies should cover the cost of capital investment.¹⁸⁷ The State Government has ignored this view and is determined to have a flat rate for all cars, regardless of a person's ability to pay. The Government argues that using the City Link Project is optional for motorists and they have the right to choose whether they wish to use it or not.

In the case of the City Link Project, demand would increase with peak hour traffic and slow during the later night-earlier morning periods. However, a capacity charge in Kirwan's pricing policy is not relevant as the City Link Project is a 'fixed supply asset' and, regardless of increased demand, it cannot increase supply. If the revenue stream for cars entering the City Link Project is based on a toll and this is set at a dollar rate based on 'peak' and 'off peak' rates (i.e. two different rates), this may make demand for the City Link Project consistent. This may also reduce traffic during peak hour and improve traffic flow. In fact, recently the Government recognised the importance of this and have cut the off-peak rate at night by 20% for commercial vehicles.

¹⁸⁷ Kirwan, Richard, "Infrastructure Finance: Aims, Attitudes and Approaches", Urban Policy and Research, Vol 8, No. 4, p185

TABLE FOUR
CITY LINK SAVINGS

Non-Commercial Vehicle	Savings	Toll
Private trip	\$ 5.25	\$3
Courier van	\$11.00	\$3
Articulated vehicle		
42 tonne	\$30.00	\$3 night \$4 day
B-Double - 60 tonne	\$45.00	\$3 night \$4 day

Source: Victorian Road Transport Association: "Estimated Value of Reduced Travel Times - Defined Commercial Vehicles", Melbourne, August, 1995

In the case of the World Congress Centre, the financial risks remained with the State Government, whilst the private sector profited from that financial risk. Consequently, one would argue that the revenue stream was too high. The State Government is keen to involve the private sector in the City Link Project to ensure the risk is not with the Government.

There are a number of risks inherent in any major construction project, irrespective of who constructs and manages the project. The main risks associated with the construction and operation of the City Link Project are:

- construction risk (construction takes longer and/or costs more than estimated)
- traffic risk (traffic volumes are less than predicted)

- operating risk (the cost of operating the City Link Project is greater than predicted), this could include difficulties with the tolling mechanism, if direct tolling is used
- financing risk (the finance costs are more than predicted)¹⁸⁸

The State Government is keen to transfer the 'risk' of all financial transactions to the private sector. The private sector is better able to handle some of these risks, particularly the construction and operating risks of the City Link Project, where VicRoads does not possess tunnelling expertise.

It could be argued that the State Government is better placed to manage traffic risk generally. Firstly, the City Link Project, whilst significant, is only a small part of the total road system in Melbourne. Secondly, given the central location, it is likely to be affected by actions along any of the traffic corridors feeding the ByPass. Accordingly, the traffic risk will be a central feature of this project. However, it does not follow that the Government is better placed to accept traffic risk, particularly as Loan Council considerations are likely to dictate a preference for a significant transfer of the traffic risk to the private sector.

In discussions with Dr Alf Smith, it is clear that the City Link Project would not proceed without private investor involvement. Like many people before him, Dr Smith acknowledges VicRoads lacks tunnelling expertise whilst this expertise is available within the private sector. Dr Smith also points to the difficulty of the State Government

¹⁸⁸ Baxter. The Hon. Bill, Minister for Roads and Ports, Briefing for Coalition Members, June, 1995

raising \$600 million itself to build the project (the amount is now \$1.7 billion). The private sector is keen to participate and their contribution will depend on the upfront capital payment by State Government. By involving the private sector, the Government would be most reluctant to be involved in recurrent expenditure items once the tunnel had been opened, leaving this task to the private sector.¹⁸⁹

Dr Alf Smith points to the fact that in just twelve months tolling has become more acceptable because of improved technology. A direct toll can now be charged electronically.

There are two main methods of charging. Firstly, people can buy 'smart cards'. This card can be purchased by the driver from various outlets and he/she may choose to buy a \$10 card or \$20 card, for example. The card is then placed on the car's dashboard. As the car approaches the City Link, a device is set to read the 'smart card' details. If a car drives through the City Link without a 'smart card', then a camera would photograph the car's registration number. A large fine could then be sent to the offending driver.¹⁹⁰

Another method is simply putting a bar code on the registration label on the car. As the car approaches the City Link, a device reads the bar code and the owner of the car receives an account, for example every month or quarter. The electronic method will mean a reduction in the cost of collection. People in general loathe the manual collection of tolls and in some cases will drive some distance to avoid them.

¹⁸⁹ Smith, Dr Alf, Senior Public Servant - Ministry of Major Projects, Interview 17 May, 1994

¹⁹⁰ Ibid

The barcode system is being tested extensively in West Germany and there are a number of private companies keen to sell the technology. More recently, the Government has announced that transponders will be fitted in each car free of charge and that private users will need to prepay to ensure the transponder is always in credit. The private sector would use the anticipated revenue raised from the electronic toll and calculate what it could contribute to the construction of the City Link Project. For example, the private sector may establish a required revenue stream of 15% of outlays. So, based on \$60 million toll collection, they could afford to contribute \$400 million.¹⁹¹

According to Dr Alf Smith, the State Government should transfer the traffic risk and revenue stream to the private sector and not contribute at all to the operations of the City Link, and not make any guarantees.¹⁹²

Will a private investor owning and operating the City Link Project affect the State Government's Global Borrowing Limits?

Essentially, the Loan Council was set up to monitor and report on state government borrowings. The global limits were introduced in 1984 in response to perceptions that the then existing arrangements had become ineffective. This was clearly demonstrated by the dramatic reduction in the proportion of state and local authority borrowings covered by the Loan Council.

¹⁹¹ Ibid

¹⁹² Ibid

Talbot¹⁹³ believes that Loan Council constraints have created opportunities for the private sector to become involved in the provision of public infrastructure. Talbot points to the NSW project of the F4 requiring the private sector to bear all the risks, including completion of construction, traffic volume, inflation, interest rates and maintenance. The same company building the F4 built similar projects in Queensland under budget in terms of dollars and on time. Talbot points to limited risk taking by financiers and even in the 1990's financiers have become more conservative. One of the more controversial risks on toll road projects is traffic volume. According to Talbot: "it is fair to say that the market is reluctant to assume traffic volume without reservation or some kind of protection".¹⁹⁴ This is contrary to Dr Alf Smith's views, whereby the Government when deciding on the terms and conditions of the City Link Project should not include any sort of guarantees on traffic volumes or financial risks.

However, it is also important that the different levels of risk involved in different projects should be recognised in that disclosure. In relation to the City Link Project, if the private and public sectors are both going to be involved, then assigning the risk between the two sectors will inevitably involve some judgement in their disclosure to the Loan Council allocation. Whether or not a private investor owning and operating the City Link Project would be subject to Loan Council guidelines is dependent on which revenue stream is finally agreed upon. Construction of the City Link Project will probably need Loan Council approval even if it is built, owned and operated by the private sector.

¹⁹³ Talbot, John: "Paying for Public Infrastructure", Directions in Government, v.5, No.1, February, 1991

¹⁹⁴ Ibid, p26

If a direct toll is being used, under the new risk weighting Loan Council guidelines under termination clauses, the Loan Council allocation required by Victoria for the project would be restricted to the value of the Government support provided. In other words, if the State Government were to fund or support 25% of the project, then only that proportion will be included in Loan Council guidelines, not the total cost of the project. The way in which Loan Council rules are applied remains a source of uncertainty and confusion, both within and outside government. There are, in fact, no fixed rules for determining whether a proposal falls within the scope of the global limit on borrowings.¹⁹⁵

The Victorian Public Accounts & Estimates Committee in their report to State Parliament¹⁹⁶ discuss some key financial characteristics of private investment in public infrastructure with special regard to Parliamentary accountability and control mechanisms. Furthermore, this report reviews "the importance of financial risk and benefit implications for State debt, cost efficiency and financial rationales and features of public infrastructure best suited to private investment".¹⁹⁷

Private investment into the City Link Project will affect the State Government's Loan Council guidelines. The degree of responsibility will depend on the amount of the project that the State Government will be held responsible for, but obviously not that proportion which will be in the hands of the private sector. The need for private sector involvement has come about primarily because global limits on Loan Council

¹⁹⁵ Loan Council: "Future Arrangements for Loan Council Monitoring and Reporting", 5 July, 1993, p1

¹⁹⁶ Victorian Public Accounts and Estimates Committee: "Private Investment in the Provision of Public Infrastructure" 1st Report to Parliament, Melbourne, November, 1993

¹⁹⁷ Ibid, p xvii

borrowings have restricted the ability of government trading authorities, such as electricity commissions and road authorities, to finance large capital projects.

Mr Craig Burke explained that Global Borrowing Limits are a gentleman's agreement in effect to limit the amount a state can borrow. If, for example, the Victorian Government has reached the ceiling of its borrowings but still insists that the City Link Project proceeds, then it has an immediate problem. If the ceiling has been reached then the State Government cannot borrow any more in its own right and would look to the private sector to raise the capital. What complicates global borrowing guidelines is the question of what element of 'risk' will the State Government bear with the private sector raising the finance? The definition of 'risk' is unclear. For example, is a guarantee on revenue, or who controls the project part of the definition of 'risk'? The Sydney Harbour Tunnel has a revenue stream of a toll and if patronage falls below the agreed number, then the NSW State Government makes up the balance. On the other hand, if the patronage exceeds the minimum toll, then the private sector receives all the revenue. Clearly, in the case of the Sydney Harbour Tunnel, the NSW Government will continue to bear some of the 'risk'. The Victorian Government may wish to avoid bearing any of the 'risk' by not issuing any guarantees which would clearly mean not breaching any Global Borrowing Guidelines.¹⁹⁸

Dr Alf Smith has suggested that there may not be the need to borrow for the Government to contribute to the City Link Project. The private sector bidding against one another in order for the maximum contribution to the construction of the City Link

¹⁹⁸ Burke, Craig, Research Director, Public Accounts & Estimates Committee, Second Interview 6 May, 1994

Project minimises the Government's contribution. Although unlikely, there is a slim chance that a private operator would be willing to pay the entire cost of the construction of the City Link, based on projected revenue tolls. If the scenario was that the highest private company contribution be \$400 million for example, and the Government needs to contribute \$200 million, then if the construction period is four years, a payment of \$50 million per year would probably not need Government borrowings. This would mean the Government would not be affected by the Loan Council borrowing limits. There has been some suggestion that if the Government had to contribute to the recurrent expenditure, then this may fall inside Loan Council guidelines. However, the best option would be for the Government to state at the outset that the Government will not guarantee revenue streams on tolls or minimum traffic flows, and this once again will mean the Government will not fall inside Loan Council guidelines.¹⁹⁹

Private Sector Involvement In The State Electricity Commission

The Victorian Government has been a reformist government, especially in the area of privatisation. However, the City Link Project was not the first area where the Government involved the private sector. To show consistency and support for the City Link Project, this major project will look briefly at other Victorian Government agencies which are being privatised or outsourced.

Moore believes that the main purpose of privatisation is to improve the efficient functioning of the economy and points to the case where the State Electricity

¹⁹⁹ Smith, Dr Alf, Senior Public Servant - Ministry of Major Projects, Interview 17 May, 1994

Commission in Victoria had the worst efficiency among the state electricity authorities in 1992.²⁰⁰

The current State Government believes that the private sector can achieve greater efficiencies in the Victorian power industry. The example of the power industry privatisation is to show the Government's attitudes to the private sector in relation to the public sector.

Minister Jim Plowman, responsible for Minerals and Energy, raised concerns about the future of Hazelwood power station when it faced competition from increased capacity as the second stage of Loy Yang B neared completion²⁰¹ Minister Plowman believed Hazelwood, which has been plagued by operating problems, could gain efficiency if the Government sold it for a low price.

The argument for and against the sale of the State Electricity Commission to gain greater efficiencies is covered in a wide range of literature including Hansard.

The debate over the sale of the State Electricity Commission has been around since the late 1980s under the previous State Labor Government. Mr Tony Sheehan, the then Minister for Finance, stated that privatisation is an important issue for Victoria, but there is a very strong case for public ownership of essential utilities, and discussions need to centre on the reasons for wishing to have public ownership.²⁰²

²⁰⁰ Moore, Des: "The Case for Privatisation", IPA Backgrounder, Melbourne, 2 March, 1995

²⁰¹ McCallum, Jan and Mayne, Stephen: "Float Could Cut Debt by \$1 Billion", Herald Sun Newspaper, Melbourne, 23 July, 1994, p26

²⁰² Sheehan, Tony, Victorian Treasurer: "Privatisation of Assets", Hansard, Victorian State Parliament, Melbourne, 14 May, 1991, p227

Critics of the sale of the State Electricity Commission believe that privatisers place "greater emphasis on consumption charges and user pays, emphasise commercial criteria in considering investment decisions, rely on competitive forces or the invisible hand of the market: direct resources towards the areas deemed by the private sector to be beneficial to them rather than satisfying the needs of the community limit public scrutiny because of commercial confidentiality".²⁰³

Moore argues that there is a close parallel between the privatisation of public trading enterprises and the elimination of protection against imports which is accepted by all political parties. Both are designed to expose the respective sectors of the economy to greater competition and through that allow goods and services to be supplied at a lower cost in terms of the use of resources.²⁰⁴ Moore would also argue that allowing the City Link Project to be put out to tender allows the market forces to dictate a price and provide a service at a lower cost.

Similarly, Niskanen argues that allowing the public sector to participate raises the concern that bureaucracy's performance cannot be monitored and, therefore, the taxpayer is not getting the product for the best price.

²⁰³ Sharam, Andrea: "Reform of Electricity and Water Utilities", Rainbow Alliance Victoria Newsletter, June, 1994

²⁰⁴ Moore, Des: "The Case for Privatisation", IPA Backgrounder, Melbourne, 2 March, 1995

Further Victorian Government Outsourcing

There are many examples within the community where private investors have operated Government works more efficiently than the public sector. For example, in the area of public transport in Victoria, the current State Government has made a dramatic shift from the public sector providing services to the private sector providing those same services.

Within twelve months of attaining Government in Victoria, the Minister for Public Transport, Mr Alan Brown, contracted out 21 major activities. Under the previous State Government, these activities provided by the public sector cost over \$40 million. Under the new State Government these 21 major activities have been given to the private sector to run at a cost of \$20 million, half the amount charged by the public sector.

The major activities include:

- freight road linehaul
- security
- cleaning of buildings, stations and rolling stock
- plumbing and maintenance
- real estate management
- child care centres
- internal audit
- supply and distribution of uniforms²⁰⁵

²⁰⁵ Brown, The Hon. Alan, Victorian Minister for Public Transport, "PTC Contracting Boosts Private Sector and Saves Taxpayer 50 Cents in the Dollar", Press Release, Melbourne, 12 November, 1993

In the case of canteens and refreshment rooms, where the public sector was providing the service at a huge loss, the private sector are now providing the service at an annual profit of nearly \$400,000 per annum.

The Minister for Public Transport, Mr Brown, in a recent press release stated that "A recent University study showed contracting out in the N.S.W. public sector was averaging savings of only 20%, while here in Victoria's public transport sector, we are saving more than twice as much".²⁰⁶

In addition to the 21 major activities all Met buses will be under contract and this will mean savings to the taxpayer of about \$10 million per annum. The contracting out of the buses in Victoria meant a shift away from a 'cost-plus' contract to a performance based contract, saving the taxpayers \$10 million per annum. The Auditor General found on a cost per kilometre basis, that Met bus services cost 48% more to operate than contracted private bus services. Based on kilometres covered by Met bus services, this differential equated to higher annual operating costs to the PTC of \$12.8 million.

The Auditor General identified the major reasons for this substantial difference in operating costs to include the following:

- 1) The hourly rate paid to Met bus drivers was 23% higher than the rate paid to private bus drivers.

- 2) Unlike private bus drivers, Met bus drivers cannot undertake alternative duties such as cleaning and maintenance when not required for driving duties. The latest figures available show that Met buses cost \$207,000 per annum to operate or nearly double the \$128,000 annual operating cost of contracted buses.²⁰⁷

A joint venture between the Government and private enterprise has reformed country passenger services. Two country rail passenger services were contracted out to the private sector (the first privately operated rail passenger services in Victoria for 100 years), luxury coaches were substituted for trains on the Dimboola, Mildura and Leongatha lines. This package will save the taxpayer in excess of \$30 million per year.

The Public Transport Corporation will continue to shift service delivery from the public sector to the private sector to provide services. In the future the Public Transport Corporation will contract out infrastructure services such as tram and train tracks, bridges, tunnels, buildings and other structures and internal communications. The outsourcing of general building maintenance activities will save \$4.1 million per annum. These services will include painting of station buildings, general plumbing maintenance to depots and general carpentry.

²⁰⁷ Brown, The Hon. Alan, Victorian Minister for Public Transport, "Public Transport Reform - Victoria: From a System to a Service", Public Transport Corporation, Melbourne, 1993

The Public Transport Corporation has delivered huge cost savings to the Victorian taxpayer by moving from the public sector providing services to the private sector providing the same services at the same level of quality.

As another example, the Education Ministry of the State Government decided prior to the last State election to privatise the cleaning of schools within Victoria²⁰⁸. With the public sector providing the service it was costing approximately \$50 million per annum, however, with the move to the private sector providing the service, the cost is around \$25 million, saving about \$25 million.

