



BENCHMARKING THE PROGRESS OF

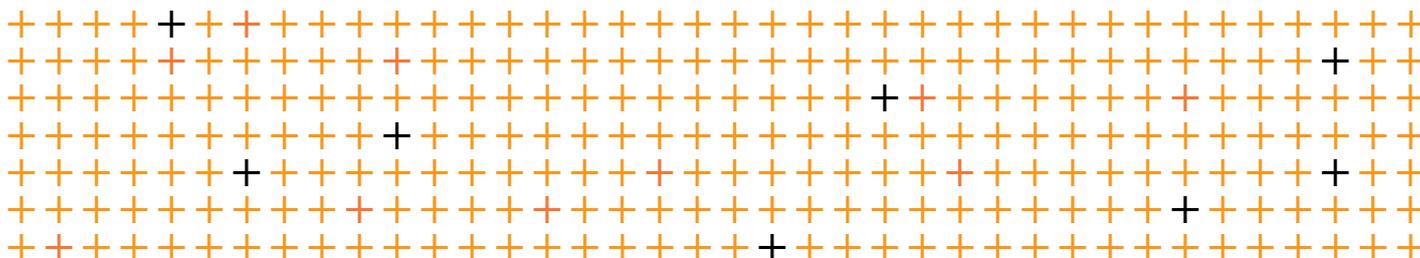
Infrastructure Reform

CHALLENGES, MILESTONES AND OUTCOMES



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Executive Summary

The Business Council of Australia (BCA) is an association of Chief Executives of 100 of Australia's leading corporations. BCA Member companies employ nearly one million Australians, generate \$340 billion in the economy and produce 30 per cent of Australia's exports. They also contribute a significant proportion of the \$49 billion in federal taxes that companies are forecast to pay this financial year.

The BCA has a deep interest in policies that promote sustained growth and prosperity in the economy through strengthening Australia's economic competitiveness. Reliable and high-quality economic infrastructure is one of its chief policy considerations in this regard.

In March 2005 the BCA released its *Infrastructure Action Plan for Future Prosperity*. Much has been written and said since that time in what has been a significant and vigorous debate on infrastructure and its critical role in Australia's future growth.

The BCA's *Infrastructure Action Plan* remains one of the few comprehensive analyses of the problems and potential benefits of major infrastructure reform and its relationship to sustained economic growth.

The BCA's analysis identified a number of deep-seated problems with Australia's infrastructure. There are numerous impediments to investment and efficiency in energy; all major cities are facing frustrating traffic congestion; there are many deficiencies in the national market for land transport; most cities face growing water shortages; and rural water supply is unreliable because our rural water systems are under considerable stress.

This year-long debate on infrastructure has been intense. Many editorials and newspaper column inches have been written; all political parties at both the Commonwealth and State levels have come to be engaged in the issue; and sector-specific reform processes are already underway in energy, water and transport.

The purpose of this brief review is to assess how much 'light' has been generated from all this 'heat'. The judgement to be made is not whether a few steps targeted at specific sectors have been taken. Rather, with all the public, policy and political focus on infrastructure, the last 12 months need to be judged by whether or not major reform steps based around structural change to Australia's infrastructure have been planned and delivered.

The headline answer is that we have – just. This qualification applies in two ways:

- 1 Solid progress was only seen at the February 2006 Council of Australian Governments (COAG) meeting in which Federal, State and Territory Governments placed infrastructure reform at the centre of a renewed national reform agenda. Prior to that there had been little substantive progress.
- 2 Despite the significance of elevating infrastructure reform to a major policy priority, the COAG meeting outcomes only start the process. The real work and decisions now need to follow.

In terms of the many positive developments resulting from the COAG meeting, a broad agenda has been outlined for energy and transport. The policy areas covered included many of those identified by the BCA to address inefficiencies and bottlenecks in these sectors.

Second, COAG has indicated it will control the process and closely monitor the outcomes. That is, the Prime Ministers and Premiers have rightly taken responsibility for the final decisions. This reflects the heightened importance now placed on infrastructure policy, planning and reform.

Third, the possibility of reform incentives has been raised, although their extent and nature are still to be settled.

Finally, each jurisdiction is to self-appraise its infrastructure position and needs on a five-yearly basis. This falls well short of the independently assessed 'state of the nation' audit every two years that the BCA had been seeking.

COAG elevates infrastructure reform to a position of national policy importance.

The key point to be made is that, with 12 months of continual focus on these issues, the recent COAG announcements have started the reform process. The serious work is ahead of us. In particular:

The governance processes need to be settled.

The precise role and status of the COAG Reform Council in driving and overseeing progress on infrastructure reform is yet to be defined.

Many reforms have long timeframes.

Therefore, there is a risk the current political and policy will to achieve improved infrastructure outcomes may dissipate.

A number of major announcements have many conditions attached.

For example, the rollout of 'smart' meters and the removal of electricity retail price caps seem to be subject to further review.

