Can the Commonwealth drive infrastructure?

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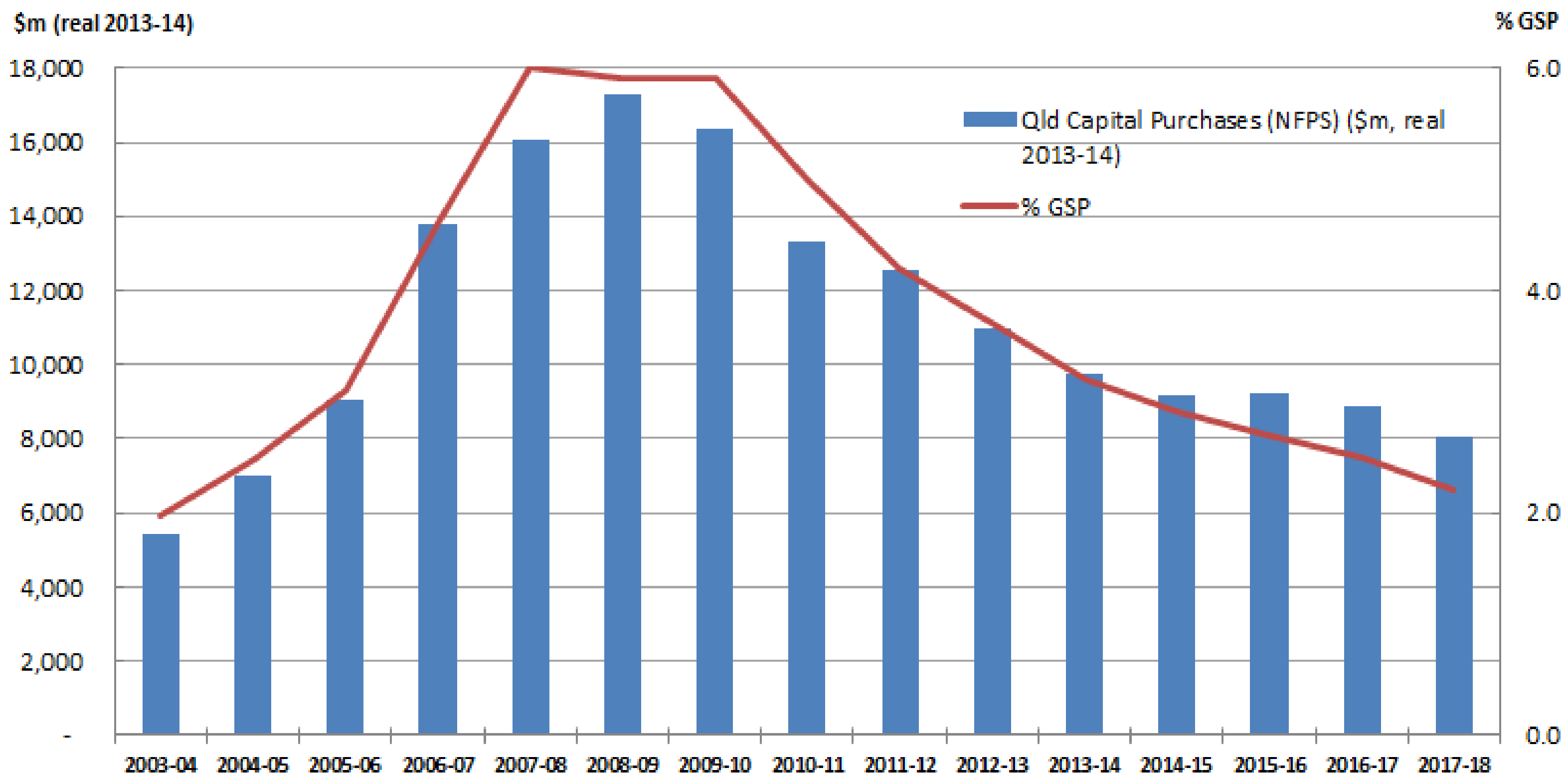
Main Points