²⁰⁸ Hayward, The Hon. Don, Victorian Minister for Education, "Planning for security in Education", Press Release, Melbourne, 20 November, 1992

CHAPTER FOUR - SUMMARY, CONCLUSIONS, RECOMMENDATIONS

It has been contended that capital expenditure by the public sector has been rapidly declining over many years. In order for Australia to become more competitive and to boost exports there is a need for efficient public infrastructure which sets the framework for businesses to operate competitively.

During the 'boom-bust' period of the 1980s, the State Government increased its debt from \$12 billion in 1982 to \$69.8 billion as at 30 June, 1992²⁰⁹ and was in a debt spiral financial crisis. Consequently, the ability for the State Government to fund large infrastructure projects itself was financially unrealistic. The current State Government does not have the funds to build the City Link Project and, like the previous State Labor Government, it could borrow the money or involve the private sector in investing in infrastructure projects.

Both major political parties in Victoria agree that the City Link Project should be built, but differ on the method of how that goal should be achieved. For example, the Kennett Government believes it should be a B.O.O.T. scheme, whereas the State Labor Opposition believes that the existing three cent fuel levy is sufficient to build the City Link Project without a toll.

Victorians have had an experience with the World Congress Centre which has made them wary of using the private sector in public infrastructure projects. Treasury officials

²⁰⁹ Victorian Commission of Audit, Towards Prosperity, Melbourne, June 1993, p12,

omitted the financial arrangement from State Budget papers for the period July 1987 to August 1990. Furthermore, the interest rate swap locking the Government into a 14.4% interest rate was not reported to Parliament until the Auditor General's report in October, 1991.

In the case of the World Congress Centre, the Government should not have indemnified or guaranteed repayments, interest rate swaps or possible Gains Tax liability. The reason for this, quite simply, is that the agreement with the private sector was poorly handled. The private sector shared in the profits, but did not have to share in any of the risk taking. The risk was borne by the Government alone. The State Government must learn from the World Congress Centre project, and one conclusion reached would be for the State Government not to be involved in any contribution to revenue stream whatsoever.

Based on arguments put forward in Chapter Three the decision for the State Government to contract out the building, owning, and operating of the City Link Project to the private sector was correct, although some would say the Government had little choice if they wanted the project to proceed due to financial constraints.

A number of writers, including Osborne and Gaebler, believe that by having competition you receive greater efficiency and value for money. In the case of the City Link Project, two companies bidding against each other ensures the Government receives the best deal possible.

As described in Chapter Three, it is unlikely that VicRoads could build the City Link Project. In fact, there is no doubt that if the private sector was not involved, the City Link Project would not proceed. Dr Alf Smith points to the fact that the City Link Project is a huge infrastructure project and the Government is not in a financial position to pay for it by itself, and would rely on private sector finance. VicRoads does not have the tunnelling expertise nor the engineering skills to complete such a project. Due to the financial constraints within the Victorian Government, it could not raise the capital or afford the recurrent expenditure to facilitate the City Link Project.

Overseas experiences in South Africa and Japan clearly show that all new freeways will only be built by the private sector. In these two countries the Governments are transferring the construction and building of the freeways to the private sector. In the case of South Africa, the Government believes the private sector offers greater efficiencies and benefits to the taxpayer, but equally as important there is the ability to free up scarce recurrent expenditure for greater needs areas such as education and public health.

However, it is acknowledged that many private sector companies are keen to invest in public infrastructure, but believe that the taxation incentives are simply not there.

The RACV²¹⁰ supports the building of the City Link Project, but believes that the imposition of tolls should be seen as a last resort for financing major improvements to

²¹⁰ RACV: "Private Sector Investment in the Provision of Public Infrastructure", Submission to the Estimates Sub-Committee of the Economic and Budget Review Committee of the Parliament of Victoria, Melbourne, 10 April, 1992, p6

the road system which cannot be financed from existing road funds due to the impact such funding would have on other priorities. Conclusions may be drawn from the revenue stream suggested by the RACV. Their first suggestion was a direct toll and this is the strongest possibility. Secondly, a shadow toll could be introduced, but this means the Government making recurrent contributions to the City Link Project which is contrary to an earlier assertion that the State Government should avoid this. Critics of a shadow toll would point to the lessons learnt from the World Congress Centre, and strongly suggest that the Government should not make an ongoing financial contribution. The suggestion of another fuel tax would not be politically acceptable because of the existing three cents per litre fuel levy which is currently in place.

Consequently, after analysing the three methods proposed by the RACV attention is drawn back to the direct toll.

Victoria has only had one direct toll previously, that being the Westgate Bridge Toll. As stated in Chapter Three, since the Westgate Bridge was completed, the volume of traffic using it has been 25% less than first predicted in 1968.²¹¹ In 1982, a major increase in tolls resulted in a noticeable decline in volume. The Bridge enjoyed steady growth in its usage in its first three years with volume levels fairly constant in 1984 and 1985. The presence of the toll seemed to be a major deterrent to traffic using the Bridge. To support this, an increase of 45% in traffic volume occurred once the toll was removed in November, 1985.

²¹¹ Thompson, R.G. and Vincent, E.N.: "Assessing the Traffic and Economic Impacts of the West Gate Bridge Toll Removal", Proceedings 14th ARRB Conference, Part 3, p168

To analyse the assumption that the City Link Project should have a direct toll may seem contradictory based on the Westgate Bridge experience. According to Dr Alf Smith, there was a reluctance by Victorian motorists to find the coins each time they wanted to cross the bridge, and this consequently built up a reluctance against tolls. However, as Dr Smith points out, technology has come a long way.²¹²

When Dr Alf Smith was first interviewed in June, 1993, he was reluctant to suggest a direct toll, based on the Westgate Bridge experience and the average cost of collection. However, as he explained in a later interview, a direct toll can now be charged electronically, through a "smart card" or a transponder.

The electronic method of toll collection would reduce the cost of collection and, rather than people having to find \$1 or \$2 coins every time they enter the City Link, they would receive an account which would be more appealing to the vehicle owners.

Contrary to earlier advice and evidence based on toll collection on the Westgate Bridge, this major project concludes that a direct toll, based on new technology, would be feasible for the City Link Project.

Assuming that a direct toll is viable and aligning this with earlier conclusions that the State Government should not be involved in any contribution to revenue stream, critics of the project suggested that no-one in the private sector would be willing to participate in the City Link Project. This, of course, was not the case in reality. Dr Alf Smith

²¹² Smith, Dr Alf, Senior Public Servant - Ministry of Major Projects, Interview, 17 May, 1994

believes that the private sector will contribute to the City Link Project despite the Government not being involved in the revenue stream. The option for the Government to put out to tender the building-owning-operating of the City Link and allow private sector firms to compete for the project proved to be the most efficient process.

Evidence clearly points to the fact that a direct toll can be collected efficiently and does not place a financial burden on the Victorian taxpayer, but rather the Victorian motorist.

The Loan Council involvement in the City Link Project is still a paramount issue when involving the private sector. The Loan Council arrangements broadly reflect the evolving nature of financial markets and their interaction with the public sector. Under the current situation relating to Global Borrowing Limits, individual projects will be reflected in Loan Council allocation only to the extent of public sector exposure. Consequently, the City Link Project agreement does not have any public sector debt exposure and theoretically should be excluded from all Loan Council guidelines. However, if in the final negotiations the Government decides to allow some concessions which may expose it to some future risk, then that proportion of risk will need to be included in Loan Council guidelines.

This major project reviewed the sale of the State Electricity Commission and argued the need for the State to reduce overall State public sector debt, as well as improved efficiency and competition. Also, the major project discussed the emergence of Optus into the telecommunications business and the obvious benefits this has brought to customers. The current debate on whether we sell off the airports was discussed briefly, with the advantages and disadvantages being addressed.

Much evidence concentrated on the efficiency of the private sector over the public sector. The H. V. Evatt Foundation and Kenneth Davidson point to Telecom and argue its efficiency and revenue streams and its improved technology should justify it staying in public ownership. However, many writers point to the need to include competition in the telecommunications industry and through this greater efficiencies have been achieved.

Niskanen argues that when using the public sector, bureaucrats are only interested in maximising their own budgets so they can pursue their own objectives. Piggott and the H. V. Evatt Foundation strongly oppose this view and argue that the public sector can achieve greater efficiencies if given the chance.

In Chapter Three, many examples where the Government has contracted out public sector works at great savings to the Government have been used. For example, the contracting out of some public transport works and Education Department cleaning have proved financially beneficial to the Victorian taxpayer.

Summary of recommendations:

- 1) that the State Government involves the private sector to build-own-operate the City Link Project;

- 2) that the State Government does not accept any responsibility for any private sector risk, or provide any indemnities or guarantees whatsoever for any financial dealing relating to the City Link Project, except in the isolated case where the State Government has the sole decision-making power to alter the financial risk;
- 3) that the State Government introduce a direct toll based on new technology available which will include 'smart cards' which would be placed on dashboards, or prepaid transponders;
- 4) that the State Government does not enter into any deals or contribution arrangement for recurrent expenditure;
- 5) that the State Government avoids any borrowings for the City Link Project and uses its Capital Works Budget to make contribution to the capital component if required by the tender process. The Capital Works Budget is funded from Federal Government grants and contributions from State taxes;
- 6) that where possible, and subject to commercial confidentiality, all State Government funding arrangements and commitments be detailed in Treasury Budget papers;

- 7) that where possible, and subject to commercial confidentiality, State Government funding arrangements pertaining to the City Link Project be presented to the Public Accounts and Estimates Committee and that this Committee receive regular submissions;
- 8) that the State Government ensures that a direct toll is the only revenue stream available to the private operator.
- 9) that in evaluating competing bidders in a project such as the City Link Project, two separate review committees be set up - one financial, one engineering and design, to independently evaluate the bids.
- 10) that bidding companies for the City Link Project continue to bid against each other to the stage where all design, engineering and financial details are secured. This will ensure that the so-called preferred bidder is locked into a performance contract, with financial security.

AREAS FOR FURTHER STUDY:

1. There is a need for the State Government to formalise the reporting requirements if private interests are to participate in the provision of public infrastructure projects.

Mr Craig Burke pointed to recommendation 3.1²¹³ in the Public Accounts and Estimates Committee report which involves making amendments to existing legislation such as the then Annual Reporting Act 1993. This legislation could apply to privately financed public infrastructure projects, in particular those with the benefit of significant support by the State.

This area needs further investigation to tighten up the present financial reporting and accountability requirements between the private sector and the government involvement in public infrastructure projects.

2. The Public Accounts and Estimates Committee has the power to call before it Ministers of the Crown. In practice, however, parliamentary committees do not generally summons Ministers of the Crown because of traditional procedures. This area needs further investigation, because it may be time Ministers became more accountable for their area of responsibility. If Ministers do not wish to appear before the Committees, then maybe the Committee should summons the Minister.

²¹³ Victorian Public Accounts and Estimates Committee "Private Investment in the Provision of Public Infrastructure" 1st Report to Parliament, Melbourne, November 1993, p49

3. On past history, Government involvement in the recurrent expenditure of public infrastructure projects appears to lead to financial and risk problems, especially looking at the World Congress Centre project. Further studies need to draw conclusions as to whether governments only participate in the capital components of infrastructure projects.
4. In the case of two bidders for a project such as the City Link Project, bidding vigorously against each other, should the losing bidder be financially compensated? Arguments to support this case include the fact that the Government will achieve a more competitive tender.

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INTERVIEW - 21/4/94

Questions to Mr Neil Cole, M.P. former:

- 1) Chairman of Economic and Budget Review Committee
- 2) Member of the Estimates Committee

Questions:

- a) Why did the Economic and Budget Review Committee investigate the finances of the World Congress Centre?
- b) Why did the Economic and Budget Review Committee not use its Government numbers to quash the investigation?
- c) Under the Victorian Government Committee system, references are given by Ministers or the Premier, why would a Minister wish to give out this sort of reference?
- d) Were the workings of the Committee investigating the World Congress Centre correct and proper?
- e) Were the conclusions of the Economic and Budget Review Committee proper and correct?
- f) General comments.

Answers:

- a) The Economic and Budget Review Committee decided to review the World Congress Centre after a series of questions were raised by the Hon. Roger Hallam, an opposition member (and now Minister for Local Government, WorkCover and Regional Development) relating to the finances and lack of accountability in relation to the World Congress Centre.
- b) It was decided by the Committee, an All Party Committee, after consideration that the facts presented to it warranted a full investigation. The members on the committee had legitimate concerns about the financial dealings of the World Congress Centre. Based on the facts presented, the Committee did not vote on party lines to quash an investigation as they felt the investigation was necessary and should proceed.
- c) Under most Parliamentary Committees, a reference is given to the committee from a Minister or the Premier authorising it to investigate or assess an area of concern. However, the Economic and Budget Review Committee do not generally receive references, but rather address matters of concern raised in Parliament or raised with the Committee direct.
- d) The workings of the Committee were correct and proper.
- e) The conclusions of the Committee were proper and correct. The general feeling of the

Committee was that proper accounting procedures were not met, which led to a series of problems within the World Congress Centre.

f) **General Comments:**

The Committee decided to adopt the report based on the facts presented to them. Mr Cole stated that there were some other options which the Committee could have followed. One of these options included a "wait and see approach". Mr Cole pointed to the fact that the World Congress Centre could have been refinanced, and then the Committee could have revisited the problem with possibly a slightly different conclusion.

Mr Cole believes the World Congress Centre is potentially a good asset and if the usage of this asset was improved then the Centre could generate better profits. Consequently, with a higher return, the World Congress Centre could be profitable, leading to "no liability to the taxpayer".

INTERVIEW - 21/4/94

Questions to Mr Phil Honeywood, M.P., Member for Warrandyte, and:

- 1) Member of Economic and Budget Review Committee
- 2) Member of the Estimates Sub-Committee

Questions:

- a) Why did the Economic and Budget Review Committee investigate the finances of the World Congress Centre?
- b) Why did the Economic and Budget Review Committee not use its Government numbers to quash the investigation?
- c) Under the Victorian Government Committee system, references are given by Ministers or the Premier, why would a Minister wish to give out this sort of reference?
- d) Were the workings of the Committee investigating the World Congress Centre correct and proper?
- e) Were the conclusions of the Economic and Budget Review Committee proper and correct?
- f) General comments.

Answers:

- a) The Australian Finance Community during the 1980's had become used to so called "funny money" deals. This was evident in the private sector, resulting in many company failures towards the late 1980's and into the 1990's.

The State Government was spending way beyond its means and also began to look at "funny money" deals for its survival.

In the case of the World Congress Centre, the deal done was, to say the least, imaginative. The problem was that these financial dealings done to ensure the project got off the ground meant huge expense was put off until sometime in the future.

- b) The Government could have used its numbers to block such an investigation, but the credibility of all Committee Members would have been put in question. The facts were so blatantly obvious, the Committee Members really had no choice but to go ahead with the investigation.
- c) Being an Estimates Committee, the range and scope of investigation can be widespread and it does not rely on references. The Committee has always had the power to initiate its own enquiries. All relevant parties (including Government Ministers) were requested to attend public hearings. When one of the Banks involved requested a private hearing (due to commercial 'in confidence' evidence), this was

permitted.

- d) The workings of the Committee were proper and correct.
- e) The conclusions of the Committee were proper and correct. Other reports had been produced in other forums leading to similar conclusions which put Committee Members, especially Labor M.P.'s in a difficult situation.

Labor M.P.'s faced a personal dilemma. Because the facts were so blatantly obvious, they could not be seen to be supporting an act of gross mismanagement. Labor Members had no choice but to agree to the final report based on facts provided. Not to approve the report would not have been in the interests of the Victorian taxpayer, nor to the members' credibility.

f) **General Comments:**

The Cain Labor Government was keen to have a show piece at any cost but did not have the money. The State Government then looked at "funny money" deals in order to achieve their dream of a show piece.

Any sensible financial analyst would never have approved a similar deal like the one the State Government did in order to finance the World Congress Centre. The private sector would have found the deal unacceptable if it was being analysed by a realistic analyst.

Mr Honeywood was critical of the financial deal, especially where a finance company was guaranteed excessive interest payments, in addition to balloon payments. He noted that the project will cost the Victorian taxpayer the equivalent of two World Congress Centre developments.

The risk to the finance company was not with the finance company themselves, but rather with the State Government. The Government should not have given such a guarantee, especially with excessive interest rates. There was, literally, no risk to the finance company participants.

INTERVIEW - 22/6/93

Questions to Dr Alf Smith, Senior Public Servant - Ministry of Major Projects.

Questions:

- a) **The Domain Tunnel** - What are the advantages for the private sector to build and operate the Domain Tunnel rather than the State Government?
- b) If a private company borrows money, will this affect global borrowing limits?
- c) What is the best form of revenue stream to pay for the Domain Tunnel?
- d) Apart from traffic related problems, what other benefits would the Domain Tunnel have?
- e) What are the benefits to the State if a private company builds, owns and operates the Domain Tunnel?
- f) What financial transactions need to be avoided when the Government works out a financial contract with the consortium?
- g) When should ownership of the Domain Tunnel be transferred to the State Government?
- h) Does the Government have the expertise to build, own and operate the Tunnel themselves?
- i) How will the Domain Tunnel affect traffic in other parts of Melbourne?
- j) What other options are open to the Government for the financing of the Domain Tunnel?

Answers:

- a) Many people think that Governments can borrow money more cheaply than the private sector because of the sheer size and ability to repay financial obligations. In the case of Victoria and Australia this is generally true. However, with the recent down rating of Victoria's credit rating, this makes State Government borrowings more expensive. Large companies can probably borrow at the same rate as the State Government.

