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Public Investment across Levels of Government: The Case of Victoria, Australia

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Key messages

- *Federal fiscal relations require that Victoria work closely with the Commonwealth government on investment (especially infrastructure) planning as a condition of funding. Despite reforms intended to loosen these arrangements, the relationship is still highly collaborative, involving considerable conditions.*
- *Nonetheless, state actors maintain that the quality of investment service delivery is more dependent on the operation of effective capacity for project planning, assessment and delivery within the state government than on the process of negotiating conditions in tied grants.*
- *The Victorian government's policy aim is to ensure that its planning processes and institutions are robust and consistently improving to attract investment and reduce the costs of operation for businesses in the state.*
- *Reforms to improve administrative processes for project planning, selection and delivery reflect past lessons, particularly in respect to delivery methods, whether through the use of public-private partnerships or traditional contracting.*
- *Challenges to future revenue will put pressure on the government to meet infrastructure needs. Early planning for this contingency by reducing operating budgets has been identified as needed to avoid the accumulation of future unsustainable debt obligations.*

1. Regional overview

1.1. Political context

The Australian federation is comprised of the Commonwealth, six states (New South Wales [NSW], Victoria, Queensland, Western Australia, South Australia, Tasmania) and two territories (Australian Capital Territory [ACT] and the Northern Territory). Victoria is the second-largest Australian state by population.

1.2. Institutional background

The Australian system of public governance comprises three tiers of government: the central government (the Commonwealth), the states and territories (hereinafter states), and municipalities. The Commonwealth government and the states share powers, and each state is sovereign according to its Constitution within its areas of competence and is led by an elected Parliament. A state Parliament may make laws on any subject of relevance to that particular state, with the exception that it cannot impose customs or excise duties or raise defence forces. Each state government is principally responsible for the delivery of its own infrastructure and public services. The powers of municipal authorities are limited by state legislation and are principally confined to town planning and local services. Municipal authorities are funded by property taxes and grants from the state and federal governments.

1.3. Socio-economic background

Victoria is the second largest economy in Australia after NSW, contributing around a quarter of the nation's GDP. Victoria's gross state product (GSP) in 2010-2011 was AUD 317 152 million. The industries which made the greatest contribution to Victoria's gross product in 2010-2011 in volume terms were: financial and insurance services (11.3%); manufacturing (9.2%); professional, scientific and technical services (7.9%); ownership of dwellings (7.8%); and construction (6.6%).[1] The unemployment rate in September 2012 was 5.5%, close to the national average of 5.3%.

Australia's population grew by 1.2% over 2010-2011, reaching 22.32 million at 30 June 2011, an increase of 258 616 people over the previous year. The population of Victoria at the same date was 5.53 million, an increase of 1.2% (66 096 persons) over the previous year. This is lower than the growth over the year before that (2009-2010 of 73 293 persons) and considerably lower than the growth in 2008-2009 (102 049 persons).

Melbourne, the capital of Victoria, has one of the largest areas of urban sprawl in the OECD, which continues to expand. Around three-quarters of Victoria's population live in Melbourne. The annual population increase in the Melbourne metropolitan area for 2010-2011 was 60 662 persons, expanding by approximately 1 167 persons per week, or 1.5%. Four areas on Melbourne's urban fringe (LGA) were amongst the ten largest growing municipalities in Australia for the year ending 30 June 2011.[2] The Victorian population outside the Melbourne metropolitan area increased by a much lower proportion of 0.4%, or 5 434 persons.

1.4. Main strengths and challenges for Victoria

Critical challenges for Victoria include the recognised need to maintain and increase its investment in infrastructure services, particularly in the areas of transport and water supply, to meet the needs of its growing population. At the same time, it faces limitations on the growth in state revenues, as it is affected by a vertical fiscal imbalance and the macroeconomic consequences of the mining boom on the Victorian economy. An independent assessment of Victoria's state finances (Interim Report) concluded in 2011 that over the past decade the trend growth in expenses has outpaced trend revenue growth, but that the rate of government spending would nevertheless need to increase further to maintain and enhance the quality of public services (Department of Treasury and Finance, 2011). The challenge of increasing investment in infrastructure is common across Australia, where all governments are more fiscally constrained following the impacts of the global financial crisis.

Victoria reports that it consistently receives less than its population share of Commonwealth grants, and over the past ten years has received less revenue from Commonwealth grants per capita than any other Australian state, making it more reliant upon its own narrow tax base.[3] In the 2012-2013 Budget, Victoria reported that it had revised forecast GST grant revenue over the budget and forward estimates years downwards by AUD 6.1 billion (compared to forecasts in late 2010), as a result of lower growth in the tax pool, following reduced consumption spending and because Victoria received a smaller share.

A key challenge to note arises as a consequence of the much discussed "two speed economy". The resources boom has provided very large growth in mining investment in some states and will provide considerable increases in production in the near future in those states. However, the impact on Victoria, which has few mining resources, is more ambivalent.

The increases in investment in mining states provide a major stimulus to the Victorian firms that service them and a reasonable share of the increased income arising from the investment also flows to Victorians through share holdings and more general growth in mining states. These positive effects are offset, to some extent, by a loss of competitiveness in Victoria's trade-exposed industries arising from a higher exchange rate, as foreigners perceive Australia's increased economic strength. However, the higher exchange rate will also benefit Victorian consumers and firms through cheaper import prices. The fast growth in other states may also draw away scarce mobile resources (capital and labour) from Victoria. Recent published estimates of state final demand (for the year 2010-2011) illustrate these impacts. While Victorian state final demand grew by 3.2%, final demand in Western Australia grew by 5.7%.