- Background
  - Rising infrastructure spending, rising costs, mining boom and post-GFC environment
- Recent Improvements
- Problems Remain
- Some Recommendations

Background – rising infrastructure spending, rising costs per unit of benefit, mining boom and GFC

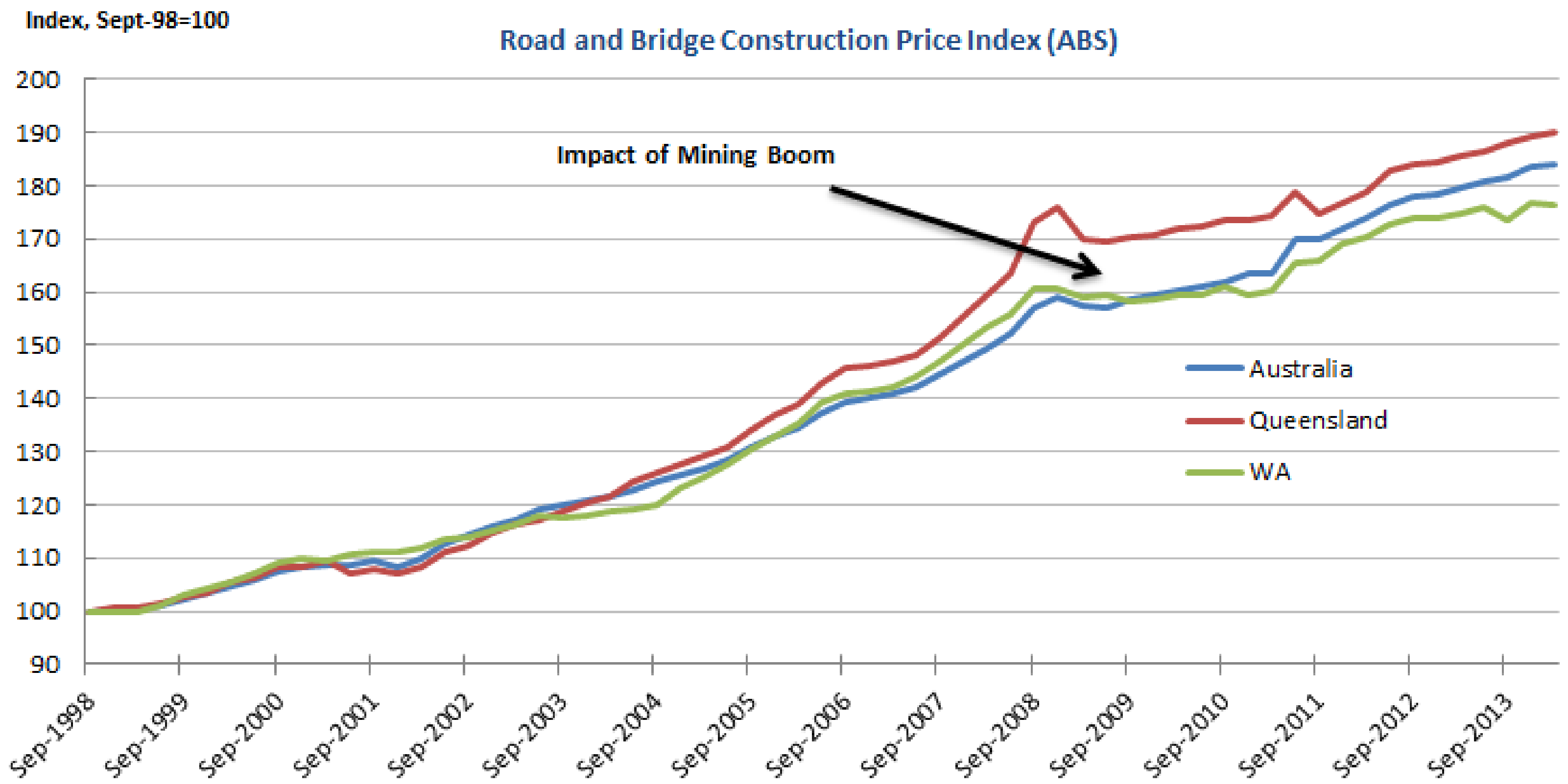
Queensland Capital Program (NFPS), 2004-04 to 2017-18