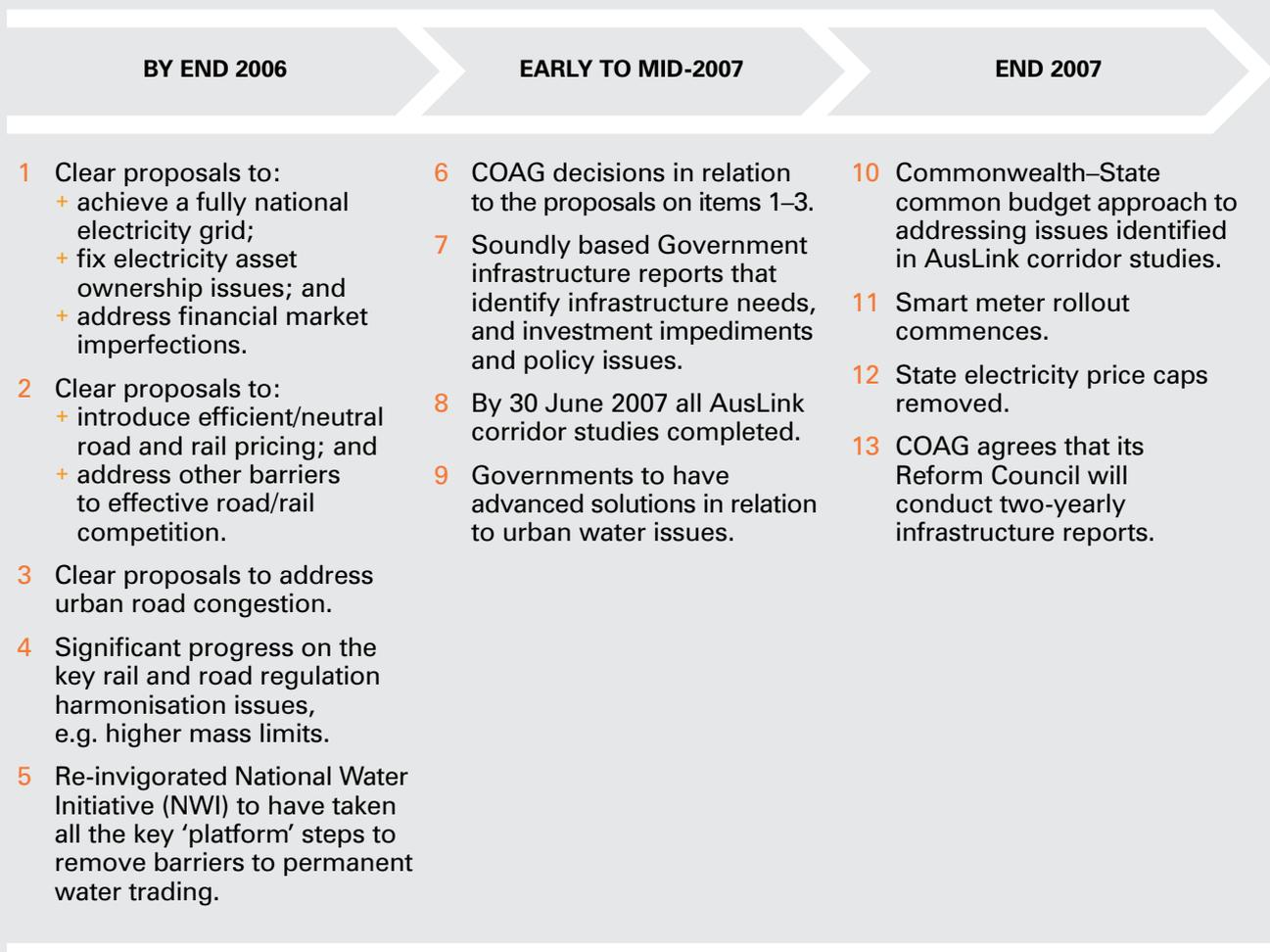
Some apparently positive announcements have unclear outcomes.

For example, it is not clear that the proposed transport corridor strategies will be backed by Commonwealth and State decision-making and budget alignment.

The outcomes of a number of reviews will be critical to progress. A key challenge is that these reviews, unlike previous reviews, must lead to significant change.

KEY MILESTONES TO BE MET

The last 12 months have seen the start of the process. We need to see 2006 as the year of action and the achievement of key milestones. The BCA will be monitoring progress closely.



THE OUTCOMES OF SUCCESSFUL INFRASTRUCTURE REFORM – COAG’S CHALLENGE

Of much more importance over time is whether the decisions of COAG lead to improved infrastructure outcomes. It will be important for COAG to provide information on improvements in the following key performance indicators as this will provide the community with evidence of successful infrastructure reform.

ELECTRICITY	<ul style="list-style-type: none"> + Urban and rural SAIDI levels (average minutes lost) in each region. + Current and forecast generation reserve margins in each region. + Transmission line congestion incidence and costs (intra- and inter-region) + Degree of interstate financial market trading.
URBAN TRANSPORT	<ul style="list-style-type: none"> + Total level of road congestion costs in each capital city. + Average travel speeds in each capital city (metropolitan area) at peak times. + On-time rail schedule performance at peak times.
INTERCAPITAL FREIGHT	<ul style="list-style-type: none"> + Rail and road travel times between main destinations. + On-time schedule reliability for road and rail. + Extent of rail speed restrictions.
URBAN WATER	<ul style="list-style-type: none"> + Extent of physical water restrictions. + Average dam levels in each capital city. + Current and forecast useage levels as a percentage of sustainable supply. + Extent of system pipe leakage or other wastage.
RURAL WATER	<ul style="list-style-type: none"> + Percentage of rural water surface and groundwater systems under stress. + Extent of water wastage by cause. + Extent of permanent water trading in each main system area. + Irrigation system reliability.

PART 1

The BCA *Infrastructure Action Plan*: A Summary of Problems and Solutions

The BCA's *Infrastructure Action Plan For Future Prosperity* highlighted the critical importance of infrastructure to the economy and the necessity of robust and strategic planning to underpin sustained growth.