Among Victoria's key strengths are its AAA credit rating and a relatively low level of net debt. Australia was one of the two OECD countries that did not go into recession during the global financial crisis. The Victorian government has expressed a clear policy preference to maintain a low level of net debt to minimise the vulnerability of the state to further economic shocks. The Victorian Treasury acknowledges, however, that it is extremely unlikely that any state would maintain its AAA rating if circumstances dictated that the sovereign rating of the Commonwealth were to be downgraded. Nonetheless, the government plans to maintain a minimum budget surplus of AUD 100 million in protection of this rating.

Notwithstanding the adverse implications of an appreciating exchange rate and the lack of mineral resources relative to the other Australian states, Victoria is well positioned to provide services to other parts of the growing Australian economy and to foreign markets. This potential is reflected in the contribution of a skilled services sector and existing high-quality infrastructure such as the nation's largest container port. Melbourne is consistently ranked among the most "liveable cities" in international rankings and, perhaps because of these features, continues to attract migrants and new businesses.

From a strategic perspective, the government aims to align its policy settings to ensure that Victoria continues to provide a competitive environment in which to establish and operate enterprises and to encourage flexibility and innovation in the economy. Accordingly, Victoria has made the provision of efficient public governance and economic management a policy priority. An important dimension of this is the development of administrative systems that are intended to maximise public value from infrastructure initiatives by ensuring the state takes steps to carefully select and manage infrastructure projects.

Returning to the caution raised by the independent assessment of Victoria's state finances (Interim Report) noted above, the question arises as to how the government will balance the need to increase expenditure on infrastructure services in an increasingly constrained fiscal environment. The Interim Report recommended a Financial Management Framework approach that maintains a target level of expenditure on infrastructure investment based on a fixed per cent of the historical average of GSP. Against this, the rising costs of public sector salaries were noted by the Interim Report as a trend which if not managed would lead the government in to a level of debt that could rapidly become unsustainable. The Interim Report concludes that "Given that on an underlying basis, Victoria's general government sector is currently achieving negative net operating balances, government has a significant challenge to transition to a sustainable level of net infrastructure investment while lifting the net operating balance to a level consistent with the Panel's Financial Management Framework" (Department of Treasury and Finance, 2011).

Unfortunately, at the time of writing the government had not responded to the Interim Report, nor released the final report of the independent assessment of Victoria's state finances – so the policy response cannot be confirmed. However, there is a strong hint in the Interim Report which noted the long run benefits of early actions to reduce spending and also notes that the final report will identify opportunities for the government to increase the efficiency of public service delivery. These conditions suggest the need to reduce the rising costs of public sector salaries. At the time of writing the government had already taken steps to reduce the overall size of the public sector. Future budget discipline may seek to lock in these savings and adopt a framework to maintain infrastructure investment based on careful priority setting within a new Financial Management Framework.

2. Public investment in the region

2.1. Key priorities for public investment in the region

Public investment in Victoria has been equated with the existing net infrastructure investment measure used by the Department of Treasury and Finance. Public investment is measured as investment of the general government sector and the state's financial and non-financial corporations. Grants to local government or other organisations, including those made for capital purposes, are not included under this definition. In 2010-2011, public investment spending was approximately 2.9% of GSP, approximately 25% of which was co-financed at the national level.

The Victorian government forecast a record spent on infrastructure in 2012-2013, of AUD 7.6 billion. Key features of the priorities for capital expenditure laid out in the 2012-2013 Budget papers are:

- focusing on improving productivity, strengthening service delivery and enhancing safety and security; and
- new projects which include major road upgrades, new metropolitan and regional train rolling stock, rail infrastructure improvements, port infrastructure redevelopments, removal of level crossings, hospital developments, and the supply of new police and prison facilities.

The budget statement reinforces the government's commitment to improve the quality of infrastructure delivery by use of good governance practices; a Gateway Review Process is applied to the assessment and approval of "high value and high risk" (HVHR) projects. This is described in more detail below.

2.2. Financing public investment

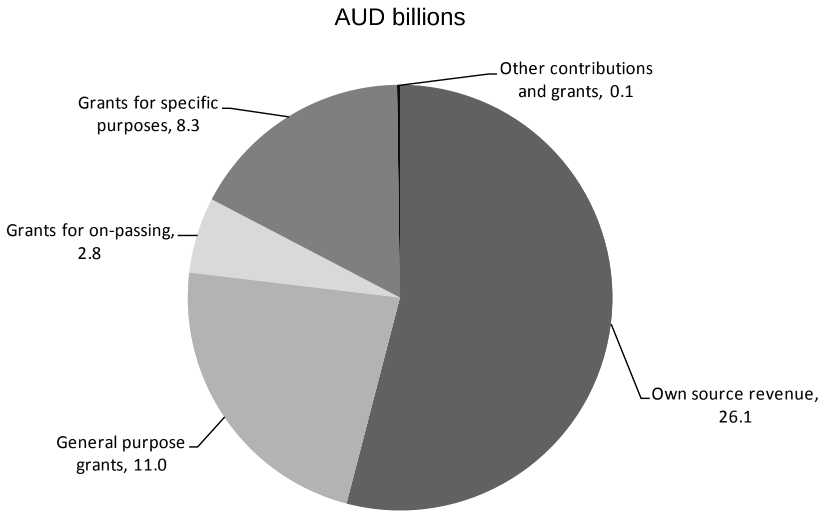
The Australian federal system is characterised by two important features: a vertical fiscal imbalance in revenue collection between the states and the Commonwealth, and a system of tied and untied payments made by the Commonwealth across jurisdictions. Having transferred income taxing powers to the Commonwealth during World War II, and given up certain stamp duties in exchange for a broad-based consumption tax in 2000, the states have retained the right to exercise only very limited taxing powers. They depend to a large extent on funding from the Commonwealth. These include the Goods and Services Tax (GST) levied by the Commonwealth and distributed back to the states, and tied grants provided for specific projects and reforms. In 2012-2013, Victoria will obtain 46% of its total revenue from Commonwealth grants, around half of which is GST revenue. The GST revenue is distributed according to a complex formula intended to produce horizontal fiscal equity across all states. The calculation of the share that states receive is based on an assessment of what would be required for each state to have the same capacity to deliver the same standard of services to its citizens, if it operated at the same level of efficiency, regardless of population size. This also takes into account the capacity of the states to source revenue from their own tax bases.