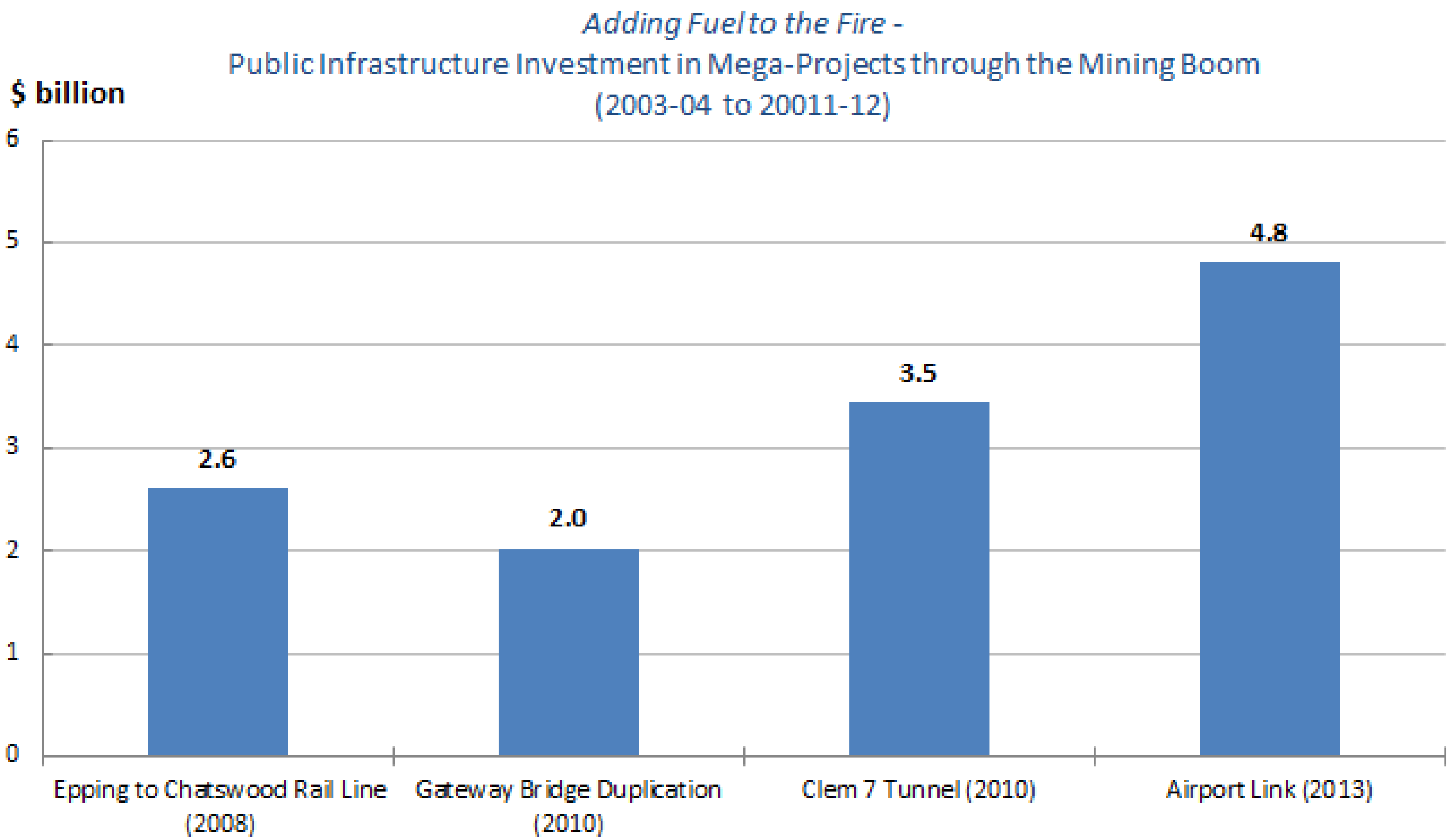
Background – Rising Costs

- Infrastructure costs have risen as a result of:
  - Competition for resources arising from the investment phase of the mining boom (cyclical driver, especially 2006-07 to 2011-12);
  - The complexity of undertaking major infrastructure work in increasingly densely populated urban environments (structural driver);
    - Proportion of Greenfields Projects in Sydney has halved over the past 20 years;
    - 'tunnel-mania' in Brisbane.
  - Environmental and workplace regulation which adds to that complexity and makes it more difficult to undertake infrastructure projects in a timely and efficient way (structural driver);
  - A tendency of governments to impose detailed input-driven specifications and standards, often set at levels of reliability and quality which have not been subjected to proper cost-benefit appraisal, and which increase costs both directly and by impeding competition among potential contractors (structural driver).
  - The growing role of very large scale projects, which involve high risks both in construction and patronage

Background – WA managed the cost impacts of the mining boom better than Qld did. Why?



Background – WA did not undertake Mega-Projects through the Mining Boom, whereas Queensland (and NSW) did

