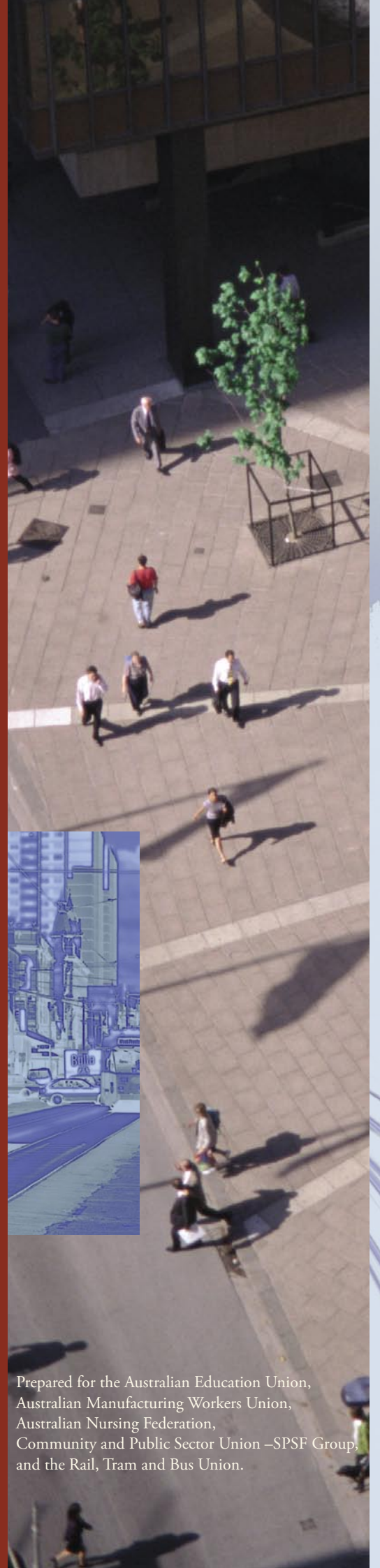


Financing our future

The case for change in financing
Australia's infrastructure needs



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Prepared for the Australian Education Union,
Australian Manufacturing Workers Union,
Australian Nursing Federation,
Community and Public Sector Union –SPSF Group,
and the Rail, Tram and Bus Union.



Few communities in Australia today are not handicapped by shortcomings in infrastructure, which detract from their economic performance and/or their broader quality of life. Most have to contend with serious gaps which, as documented in the Study, seem to be widening, not closing. Indeed, rising public resentment at serious problems in so many areas – including energy, water, transport, housing, education and health – is at last forcing governments at all levels to focus more diligently on the problem.

Several factors help to explain how the present deplorable situation developed. Chief among them has been the strong ideological addiction – at all tiers of government – to smaller public sectors and lower levels of tax and public debt. This has been reflected also in what appeared as relatively easy options for governments, namely extensive privatisation of public assets and resort to PPPs, with very mixed results. Capital availability as such has not been the problem: additional loan and revenue funds could have been raised for infrastructure projects if federal and state governments had been so inclined.

As governments turn their minds to more effective private sector involvement in future arrangements, they will be confronted with a wide spectrum of funding options, from straight public debt raisings through mixtures of public and private debt/equity to outright private sector provision. Ultimately the same pool of national savings will be drawn upon but the different risk/return characteristics of particular categories of infrastructure will warrant a variety of funding models.

Some innovative public funding instruments which have been adopted overseas, should be considered, along with greater recourse to superannuation savings. Industry super funds in particular have a history of investing in infrastructure projects and are keen to increase their exposure as opportunities arise: as investors, tax-payers and consumers of infrastructure services, members of industry super funds have a particular interest in seeing that the chosen funding arrangements strike a reasonable balance from the perspectives of all stakeholders.

There has been a past lack of vision and leadership in the planning and coordination of an effective national response to our infrastructure problems. Perhaps we should not get too excited quite yet, but rising public pressures are generating increased interest in possible national approaches.

Bernie Fraser

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Australia's public infrastructure is in a state of disarray.

We have reduced the share of national resources invested in public infrastructure. Our public transport is rundown and unreliable, forcing more people to depend on cars; public hospital waiting lists are extensive, and public education has been starved of resources. We are experiencing regular electricity shortages and we are making few inroads into solving our looming water crisis.