A large proportion of Commonwealth tied grant funding to the states is distributed as specific purpose payments (SPP). These are payments that can only be spent in a broadly specified area. Prior to 2008, the conditions attached to these payments were very specific and directive, and funding was divided up across more than 90 separate agreements. In 2008, a new Intergovernmental Agreement on Federal Financial Relations (IGA) streamlined a number of separate payments by the Commonwealth to the states into five broad national specific purpose payments (NSPP). These covered the areas of: health, affordable housing, schools, vocational education and training, and disability services.[4] The intention of this reform was for the Commonwealth to take a more "hands off" approach, and to increase the flexibility available to the states to manage their own budgets within broad parameters. Under the terms of the new IGA, in which the Commonwealth and states want to work towards the achievement of mutually agreed outcomes through certain projects or reforms, these should be developed through a separate time-limited payment arrangement called a National Partnership Agreement (NPA). It was envisaged that under the new "hands off" arrangements, relatively few NPA would be required.

Under Australia's constitutional arrangements, states are responsible for setting their own infrastructure priorities. As noted above, Victoria generates 54% of its revenue from its own sources (Figure 1) and is the lowest recipient of Commonwealth funds on a per capita basis (Figure 2). It is therefore both the main funder and the main driver of its own infrastructure investment strategy. Investment by the Commonwealth is very important in some areas. However, the general view at the state level at least, is that for the most part the state is responsible for priority setting and the Commonwealth assists the state by funding projects which the state government has already decided are a priority. Commonwealth funding is significant, however, and it would appear that the prospect of Commonwealth funding can re-order the priorities of certain projects.

Specific areas where the Commonwealth government clearly plays a role relate to projects requiring co-operation between the Commonwealth and more than one state, such as the delivery of the Murray Darling River Basin Plan under which an authority representing five states and territories regulates the use of water and the environment of a nationally vital water catchment area covering multiple jurisdictions. Other projects supported by the Commonwealth are for infrastructure assets that, while located entirely within a single state, are nonetheless considered to be of national significance.

Figure 1. Sources of revenue for Victoria (2012-2013)



Source: Department of Treasury and Finance, *2012-13 Budget Information Paper No. 3*

Figure 2. Total per capita Commonwealth grants (2000-2001 to 2011-2012)

Note: The Northern Territory has been excluded for presentation purposes. The Northern Territory received AUD 137 700 per capita over this period.

Source: Department of Treasury and Finance.

3. Co-ordination for public investment across levels of government

3.1. Overview of co-ordination for public investment

One mechanism through which the Commonwealth directs funding to infrastructure projects of national importance undertaken by the states is through the Building Australia Fund (BAF). The BAF was established in 2008 to fund critical infrastructure in the transport, communications, water and energy sectors. The Nation Building Funds Act was enacted in December 2008. Under this act, funding applications from the states are assessed by Infrastructure Australia.

Infrastructure Australia was established under the Infrastructure Australia Act 2008. The stated focus of Infrastructure Australia is to help Australian governments "to develop a strategic blueprint for unlocking infrastructure bottlenecks and to modernise the nation's economic infrastructure" (Australian Government, n.d.). Infrastructure Australia advises the Commonwealth government on national infrastructure priorities, undertakes cross-cutting infrastructure research on issues such as national freight transport or ports systems, and appraises bids and business cases presented by the states for project funding under the Building Australia Fund (BAF). Infrastructure Australia also acts in an advisory capacity on infrastructure policy issues and the development of relevant national strategies. The appraisal and advisory reports of Infrastructure Australia are made publicly available. It reports to the Council of Australian Governments (COAG) through the federal Minister for Infrastructure and Transport.

In 2009/2010 the Commonwealth government committed AUD 8.5 billion for road, rail and port infrastructure. Of this, AUD 7.6 billion was to be funded through the BAF. Victoria received AUD 3.2 billion for a regional rail link project which began in 2009 and AUD 40 million for design and preconstruction work on the first phase of the Melbourne Metro Project to construct an east-west rail tunnel under the central business district.

One feature of the process by which Infrastructure Australia assesses applications for funding under the BAF is that it puts the onus on the states to prepare a solid business case that addresses the criteria to demonstrate that projects for which funding is sought will be delivered efficiently and will address the anticipated infrastructure demands. It is understood that Victoria received a higher initial allocation of BAF funding relative to the total amounts that were allocated to other states because it had prepared a "pipeline" of nationally significant projects with well-developed business cases that could be judged by Infrastructure Australia as meeting the assessment criteria. This underscores the importance for states to have a solid business case as a precondition to securing funding.