First, it described how electricity, gas, water, roads, ports and rail are central to a modern economy. In fact, 70 per cent of the total demand for such infrastructure comes from Australian businesses that rely on these services to produce and market their outputs. The report highlighted a number of key issues and problems, as summarised in Exhibit 1.

Exhibits in this paper draw on information contained in the BCA's *Infrastructure Action Plan for Future Prosperity* (2005).

Adequate infrastructure is essential to sustained economic growth.

EXHIBIT 1: EXAMPLES OF KEY INFRASTRUCTURE PROBLEMS

ELECTRICITY	The National Energy Market (NEM) is still largely State-based, with many impediments to appropriate investment and efficiency in all parts of the value chain.
URBAN TRANSPORT	All major cities are facing increasing road congestion and this has major implications for economic growth.
INTERCAPITAL FREIGHT	We do not have an effective national market in land transport. Governments are struggling to expand and/or maintain roads, and rail tracks are in poor condition.
URBAN WATER	Most cities have low dam levels, physical water restrictions and a worrying supply outlook.
RURAL WATER	Our rural water systems are under great stress. Rural water reliability is low, and progress towards a national water market is very slow.

Second, the *BCA Infrastructure Action Plan* identified the broad direction of change required. Overall, it found that shortfalls in the capacity of Australia's infrastructure flow from poor policy and planning, rather than from high economic growth or a lack of available funding. Importantly, it found infrastructure reform that removed infrastructure bottlenecks and capacity constraints could boost Australia's gross domestic product by around 2 per cent.

Third, and most important, it outlined what needed to be done through four key recommendations:

- 1 The BCA called for the formulation of a comprehensive reform agenda. The BCA simultaneously released a report by Rod Sims of Port Jackson Partners Limited (PJPL) which identified some of the key elements of such an agenda.
- 2 The BCA called for strengthened governance and institutional arrangements in infrastructure planning. These were to involve clear roles and responsibilities among Federal, State and Territory Governments; well-defined targets and timelines; and the need for continual involvement by COAG or a similar peak intergovernmental body to have oversight for what is effectively a national reform issue.

- 3 The National Competition Policy incentives for reform needed to extend to infrastructure planning and provision with clear timeframes and specified outcomes forming the basis for payment.
- 4 There needed to be a two-yearly 'state of the nation' audit to ensure the continual focus and transparency around these issues. The BCA recommended that the Productivity Commission facilitate such a policy and condition audit.

KEY ELEMENTS OF INFRASTRUCTURE REFORM

The *BCA Infrastructure Action Plan* and the work of Rod Sims of Port Jackson Partners identified the key elements of infrastructure reform. These can be broadly summarised as follows.

Reform that removes infrastructure bottlenecks and capacity constraints could boost GDP by around 2 per cent.

ELECTRICITY

In electricity a number of problems that impede effective supply and pricing need to be addressed at each level of the value chain. These impediments are summarised in Exhibit 2.

EXHIBIT 2: ELECTRICITY PERSPECTIVES

THE PROBLEM	REFORM DIRECTIONS
1 GENERATION <ul style="list-style-type: none"> + Retail price caps dampen investment signals. + Poor greenhouse policies create uncertainty and/or distortions. 	<ul style="list-style-type: none"> + Remove retail price caps. + Have one Australian greenhouse response.
2 TRANSMISSION <ul style="list-style-type: none"> + The current regulatory transmission approval process seems flawed. + Regions are State-based and do not reflect market needs. 	<ul style="list-style-type: none"> + Create better investment signals for transmission. + Create more market-based regions.
3 DISTRIBUTION <ul style="list-style-type: none"> + Regulation is undertaken by many bodies, is too costly, and favours cost reduction over service standards. 	<ul style="list-style-type: none"> + Seek single transmission and distribution regulation that places more emphasis on service levels and relies more on benchmarking.
4 RETAIL <ul style="list-style-type: none"> + Most consumers do not face price signals to curb peak demand growth. + Inter-region trading is limited. 	<ul style="list-style-type: none"> + Introduce 'smart' meters and allow time-of-use retail and distribution pricing. + Improve inter-region financial arrangements.

URBAN TRANSPORT

In urban transport three problems were identified. These problems and key directions for reform are summarised in Exhibit 3.

Urban congestion results in considerable wasted time and economic inefficiency.

EXHIBIT 3: URBAN TRANSPORT PERSPECTIVES

THE PROBLEM	REFORM DIRECTIONS
<ul style="list-style-type: none"> + Increasing urban road congestion in all cities involves considerable wasted time and therefore, economic inefficiency. 	<ul style="list-style-type: none"> + Move to some form of congestion pricing. Actively manage congestion rather than let it manage itself.
<ul style="list-style-type: none"> + Many Government-owned public transport systems are losing share and not coping. 	<ul style="list-style-type: none"> + Make public transport more efficient, which can encourage investment. For example some aspects of the mid-1990s Victorian reforms could be replicated elsewhere.
<ul style="list-style-type: none"> + Urban transport planning approaches impose delays and unnecessary costs. 	<ul style="list-style-type: none"> + Improve urban transport planning and coordination. + Consider moving aspects of transport planning to the State rather than the Local Government level in many major cities.

INTERCAPITAL FREIGHT

In intercapital freight three broad problems were identified. Addressing these problems is essential to improving freight movements and reducing bottlenecks. Exhibit 4 summarises the intercapital freight challenges.