Mr Smith makes the point that a company which wins the tender to build the Domain Tunnel would have to be a sizeable organisation. The building of the Domain Tunnel would require costly capital equipment, a large workforce and the ability to finance a large debt. The financing of the large debt would depend on how the contract for the "payment for works" is structured.

However, this aside, if the projected cost of the Domain Tunnel is between \$500 million and \$1,000 million, the company would have to be responsible for carrying

large amounts of debt.

- b) The Loan Council is reassessing the global borrowings at present. The global borrowing limits area big problem as it can restrict Governments from getting on with much needed projects.
- c) Mr Smith is uncomfortable with the concept of a direct toll and believes that the Domain Tunnel would only raise \$20 - \$30 million (net of collection). Mr Smith points to the Westgate Bridge example where the amount of toll collected was not significant, and when the toll was removed, the amount of people using the bridge increased significantly.

There is a significant number of motorists who take alternative routes to avoid paying for the toll, which may defeat the purpose of building the project in the first place.

The Domain Tunnel is primarily being built for traffic efficiency, pollution control time savings and to reduce road congestion. If a toll was placed on the Domain Tunnel, some motorists may find alternative roadways to avoid paying the toll. The tunnel will be an expensive project and the Government will want to ensure maximum usage in order to justify the financial outlay.

Mr Smith points to the fact that if the Domain Tunnel is going to cost \$1 billion, and the toll collected is going to be between \$20 - \$30 million, then the tunnel would clearly not be paying for itself

General assumptions:

\$1 billion x 10% interest rate	
Interest bill per year	\$100 million
Toll collected	30 million
	<hr/>
Loss on Interest	\$ 70 million

Another alternative would be for the consortium to have a traffic count and charge the State Government for the number of cars which use the Tunnel. This would be a shadow toll and the consortium could bill the State Government on a weekly or monthly basis for the number of cars which use the Tunnel.

Another alternative could be that the consortium charges the State Government for lane availability. In peak hour, the Government would insist that all lanes are open. The contract between the consortium and the Government could have penalty clauses if a lane was closed during peak hour. This would ensure the operator had a significant incentive to keep the lanes open.

Another revenue stream would be for the Government to introduce a fuel levy of 3¢ (for example) on all petrol sold in Victoria. This would give the Government a steady revenue stream and motorists could see a direct benefit for their fuel levy.

However, country drivers who rarely visit Melbourne and, more specifically, use the Domain Tunnel, may find it unfair that they are contributing to such a project.

Another revenue stream would be for the Government to pay the consortium out of consolidated revenue and make budgetary allocations.

If the consortium was to pay a shadow toll on the amount of the cars which use the Tunnel, then they would want a guaranteed amount of traffic. Consequently, it may be the responsibility of the Government to market the Tunnel.

- d) We are going through a period of high unemployment, the Domain Tunnel construction would create many jobs. Not just in the actual building, but many associated industries would have to increase their workforce.
- e) If the State Government did not build and operate the Domain Tunnel, it would then only have to be concerned about the revenue stream and building and planning guidelines.

The actual planning and construction works would be the responsibility of the winning tenderer. If the winning tenderer is going to build and operate the Tunnel themselves, they may take particular attention to detail to ensure the Tunnel is going to last for the long term, with low maintenance costs.

The operating of the Tunnel remains the sole responsibility of the consortium, which it may be assumed would run it more efficiently than the State Government.

By having a private operator build, own and operate the Domain Tunnel, the State Government would be protected from any short cuts the builder may opt for, creating problems later in the way of greater maintenance.

With the consortium building and operating the Tunnel, they may choose to increase their building costs (i.e. more expensive components) in order to reduce their running and maintenance costs.

- f) The Government should not be involved in any financial dealings between the consortium and the financial institution.

If the consortium goes bankrupt, then this is a matter between the consortium and the financial institution, not the Government.

The risk of the debt should never be transferred to the State Government and there must be strict guidelines set down for the long term investment.

- g) Generally speaking, the project should be debt-free within 20-30 years. In other words, the revenue stream and financial agreements between the consortium and the State Government should be set in such a way that the Tunnel is fully paid for within 20-30 years.

At the conclusion of this period the Tunnel is to be transferred to the State

Government risk free.

- h) A little difficult to answer as Vic Roads has never attempted a tunnel project of this magnitude.
- i) The Domain Tunnel will affect traffic in the outer parts of Melbourne such as Dandenong. If traffic can move readily through the Tunnel there would be less traffic build up and that affect would flow to the outer parts of the city.

The private sector may be required to only borrow 85% of the total project, which means the company would have to put in 15% of its own money. This would ensure that only those financially viable companies would apply. On the other hand it could discourage all companies.

Another option could for the State Government to go into a partnership deal with a private consortium.

INTERVIEW - 25/3/93

Questions to Mr Craig Burke, former Senior Research Officer of the Estimates Sub-Committee.

Questions:

- a) What examples of private investors can take place within public infrastructure systems?
- b) What problems are involved in the private sector being involved in public infrastructure projects?
- c) For accounting purposes, how do we treat the operation of the private operators involvement and their relationship within the Government?
- d) What are suitable public infrastructure projects that the private sector could invest in?
- e) What is the future needs of public infrastructure and its relationship with the private sector?

Answers:

- a) There are some straight forward examples, ones such as the contracting out of cleaning in schools and public hospitals. Other areas could include the privatisation of the prison system, the building police stations and hospitals.
- b) There are problems with global borrowing limits, for example if a private investor builds a project, should the cost of that project be included in the State's global borrowing limits?

Another problem exists when at what point in the life of the project does the "transfer of risk" take place between the private operator and the Government?

- c) There has always been an ongoing debate as to whether a project should be treated as a financial lease or an operating lease. Finance leases had to be included in global borrowing limits and just recently the Federal Government included operating leases under this umbrella.
- d) Many projects could be restricted because of the lack of reliable revenue streams. However, road construction is an obvious one, whether you use a shadow or a direct toll is up to the Government.
- e) In the Premier's department, there is a "one stop shop", which encourages the private sector to become involved in the investigating of Government works. This shop cuts through a lot of bureaucratic red tape and fast tracks projects which is a direct incentive to private investors.

INTERVIEW - 26/4/94

Hon. Graeme Weideman, M.P., Member for Frankston. Chairman of Public Accounts and Estimates Committee.

Questions relating to the First Report to the Parliament, November, 1993 "Private Investment in the Provision of Public Infrastructure:

Questions:

- a) Why did your Committee chose to investigate Private Investment in the provision of Public Infrastructure?
- b) Why did your Committee feel it necessary then to complete this unfinished report left over from the previous Government?
- c) What significant outcome did the Committee hope to achieve in its investigations?
- d) Was there any specific area of funding which the Committee investigated in relation to private involvement in the public infrastructure?
- e) Was this style of funding acceptable to the Committee?
- f) What were the objectives of the Accelerated Infrastructure Program?
- g) What attracted the private sector to investment in the Accelerated Infrastructure Program?
- h) Was the Accelerated Infrastructure Program funding method an efficient way of funding public infrastructure projects from the private sector?
- i) Is it appropriate for the State to further involve itself in the Accelerated Infrastructure Program?
- j) What is the main criticism of the Accelerated Infrastructure Program?
- k) What has your Committee achieved in responses to the Accelerated Infrastructure Program?
- l) Are there any examples where the Accelerated Infrastructure Program has worked?
- m) Will the Public Accounts and Estimated Committee have any influence over the Guidelines for the construction of the Domain Tunnel?
- n) Why then, did the previous Economic and Budget Review Committee not make the Treasurer handling the World Congress Centre come forward to explain the financial arrangements?
- o) As Chairman of the Committee, do you feel a personal responsibility that we do not

see a repeat of the World Congress Centre funding arrangements?

Answers:

- a) The Public Accounts and Estimates Committee took up this issue because it was a carryover from the previous Economic and Budget Review Committee set up under the previous Government. The previous Committee had started to investigate the topic but were unable to complete it due to the 1992 State election.
- b) The Government and the Parliament felt that it had significant importance to the State and the Nation and that there was a real need to investigate the importance of private investment into public infrastructure projects.
- c) The Government report allows the Parliament, Government and the Premier a basis upon which to lay the foundations to discuss and debate with the Prime Minister what should or should not be included in Loan Council guidelines when it comes to private investment into the public infrastructure. The Premier could use the findings of the report to argue for a better deal for the Victorian Government.
- d) The Committee spent some time investigating Accelerated Infrastructure Programs. This form of funding provided for an arrangement to provide office style accommodation (new or existing), which the Government will pre-commit to lease for approximately 20 years at indexed rents. The accommodation was primarily intended for the use of the Police, the Courts and health services. The estimated construction cost of the accommodation was in the order of \$200 million for approximately 20 individual projects, primarily comprising police and court complexes.
- e) In accordance with the current Government policy, three of the Program's projects have been cancelled while a further nine have been suspended. The Department of the Treasury have advised that the Program does not explicitly allow for the State to cancel or suspend projects. Consequently, if a project is cancelled or suspended, the State becomes liable for damages incurred by the other parties to the Program as a matter of common law. \$2.6 million has been paid by the State to other parties arising from the cancellation of three projects.
- f) The objectives of the Accelerated Infrastructure Program was to secure accommodation for Government services at rental costs below ruling market rates.
- g) The private sector participants have identified five reasons why the rentals are cheaper under the Accelerated Infrastructure Program than estimated market rentals:
 - low borrowing costs
 - guaranteed long term tenant
 - escalation of rents at CPI and not market review
 - Valuer-General monitoring, and
 - low construction cost of building due to the lack of a developers profit
- h) The final cost of the Accelerated Infrastructure Program to the State will depend to a large extent upon the outcome of key uncertainties highlighted by Treasury in its

analysis of the rate of earnings on the contingency fund held by Property Leasing Limited (PLL).

The outcome of the Committee's modification to Treasury's 1003 analysis is that the provision of accommodation under the Accelerated Infrastructure Program is 20% more costly when compared to borrowing by the State.

- i) The Committee focussed on three key questions:
 - Is it appropriate for the State to become involved in very speculative arrangements?
 - How appropriate is a private investment strategy in cases such as the provision of police stations? and
 - What is a reasonable cost to Government of private investment in public infrastructure compared to borrowing by the State given the benefits of such programs?
- j) Under the Accelerated Infrastructure Program, the rentals escalate in line with the CPI and CPI escalation of rentals over a long period may not result in any significant variation in the total rent paid, although it may produce rents at given times which are dramatically different from market based rentals.
- k) Government has stated that there are no further attempts to enter into Accelerated Infrastructure Programs, and no likely chance that they will look at Accelerated Infrastructure Programs.
- l) The Sydney Harbour Tunnel was built successfully under the Accelerated Infrastructure Program.
- m) The Committee has the power to call before it Ministers of the Crown, namely Education, Health, Transport, The Premier and Finance, to explain financial and funding arrangements. Consequently, if and when the Domain Tunnel is announced, the Committee would invite the Minister for Major Projects to explain the funding arrangements for the Domain Tunnel.
- n) Yes, as Chairman I would ensure that funding for the Domain Tunnel is within strict guidelines.

INTERVIEW - 6/5/94

Questions to Mr Craig Burke, Director of Research for Public Accounts and Estimates Committee.

Questions:

- a) What is the cost of finance when comparing the private sector investing in private infrastructure projects and the Government using its own money?
- b) What sort of community gains are available if the Government chooses to involve the private sector? *other extension case?*
- c) Is the cost of borrowing from the Government less expensive than what it is for the private sector?
- d) What would happen if the Government participated in part of the finance for the infrastructure project?
- e) What taxation implications are involved with the private sector participating in public infrastructure projects?
- f) Are there any examples in Victoria where the private sector has been involved in a public infrastructure project and taxation has been a problem?
- g) Are there any further implications regarding finance when it comes to the private sector being involved in a public infrastructure project?
- h) One of the problems which led to the difficulties experienced with the World Congress Centre, according the Economic and Budget Review Committee 'Funding of the World Congress Centre', May, 1992, was lack of reporting and accountability. With this in mind, how should future projects which include private investors be made more accountable?
- i) Surely you should have the power to summons a Minister of the Crown, especially if they are ultimately responsible?
- j) If the Public Accounts & Estimates Committee and the Economic & Budget Review Committee have so much power, why then did the Economic & Budget Review Committee not act more quickly on the World Congress Centre?
- k) On reading the report, it appeared that Government public servants were not very co-operative, is this so?
- l) How do we ensure that the World Congress Centre situation does not happen again?
- m) Should the State Government accept any financial risk on behalf of the private investor.

- n) Should the Government privatise the project at the completion of the project?
- o) How would the Domain Tunnel project fit into the above question?
- p) Would a direct toll work on the Domain Tunnel?
- q) Are Victorians ready for a direct toll?
- r) What are the effects of private investments into public infrastructure with regards to the Loan Council borrowing limits?
- s) What benefit does the private sector have on public infrastructure projects?

Answers:

- a) When the Government makes plans to build an infrastructure project, the cost of finance is paramount when deciding whether the project should proceed or not.

If the Government decides to use its own money, then the project may take 10 years to accumulate the finance. However, if the Government decided to involve the private sector, then the project may be able to start immediately.

Consequently, the Government must decide what advantages are available to the community if the project is started immediately, and analyse whether the cost of finance through the private sector can be traded off against these gains.

- b) If we are talking about the Domain Tunnel, for example, then reduced petrol costs and travelling time would save the overall community money. The savings here in these two items may be enough to offset the cost of borrowing from the private sector.
- c) Generally speaking, the Government can borrow more cheaply than the private sector. One of the reasons for this is because the private sector builds in a profit factor, which increases the price of finance. Obviously, if the private sector is going to participate, it will be because of a profit motive.

When Victoria had a Triple A rating, it could borrow at the cheapest rate. Today we have Moodys and Standard and Poors, who both rate differently, and borrowing rates would change on a daily basis.

- d) If the State Government were to guarantee all or part of the finance for the infrastructure, this would generally speaking, decrease the borrowing cost to the private investor. It may be that the private sector will not participate in the project unless the Government is prepared to guarantee all or part of the finance.

If the private sector can get a finance guarantee from the Government, then with a cheaper cost of borrowing it should mean a higher profit for them.

- e) Taxation has a significant role to play in the private sector investing in public infrastructure projects. Under Section 51DD of the Taxation Act, the private sector

may not be able to claim expenditure items as a tax deduction because of the role the Government plays in the project. If the Government is bearing the financial risk of the project, then the private investor will not be able to claim tax deductibility for expenses incurred.

- f) In the case of the World Congress Centre, there was a problem with Capital Gains taxation. If Capital Gains Tax is payable by Unitholders, it would raise the 1997 outstanding principal from \$149 million to \$185 million. The refinancing of equity for the World Congress Centre is not to be finalised until 1996 with the applicable interest likely to equal the five year swap rate of the time (10.5% in March, 1992) plus bank margin (0.7%), i.e. a total of 11.2% at current rates. While this interest rate would most likely be applied to the seven year Redemption Price of \$149 million, if Capital Gains Taxation is payable by the Unitholders, under an assumed 3% CPI scenario, the Redemption Price in 1997 against which interest is then charged rises to \$185 million. This occurs because quarterly distribution payments to the Unitholders under the Capital Gains Taxation option are held down to the same level as the non-Capital Gains Taxation option, i.e. additional Capital Gains Tax linked distributions are deferred until 1997. The Government guaranteed this loss, thus increasing its cost of finance.
- g) If the infrastructure project is in the hands of the private sector, it may be liable for Council rates, which could be costly. Of course, if the project is in the hands of the Government, then Council rates are not payable.
- h) Reporting to Parliament at present is a real problem. Information from the Government regarding a particular project has been in the form of press releases, budget papers and press interviews. This needs to be formalised into more correct reporting. Press releases can be slanted or biased for one reason or another.

On the other hand, if reporting requirements meant the private sector had to disclose commercially sensitive materials, it could be a disincentive for the private sector to participate.

The Public Accounts Committee and Estimates Committee can summons anyone, although, tradition has it they do not summons Ministers of the Crown.

- i) If a Minister refuses to accept an invitation, then there is nothing the Committee can do. However, the public would probably find it unacceptable that a Minister refused to attend a meeting of the Committee and explain his actions regarding an infrastructure project, for example.
- j) The Committee was unaware of the dealings of the World Congress Centre until Mr Roger Hallam, M.P. questioned some of the financial transactions relating to the Tourism budget. It was only then the Committee started to investigate.
- k) In the case of the World Congress Centre, Treasury officials were not the ones who were previously in control when the problems started. Unfortunately, many of the records of previous financial transactions were not able to be found.

- 1) The Government needs to enforce the requirement for formal statements of financial dealings when the private sector is involved in public infrastructure projects. This could be done through legislation and include future liabilities, ongoing costs and details of financial arrangements, for example.

The Public Accounts & Estimates Committee, in recommendation 3.1, states that the Parliament enact amendments to existing legislation, such as the Annual Reporting Act 1983 with application to privately financed public infrastructure projects, which, in particular, have the benefit of significant support by the State. Such legislative amendments could include:

- a) provision to the Parliament of key details of the private and public participants and agreed arrangements, this would include the level and type of public sector support and the allocation of risk between the public and private sectors;
- b) reporting of Government guarantees, indemnities, undertakings and like instruments detailing their nature and purpose to the Parliament; and
- c) provision to the Parliament of the likely or estimated financial exposure and the total possible exposure, including underlying key assumptions, that may arise from support provided by the State for privately financed infrastructure projects, as for example arise through Government guarantees.

This would certainly tighten up present financial reporting and accountability requirements.