Co-ordination among the lower levels of local government (at the regional level outside of the metropolitan area) is mostly a function of the state administration. The national government does, however, organise regional development Australia committees (RDA) representing groups of local government areas. These RDA are intended to give RDA regions a higher profile voice when seeking to attract the attention of stakeholders about regional needs aspirations and priorities.[5]

3.2. Vertical co-ordination between the region and the national government and other supra-national authorities

In its budget papers, the Victorian government refers to the National Partnership Agreement as a "successful vehicle for the joint investments in projects and reforms of national significance."[6] However, it has also expressed concern over a return to intrusive oversight and control by the Commonwealth that the IGA was designed to avert, and that the NPA is not being used as it was originally envisaged. Contrary to the expressed intention of the IGA to limit the number of separate grants from the Commonwealth, the number of NPAs between the Commonwealth and states that provide for both capital and operational funding has grown to 150. The Victorian government reports that the proliferation of these separate small agreements has generated excessive transaction costs, increased red tape and bureaucracy, and resulted in Commonwealth micro-management of matters better dealt with by state governments. A significant proportion of agreements involve funding of less than AUD 10 million. The Victorian government reports that "the reporting burden associated with these agreements is unduly onerous relative to the low levels of funding available, and appears to be for the benefits of Commonwealth bureaucrats or ministers rather than principles of public accountability".[7] For example, one agreement worth just AUD 880 136 over a four-year period required the completion of 23 separate reports.

A further issue for the Victorian government is the implication for the state budget of any lack of Commonwealth commitment to ongoing reform and continued funding of initiatives. The Commonwealth may use NPAs to initiate policy programmes and may also require a joint funding commitment from the states for specific programmes. The Victorian government has reported a concern that, in respect to NPAs that are focused on service delivery, should the Commonwealth elect to cease funding an initiative, this would result in the cancellation of services that citizens have come to expect or force cost shifting from the Commonwealth to the state to continue the service. However, as the first wave of the IGA NPAs is not due to expire until the end of 2012-2013 this problem has not yet manifest.

3.3. Horizontal co-ordination among states and across levels of sub-national government

Because of the large distances separating population centres across Australia, co-ordination across states for infrastructure provision is not always necessary. However, it becomes important where the activities of one state impact on another, such as the management of the Murray Darling Basin, which covers three states, and is administered by the Murray-Darling Basin Authority involving the governments of South Australia, Victoria and New South Wales, as well as the Commonwealth. A collaborative investment model has been in place and operating since 1915 for agreed joint actions in the Murray-Darling Basin that deliver mutual benefits to all parties in the planning and management of shared water resource systems. The core of this investment model is an agreed cost-sharing arrangement that determines the quantum of investment to be made by each party to fund both capital and operating expenditure. Jurisdictions collectively review and endorse budgets for expenditure each year, which deliver outcomes across the basin.

4. Selecting and monitoring public investment projects

4.1. Strategic planning and horizontal co-ordination mechanisms

Cross-sectoral co-ordination

Victoria works bilaterally with the Commonwealth Department of Infrastructure and Transport and the Commonwealth's advisory body Infrastructure Australia to identify and jointly fund nationally significant transport projects. Transport projects funded under the Commonwealth's Nation Building Program (currently from 2009-2014) are administered through a bilateral Memorandum of Understanding executed between the Commonwealth and Victorian governments. The objective of the Nation Building Program is to promote sustainable national and regional economic growth, development and connectivity by contributing to the development of an integrated National Network to improve national and regional connectivity.[8]

Victoria reports that the creation of Infrastructure Australia has made it possible for projects to be more rigorously assessed on transparent and objective criteria and to help inform development of a national priority infrastructure pipeline, reducing political influence and creating a better alignment of state and Commonwealth priorities.

Formal co-ordination with other states on transport and infrastructure is led through the Standing Council on Transport and Infrastructure (SCOTI). The SCOTI is chaired by the federal Minister for Infrastructure and Transport and comprises all state and territory transport and planning ministers. Significant initiatives impacting on transport policy and funding are pursued through the COAG and/or the Standing Council on Federal Financial Relations. Informally, Victorian government officials also share lessons from specific projects and the development of policies with colleagues from other states.

Co-ordination of land-use planning and transport planning with local councils is facilitated through the development of regional growth plans in consultation with the community and key stakeholders. Each region receives funding and support from the Victorian government. Municipalities join steering groups along with relevant Victorian government departments and authorities to oversee transport projects.

Horizontal co-ordination across sub-national governments

Two agreements for Commonwealth investment in water projects within states and territories operate under the broad guidance of the IGA: the National Partnership Agreement on Water for the Future and bilateral water management partnership agreements (WMPAs) for state and territory governments within the Murray-Darling Basin. WMPAs provide targeted funding for infrastructure-based water projects within each jurisdiction. The general approach under these agreements is for the Commonwealth to provide a series of milestone payments to states/territories over the life of individual projects.

Payment is typically contingent upon states demonstrating progress in project delivery and, in the case of the WMPAs, progress in the delivery of water policy reform. The Victorian government reports that it took many months to negotiate an agreement that could be supported by both the Commonwealth and states (particularly under the WMPAs). The key challenge was that the Commonwealth sought certainty on milestone payments and agreed timeframes, while the states sought sufficient flexibility (especially regarding timelines) to allow for contingencies to be managed without putting Commonwealth payments at risk. In October 2011, the Victorian and Commonwealth governments signed an agreement for the Commonwealth to provide AUD 1.216 billion to fund the modernisation of irrigation systems in northern Victoria's "Food Bowl" region (NVIRP Stage 2), and to receive 214 GL of water savings. The agreement is performance based, with the Commonwealth making payments to the state based on the achievement of milestones.