EXHIBIT 4: INTERCAPITAL FREIGHT PERSPECTIVES

THE PROBLEM	REFORM DIRECTIONS
<ul style="list-style-type: none"> + Road and rail regulation is still not harmonised in key areas such as truck mass limits and in many areas of rail regulation. + Transport planning is poorly aligned between the States and the Commonwealth so that cost shifting and inertia often prevail. + There is a lack of competitive neutrality between road and rail with quite profound economic and social effects. 	<ul style="list-style-type: none"> + Accelerate efforts to achieve harmonisation of and reduction in road and rail regulation. + Develop frameworks and processes to ensure coordinated land transport planning and decision making. + Ensure competitive neutrality in road and rail pricing.

URBAN WATER

In the case of urban water there is simply a lack of forward planning. The essential element of reform is the introduction of effective and coordinated planning which recognises the relative benefits and costs of different supply and demand solutions. The recent decision in NSW to shelve the proposed Kurnell desalination plant is clear evidence of this need. Moreover, water is priced as if it were plentiful, leading to demand exceeding supply. Exhibit 5 highlights this point.

EXHIBIT 5: CONTRASTING PROBLEMS IN URBAN WATER

THE OBSERVED PROBLEM	THE HIDDEN PROBLEM
<ul style="list-style-type: none"> + Dam levels are low in most city catchment areas. + Sydney is using more water than is sustainable and water could be a key limiting factor on Sydney's future growth. + By 2025, with 26 million people, Australia will see nearly all of its main cities consuming more water than is sustainable. + State Governments are responding with a wide range of water rationing measures. 	<ul style="list-style-type: none"> + Sydney city users pay AU\$1.51 for every 1,000 litres of high-quality drinking water delivered to the home 24/7: <ul style="list-style-type: none"> + this price covers the cost of water treatment and delivery only. The price for the commodity is zero, when it should be the cost of the next supply increment; and + higher prices would make the required supply options economic and more investment practical. + Australians are very high water users. Higher prices would encourage demand management.

RURAL WATER

Finally, in the case of rural water, there is a need to create a national water market and introduce permanent trading in water to ensure its more efficient and sustainable allocation in regional and rural areas. Exhibit 6 summarises the key problems and solutions.

EXHIBIT 6: PERSPECTIVES IN RURAL WATER

THE PROBLEM	REFORM DIRECTIONS
<ul style="list-style-type: none"> + East Coast major surface and groundwater systems are under serious stress: <ul style="list-style-type: none"> + of 325 surface water basins 84 are close to, or are over-used; and + of 538 groundwater management units, 168 are close to or are over-allocated. 	<ul style="list-style-type: none"> + Introduce permanent trading in water property rights along the East Coast and into South Australia: <ul style="list-style-type: none"> + base the trading rights on sound science to achieve wide acceptance, particularly in terms of ‘currency conversion’ factors; and + allow ‘low-value’ users to trade out (i.e. win/win).
	
<ul style="list-style-type: none"> + Many irrigation systems have very poor reliability. + Insufficient water for high-value users. + Poor water quality (e.g. salinity) + Unhealthy rivers. 	<ul style="list-style-type: none"> + Achieve high reliability in all irrigation areas.

PART 2

Progress on Infrastructure Reform

This part of the paper assesses the progress that has been made in relation to key infrastructure reforms between March 2005 and March 2006.

THE PAST 12 MONTHS

In February 2005, the BCA identified infrastructure reform as one of the four areas of the economy that require extensive reform in order to lock in sustained growth for the long term.

In March 2005, the BCA released its *Infrastructure Action Plan For Future Prosperity* which outlined a comprehensive infrastructure reform agenda supported by processes and structures to ensure accountability and change.

The debate over the last 12 months has been extensive, and welcome. It has helped to elevate the issue to one of national importance, compared to the earlier sectorial and sometimes parochial character of the debate. The Governor of the Reserve Bank of Australia highlighted infrastructure bottlenecks as potentially impacting on the country's growth prospects; while the Productivity Commission's call for a new round of policy reform focused heavily on infrastructure. Many newspaper editorials were written advocating a more strategic approach to infrastructure planning. A large number of influential Commonwealth and State politicians, including the Victorian Premier, called for urgent policy action on infrastructure.

Perhaps most importantly, in October 2005 Prime Minister John Howard said in an address to the Australian Davos Connection Infrastructure Conference that: 'The Commonwealth is strongly committed to initiating a new set of productivity-enhancing reforms ... This agenda will focus primarily on infrastructure reforms ...'¹

Moreover, the Prime Minister commissioned a report from a taskforce focused specifically on Australia's export infrastructure (Fischer Taskforce).

The past 12 months have also seen some progress in a number of sector-specific reform areas such as the Ministerial Council on Energy (MCE) and the Australian Transport Council's AusLink program, and a number of State Governments have made major infrastructure announcements.

However, the progress of the National Water Initiative has been slow, with some key deadlines missed (for example on water trading); and other Government decisions such as those related to ensuring consistency in vehicle mass limits have not yet been implemented.

The February 2006 COAG meeting renewed the push for infrastructure reform at a strategic level.

¹ The Hon John Howard MP, address to the Australian Davos Connection Infrastructure Conference, Melbourne, 19 October 2005.

COAG 2006: DIRECTIONS

The overall policy directions of the February 2006 COAG meeting reflected the new consensus around the need to elevate infrastructure to an issue of national reform importance and for Governments at all levels to adopt a far-reaching, more coordinated approach to infrastructure planning.

COAG outlined a number of major steps in relation to infrastructure reform, and in broad terms addressed all of the BCA's key reform recommendations in some way. Exhibit 7 provides an overall assessment.