- m) There a number of definitions of risk. The Government could be involved in minimal risk or a defined risk. Defined risk may mean the Government will cover the financial risk during the construction of the project. Minimal risk may include the Government being involved in say 10% of the total cost of the project.

If the Government wants the project to proceed, it may have to accept some of the risk. For example, if there is no interest from the private sector to bear 100% of the financial risk, then the Government must weigh up its priorities of accepting some of the risk or not. If the Government does accept some or all of the risk, then this must be reported to Parliament.

- n) The question is whether the asset needs to be in public hands. Some projects with a healthy revenue stream and are economically viable and open to the market, could be privatised. However, 'social' infrastructure projects are probably best suited to be transferred to the Government. For example, Police Stations should be in the hands of the Government, as the public would probably feel uneasy about the private sector owing a police station. Another example of a social infrastructure project would be a library.
- o) The Domain Tunnel could have a revenue stream for the entire life of the project, or for a limited period. However, the community benefits would continue, so in the case

of the Domain Tunnel, it may be a situation where it is part privatised and part public ownership.

- p) If the Domain Tunnel had a monopoly, i.e. there were no other alternative routes, then a direct toll would have to be regulated. That is, the private sector would be restricted in what the toll could be. Otherwise, the toll could be any price the private operator desired. However, on the other hand, if there were alternative routes, the Domain Tunnel would not have a monopoly and this regulation would not be necessary. The private operator would have to price accordingly to ensure patronage.
- q) Unlike N.S.W., we do not have the culture of paying tolls. The experience of the Westgate Bridge showed that many people avoided the bridge regardless of the toll. Some people would not pay the toll purely on principle. This is supported by the fact that patronage on the Westgate Bridge jumped sharply once the toll was scrapped. Some people may not have realised it, but they were spending more on petrol by avoiding the toll than the amount of the toll itself
- r) There is a gentlemen's agreement in effect that limits the amount of borrowings a State can make. If all borrowings are allocated and the Government wants the Domain Tunnel built, then it may have to bear some of the risk. The problem starts when we try and define risk. Is it a guarantee or is it who controls the project or some other mechanism. For example, the Sydney Harbour Tunnel has a revenue stream of a minimum toll. If patronage falls below the agreed number, the State Government makes up the difference. On the other hand, if the patronage exceeds the minimum toll, then the private sector receives all the revenue! Consequently, the State Government will continue to bear some of the risk.
- s) Infrastructure projects are normally very expensive and have a long return time on the investment. The Government must then be prepared to make these types projects attractive to the private sector.

The Public Accounts & Estimates Committee, in its finding 2.10 listed the reasons why it is in the interest of the Government to include the private sector.

The Committee found that possible objectives for the utilisation of private investment in the provision of public infrastructure can include:

- * to offset reductions in Government spending on new and existing public infrastructure;
- * to enable a project to proceed when the Government may otherwise be unable or unwilling to provide the funds;
- * to allow legal ownership of the infrastructure asset to rest with private sector bodies and so improve the flexibility of the Government's available capital and recurrent funds;
- * to avoid Global Borrowing Limit restrictions on public borrowings;

- * to qualify for available taxation benefits;
- * to exploit private sector competitive efficiencies;
- * to share financial risks and benefits between public and private partners;
- * to accelerate the start of a project, but at an overall cost which is comparable to conventional public sector borrowings;
- * to create a profitable investment for the private sector, with secure cash flows and attractive rates of return (with direct or indirect user charges or Government subsidies);
- * as a means of introducing market disciplines in the construction and operation of public infrastructure;
- * to allow those groups best placed to contribute, on a user pays basis, for certain infrastructure; and
- * to lessen the transparency of a Government's future financial obligations.

INTERVIEW - 17/5/94

Questions to Dr Alf Smith, Senior Public Servant - Ministry of Major Projects.

Questions:

- a) If the Domain Tunnel goes ahead what methods of payment can the Government use to repay it?
- b) Last year when we spoke, there was great concern about the cost of collection of a direct toll?
- c) What effect will this have on the public perceptions in Victoria of tolls, based on the experience with the Westgate Bridge?
- d) What will the operators save by having an electronic toll?
- e) Has the electronic toll system been tested in Australia?
- f) What other advantages are there with the electronic toll?
- g) How should the Domain Tunnel be structured financially to ensure the Victorian taxpayer is protected?
- h) Why should the State Government have to contribute at all?
- i) What are the advantages of the private sector being involved in the Domain Tunnel?
- j) Would the Government be required to make ongoing recurrent payments to the Tunnel?
- k) How could the transfer of the ownership of the Domain Tunnel take place?
- l) If the Government has to make a contribution, won't they have to borrow this money?
- m) Will the electronic toll revenue be enough to repay the private operator, without Government contributions?
- n) Do you anticipate a high diversion factor with the Domain Tunnel?
- o) What other advantages does an electronic toll have over a manual toll?
- p) If the Government contribution to the project is, for example, \$200 million, how could they finance it?
- q) How does the State Government ensure that reporting and accountability is first class, based on previous experience with the World Congress Centre?
- r) What about accountability and reporting, in regards to the day to day operations of the

Tunnel?

- s) What would the reaction of the Victorian be if the successful tender is an overseas company?

Answers:

- a) A direct toll is one very strong possibility.
- b) Technology has come a long way in just 12 months. A direct toll can now be charged electronically. There are two main methods of charging. Firstly, people can buy 'smart cards'. This card will be purchased by the driver from various outlets and they may choose to buy a \$10 card or \$20 card, for example. The card is then placed on the car's dashboard. As the car approaches the Tunnel, a device is set to pick up the 'smart card' details. If a car drives through the Tunnel without a 'smart card', then a camera would photograph the car's registration number. A hefty fine could then be sent to the offending driver.

Another method is simply putting a bar code on the registration label on the car. As the car approaches the Tunnel, a device reads the bar code and the owner of the car receives an account every month or quarter, for example.

- c) The electronic method will mean a reduction in the cost of collection. People loathe the manual collection of tolls and people in some cases drive some distance to avoid them.
- d) If we were to rely on a manual toll, we would have to build a collection centre which is costly. The size of the collection centre would nearly be the size of the M.C.G. This, logistically, would be a problem because the Tunnel is surrounded by parklands.
- e) Not as far as I know, however, it is being tested in West Germany. In fact, there are a number of companies doing trial runs. The companies set up their devices on roads and do trials. Of course, this is a windfall for the German Government with a number of companies competing because not only do they get an accurate machine but a less expensive one as well.
- f) With a manual toll, you are restricted to charging \$1.00, \$1.50 or \$2.00, for example. However, with an electronic toll, you can charge whatever. For example \$1.0756 if the need was there.
- g) The expected cost of the Domain Tunnel is around \$600 million now, which is less than first thought. One option the Government could take is to put to tender the building, owning and operating of the Domain Tunnel to the private sector. The private sector will do its homework based on anticipated revenue stream (electronic toll) and bid up to \$600 million. If, for example, the highest bid the Government receives is \$400 million, then this will require the Government to contribute \$200 million. Therefore, the final outcome could be a joint partnership between the State Government and the private sector.

- h) If someone in the private sector bids \$600 million, then the State Government won't have to contribute. However, if the highest bid is only \$400 million, for example, then if the Government wants the project to go ahead, it will have to contribute.

What must also be remembered, is that it could cost an additional \$150 million to tunnel rather than cutting through the parklands. It could be argued that the taxpayer should pick up the tab for protecting its parklands.

- i) Firstly, Vic Roads do not have tunnelling expertise. Unlike Switzerland or other European countries where they are building tunnels regularly, we do not. By involving the private sector, it will mean the Government has less borrowings, which could conflict with the Loan Council guidelines. The private sector could be given added incentives to ensure they finish on a set date. The financial risk should be kept with the private sector, rather than being transferred to the Government.
- j) Loan Council guidelines prefer up front capital contributions, rather than maintaining an ongoing revenue stream. The Government will need to ensure that they have clear guidelines regarding financial arrangements.
- k) One method could be that the Domain Tunnel remains in private hands forever, based on the assumption the Government makes an upfront capital payment and is not committed to recurrent payments.

Another option is the private sector transfers the ownership of the Tunnel to the Government after 20-30 years. The Government could then tender out the operations of the Tunnel after that period of time. Vic Roads may wish to tender at that point in time.

- l) If, for example, the Government has to make a \$200 million contribution, and the construction period is four years, then it is feasible to make 4 x \$50 million payments. A \$50 million payment could be made out of the budgetary allocation component of Treasury.
- m) One way of structuring the initial tender would be to state that the only revenue stream available for the project would be the toll it collects. The private sector would then base their contribution to the capital component accordingly.

For example, if a \$2 toll was to raise \$60 million, then the private sector may calculate a \$400 million contribution:

\$40 million interest expense
\$10 million operation expense
\$10 million profit

If anticipated toll payments were increased/decreased, then the capital contribution could vary accordingly.

- n) It may depend on how much the toll is set at. If it is high then people will look for alternative routes around the Tunnel.

With electronic charging, drivers will be probably more likely to feel more receptive to paying a monthly account than putting their hand in their pocket to pay a manual toll. Many vehicles are owned by companies, so many drivers would not even see the account.

- o) One significant feature is that there are no queues. Drivers do not slow down, or stop, as the electronic devices can read the card/bar code at high speeds. This means that there could be a near perfect traffic flow entering the Tunnel.
- p) A lot hinges on how much the private sector is prepared to contribute. The M2 in Sydney evidently had a significant private equity. Other methods of raising finance could include a proportion of the 3¢ fuel levy, or money coming out of the State capital works programs. The other unknown factor is when the Government wants to start the project. If it wants to start in the near future, then it may have to make other arrangements, because State capital work programs are usually planned a number of years in advance.
- q) The easiest way is for the Government to avoid borrowing. Problems occur when there is a debt of 100% to build capital work projects. If the Government contribution is \$200 million and the construction is over 4 years, then \$50 million per year is not an unreasonable amount from the capital works budget.
- r) To avoid pitfalls, the Government should stay away from contributing to the revenue stream. The best option for the Government is not to guarantee traffic figures. That is, if the traffic is less than anticipated, the private sector wears the risk, not the Government. On the other hand, there could be a public outcry to drop the toll if the Tunnel company made super profits. To deflect such an attack, the Government may wish to share in these profits and return them back to the public.
- s) The actual tunnelling machine would most likely be from overseas. However, there are many Australian engineers who are experts in this area, who travel overseas working on tunnel projects. The Snowy River scheme is still an amazing engineering task, built largely by Australians. So it be may anticipated that although there will be many experts from overseas, the project will include many Victorian's as well.

Friday, 13th January, 1995

MEETING WITH LEONARD RAMATLAKANE, MINISTER OF ROADS, TRANSPORT AND PUBLIC WORKS, PROVINCE OF WESTERN CAPE, CAPE TOWN

Arrived at the specified office in a letter sent to me by the Minister's private secretary only to find an empty office.

The people in the office next door informed me that the Minister had moved to another office. I had not been informed of this, even though the Minister had my Melbourne and Cape Town address.

I arrived at the new office to find that the Minister is still on leave and that the meeting had been rescheduled until Wednesday, 18th January, 1995 at 3.00pm. At no time had the Minister's office attempted to contact me to advise me of the meeting being rescheduled. The secretary informed me that it had been changed in the Minister's diary and that was the extent of her responsibility.

South Africa is having huge problems with Ministers not turning up to meetings, Parliament unable to get a quorum and Ministers failing to turn up to speaking engagements. In one case, a large Rotary dinner was organised for a Minister to speak and he did not appear. MP's are now fined R100 for failing to attend a Parliament quorum.

Wednesday, 18th January, 1995

MEETING - MINISTER RAMATLAKANE, MINISTER OF ROADS, TRANSPORT AND PUBLIC WORKS, 9 DORP STREET, CAPE TOWN, MR STEVE FANNER, CHIEF ENGINEER - WESTERN CAPE PROVINCE, MINISTER RAMATLAKANE, ADVISER

Recently moved from Cape Provincial building so meeting in almost empty offices.

Discussed the role Western Province Government will play in relation to the National Government. At present the system is in its infancy and the boundaries of responsibility are still unclear, except for the basic principle that if it is a "national function", it will be the responsibility of the National Government, if it is a "provincial function," it will be the responsibility of the Provincial Government and so on. An example of this is the port of Cape Town is a national function, whereas Hout Bay or Hermanous along the coast will be a Provincial responsibility.

Haggling over who is responsible for what in grey areas will happen similar to the Federal/State issues in Australia.

The Minister sees problems with generating revenue at a Provincial level. He will be able to use car registration as a possible source of revenue, however, this may be used for general revenue.

Road tolls are one option that the Western Province Government could use on new roads, although South Africa has excellent road systems at present. They are very keen to hear more on Victoria's 3¢ per litre fuel levy which we use to construct roads.

Fuel in South Africa is 165¢ per litre (\$A0.66¢). The Minister is keen to receive more information, especially the political impact of this introduction.

Western Province does have a couple of toll roads, but because there are on national highways, the revenue is going to the National Government. National Government Minister for Roads, Mac Maharaj, has warned that he is keen to implement more toll roads.

At present the Province has not reviewed how it will manage Provincial ports or if it will use the user pay principle. Once a position is formulated they will send me a copy of this policy.

Discussion moved to third party insurance and how Victoria manages this. The Minister is keen to receive literature on this to review Western Province methods of compulsory insurance and if it can be run profitably. Currently South Africa has an horrific road toll. The Minister is also keen to receive literature on advertisements shown on television, the booze bus campaign and speed camera technology. In South Africa, speed cameras have been a problem because they were unmanned, so as a result many were vandalised.

Talks covered the Provincial Government role and its relationship with local government authorities.

Discussion on Cape Town's half built overpass revealed this was not completed as the project ran out of money. The Minister believes this project will need to be completed soon due to traffic pressures. However, the Minister has a "political" problem trying to finance and complete this project when children are being turned away from schools and there is huge pressure on the health system. (The National Government has promised free health treatment to all pregnant women and children under six and free education up to year 10).

The Minister has a difficult portfolio because it is not seen as a high priority in relation to human issues.

What may help is the Restructuring Development Program (RDP). This program is funded by a surcharge on people's taxes to fund the inequities in the black townships. This money may be used to improve public transport, roads and public infrastructure.

Further good news for the Minister is that with the Olympic bid, the National Government is keen to build the public infrastructure and improve public transport in Cape Town to help the city win the bid. Consequently, the Minister's priority list of public works projects is keenly consulted with the Olympic committee and the National Government. One of the first priorities is to build a light rail system from the water front to the main rail station and then to build a loop rail system to connect outlying black townships. At present, to get to a neighbouring suburb involves travelling into Cape Town then back out on another line (similar to Melbourne).

If the Olympic bid is to be realised they will need excellent transport between venues. The Minister's department is reviewing and prioritising projects.

I have agreed to send briefs of current Victorian legislation and the Minister will contact Minister Baxter and his department if he wishes further information.

Friday, 20th January, 1995

MEETING - DR MALCOLM MITCHELL, DEPUTY DIRECTOR-GENERAL, FORUM BUILDING, STRUBEN STREET, PRETORIA, MR NAZIR ALLI - DEPARTMENT OF TRANSPORT - PRETORIA

Discussed road funding and its priorities in the New South Africa. Transport has been identified as one of the five National Government priorities. Minister Mac Maharaj, Minister for Transport, has been identified by President Mandela as a possible future leader. Consequently, Minister Maharaj has a lot of political power which helps when arguing the case for your portfolio at budget time.

Discussions moved to the role the National Transport Department will play in the provision of funding of Provinces was covered

National roads will remain the responsibility of the national Government and funding for this will be determined by the national budget.

Funding for provincial roads is a different matter. The national Government allocates a global budget to the provinces (transfer payment) and it is the provinces who decide how the money will be spent. The Provinces will decide priorities within their own Parliament and formulate their own Provincial budget.

Any new national roads are built by the private sector and this has been the practice for many years. They have been efficient and the work has been completed satisfactorily. Maintenance of national roads is a different matter. This work has in the past been contracted to the Provinces to do the work, however, disputes have arisen over the quantity of the work. Provinces have felt that they are in the "box seat" and many believe they have used the money exclusively for provincial roads maintenance. Consequently, the National Transport is expected to issue an ultimatum to the Provinces that if they do not do the work satisfactorily, the maintenance work will be put out to tender.

The National Transport Department does not have any construction works capacity itself and that policy will continue.

Toll roads exist in South Africa and these have worked very successfully. In fact, in the recent past the only new national roads have been funded by a user pay principle. The Government organises the finance and the toll collected is used to repay the loan. In some cases the loan has been re-adjusted where vehicle estimates have been too conservative or too generous. This has worked well.

Minister Maharaj has indicated in press statements that South African drivers need to accept the fact that toll roads will be a fact of life.

South Africa has tolled existing roads on two previous occasions. This discussion is particularly relevant to the Victorian Government and the City Link (bill) and the way the

Victorian Government is to raise the finance the widening and extensions of the Tullamarine Freeway, the building of the Domain Tunnel and the widening of the South Eastern Freeway.

The public outrage that followed when South Africa introduced tolls on existing roads was enormous with protests and attempts by the public to pull down the toll. One of the most common arguments put forward by the public was that previously paid taxes have already paid for the roads.

Dr Mitchell staunchly defends the Transport Department's push to toll existing roads, because figures constantly show that the construction of a road represents about a third of the total costs in the life of a road. The other 2/3 of total costs represents maintenance and upgrading. Consequently, Dr Mitchell believes that the public's claim that the roads have already been paid for is a poor misinformation.