Ex ante *economic assessments – the high value/high risk framework (HVHR)*

In December 2010, the Victorian government introduced a high value/high risk (HVHR) project assurance process, largely in response to the experience of a range of major projects of the previous government incurring significant time and cost overruns (Victoria Auditor General, 2012). This requires infrastructure and ICT projects identified as being high value and/or high risk to undergo rigorous scrutiny and approval processes, involving increased central oversight over various stages of investment development, procurement and delivery. This includes a requirement to obtain the Treasurer's approval of project documentation at key stages of the project's lifecycle and to undergo compulsory Gateway Reviews and active monitoring throughout the life of the project. The objective is to ensure that major infrastructure and ICT investments are delivered successfully, on time and on budget. The process applies to all general government sector infrastructure and ICT investments with a total estimated investment of AUD 100 million or more (whether funded by the government or in conjunction with the private sector) and/or projects identified as high risk under the Gateway Project Profile Model, which assesses the potential impact and complexity of the project.[9]

Partnering with Citizens

Engagement with citizens and businesses is an important component of project development and delivery. Under Victorian legislation, long-term water resource planning is developed through sustainable water strategies, which are developed with extensive community involvement. This includes the appointment of a Consultative Committee by the Minister for Water and a public consultation and submission period. The consultative process allows for priorities to be selected and assessed, and for the development of innovative solutions that have a high level of support from stakeholders.[10]

Implementation of the sustainable water resource strategies is co-ordinated by the Victorian Department of Sustainability and Environment, but the regional water authorities are responsible for implementation. Progress with implementation of the actions is assessed quarterly and reported in the department's annual report. In addition, regional water authorities report to specific stakeholder groups on progress.

4.2. Financing public investment and involving private actors

Public-private partnerships

A key mechanism through which public sector investment is made in Victoria is the Partnerships Victoria framework for PPPs. The style of procurement through PPPs is defined as:

> ... a contracting arrangement in which a private party, normally a consortium structured around a special purpose vehicle (SPV), takes responsibility for financing and long-term maintenance or operation of a facility to provide long-term service outcomes. This may involve the private entity taking responsibility for the design and construction of a component of new infrastructure, and the development of a new long-term contract to operate and manage the infrastructure. Typical forms of procurement include: design, build, finance and operate/maintain (DBFO/M), build-own-operate and transfer (BOOT) or build-own-operate (BOO). A key component of such arrangements is that there is a requirement to pay only for defined assets or services when they are delivered. (Duffield et al., 2008)

Victoria has been a pioneer in PPPs, and its processes have been a model for the Commonwealth and for other states. Since 2000, when PPPs began in Victoria, they have comprised approximately 10% of infrastructure investment. There are now 22 PPP projects representing a total investment of AUD 11.5 billion. The Department of Treasury and Finance has established a unit called Partnerships Victoria as a source of standards guidance and policy development. A feature of the PPP business case development process is the requirement in each project to establish a "Public Sector Comparator" (PSC) – an independently verified cost estimation of the project assuming conventional contracting. The PSC then serves as a benchmark for assessing the value for money of the PPP proposal. Over the past ten years government departments have had to acquire a deeper understanding of the private sector in each area in order to better calibrate the contract incentives.

PPPs procure private sector expertise and finance to design, build, maintain and refurbish the asset over the long term, transferring design, construction and performance risk to the private sector. It does so through a price-certain contract over a fixed term, usually between 15 and 30 years. This structure, along with defined output performance metrics and non-performance abatements, is intended to produce value for the government by aligning the private provider's incentives for economic and efficient "whole of life" asset management and performance. Putting the private returns and profit at risk for non-performance is a strong driver for promoting contractor performance.

The Victorian government policy and philosophy around PPPs are in the public domain. This provides transparency to the private sector on the objectives, policies and processes for the application of PPPs, broadens market confidence and reduces the time and cost associated with private sector engagement. The government has noted, however, that as PPP contracts are output-based, identifying the appropriate output measures and performance levels is a substantial challenge. Additionally, the public interest generated by some of the more complex PPP projects in the water sector, such as the construction of a desalination facility to secure Melbourne's water supply in the event of continuous prolonged drought, has also required the management of significant political risk.

Nevertheless, there are examples of PPPs working well in protecting the state from construction cost over-runs that have instead been borne by the private sector. General challenges include ensuring appropriate risk transfer and value for money while attracting private investment. Initially assessing and managing the risk of transport-based PPP contracts for the delivery of toll roads has presented its own challenges and has led to instances of the market reassessing the net present value of the roads asset based on adjustments to the initial estimated demand.

Alliance contracting

Alliance contracting is a method of procuring, and sometimes managing, major capital assets. Under an alliance contract the state agency (as the owner) works collaboratively with the private sector parties to deliver the project. The alliance participants work as an integrated, collaborative team to deal with key project delivery matters. Under alliance contracts, risks of project delivery are often jointly managed by the parties. Normally, alliances are used to deliver more complex projects (capital costs exceeding AUD 50 million) where the owner has particular capability to provide skills and expertise, and where the project is for one reason or other, difficult to specify in advance.

Alliance contracting was first used in Australia in 1994. It has been estimated that across Australia about 30% of the total value of public sector infrastructure projects is undertaken through alliance contracts. (That proportion is significantly lower in Victoria.) A cross-state benchmarking study convened by the Victorian Department of Treasury and Finance in 2009 concluded that for the alliance contracts studied, the actual out-turn cost was 45-50% higher than the business-case cost. It revealed that alliance contracting arrangements were being chosen almost as the default option, and the approach was therefore often being applied in circumstances where more conventional contracting approaches were more suitable (University of Melbourne, Evans and Peck, 2009).