EXHIBIT 7: GENERAL OUTCOMES FROM COAG ON INFRASTRUCTURE

BCA PROPOSAL	COAG RESPONSE	INITIAL ASSESSMENT
+ Australia needs a comprehensive infrastructure reform agenda.	+ COAG endorsed a new reform agenda covering energy and transport.	✓
+ There should be clear responsibilities and targets and continual COAG involvement.	+ There is to be continual reporting back to COAG on progress by a COAG Reform Council.	✓
+ Reform incentives need to be maintained.	+ Case-by-case payments linked to results will be negotiated.	✓
+ A 'state of the nation' policy and performance infrastructure audit should be facilitated two-yearly by the Productivity Commission.	+ Each jurisdiction will complete five-yearly infrastructure reports focusing on strategic overview and future demands and needs. The first reports are due by January 2007.	✗

✓ positive decision + positive review ? progress unclear ✗ no progress, or concern at direction

The COAG meeting has announced a major reform agenda for energy and transport. The elements of this agenda aligned very well with the key areas of concern to the BCA.

Importantly, there is to be continual reporting back to COAG on progress, and progress monitoring by a COAG Reform Council (CRC), which will take over from the National Competition Commission. That is, COAG is taking responsibility for infrastructure reform progress.

Reform incentive payments are contemplated, albeit on a negotiated case-by-case basis. As the BCA has consistently stated, these are fundamental to providing a continuing incentive for reform.

Each jurisdiction is to complete a five-yearly infrastructure report which will provide a strategic overview, as well as perspectives on future demand and a forward-looking assessment of future needs.

The agreement to provide reports by jurisdiction is a disappointing result. The focus of these reports appears to be more on physical needs, not policy and planning issues and impediments, and they will not represent an independent assessment.

The BCA has called for a 'policy and condition' audit to be conducted by the Productivity Commission every two years. It is to be hoped that COAG will amend its decision over time. The first set of self-assessments is due by 31 January 2007. Once these are completed subsequent assessments could be undertaken much more regularly by the COAG Reform Council.

The overall assessment, however, is one of clear reform progress at a broad policy level. The clear message from COAG was that Federal, State and Territory leaders agreed on the imperative for a national, coordinated approach to infrastructure reform and firmer processes for infrastructure decision-making and assessment.

COAG agreed to a national, coordinated approach to infrastructure reform and firmer processes for decision-making and investment.

COAG 2006: SPECIFIC REFORMS

The BCA's *Infrastructure Action Plan* highlighted three areas for reform: energy, transport and water. In the first two areas COAG has made a promising start. On the other hand, progress on water has been disappointing.

ENERGY

The February 2006 COAG meeting produced major new announcements and also built on the steady progress being made by the Ministerial Council on Energy. The key agreements made are summarised in Exhibit 8.

EXHIBIT 8: COAG AGREEMENTS ON ENERGY

KEY DECISIONS	ELABORATION
<ul style="list-style-type: none"> + Phase out retail price caps where effective competition can be shown. + Progress rollout of electricity 'smart' meters from 2007. + Australian Energy Regulator (AER) to regulate all transmission and distribution for electricity and gas. + Strengthen national transmission: <ul style="list-style-type: none"> - improve framework for planning and investment; and - consider establishing a national grid. + Consider measures to address structural issues, including: <ul style="list-style-type: none"> - separate generation/transmission; and - ownership and structure of GBEs. + Consider measures to ensure effective financial markets. 	<ul style="list-style-type: none"> + Reviews to establish this will commence in 2007. The details of decision-making process are to be determined. + Implementation must consider States' individual circumstances and cost-benefit. + An expert group is considering new pricing principles to guide this regulation in the future. + A high-level COAG Energy Reform Implementation Group has been established to develop detailed implementation arrangements. This gives these issues profile, but the nature and extent of future change is unclear.

There were several key decisions which aim to remove regulatory impediments to new investment and provide greater price transparency in order to curb peak demand growth.

First, COAG announced that the MCE has agreed to phase out retail price caps where effective competition can be demonstrated. This is a key reform. Price caps clearly discourage investment, especially in generation. They currently exist in all markets in one form or other. To the extent these caps benefit consumers through artificially low prices they will, at a later stage, lead to supply shortages.

Second, COAG agreed to introduce 'smart' meters from 2007. These will allow higher prices to be charged at times of peak demand. Currently, over 3,000 megawatts of capacity across the National Electricity Market (NEM) is required for less than 1 per cent of the time. This 'peakiness' imposes a large cost on all consumers and could be significantly smoothed if consumers were to be given price signals concerning when consumption is placing the strongest demand on the system.

In addition, COAG endorsed the MCE decision that the Australian Energy Regulator will take over the regulation of all transmission and distribution for electricity and gas. This is also a major step forward in streamlining regulatory and other approval processes for new energy investment.

Further, the MCE has established an expert panel to consider new pricing principles for distribution and transmission regulation. While its objectives are currently unclear, such a review needs to achieve at least two things:

- + incentives that better balance the current focus on cost reduction with an emphasis on network performance; and
- + clear moves towards the benchmarking of performance against other entities to eventually replace the intrusive line-by-line capital expenditure and operational expenditure checking of each entity that currently occurs.

Perhaps of most significance for the future is the establishment of a high-level COAG Energy Reform Implementation Group to report to COAG before the end of 2006 on:

- + achieving a fully national transmission grid;
- + measures to ensure effective financial markets; and
- + measures to address structural issues.

All three areas are fundamental to a well-performing energy market. The first two are linked in that effective financial market measures can signal the need for additional transmission capacity more effectively than the current regulatory framework. The third measure may address the issues related to Government ownership of retail and generation assets in both NSW and Queensland.