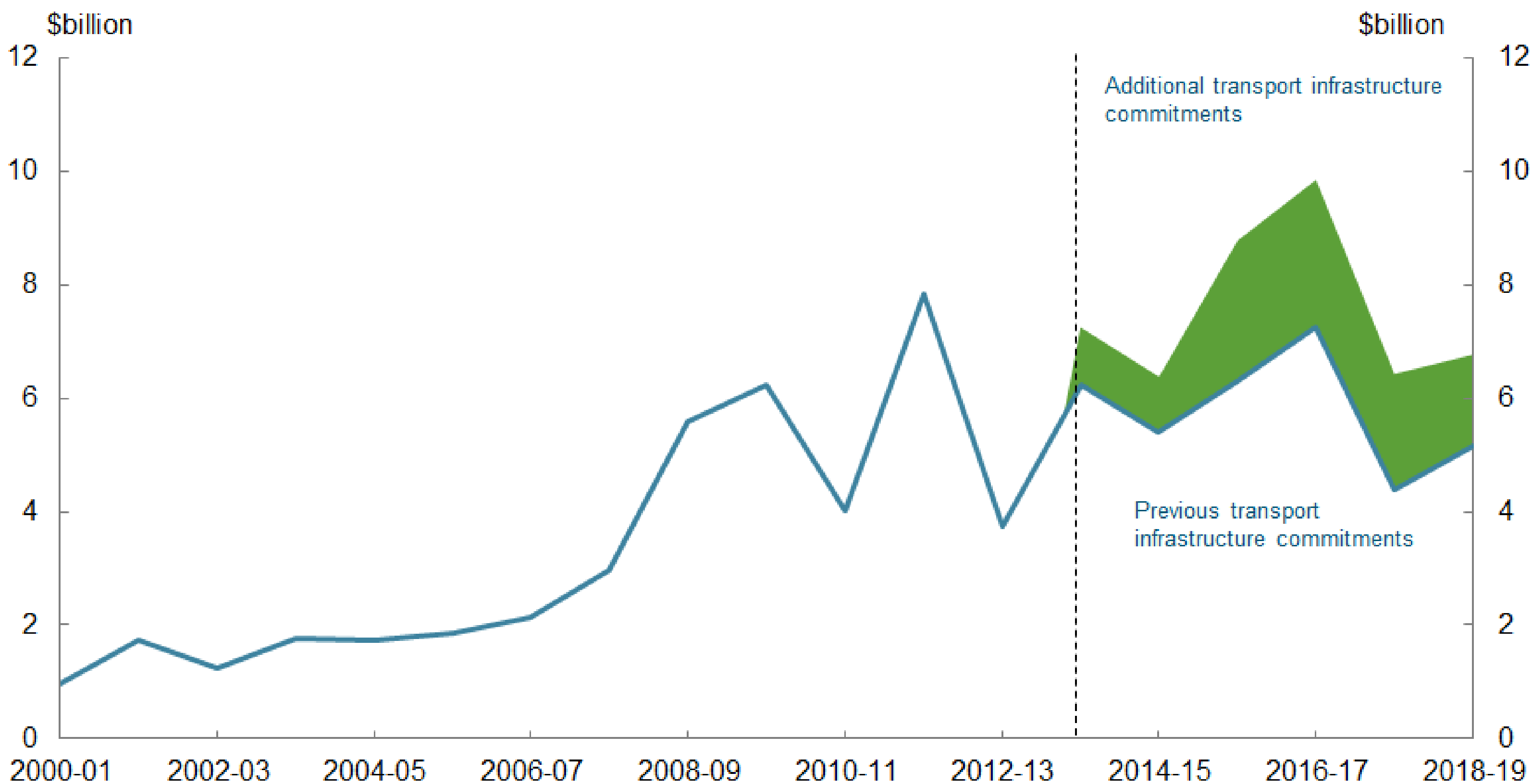


Dates refer to project completion.

Policy Background – recent reforms induced by budget constraints, and evidence of poor decisions and waste

- States (esp. Qld and NSW) and Commonwealth looking for value-for-money on behalf of taxpayers
- Recent Federal Budget - $11.6 billion Infrastructure Growth Package
  - $5.0 billion Asset Recycling Initiative
  - $2.9 billion for Western Sydney
  - $3.7 billion added to Infrastructure Investment Programme
- Redirection of significant levels of recurrent spending to capital investment
- Proposed reintroduction of indexation of fuel excise and hypothecation.

Commonwealth spending to increase significantly, partly as a result of Asset Recycling Initiative



Source: Commonwealth Treasury, 2014.

Recent Improvements – IA Reforms

- Infrastructure Australia:
  - *Infrastructure Australia Amendment Bill 2013* passed on 26 June 2014
  - Greater independence and improved transparency for the expert advisory body
  - Abolishes the role of the Infrastructure Coordinator (heretofore appointed by the Minister), and establishes the role of a CEO to be appointed by and reporting to the Infrastructure Australia Board
  - Rolling 15-year infrastructure plan
  - 5 yearly infrastructure audit (nationally significant infrastructure)
- Cost Benefit Assessment of projects, with funding over $100m
- Setting Asset Recycling Initiative eligibility criteria

Recent Improvements – NSW and Qld

- INSW responsible for preparation of State Infrastructure Strategy
  - Better prioritisation and more transparent approach
  - Budget constraint and budget gap clearly explained
  - Report showing potential economic benefits published
- NSW Government committed to Asset Recycling
  - Assets sold and under consideration are a ‘no-brainer’, but still need rigour around new project selection
- Qld has committed to better CBA and governance arrangements