This study identified a tendency for this cost uplift to occur early in the project cycle, between the business case (making the decision to build) and negotiating the target outrun cost (contracting commitment). Causal factors include the selection of the non-owner participants on a non-price basis, when there was no reason for this, and a failure to consider a range of other delivery options. The study concluded that it is necessary to ensure that a business case assessment is made of the optimal delivery method and advised that price criteria should be a default position. It identified that state government guidelines were required to ensure that an adequate business case, which includes the case for the procurement decision, is prepared and approved before the alliance selection process commences.

To effectively address the emerging opportunities and issues in alliance contracting, the Inter-Jurisdictional Alliancing Steering Committee was established in 2009 to pursue a number of joint initiatives, including the development of the alliance policy, guidance materials, templates and training programmes. The committee has representatives from the Treasury departments of Western Australia, Queensland, New South Wales, Victoria (the Chair) and the Commonweath government (Department of Infrastructure and Transport).

Following a major reform initiative implemented by the COAG’s Infrastructure Working Group (IWG), the National Alliance Contracting Policy and Guidelines were released on 4 August 2011. These guidelines aim to drive better value for money, promote leading practice and give rise to cost savings by creating a consistent national alliance contracting standard for the delivery of infrastructure projects across jurisdictions whilst maintaining the existing benefits of alliancing.

Traditional contracting

In December 2011, the COAG's IWG engaged the Victorian Department of Treasury and Finance and the Commonwealth Department of Infrastructure and Transport to investigate opportunities for improving the efficiency and effectiveness of market engagement and tendering strategies for traditional contracting. The findings[11] identified three key challenges that must be satisfactorily addressed to deliver an optimal project outcome for both the client and the tenderer. These focus on: the capability of the people negotiating and managing the contract; foundation success factors including matters such as quality tender documentation, project definition, and the tender selection criteria and its application; and effective collaboration to enable a full and mature understanding of the client's "request for tender" and the contractor's "tender response". A National Framework for Traditional Contracting recommended by the report is currently under development.

4.3. Organisational and management capacities

In addition to the central role of the Department of Treasury and Finance in providing oversight of the selection and management of significant projects, the structure of the Victorian government places principal responsibility for service and asset planning and delivery with the relevant department and portfolio minister. The Victorian Department of Transport (DOT) is charged with ensuring that the transport system is developed in a manner consistent with the government's objectives and that policies and plans for an integrated and sustainable transport system are developed, aligned and implemented.

At the time of writing, the Victorian government was developing a new Melbourne Metropolitan Planning Strategy to set long-term transport priorities. Strategic land-use and transport planning are brought together under the policy framework of the Victorian Transport Integration Act 2010. Ultimately, project priorities and funding are determined by the government through the decisions of Cabinet committees.

This act requires that investments be consistent with the vision and long-term objectives for the transport system as defined in the legislation. They include facilitating economic prosperity; promoting efficiency, co-ordination and reliability; and contributing to environmental sustainability. The act also defines decision-making principles that the government is required to exercise to achieve the best outcomes against the objectives of the act. One mechanism by which the DOT monitors the impact of the government's investment in transport is through the achievement of its corporate plan. The DOT's corporate plan links transport system investments funded by the Victorian government to a number of short-term priorities for the transport portfolio consistent with act's long-term objectives. Each of these priorities is supported by outcome indicators that aim to demonstrate the achievement of the priority.

For example, one of the short-term priorities in the DOT's 2011 corporate plan is to increase transport system capacity, efficiency and resilience. This priority covers a number of investments to build and maintain the road network, the effectiveness of which is measured through monitoring road congestion. Other priorities in the DOT's 2011 plan relate to improving transport system planning, improving the safe operation of the transport system and undertaking planning for future demand. Each of these priorities is supported by outcome indicators which are reported quarterly to the DOT executive and reported publically in the DOT's Annual Report.[12]

The Victorian government advises that the DOT has implemented an Outcomes Framework on a trial basis to consistently identify and track the benefits of investment projects from strategic conception through to completed delivery. This framework is intended to allow the department to review whether projects deliver the expected outcomes from their business cases. It is planned to extend this framework to all major transport investments.

4.4. Integrity and transparency

Procurement

Victorian state government procurement policy is the responsibility of a statutory body, the Victorian Government Procurement Board (VGPB). The VGPB's mission is creating "...a policy framework which achieves value for money in government procurement, while *maintaining the highest standards of probity, minimising risk, and maximising opportunities for local businesses*." The VGPB delegates authority to departmental accountable officers to approve procurement processes up to each department's level of accreditation. Departments are required to report to the VGPB each year on their procurement activities. The Victorian Department of Treasury and Finance provides secretariat support to the VGPB, and is responsible for whole-of-government and state-wide procurement. It also oversees public service procurement and supports the VGPB in developing and reforming procurement policies. The department also maintains a web-based platform to ensure procurement transparency. All government tenders of AUD 100 000 or more are required to be made public through the Victorian Government Tender System. For contracts over AUD 10 million in value, the text of the contract must also be published. In 2012-2013, the VGPB is implementing a new Supply Policy Framework which includes a focus on taking advantage of opportunities for greater market competitiveness when aggregating demand for commonly purchased goods and services.

Victoria's procurement rules do not require a preference for suppliers from within the state. However, on individual contracts, government departments often take measures to encourage the engagement of local suppliers by ensuring that opportunities are advertised and giving consideration to how requests for contract services may be structured or consolidated, so that they are both efficient and can be met by local suppliers.