Overall, the recent COAG announcements in relation to electricity closely reflect the BCA's priorities. This is seen in Exhibit 9 overleaf.

EXHIBIT 9: RATING COAG ON ELECTRICITY

BCA ISSUES	COAG RESPONSE
1 GENERATION	
+ Retail price caps dampen investment signals.	✓
+ Poor greenhouse policies create uncertainty/distortions.	?
2 TRANSMISSION	
+ The current regulatory transmission approval process seems flawed.	+
+ Regions are State-based and do not reflect market needs.	?
3 DISTRIBUTION	
+ Regulation is undertaken by many bodies, is too costly, and favours cost reduction over service standards.	+ ?
4 RETAIL	
+ Most consumers do not face price signals to curb peak demand growth.	✓
+ Inter-region trading is limited.	×

✓ positive decision + positive review ? progress unclear × no progress, or concern at direction

COAG has also established a high-level Climate Change Group to oversee implementation of a new national Climate Change Plan of Action. Exhibit 10 summarises the key COAG decisions on climate change.

EXHIBIT 10: COAG AGREEMENTS ON CLIMATE CHANGE

KEY DECISIONS	COMMENT
<ul style="list-style-type: none"> + Seek greater collaboration between jurisdictions in areas where there is common agreement. + Adoption of national Climate Change Plan of Action. + National climate change adaptation framework to be developed. + Recognition of the proliferation of programs and approaches across jurisdictions. + Accelerated development of low-emission technologies and renewables. 	<ul style="list-style-type: none"> + Extensive section in Communiqué. + Reflects a collaborative approach across jurisdictions in some key areas. + Challenge is to ensure these decisions develop nationally consistent policies that do not discourage investment.

This commitment to collaborate across jurisdictions is an important step to ensuring national policy consistency on these matters. A key outcome of this renewed focus on collaboration should be the development of a policy environment supportive of investment in the necessary energy infrastructure.

A policy environment supportive of investment in necessary energy infrastructure is important.

+

The challenge for COAG in addressing transport reform is to ensure the many reviews announced lead to effective and timely outcomes.

+

TRANSPORT

The COAG announcements on transport provide a framework to address many of the key transport issues identified by the BCA. Exhibit 11 provides a summary of the key decisions.

EXHIBIT 11: COAG AGREEMENTS ON TRANSPORT

COAG DECISION	ALIGNMENT WITH BCA
+ Productivity Commission review to advise on efficient/neutral road and rail pricing including mass distance charging, and to identify other regulatory/access constraints.	+
+ Governments agree to harmonise road and rail regulations within five years to align standards that allow access to the national network.	✓
+ Improve national transport planning through: + common guidelines for road and rail investment appraisal; and + completion of all 24 corridor strategies under AusLink by mid-2007.	+
+ Commonwealth–State review into causes of and options for managing urban congestion on national corridors and the local networks they interact with.	+

✓ positive decision + positive review ? progress unclear × no progress, or concern at direction

The Productivity Commission review to advise on efficient and neutral road and rail pricing including mass distance charging, and to identify other constraints, deals directly with the BCA’s concerns in this important area.

The decision to harmonise road and rail regulation should provide a renewed impetus to complete this much-delayed work. The aims are to ensure common higher mass limits for trucks and to tackle the multiplicity of regulations governing rail.

The next measure seeks to align Commonwealth and State transport planning by ensuring one set of corridor strategies. These will hopefully focus attention on problem areas and avoid the

cost-shifting of the past. The BCA looks forward to the progressive release of these strategies as a matter of priority as they are a critical input into investment decisions.

Last, and of considerable significance, is the agreement to review the causes of and solutions to urban road congestion. Treating this as a national issue, with joint Commonwealth and State focus, is extremely welcome.

The challenge for COAG in the transport policy area is to ensure the impetus is maintained and the outcomes of the announced reviews are considered and implemented in a timely manner.

WATER

In the announcements on 10 February COAG did not address either rural or urban water issues. Apparently it felt the 2004 National Water Initiative (NWI) was sufficient.

While the NWI was a welcome step when first announced, it can also be seen as a continuation of the past lack of clear reform urgency in relation to rural water issues. Exhibit 12 provides an overall perspective on these issues.

EXHIBIT 12: THE NEED FOR MORE FOCUS BY COAG ON RURAL WATER

- + The mid-2004 National Water Initiative (NWI) sought permanent water trading in a national water market.
- + But progress is slow; States are moving at different rates on key issues, for example:
 - + key platforms for water accounting, creation or property rights, separation of land/water/channels;
 - + adjustments for over-allocations to create reliable common products; and
 - + removal of rules and exit fees that limit trading.
- + Some timetables are not clear for key steps or are too far out.
- + Payments under the NWI are not conditional on the key steps needed.
- + Consequently:
 - + we are missing some key targets;
 - + there are few permanent trades;
 - + there are few trades between systems and interstate; and
 - + the more we progress, the more barriers we seem to find.

What seems apparent is that, while significant progress has been made in allowing the temporary trading of water within water systems, there has been insufficient progress on the key supporting systems necessary for wider and more permanent water trading. This goes to issues such as the creation of property rights; water accounting; and the separation of water from land and delivery assets.

There has also been insufficient progress on adjusting for over-allocation to create highly reliable water products. These are important to support high-value crops.

Unfortunately, much of the NWI focus appears to be on spending for particular projects rather than on removing impediments to trading and creating the platform for trading in the future. Spending is required on metering and water accounting, for example, as well as more conventional projects.

