

# Chapter 20

## Value for Money: Procuring Infrastructure

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### ABSTRACT

*Australia is just one of many developed countries facing the challenge of delivering value for money in the provision of a substantial infrastructure pipeline amidst severe construction and private finance constraints. To help address this challenge, this chapter focuses on developing an understanding of the determinants of value at key procurement decision points that range from the make-or-buy decision, to buying in the context of market structures, including the exchange relationship and contractual arrangement decision. This understanding is based on theoretical pluralism and illustrated by research in the field of construction and maintenance, and in public-private partnerships.*

### INTRODUCTION

Along with many other developed countries, Australia is suffering from a backlog of infrastructure that threatens to undermine productive capacity and efficiency. As part of the Federal government's strategy to address this backlog, *The Infrastructure Australia Act 2008* came into effect on 9 April 2008, effectively establishing Infrastructure Australia. Infrastructure Australia advises all levels of government in Australia and one of its primary functions concerns the evaluation of Australia's

current and future needs and priorities relating to nationally significant infrastructure. To indicate the scale of Australia's infrastructure backlog, Infrastructure Australia received over 600 submissions requesting funding support for specific projects from the Federal government's \$20 billion Building Australia Fund (BAF). Of these submissions, Infrastructure Australia identified 94 projects (with a total value around \$200 billion) that are subject to further rationalization (Australian Government, 2008). Infrastructure Australia explains, however, that 'Commonwealth funding does not have all or nothing – Commonwealth funding for projects is often provided in partnership with the states and

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territories'. This can be interpreted as an indication that the BAF can be used to leverage private finance towards infrastructure development.

If estimates of the \$800 billion needed to construct Australia's infrastructure in the next decade are anywhere near realistic (Ferguson, as cited in Forward & Aldis, 2009), this approach to expending the BAF can be both justified and appreciated. Apart from a backlog in infrastructure, interest amongst all levels of government Australia-wide has been heightened by the global financial crisis (GFC). The GFC is causing a severe contraction of debt and equity markets and this appears to be negatively impacting on government attitudes towards funding their desired programs of infrastructure – both in terms of governments directly financing infrastructure, as well as their ability to attract private finance. Hence, the impression is that all levels of government in Australia are clamoring to obtain a part of the BAF that is small relative to estimated demand.

The other key supply constraint concerning infrastructure is construction capacity. Only two of the world's largest 225 multinational contractors are Australian-based (ENR, 2008). This restricts the pool of contractors that can afford the high costs involved in bidding for major infrastructure and which can form consortia to privately finance infrastructure. This lack of construction capacity may also be affecting prices. For example, the Federal minister responsible for infrastructure, was reported as saying 'that the world's biggest construction companies needed to be attracted to Australia to cut the costs of building infrastructure' (Cameron, 2008).

Moreover, these key constraints concerning finance and construction capacity are made even more intractable by virtue of their complex relationship. It is suspected that the more sophisticated superannuation funds (including Australian pension funds) are looking to invest alongside the largest and most experienced multinational contractors and consortia – of which there is currently a severe shortage in Australia (Banks,

2005). At the same time, and from the multinational contractor's perspective, the effect of the procurement's facility for private finance and the availability of financial partners may impact on the attractiveness of investing in, and moving to, a new overseas location. It is widely conjectured that, from the perspective of multinational contractors, there are significant barriers to entry to the Australian major infrastructure market. These barriers may include high bid costs associated with infrastructure projects, a small number of Australian financial institutions involved in this sector, and a lack of consistency of standards across jurisdictions in Australia (Australian Government, 2008; Forward & Aldis, 2009). Hence, the two key and immediate constraints concerning finance and construction capacity, as well as their combined effect, create substantial challenges for all levels of government in Australia in terms of ensuring value for money (VFM) in the delivery of major infrastructure. This situation emphasizes the importance of developing an improved understanding of the determinants of value at key procurement decision points. These include: the make-or-buy decision; the decision concerning nature of the exchange relationship decision and contractual arrangements; and decisions that can adjust the balance of power in favor of government in the context of buying construction services in different market structures.

The aim of this chapter is to develop an improved understanding of these determinants of value by adopting theoretical pluralism and outlining and illustrating a structured approach to selecting the procurement approach most likely to deliver superior VFM. It is concluded that this structured approach may help address some of the challenges government currently faces amidst the GFC and in pursuance of enhancing VFM. These include: the issue of risk allocation; the development of the Public-Private Partnership model; and the prospect of a complementary/alternative approach to the Public Sector Comparator.

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