Arguments stressing the need to explain the importance of the cost of road maintenance would help when trying to sell the need to toll existing roads.

In the two cases where South Africa have introduced tolls on existing roads, the roads in question have required a major upgrade and widening works. Dr Mitchell believes that the public will accept the toll if they can see the extent of the upgrade.

Until 1988, South Africa had a dedicated fuel levy which was used specifically for road funding. This was used for road building and maintenance.

The Road Transport Department did not receive any other revenue except for this dedicated fuel levy. However, in the early 1970's the fuel levy system reached its peak. Inflation and rising costs meant that the Rand was no longer buying as much road as it once was. Combined with only modest growth in fuel sales, the Department of Transport pressurised the Government to increase the fuel levy in a bid to keep pace with the demand for road building and maintenance. By the late 1970's the Government had to make financial contributions to help the shortfall in the fuel levy. Finally, it was decided that the fuel levy would go into consolidated revenue and that Treasury would make an allocation to the Transport Department at budget time. The Transport Department lost a certain amount of autonomy whereas previously at least they had the fuel levy as a guaranteed source of income.

Under the New South Africa, apart from tolling roads, a fuel levy is another option that the Department could consider.

Dr Mitchell and Mr Alli have agreed to send me further information and papers on tolling especially in the area of tolling existing roads.

Further talks covered the areas of:

- road safety - comparison to Victorian roads
- further funding problems
- Department of Transport bureaucracy

There were further inspections of Johannesburg roads, especially major link roads, including safety signs.

Kim Wells & Ken Evans - Meeting with Osaka Prefectural Government, Department of Public Works, Roads Division.

Department of Public Works Represented by -

Mr. Katsunori Hayakawa - Director, Trunk Road Office, Roads Division, O.P.G.

Mr. Shinji Nakone - Senior Staff, Trunk Roads Office, Roads Division, O.P.G.

Discussion specifically on Toll Roads.

Department does not construct roads directly.

Roads are constructed by other organisations, which the Public Works Department supports namely:

1. Japan Highway Corporation - Freeways
2. Hanshu Express Corporation - Highways
3. Public Roads Corporation, Osaka Prefectural Government.

The Public Works Department also supports the Central Government's Ministry of Construction that has responsibility for Osaka's regional road construction.

Japan Public Highway Corporation operates the toll way system.

History of Transport in Japan -

Until 19th. Century, by foot and horse.

Late 19th. Century, first priority was railways.

Roads were the poor cousins.

After W.W.II, highways became the highest priority.

Japan's major problem is that although highways are built relatively quickly, there is insufficient funding for road infrastructure to keep up with the demands of vehicle users.

In 1952, Japan introduced laws to allow tolls to be collected. These were included in the "Road Improvement Special Construction Act."

Politicians believe that people who use roads should pay.

A unique situation is the toll road on the Osaka Hill's tourist route that is run by the local government. This road has always been a toll road and is particularly popular.

Funding for roads come from a number of sources including: the Central Government, banks and publicly issued bonds.

Japan Public Highway Corporation plans to build 14,000 km of new roads under a National Government infrastructure plan. To date, it has completed 5,500 km.

Tolls are collected and used for either specific projects, or for maintaining the entire road network.

Osaka has 325 kms of National Highway.

Osaka's regular roads cover 1,332 kms and are the responsibility of the Osaka Prefectural Government.

Toll roads cover a distance of 150 kms, constructed and operated by Japan Public Highway Corporation throughout Osaka.

Problems for future include:

Recovering costs on an equitable basis.

In order to cover all costs, high tolls would have to be set.

Rural areas have low usage rates. How do you fund roads in rural areas?

Conversely, urban roads are highly used and increasingly congested.

The tolls for the Hanshu Expressway are Y600 (A\$9) for passenger cars and Y1200 (A\$18) for trucks and buses.

Tolls are collected manually on the Hanshu Expressway.

There are no plans to move to fully developed electronic collection methods. Japan Public Highway Corporation toll roads do have electronic collection, but it is not a sophisticated system. Vehicles pass over weight scales and height detectors at the entrance to the Expressway. A ticket is issued at the beginning of the journey whilst payment is made at the end.

There is a National Highways charge also. There is a minimum charge of Y150 plus Y24/km for passenger vehicles and Y30/km for trucks and buses.

This National Highways charge is uniform throughout Japan and is collected on behalf of the Central Government.

There is a pay later card system in use for large truck and bus companies.

When using a taxi, the customer pays the toll separately in Yen currency.

A large problem in Japan is that local government taxes are used in road construction, therefore, the public likes to see as low a toll as possible.

Petrol tax is controlled by the National Government.

The National Government imposed petrol tax is used solely for road construction.

Tax is distributed 50/50% between local and national roads.

Diesel oil taxes go to the local governments.

The cost of petrol is Y110/litre of which, Y48 is national tax.

The cost of diesel is Y70-80/litre of which, Y32 is tax collected by local government.

The 14,000 kms of new roads to be built in the National roads plan, will all be toll roads.

The public reaction to this is generally favourable.

People want super highways to reduce existing congestion and they are prepared to pay.

Road tolls can be an election issue, however, this is dependent on the area.

There is a growing environmental awareness in the cities.

In rural areas, if the environment is harmed then this can become an election issue.

Nevertheless, there is still strong support for super highways in rural areas.

If roads are constructed in an environmentally sensitive manner, then public support will be gained, particularly with regard to design practices to reduce noise and air pollution.

Public consultation on road construction plans is a very high priority in Japan.

In Japan, people do not resent paying both tolls and taxes when they used directly for road construction and maintenance.

Land acquisition is always a problem for road construction.

When there are public protests concerning a particular road project, the Government halts work and begins consultative discussions if the Government feels that the protesters have the majority position.

However, most Japanese understand the need for public highway construction.

As a counter-measure to resolve environmental issues, some roads are going underground.

Existing roads are never tolled.

Upgrades to existing roads remain toll free so as not to disadvantage old users

Therefore, there is a desire to build new roads than upgrade existing roads.

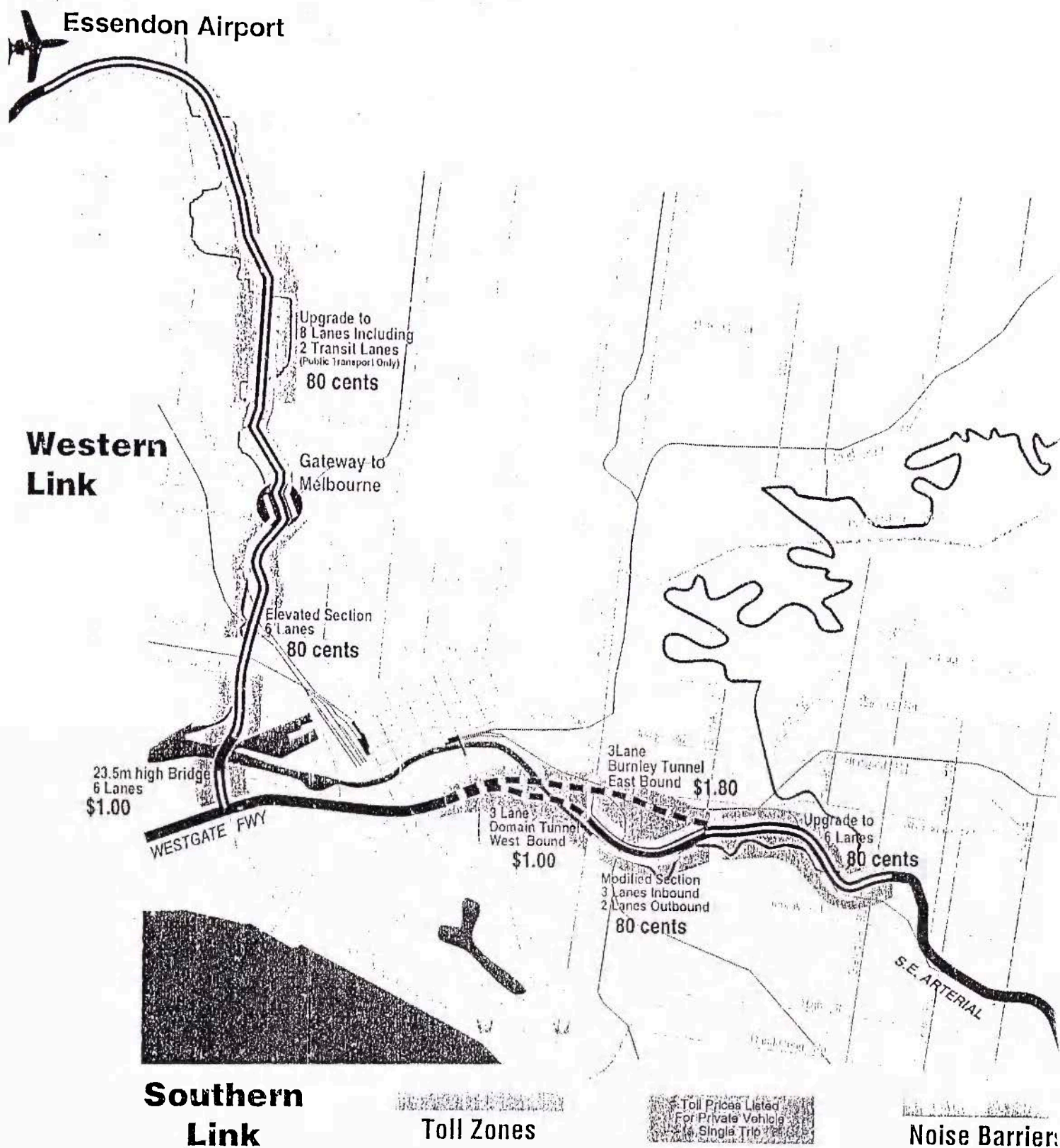
Freedom of choice remains, existing roads are an alternative to toll roads in many places.

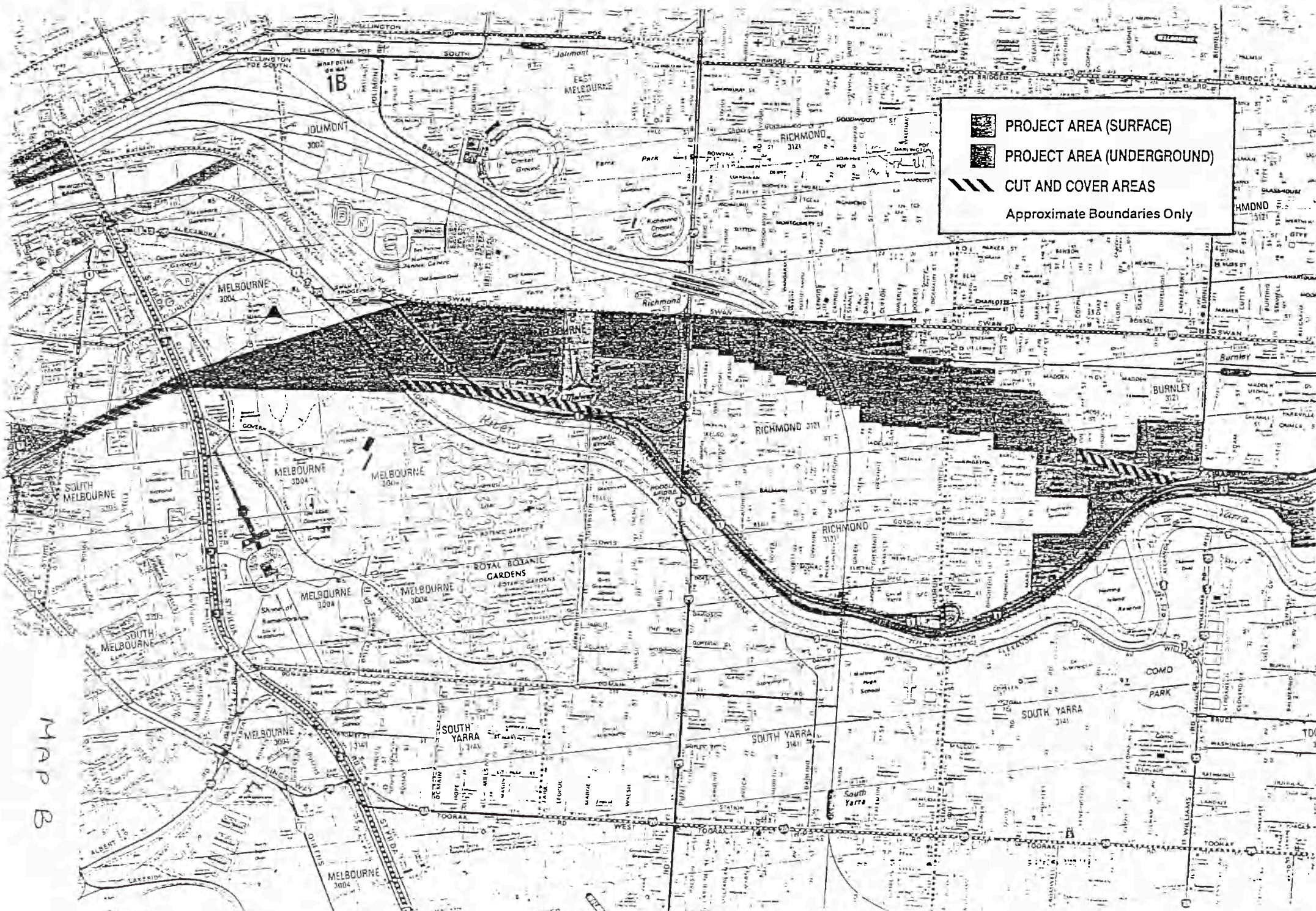
After a toll road operated by Japan Public Highway Corporation is paid off, the toll is continued and the revenue is then used to support other freeway projects.


The Tokyo - Osaka expressway is paid off but a toll is still collected for use on other projects.

Highways are built by the private sector in open tender contests for the projects..


Toll collection is by private management companies.








PROJECT AREA (SURFACE)



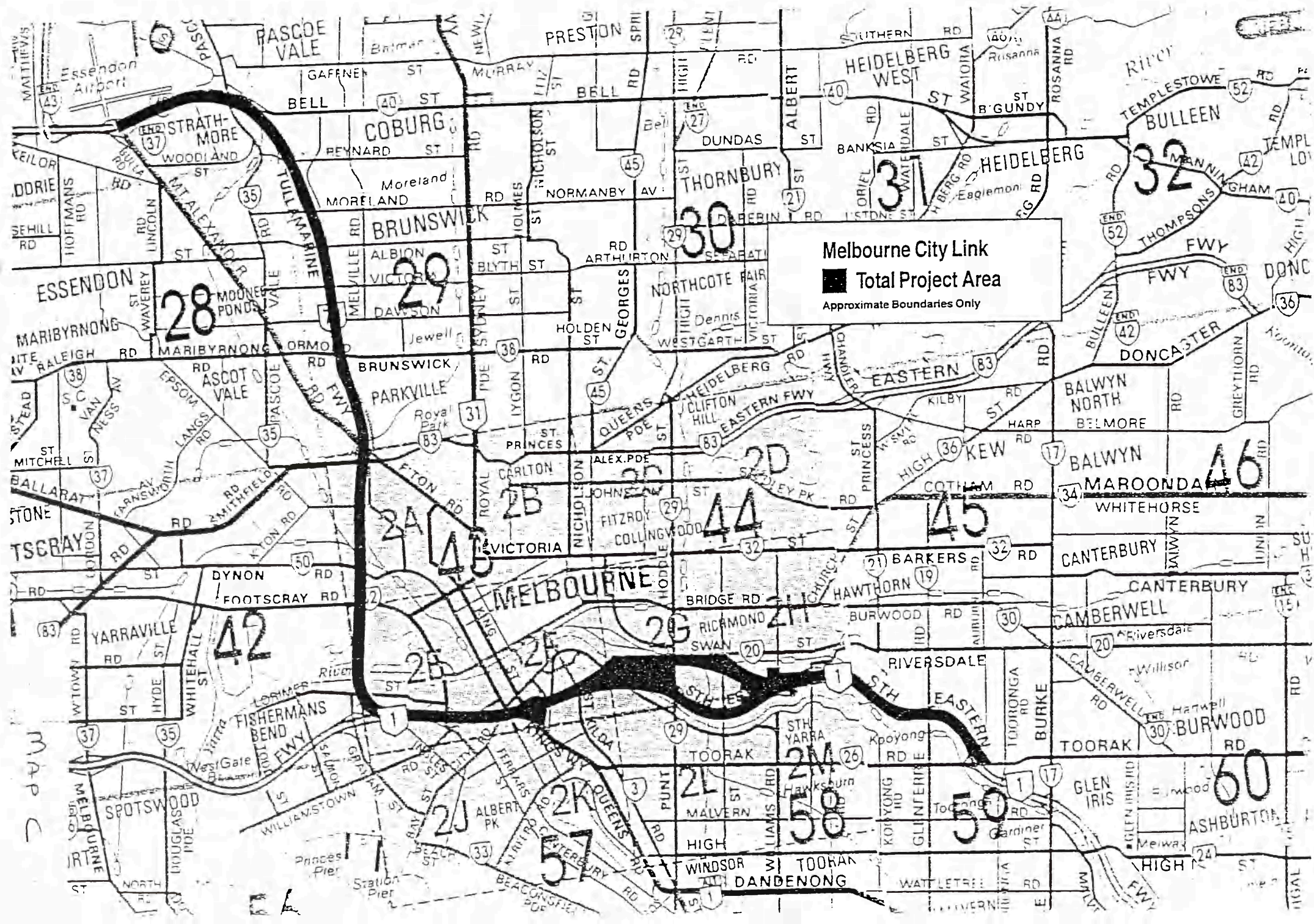
PROJECT AREA (UNDERGROUND)