In addition, the release of funding is not conditional on clear progress in relation to water trading. Overall, rural water issues would benefit from regular COAG focus and clear, stretching and transparent targets.

The issues in relation to urban water are just as pressing, but they were not a significant part of the NWI. Exhibit 13 summarises the matters that remain outstanding but which have a major impact on investment and economic growth.

EXHIBIT 13: THE NEED FOR MORE FOCUS BY COAG ON URBAN WATER

- + Little mention of this in mid-2004 NWI.
- + Poor urban water planning/focus e.g. recent NSW desalination and recycling debates.
- + Limited rural/urban trading encouraged.
- + Prices do not reflect next likely supply sources e.g. recycling, rural trades, more dams/groundwater use, desalination.
- + Little focus on industrial water standards to increase options (i.e. need for potable water).
- + Little focus on rules for access to water infrastructure to allow larger private role.

The key concern is a lack of planning. This is best illustrated with the recent review of the NSW desalination project and water recycling debates. The NSW Government has not significantly added to the available water supplies in recent decades as Sydney's population has steadily increased. Faced with a cyclical shortage, it ruled out more dams, or raising the height of existing ones, and opted for desalination. In the face of public opposition to desalination, it was abandoned. It then opted to tap known groundwater supplies. It is still unclear where these issues will settle.

What is clear is that basic, long-term water planning has not been embraced. What is needed is not only better planning, but also some other steps that will help decision-making. These steps need COAG backing to help all Governments address these difficult issues such as:

- + More rural/urban water trading is needed.
- + Urban water prices need to rise to reflect the cost of the next likely supply sources.
- + Industrial water standards need to be reviewed to determine whether non-potable water will suffice in more circumstances.

Rules need to be established to allow access to water infrastructure to allow a larger private sector role in water provision. Competition is always a useful stimulant.

PART 3

The Clock Is Ticking

While the COAG announcements represent clear progress, in many ways they only start the process of infrastructure reform. This point is clearly illustrated in Exhibit 14.

COAG starts the third wave of reform.

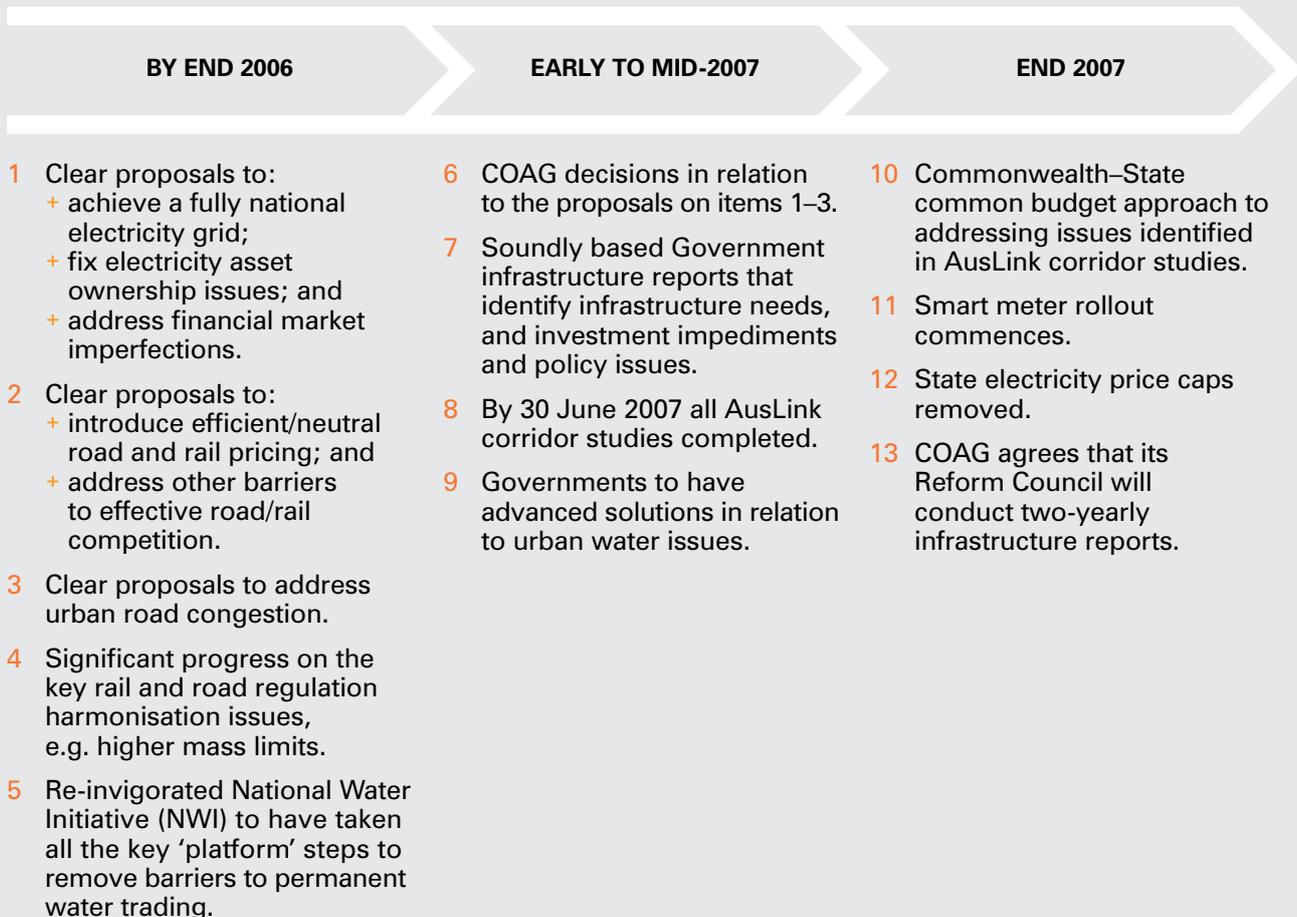
EXHIBIT 14: STARTING THE THIRD WAVE OF REFORM