Traditionally, public infrastructure assets are basic installations and facilities that provided long-term economic and social benefits to the community. These facilities underpin the functioning of society and the economy and include railways, roads, electricity and gas, water and social infrastructure such as schools, training colleges and universities; hospitals and community health facilities, public housing and retirement age homes and libraries.

Australians have lived through a long period of economic prosperity in terms of wealth and household income growth but our infrastructure system is unable to keep up with the demand. We have three major infrastructure challenges:

- How can Australia increase the share of Gross Domestic Product that is invested in new public infrastructure to enable us to meet the challenges of a competitive and humane society?
- How can we increase investment in the maintenance and operational expenses associated with existing public infrastructure?
- How do we shift resources into public infrastructure that enhances social and environmental sustainability? This includes public transport, community health infrastructure, public housing and infrastructure that reduce greenhouse gas emissions such as renewables and gas-fired power stations.

Most people believe that we need to put more resources into public infrastructure but don't know how this can be achieved. The traditional mechanism for financing public infrastructure was through government debt borrowings supported by taxation. In market economies it was recognized that market failures exist. It was recognised that the private sector couldn't provide the entire economic and social infrastructure required. There were many reasons for this including the massive up-front costs associated with infrastructure, the advantages in some sectors of having infrastructure run by a public natural monopoly, and positive "externalities" associated with public infrastructure such as cleaner air, reduced travel times and fatalities, a highly educated and skilled workforce and a healthier population. The latter are benefits that cannot usually be captured through private sector markets.

The benefits of government debt financing have been confirmed by recent studies into the best methods to finance infrastructure, which have highlighted advantages of public borrowings including low costs of borrowing and linking costs over time to the flow of benefits.

The dominance of neo-liberal economic policy and practices – characterised by low taxation, debt reduction and small government – has had disastrous consequences for public infrastructure. The neo-liberal perspective is that the private sector has the resources and expertise to invest in, own and manage our infrastructure. In extreme form, this entails a continuing winding back of public sector investment in infrastructure and reliance on the private sector to come up with unsolicited proposals to meet our infrastructure needs.

Over the past 15 years, Australian governments have sought to increase private sector participation in financing, managing and ownership of public infrastructure. This included privatisation of airlines, telecommunications, rail lines, water and energy infrastructure. Increasingly focus has shifted away from outright privatisation toward Public Private Partnerships, which involve a sharing of risks, responsibilities and rewards between public and private sectors.

The mobilisation of national savings for public infrastructure through the use of superannuation funds (now around \$878 billion) presents an important opportunity to address the capital constraints on public infrastructure. Super funds are increasingly active in exploring infrastructure investment opportunities. The important point, however, is that in protecting their members' savings, the super funds are obliged to invest in those activities that maximise commercial rates of return over a long period of time.

We need to reinvigorate the role of the public sector in the provision of public infrastructure. There needs to be a stronger commitment from the three tiers of governments to address our major infrastructure challenges. There are real advantages in public investment in infrastructure, and there are a range of innovative financing techniques that could increase investment in infrastructure and the efficiency with which it is managed.

Australia has not been innovative enough in financing public infrastructure because of:

- The historic taxation imbalance between local, state and federal governments, which has centralised most fundraising capacity in the Commonwealth.
- Legal problems that limit the powers of state and local governments to raise funds.
- A less developed public capital market which has traditionally relied on the expanding tax base for budget funds.
- The dominance of neo-liberalism, which erroneously emphasises the benefits of small government and budget surpluses by both state and federal governments, regardless of the changing needs of the community.
- The tax system is biased against long-term investments in public infrastructure.



Australian experiences with public private partnerships

Public private partnerships became fashionable in Australia over the past five years, particularly with state governments. The Australian PPP market is approaching \$20 billion, with projects ranging from motorways, rail lines and stock, water and waste facilities, prisons, educational institutions and hospitals. They have become an attractive option to address the funding shortfall in public infrastructure provision. The funding shortfall is due to the unwillingness of governments of all persuasions to increase taxes and/or borrow to finance infrastructure.

Governments were able to increase revenues from the mid 1980s by selling government assets, but from the mid 1990s this source of revenue, with the important exception of Telstra, began to slow. Governments look to the private sector to finance much of the new infrastructure, without privatisation. As opposed to privatisation, where public assets are transferred to the private sector, different aspects of a project including financing, ownership and management are the subject of negotiations in PPPs. Public Private Partnerships involve more substantive agreements about risk and delineation of responsibility between the public and private sector. Public Private Partnerships are not a new concept. They can be traced to the funding of tollways in North America where private consortia were established to bid for the construction, financing and ownership of tollways. They were popularised by the Blair Government in the UK in the late 1990s and embraced by Australian state governments.