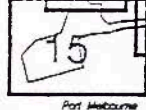
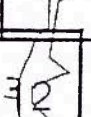
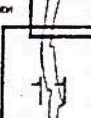
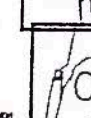
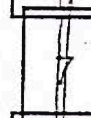
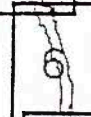
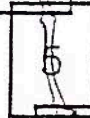
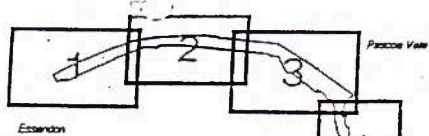


CUT AND COVER AREAS

Approximate Boundaries Only

MAP B





Bundoora

Pasadena

MELBOURNE CBD

Richmond

Port Melbourne

Newport

Toorak

THE MELBOURNE CITY LINK

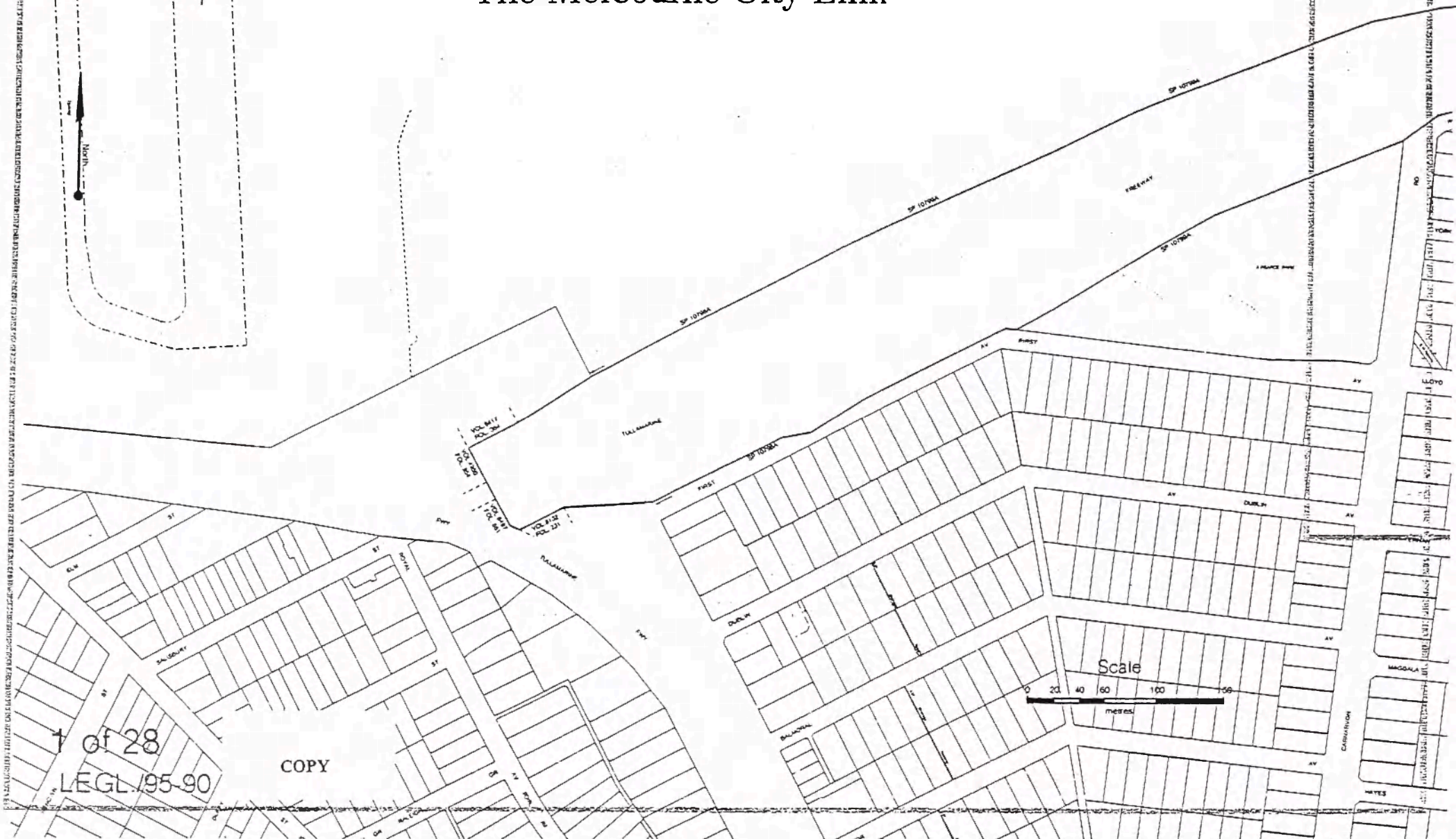
INDEX TO 28 DETAIL PLANS
DEFINING THE PROJECT AREA

COPY

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MAPPING PRODUCED BY OFFICE OF THE SURVEYOR GENERAL &
OFFICE OF GEOGRAPHIC DATA COORDINATION,
AT THE STATE DATA CENTRE, BALLARAT.

The Melbourne City Link



The Melbourne City Link

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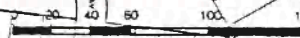
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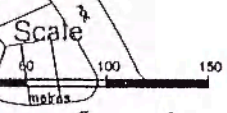
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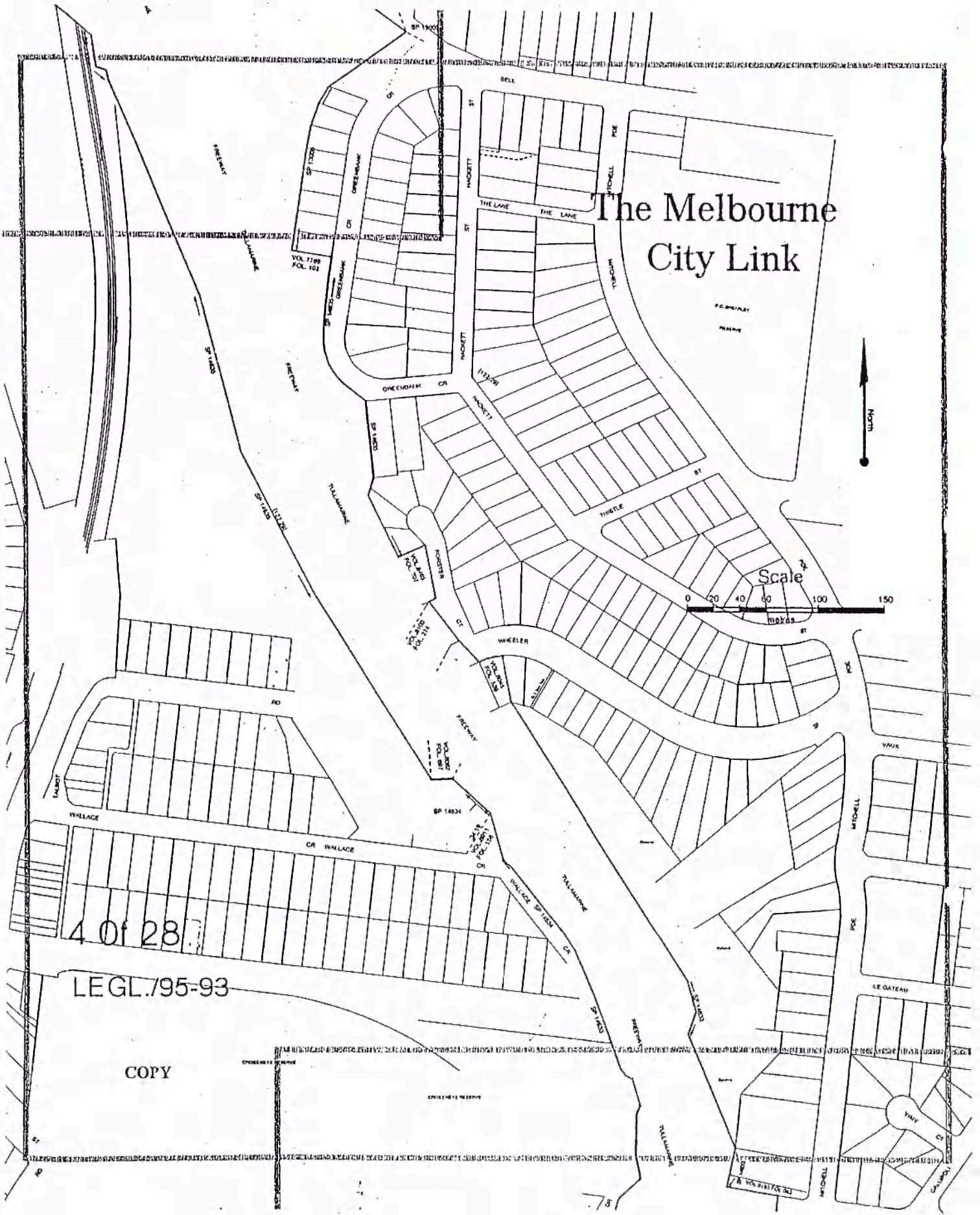


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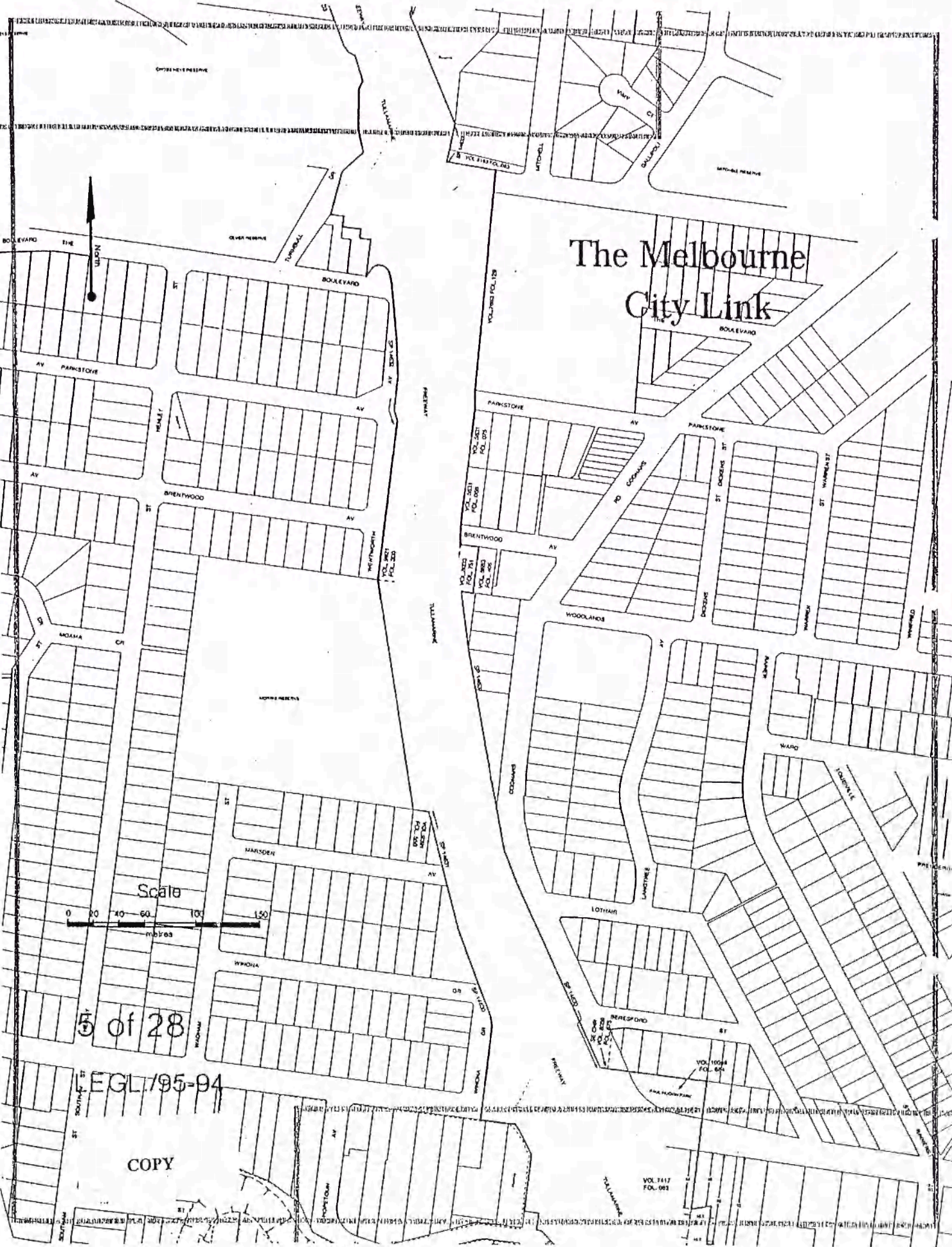


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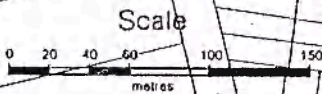


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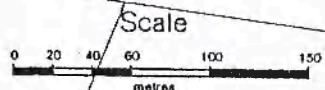
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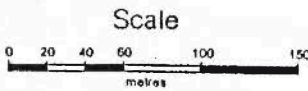
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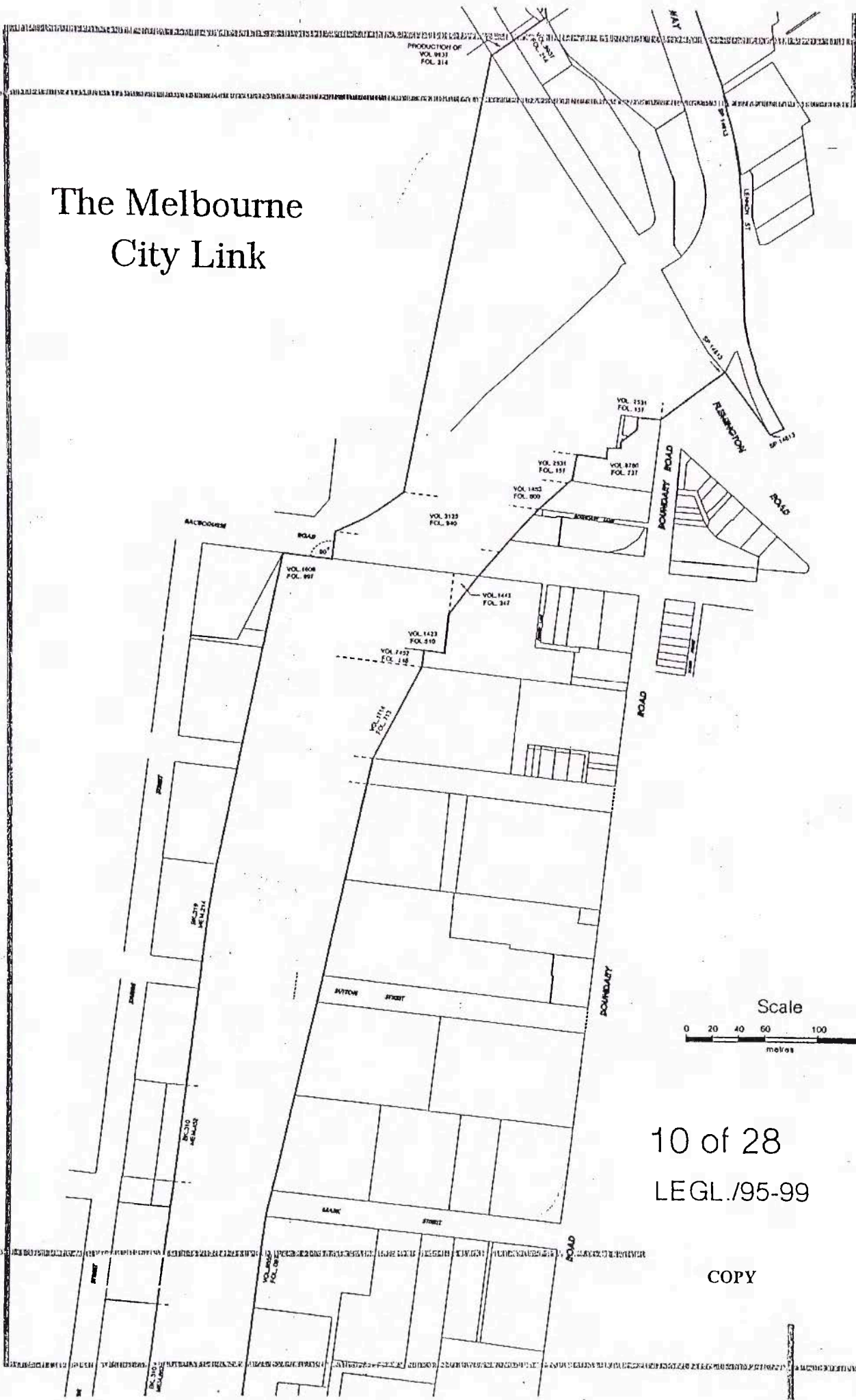