4.5. Institutional capacities

The Victorian public sector is characterised by flexible employment arrangements and has a range of public sector organisational forms which can be tailored to the particular demands of planning and managing infrastructure investment. The government reports that departmental capacity for developing and managing capital investments has improved in recent years, developing a more "whole of sector policy perspective." The Victorian Department of Treasury and Finance has been instrumental in developing overall institutional capacity for infrastructure investment, providing central quality assurance and control, as well as process guidance and research. For departments dealing with unusually big projects, the Department of Treasury and Finance also facilitates access to experienced technical staff.

The state Audit Office and the state Ombudsman are both important in reinforcing accountability in infrastructure administration, providing performance reviews and investigations of procurement practices. In October 2012, the Audit Office provided a sharply critical assessment of the delivery of major projects by Major Projects Victoria (MPV). MPV is a business unit within the Department of Business and Innovation (DBI). Its role is to provide "expert project delivery services to Victorian government departments and other agencies engaged in the delivery of complex, technically challenging and unique projects of state significance". The typical role of MPV is to deliver projects on behalf of public sector entities that do not have the required in-house project management capability or expertise. The Audit Office found that the MPV lacked effective internal controls and governance standards to ensure that its project delivery services were being provided efficiently and recommended a number of improvements to internal governance practices (Victoria Auditor General, 2012).

Other important institutions for infrastructure policy making are arm's-length public bodies at national and state levels dealing with cross-cutting issues such as competitiveness and productivity. These include the Victorian Competition and Efficiency Commission (VCEC), which provides independent advice to the Victorian government on business regulation reform and opportunities for improving Victoria's competitive position. The VCEC receives references from the Department of Treasury and Finance to undertake inquiries, review and advise the government on matters relating to, among other things, the efficient provision of infrastructure services.[13] The Australian Productivity Commission also receives references to advise the Commonwealth government on improvements to the regulation of sectors, including infrastructure regulation applicable at the national and state level. The Productivity Commission publishes annual reports on the effectiveness and efficiency of government services in Australia.

The national or state-wide perspective of such bodies, and their focus on market mechanisms, incentives, and the interests of consumers, provide a much richer policy perspective than is normally available from the public sector. The reports of the Australian Competition and Consumer Commission, for example, played an important role in assisting states, including Victoria, in establishing market mechanisms for the efficient management of rural water.

The independent economic regulation of the activities of state-owned water businesses is one mechanism through which Victoria aims to achieve efficient investment in infrastructure for the provision of water services. In 2004, the Essential Services Commission (ESC) was given statutory responsibility for the economic regulation of the Victorian water sector covering 19 water businesses providing bulk and retail water and wastewater services to all of Victoria's urban and rural irrigation customers. The role of the ESC encompasses price regulation as well as monitoring service standards and market conduct.

Economic regulation is intended to help optimise investment in the water sector through the provision of positive incentives. These include increased scrutiny and accountability of water authorities, promoting increased management expertise and a focus on keeping costs down, and prudent planning of the augmentation of water infrastructure. However, as water authorities are state-owned enterprises, in the absence of any profit incentive or market pressure, improvements to performance ultimately depends on the government exercising a strong shareholder role and putting pressure on businesses to maximise the use of the water assets. In the case of urban water planning, at least, the VCEC has identified that this is not yet certain and has raised specific concerns that there is a need for the government to set "clear, commercially-focused objectives, roles and responsibilities for water businesses, with non-commercial objectives funded as community services obligations" (Victorian Competition and Efficiency Commission, 2011).

This study has not undertaken a comparative evaluation of the success of the institutional approach applied in Victoria. In general, this assessment is an in-principle one that concludes that institutionally, there are a number of complementary functions in the machinery of government, that together are intended to deliver better performance outcomes. In practice, some of these institutions such as the Audit Office, the VCEC and the ESC, have provided criticism that not only identified issues but also led to reforms that improved the overall performance of the system. Possible longer term indicators of success are that Victoria has maintained strong fiscal management over an extended period of successive governments, the adoption of Victorian institutional approaches for project assessment and selection by other states and the Commonwealth, and that Victoria has been a key player in moving forward the national reform agenda in Commonwealth and state fora.

5. Lessons learnt and good practices

This case study has sought to examine the important features which contribute to ensuring quality in the delivery of infrastructure services in the state of Victoria. In particular, it has focused on how the imposition of conditions on the provision of infrastructure funding by the Commonwealth of Australia is a feature of the public management framework. It provides some assessment of how this contributes to the delivery of better infrastructure.

As Australia is a federal country, co-operative administrative arrangements between the states and the federal government are necessary, particularly in regards to the distribution of revenue. A key feature to note, however, is that although a significant proportion of state revenue is derived from the Commonwealth, Victoria is sovereign within its areas of competence and is principally responsible for managing its own fiscal position. Victoria is also primarily responsible for planning and delivering the necessary infrastructure services for the state. This is accented by the potential for the democratically elected government to be removed through the ballot box if it fails to demonstrate that it is meeting the needs of its citizens.

Historically, the authority of the Commonwealth government to collect and distribute revenue to the states led to an increasing degree of centralisation of fiscal control at the national level, resulting in a proliferation of detailed special purpose payment arrangements. However, the reforms to federal-state fiscal arrangements, embodied in the 2008 Intergovernmental Agreement on Federal Financial Arrangements (IGA), acknowledge in principle that devolving responsibility and accountability to the states to deliver services within a limited number of broad budget envelopes is a more efficient means of ensuring the delivery of public services.