Neo-liberalism drove the creation of PPPs in Australia. Instead of paying for infrastructure up-front, the typical PPP involves a contractual relationship where a special purpose vehicle is created and the government leases the assets from the private sector for a specified period of time, normally 20-30 years, when the asset is transferred back to the public sector. There are many different types of PPPs. The traditional arrangement was design and construct – where government contracted the private sector to design and construct an infrastructure asset for a specified amount and guaranteed level of service. With design and construct projects, the private sector is responsible for construction risk, and was required to construct to a certain standard. Build Own Operate and Transfer (BOOT) projects are another type of PPP. Many capital constrained developing countries made use of these schemes from the 1980s, whereby the private sector might finance the construction of a power station, for example, operate and maintain it for a period of 30 years, charge users based on a formula taking into account capital plus electricity consumption, and transfer back to the government at the end of the period.

Australian state governments have taken a leadership role in developing PPP policies and projects.

Australia's very low public debt

Australia's net debt position is remarkably different from other comparable countries. In 2001-02 Australia's debt as a proportion of Gross Domestic Product had fallen to 6% compared to an OECD average of 40%. Government share of this debt is estimated at less than 4.6%, making Australia one of if not the lowest debt holding country in the world. Whilst admirable from a budget point of view, it has been at the cost of ongoing strategic investment into public infrastructure. Australia's extremely conservative approach to debt is perhaps best illustrated by comparing it with the USA at 60% of GDP, the UK at 30% of GDP and France at 40% of GDP.

Debt in itself is not a problem if it is invested into productive assets. Direct and indirect returns as measured by greater economic efficiency (cost of goods and services) and effectiveness (strategic positioning in the longer term) must be the test for public infrastructure investment.



Recommendations

- 1 The Federal Government should recognise that under-investment in infrastructure is a major impediment to Australia's economic and social development and put forward a target to increase public infrastructure investment by Australian governments and government-owned enterprises to 5% of GDP. This is equivalent to around \$50 billion per year for public investment in infrastructure.
- 2 New institutional arrangements need to be developed to improve cooperation and coordination between the three tiers of government in relation to public infrastructure. Consideration should be given to the establishment of an organization known as the National Infrastructure Council with a charter to increase public and private sector investment in economic, social and environmental infrastructure. The National Infrastructure Council should comprise representatives of the three tiers of government, industry, unions and community groups and be resourced sufficiently to undertake research and provide high level policy advice to the three tiers of government.
- 3 Given the high level of fiscal imbalance that exists between the three levels of government, the Federal Government should facilitate through legislation the capacity to establish:
 - Local community investment funds
 - Special purpose statutory investment corporations
 - Loan guarantee facilities for designated national infrastructure projects coupled with bond issues
 - Provide standby lines of credit to local, regional and state government projects thereby reducing the cost of public capital for the provision of local infrastructure.
 - A Grant Integration Note Program to accelerate immediately needed investment.
- 4 The Federal Government should establish a national capital formation agency to facilitate the establishment of dedicated investment funds suitable for individual and institutional investment in infrastructure, particularly by superannuation funds. In the absence of national leadership, state governments could enact enabling legislation to achieve the same outcome.
- 5 Rating caps on local government authorities should be eased to enable increased spending on local infrastructure, subject to detailed economic and social evaluations of projects.
- 6 The current application of PPPs should be reduced to those programs that meet a comprehensive comparative analysis with alternative strategies.
- 7 The Federal Government should be approached to establish a Cities Development Corporation to work with state and local government to address major urban infrastructure problems in Australia's rapidly growing urban areas.
- 8 AusLink should be extended to provide a framework for significantly increasing public transport in Australia's cities, including new investments in heavy and light rail, and upgrading rolling stock.
- 9 A national inquiry should be held into Australia's knowledge infrastructure with a view to planning, developing and financing knowledge infrastructure at national, state and community level, to support a competitive, knowledge-based economy.

To order copies of this leaflet or the full report "Financing Our Future", please call the State Public Services Federation (CPSU) on 02-9299 5655 or email fedsec@spsf.asn.au