The Melbourne City Link



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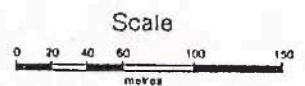
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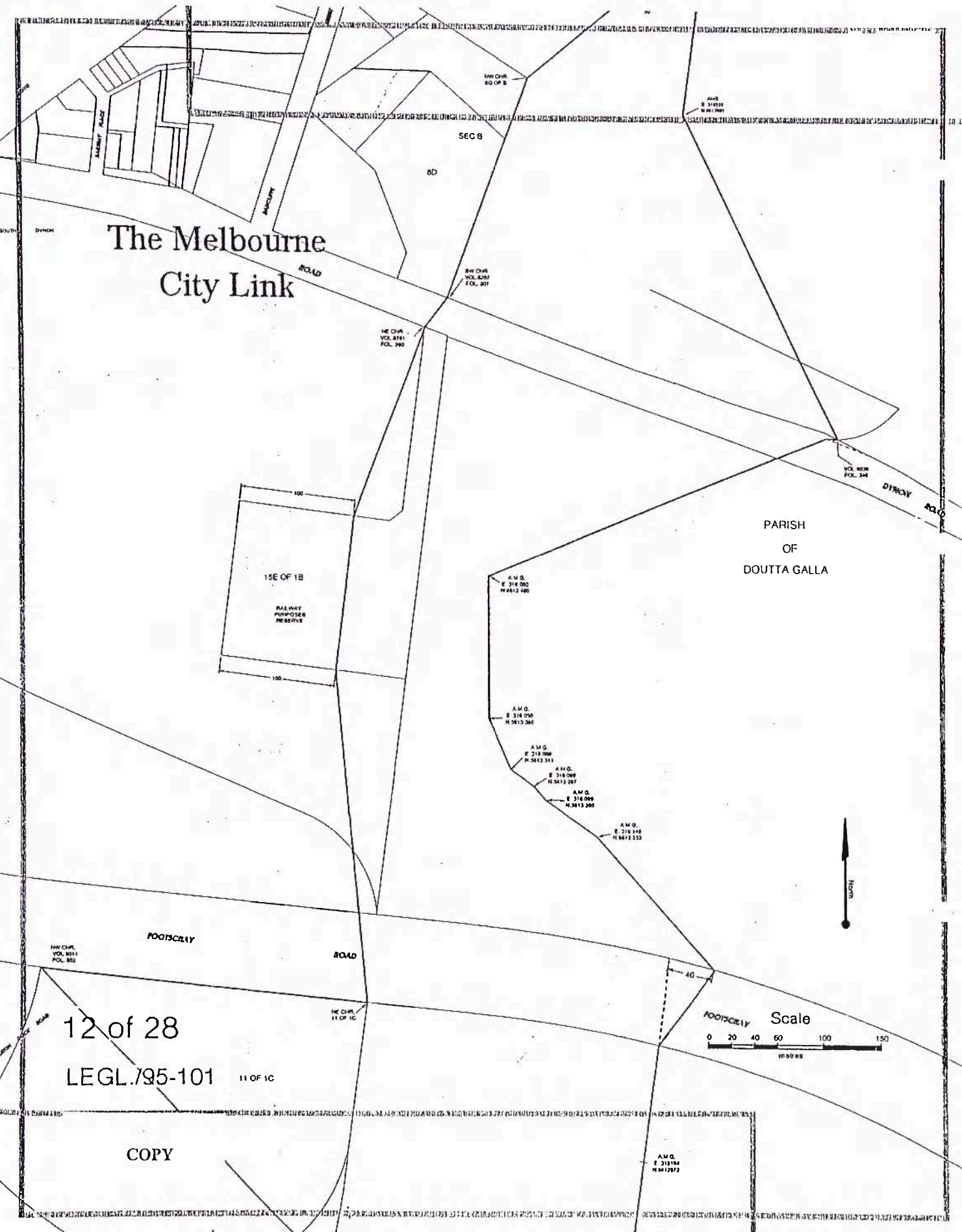
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The Melbourne City Link

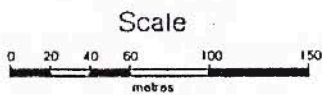


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AMQ
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PARISH
OF
DOUTTA GALLA

The Melbourne City Link



DOUTTA GALLA



DOUTTA GALLA

AMQ
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LEGL./95-102

COPY

The Melbourne City Link

E. 317 844
N. 5812 270

PITT STREET

NORTH WYNDHAM

NORTH WYNDHAM

A.M.D.
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SOUTH WYNDHAM

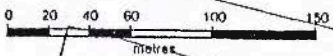
SOUTH WYNDHAM



LOVING STREET

72 B

Scale



100 METRES

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LEGL/95-103

COPY

THURSDAY STREET

CA 118

CA 11A

The Melbourne City Link

North

WESTGATE
FOOTWAY

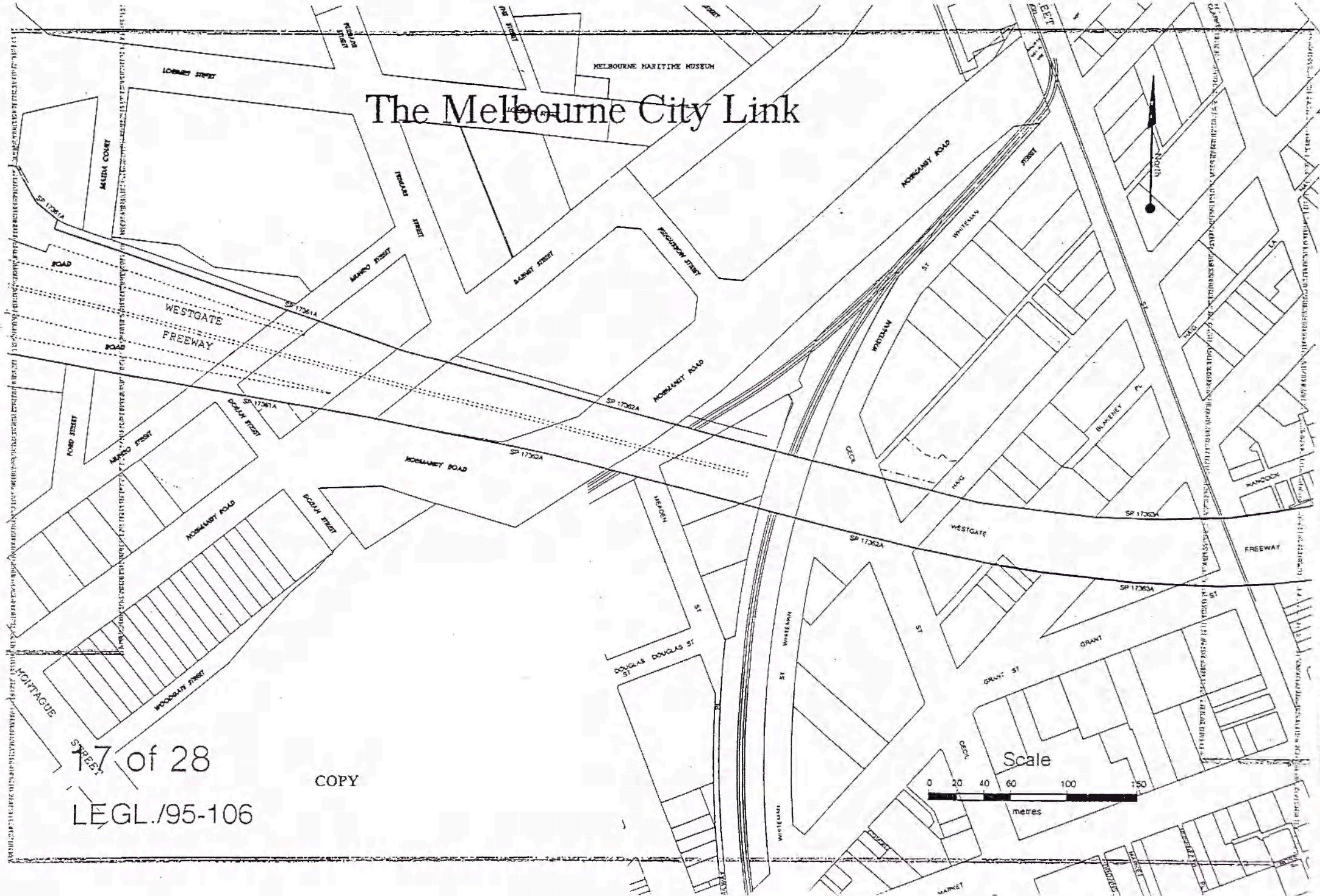
PARISH OF MELBOURNE SOUTH

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The Melbourne City Link



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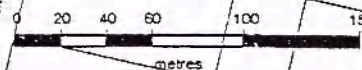
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The Melbourne City Link

North

KINGS DOMAIN

19 of 28

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The Melbourne City Link

PARISH OF MELBOURNE SOUTH

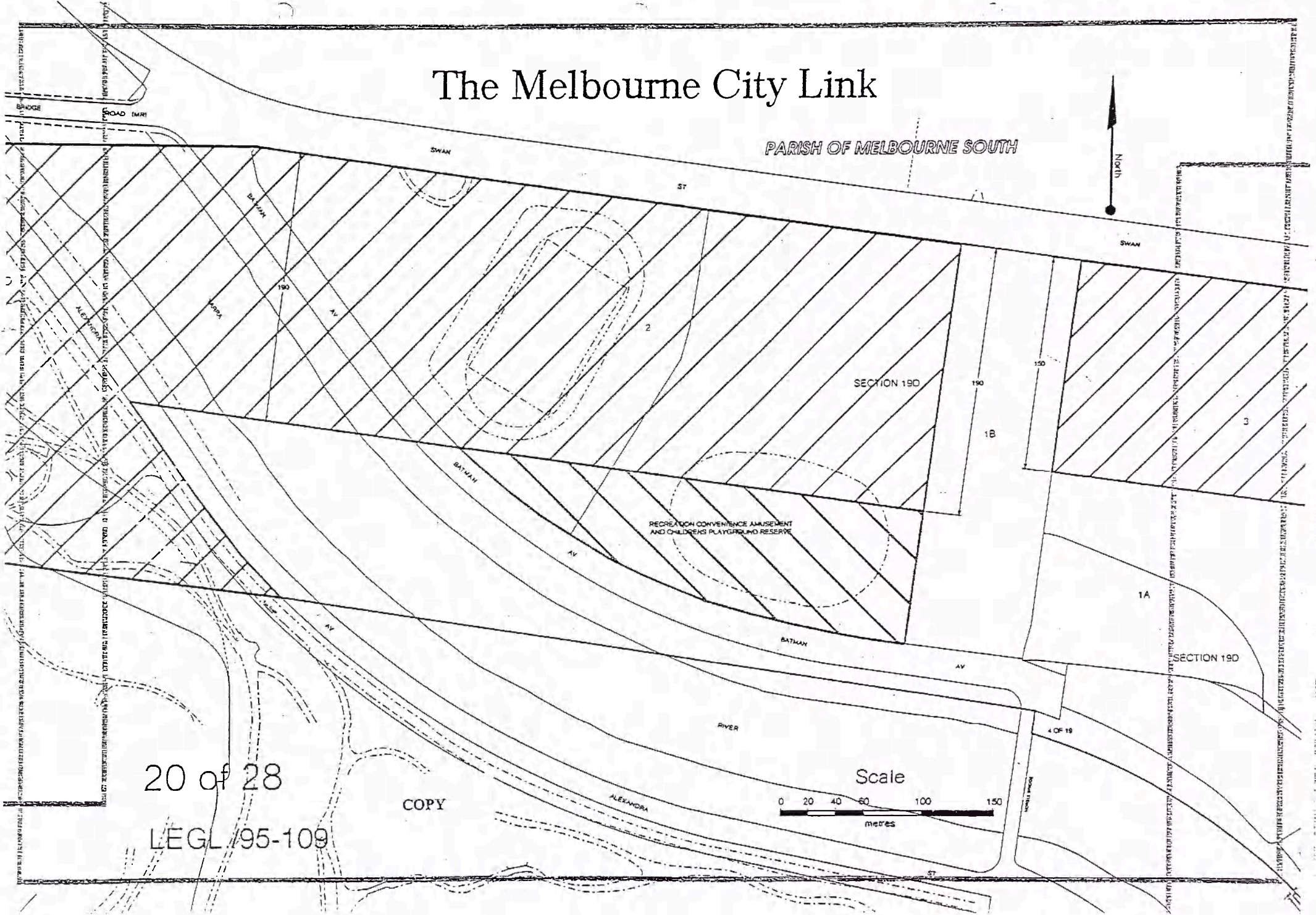
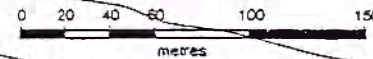
North