- Qld Gov’t has replaced the Cross River Rail ($10 billion) for a cheaper and more incremental, lower risk, Bus and Train (BaT) Tunnel ($5 billion)

But Problems Remain

- Poor project evaluation and selection
  - Optimism bias on both costs and benefits
  - Too little optionality built into project design, so little scope to reconsider projects should costs escalate or adverse demand shocks eventuate
  - Scope creep, without projects being reassessed as scope changes
- Poor monitoring of returns on investment
  - Conceptually more difficult with roads under current structure
  - Need for institutionalised *ex-post* review
- Continued emphasis on mega-projects, high cost/patronage risk
  - Partly catch-up, as lack of incremental investments and poor integration with land use decisions ultimately requires 'make or break' projects
  - Increasingly competitive political environment favours 'iconic' projects
  - C/W involvement and (previous and to a lesser extent, current) IA set-up, institutional structure also encourages mega-projects
  - Asset recycling could aggravate this, especially if highly discretionary decision-making process
- Too little integration of long term transport and land use planning

Some Recommendations - Roads

- Vest responsibility for state road assets arms-length entity
  - independent board and balance sheet/income statement.
- State Government provides clear Statement of Objectives
  - including performance indicators such as road condition and traffic flow, and subject it to appropriate reporting requirements.
- Entity to estimate required capex and opex to meet Statement of Objectives subject to regulatory approval.
- Allow that entity to impose user charges on the road network:
  - Where the benefits from doing so to the community can be shown to exceed the likely costs; and
  - Where the charges themselves are subject to prior approval by an independent regulator.
- Private funding allowed, subject to:
  - Transparency and benefits test.