- + Some unclear governance:
 - + what will be the role and status of the COAG Reform Council and financial incentives?
- + Some long timeframes:
 - + harmonise road and rail regulation within five years (this effort started in the mid-1990s)
- + Many conditions/unclear outcomes:
 - + smart meters and price cap removal announcements are subject to further study; and
 - + transport corridor strategies need to be backed by clear Commonwealth–State budget alignment.
- + Most announcements were to commence a review:
 - + will the electricity reviews in relation to transmission, regions, effective financial markets, structural issues lead to change when previous reviews have not?
 - + will the transport reviews into efficient/neutral road and rail pricing, mass distance charging and urban congestion result in significant change?
- + Key omission:
 - + nothing to re-invigorate progress in relation to water issues.

COAG MILESTONES

There is much work to be done and many milestones to be met. These milestones will be closely monitored by everyone with an interest in the debate, including the BCA. Exhibit 15 outlines the key milestones and timelines that will need to be met by COAG in light of its recent decisions.

EXHIBIT 15: KEY MILESTONES TO BE MET



MEASURING INFRASTRUCTURE REFORM

Of much more importance over time, however, is whether Australians experience improved infrastructure outcomes. Decisions can be made, processes can be established and milestones can be met, but they count for little if outcomes are not delivered. If infrastructure reform outcomes continue to be poor then policies and processes must be reconsidered.

The BCA has identified a set of possible key performance indicators in Exhibit 16. An improvement in each of these key indicators is the information COAG should publish to provide the evidence of successful infrastructure reform. Ultimately, Governments cannot sensibly put in place infrastructure policies without providing the public with transparent evidence of progress and policy effectiveness.

EXHIBIT 16: THE OUTCOMES OF SUCCESSFUL INFRASTRUCTURE REFORM – COAG’S CHALLENGE

ELECTRICITY	<ul style="list-style-type: none"> + Urban and rural SAIDI levels (average minutes lost) in each region. + Current and forecast generation reserve margins in each region. + Transmission line congestion incidence and costs (intra- and inter-region) + Degree of interstate financial market trading.
URBAN TRANSPORT	<ul style="list-style-type: none"> + Total level of road congestion costs in each capital city. + Average travel speeds in each capital city (metropolitan area) at peak times. + On-time rail schedule performance at peak times.
INTERCAPITAL FREIGHT	<ul style="list-style-type: none"> + Rail and road travel times between main destinations. + On-time schedule reliability – road and rail. + Extent of rail speed restrictions.
URBAN WATER	<ul style="list-style-type: none"> + Extent of physical water restrictions. + Average dam levels in each capital city. + Current and forecast useage levels as a percentage of sustainable supply. + Extent of system pipe leakage or other wastage.
RURAL WATER	<ul style="list-style-type: none"> + Percentage of rural water surface and groundwater systems under stress. + Extent of water wastage by cause. + Extent of permanent water trading in each main system area. + Irrigation system reliability.

THE ECONOMIC BENEFITS OF INFRASTRUCTURE REFORM

As the BCA outlined in its Infrastructure Action Plan, the benefits from addressing Australia's infrastructure problems are substantial. These have been estimated at \$16 billion per annum, or a 2 per cent boost to GDP once the infrastructure reforms are implemented. This is shown in Exhibit 17.

EXHIBIT 17: BENEFITS FROM INFRASTRUCTURE REFORM

PROPOSED CHANGES	POSSIBLE BOOST TO GDP FROM REFORMS
+ Remove the many impediments to energy investment and efficiency.	+ 0.41%
+ Introduce congestion pricing, improve/boost urban public transport and transport planning.	+ 0.38%
+ Coordinate interstate corridor planning; ensure neutrality between road and rail freight; harmonise regulation.	+ 0.3%
+ Improve urban water planning; let prices encourage the necessary investment and demand management.	+ 0.35%
+ Introduce effective and transparent water trading, and make appropriate allowances for environmental flows.	+ 0.5%
+ Comprehensive infrastructure agenda	+ ~2.0%
	Boost to GDP of \$16 billion per annum

With these benefits at stake, it is clear that we cannot delay the implementation of the solutions agreed to at COAG, or leave issues unresolved, especially major water reform.

Each year's delay costs Australia at least \$10 billion in net present value.² This is based on the \$16 billion in gains building up over 5 years compared to this timetable being pushed out a year. In addition to these direct benefits, of course, there are the dynamic benefits from an invigorated economy versus one accustomed to procrastination and delay.

The choice is in our hands.

² The benefit of reform is estimated at 2 per cent of GDP or AU\$16 billion per annum. Assuming the \$16b is achieved in equal increments of \$3.2b over 5 years then delaying the reforms by one year means that the first year's \$3.2b is not achieved, and in each subsequent year for five years there is a delay of \$3.2b until the reform benefit is achieved. Applying a 10% discount rate on the \$3.2b, and assuming the reform implementation will be weighted more to the end of the five-year period, the cost of delay will be at least \$10b.

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processes can be established
and milestones can be met,
but they count for little if
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+

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