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LEGL/95-109

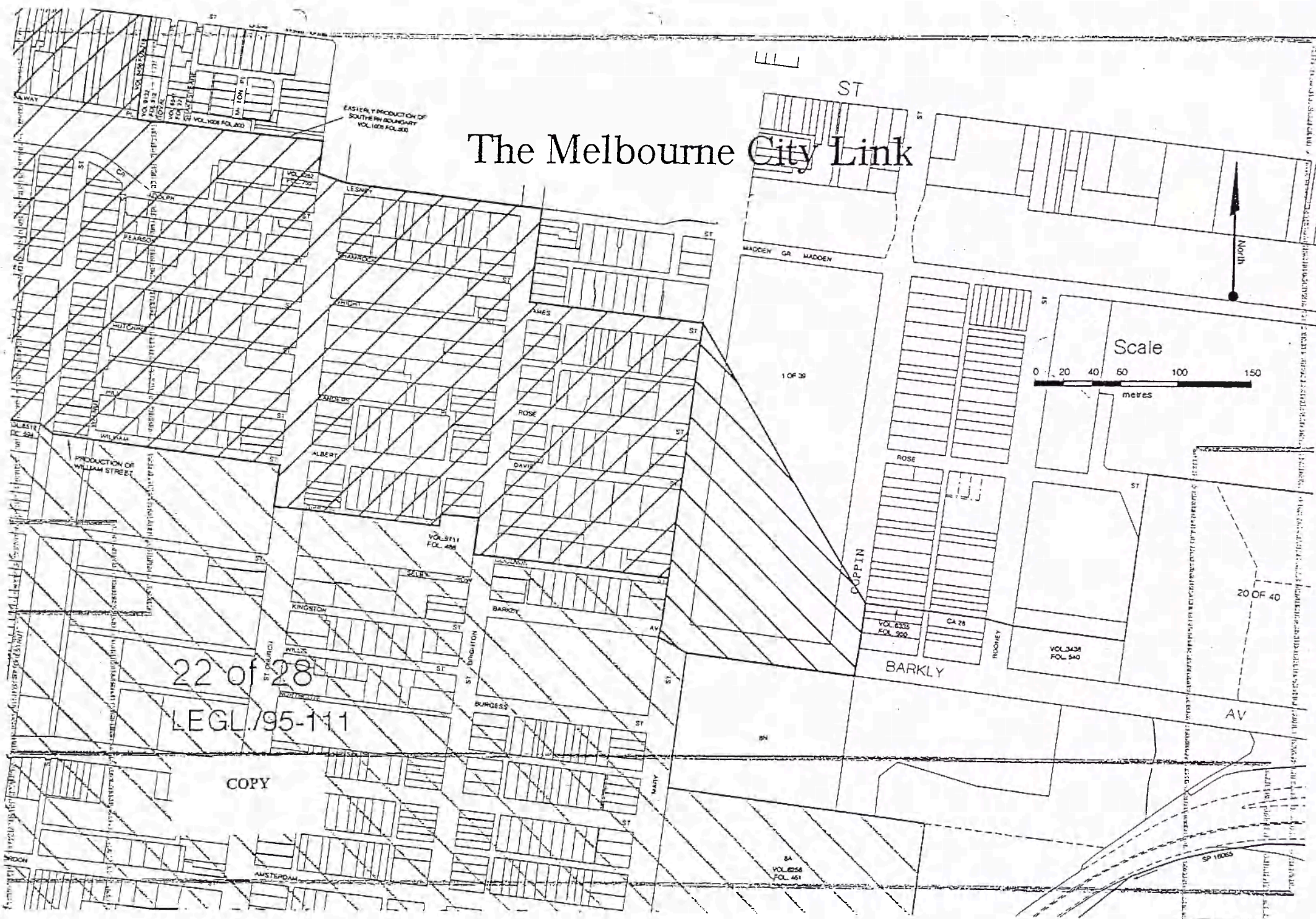
COPY

Scale



COPY

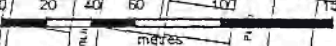
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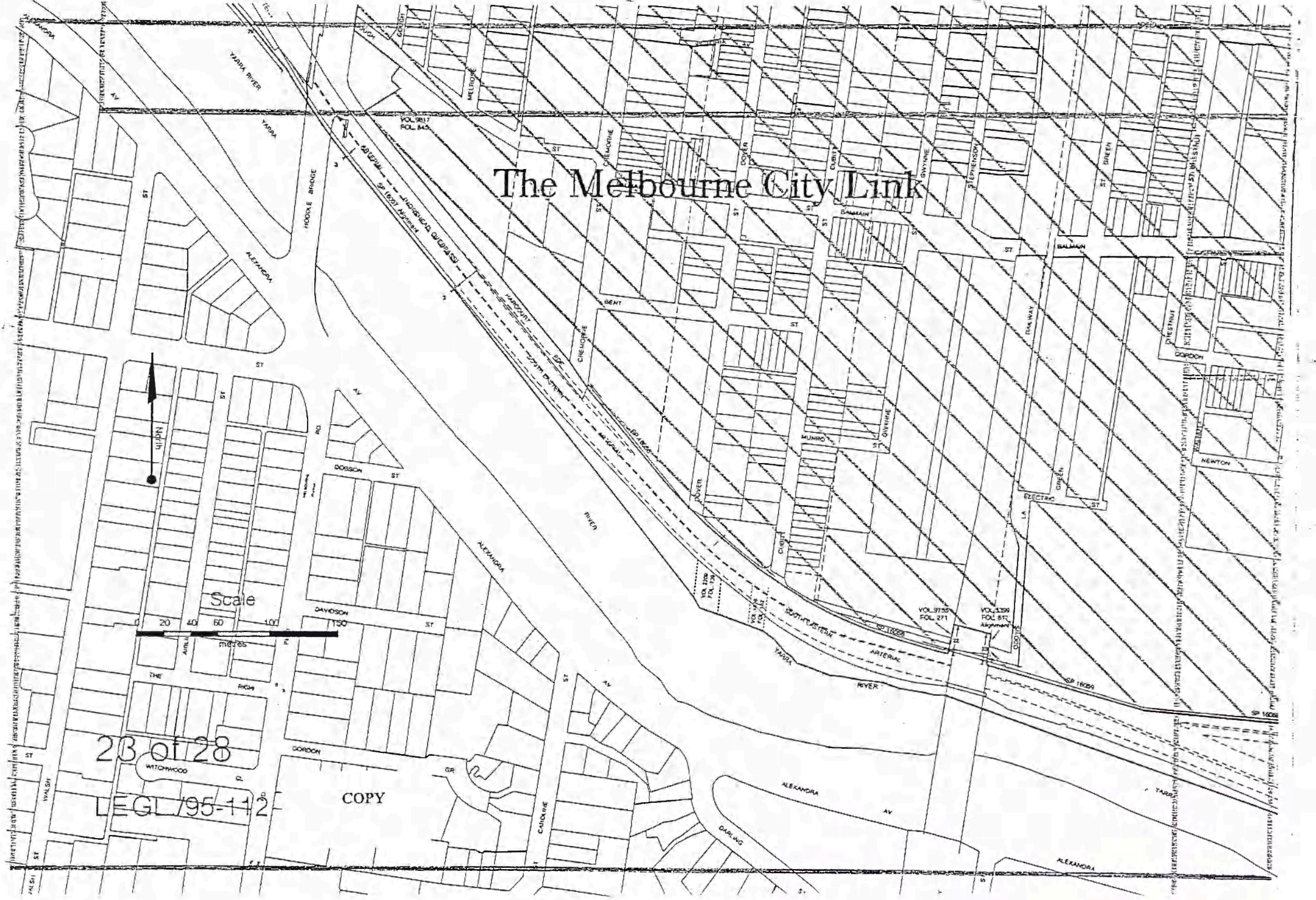
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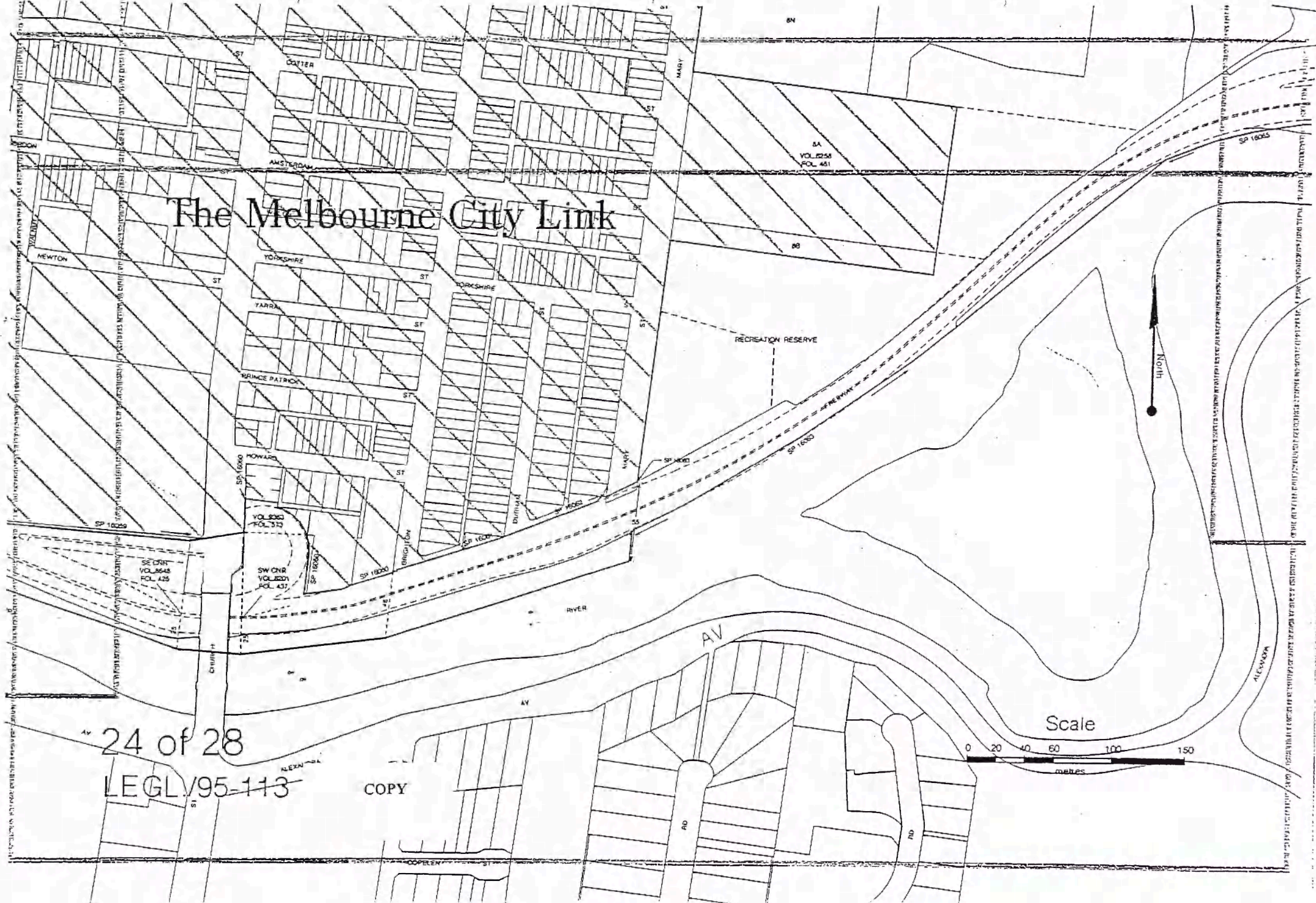
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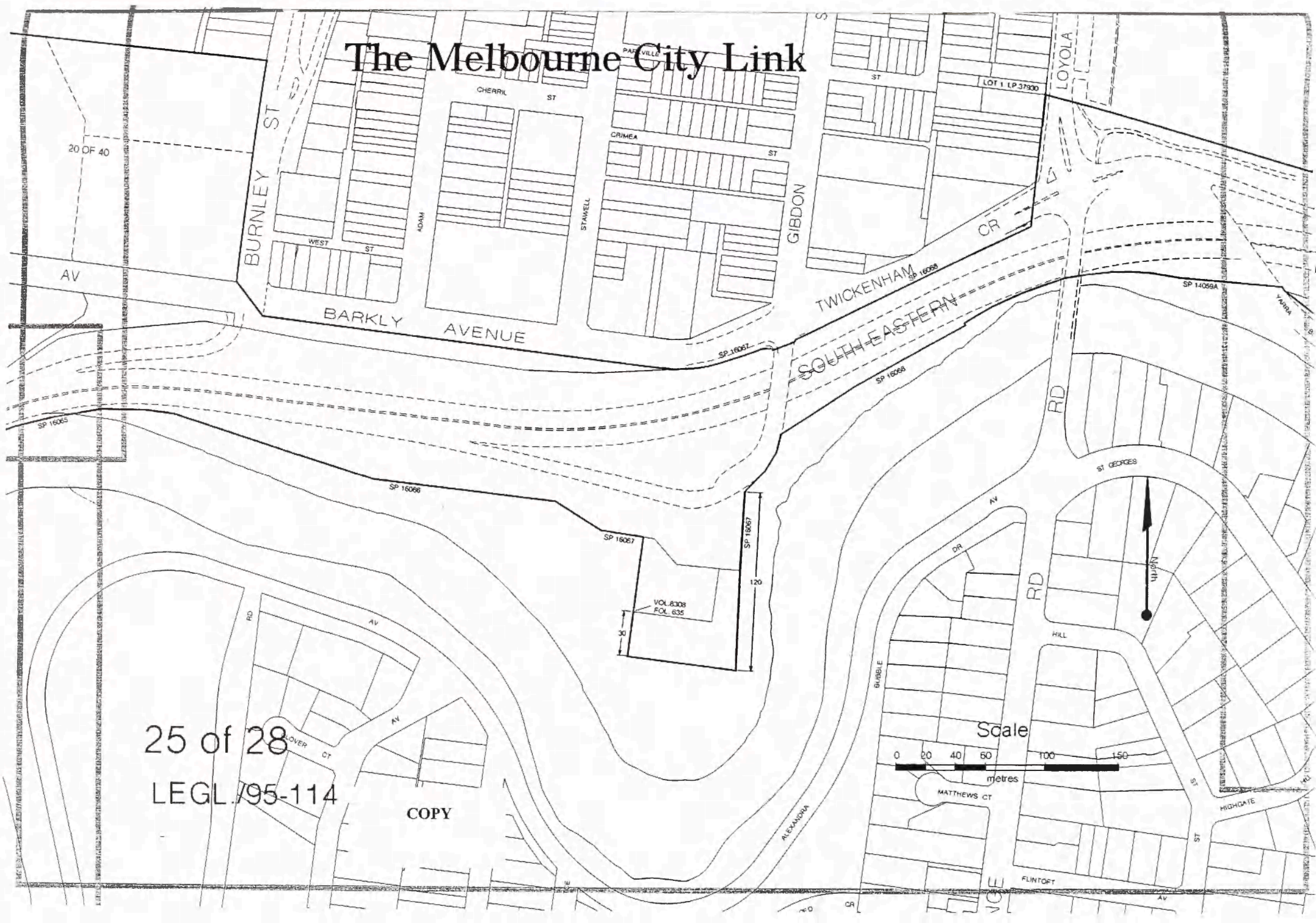


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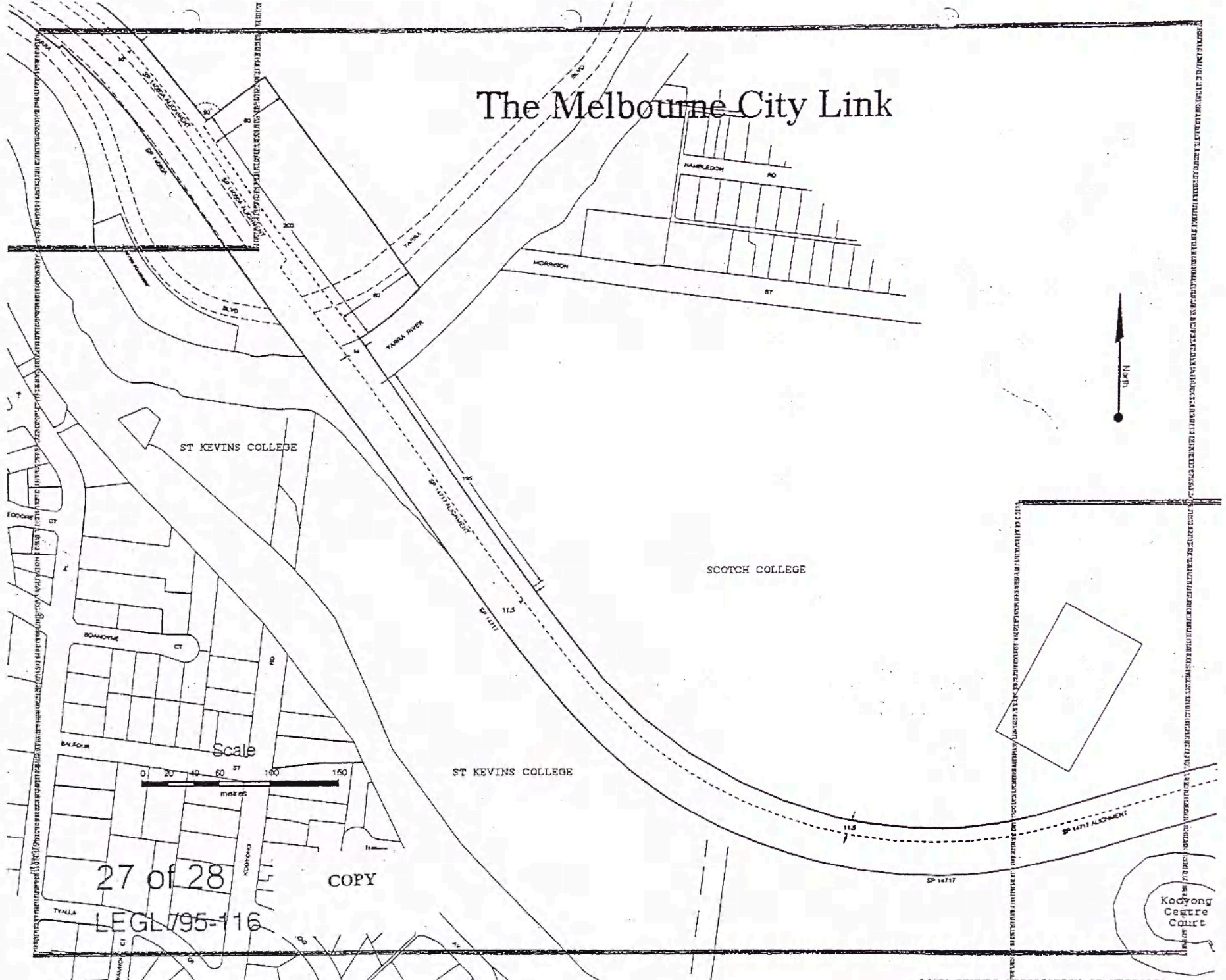
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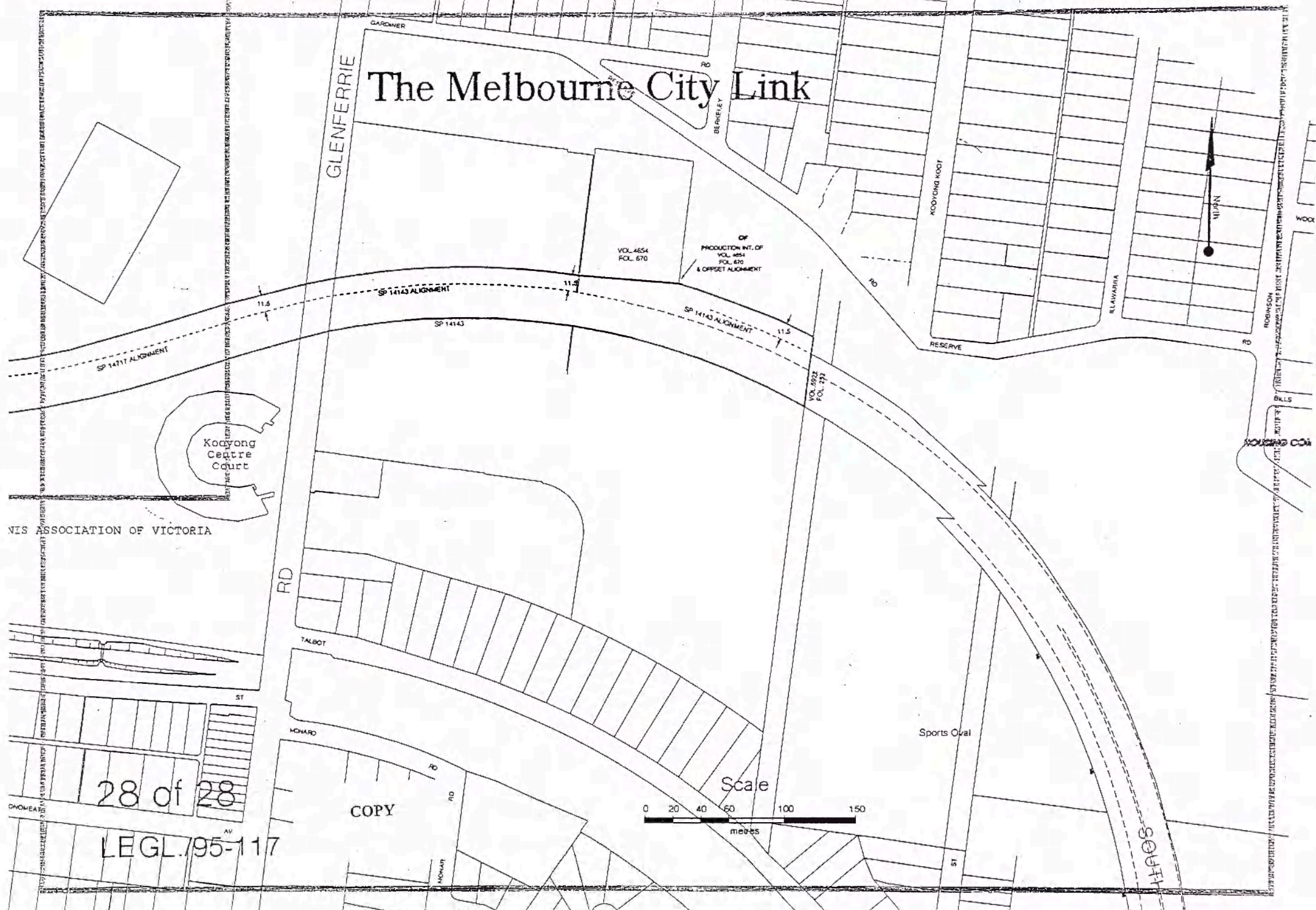
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LEGL 95-117

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