Some Recommendations – Funding/Financing, Comm-State burden sharing

- Current C/W-State burden sharing is not efficient. A better approach would be for the Commonwealth, for so long as it remains better placed to raise revenues, to:
  - Provide states with infrastructure funding on a formulaic basis, with the formula-driven funding accounting for at least 80 percent of Commonwealth infrastructure spending; and
  - Where there are spillover effects to state infrastructure decisions, announce a subsidy it is willing to provide for particular infrastructure outcomes to be achieved, leaving as much scope as possible for the exploration of alternative ways to achieve that outcome.
- As part of such a formula-driven allocation, the Commonwealth could require the states and territories to comply with the corporatisation approach.
- Moving to a formula-driven allocation would reduce costs in the Commonwealth's administration of transport spending. It would also allow Infrastructure Australia to be abolished, or at least reduced in scope to:
  - Monitoring compliance with the project evaluation principles; and
  - Advising the Commonwealth on the small number of projects where:
    - There are significant spill-overs between jurisdictions; and
    - Those spill-overs are 'decision relevant', in the sense that in the absence of compensation for those spill-overs, the projects would not be undertaken.

Commonwealth conditions on its funding

- Commonwealth should require that all projects above a given scale of outlays (say $100 million) are subject to appraisals that:
  - Examine the scope to avoid or postpone undertaking major projects by instead undertaking more targeted ‘de-bottlenecking’;
  - Examine and where efficient provide options to terminate, postpone or re-dimension projects in the face of adverse cost and demand shocks;
  - Demonstrate proper integration with land-use planning, including by assessing options to instead meet transport needs by increasing the efficiency with which land is used;
  - Use the Commonwealth CBA Guidelines and are subject to full ex-post review; and
  - Are fully publicly available.

Pricing

- Scope for better, more use-related, charging.
- As most Australian road networks, including in metropolitan areas, have relatively low levels of congestion, road user charges would mainly reflect road wear costs and some non-congestion externalities.
- Except for heavy vehicles on country roads, these efficient charges are likely to be very low, and (given scale economies to road expansion) will not cover the long run costs of the road network. However, they will provide valuable guidance on investment and road quality decisions.
- Excepting arterial, point-to-point links, even for those links that are congested, designing efficient congestion charges is highly complex, notably in densely meshed urban road networks. Efficient charges for these should also be low for passenger vehicles.
- Precisely for those reasons, this is a relatively good time to introduce better pricing, at least making vehicles and roads ‘charge ready’, as:
  - low prices reduce adverse impacts on road users and minimise disruption to house prices
  - But send signal about long run costs of living in outlying areas, and
  - Encourage demand-side innovations such as real-time GPS and car pooling.
- Better charging for roads should also be accompanied by substantial cuts in public transport subsidies, as the fact that road use was being priced efficiently reduces case for subsidising public transport.

Land use

- Many of the most complex issues about Australian infrastructure arise from poor design of metropolitan governance, which means those taking decisions neither bear their costs nor reap their rewards.
- In Sydney, for instance, decisions about long run urban form are dispersed between layers of government that do not ‘internalise’ the consequences of those decisions and may not even be especially aware of them.
- The problems are accentuated by the intrusion of state and Commonwealth governments, which can result in infrastructure being expanded in areas with high settlement but little jobs growth, imposing high transport costs and leading to solutions in which money is thrown at problems.
- Improving the design of metropolitan governance deserves far more attention than it receives.

Conclusion

- While there have been improvements, particularly at the project evaluation stage, there is a very long way to go.
- The capital recycling initiatives are welcome, but accentuate the risk of a focus on mega-projects.
- Significant institutional change, with more commercial governance arrangements, is crucial to getting better infrastructure decision-making.

Thank you