Since 2008, the broad framework, therefore, has – in principle, at least – been to limit the conditions attached to federal funding and to rely instead on the state government to develop and embed the necessary public management practices within its own administration. This recognises that the quality of the delivery of infrastructure services is largely a function of the quality of the performance of the public sector in the state of Victoria, not the acuity of any specific conditionality embedded in funding agreements. That said, the rapid multiplication of partnership agreements, which were envisaged as an instrument for exceptional circumstances, suggests that the changes in federal-state relations have not run as deep as intended.

In part, this simply reflects the fact that the Commonwealth retains an economic, political and financial interest in directing the priorities of the state in some areas. This can be observed in the increasing number of tied grants and the expanding range of conditions that are attached to funding arrangements. Whether these conditions actually assist in improving the quality of service provision can probably only be determined with reference to each individual case. In some cases, at least, they appear unhelpfully bureaucratic.

Accordingly, a broader consideration of the capacities that the Victorian public sector considers necessary to ensure quality service provision is more likely to be instructive to OECD countries seeking lessons and good practices. In this respect, the following lessons from the case study are worth highlighting:

- Victoria promotes an integrated approach to land-use and infrastructure planning, where the need for maintaining and delivering new infrastructure services is considered alongside measures to manage the demand for infrastructure services. In this context, alternative ways of meeting emerging demands, such as the trade-off between additional investments in roads or railways, can be evaluated.

- Allocations for infrastructure spending are managed within the long-term fiscal position of the government, having regard to the goals of minimising state debt and maintaining the state’s AAA credit rating. This supports the integration of long-term strategic and budget planning, and a consideration of how private service providers can effectively deliver public services on a commercial basis.

- While each incoming government sets its own infrastructure investment strategy, continuity between governments is largely maintained, especially for major investment strategies. For large-scale investments, decision making is centralised with the Treasurer, supported by the Department of Treasury and Finance, which, under the current government, has assumed direct accountability for assuring the quality of major public investment proposals.

- The Department of Treasury and Finance provides support and guidance for investments (including a template for "investment logic") for the public sector. This aids in determining investment priorities, identifying value for money and assuring the quality of procurement. It has also established internal units which deal with procurement through PPPs and "Alliance" contracts. These modalities apply when the transaction is more than a simple contract for service – and extends to such arrangements as design and build, or as with many PPPs – finance, design, build and operate. The Department of Treasury and Finance also supports a "Gateway" process whereby major proposals are peer reviewed by a committee of other relevant ministries and agencies before being submitted for ministerial decision.

- An innovation of the current government is the establishment of a HVHR process. Under this process, for investment projects which have a value above a defined threshold, or are judged by the Gateway process of being high risk, the Treasurer (i.e. the minister) must personally verify and approve the investment proposal at crucial points before it is presented for final decision. In contrast with their former role of *ex post* review of spending proposals, this process engages the Department of Treasury and Finance in the decision process directly and "in real time."

- The focus of the new central quality assurance arrangements is on enhanced *ex ante* control – improving the business cases for major investments. These now require much more effort and expertise by the ministry responsible, and are subjected to rigorous scrutiny, both at a technical level and in terms of their wider assumptions. This helps to reduce one important source of investment failure – the tendency for the scope of investment projects to expand as they are developed, without express approval.

- The bulk of the monitoring therefore tends to occur prior to the commencement of the project. The business case process does, however, include the development of performance indicators which are the basis for monitoring once the infrastructure is operational. However, under the Victorian public service system, *ex post* evaluation of investment rests firstly with the ministry responsible. There is criticism in some academic literature that, in general, the overall performance of PPPs has received insufficient evaluation.

- A range of arm's-length statutory bodies has been established both for the implementation of major infrastructure projects (such as the creation of Transport Victoria) and/or to provide more technical and client-oriented governance (such as the Victorian Government Purchasing Board). However, the recent sharp criticism of one such body – Major Projects Victoria – underscores the need to ensure that such structures are subject to appropriate oversight and that their incentives are well aligned with public policy goals.

- At the national level, a most important institutional innovation is Infrastructure Australia, which provides national infrastructure strategy advice and competitively assesses state bids for the Building Australia Fund. Other states in Australia have established their own state version of Infrastructure Australia, and Victoria may follow this lead.

- Other institutions, including the Victorian Competition and Efficiency Commission and the Essential Services Commission, provide regulatory services and policy oversight to promote a commercial focus in the delivery of government services.

NOTES

[2]. These were Wyndham (up 11 291 persons or 7.3%), Whittlesea (up 7 807 or 5.1%), Melton (up 5 836 or 5.5%) and Casey (up 6 188 or 2.4%).

[3]. The *total* value of Victorian public sector capital works underway in 2012-13, including projects across both the general government and public non-financial corporations sectors and public-private partnerships is expected to exceed AUD 41 billion. *N.b*. This comment does not appear in Info Paper No. 3. It is a quote from BP4 – the footnote is correct for the comment in the body of the document.

[4]. The Healthcare NSPP expired under the National Health Reform Agreement on 1 July 2012, the remaining broadband agreements have been retained in their current form.

[5]. Commonwealth response to OECD questionnaire on good practice models.

[8]. *www.nationbuildingprogram.gov.au/whatis/obj_and_key_features.aspx*.

[9]. *www.gatewayreview.dtf.vic.gov.au/CA256EF40083ACBF/0/8F53861594987016CA2579180000B85F?OpenDocument*.

[10]. The Victorian Coalition Government released *Sustainable Water Strategies for Gippsland and the Western Region of Victoria* in November 2011, available at *www.water.vic.gov.au/initiatives/sws*.

[12]. www.transport.vic.gov.au.

[13]. See Victorian Competition and Efficiency Commission (2012).

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