Business Council of Australia

Submission to the Productivity Commission Draft Report on Public Infrastructure

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The Business Council of Australia (BCA) brings together the chief executives of more than 100 of Australia's leading companies, whose vision is for Australia to be the best place in the world in which to live, learn, work and do business.

About this submission

This submission is the BCA's response to the Productivity Commission's draft report into public infrastructure, released on 13 March 2014.

Key points

- The commission's report is an opportunity to once and for all get Australia's thinking right about the set of policies needed to ensure infrastructure provision meets the needs of our economy and communities.
- There are no single bullets and no quick fixes, as highlighted by the commission's draft report. For too long the policy debate has been about looking for a magic solution to infrastructure provision. It will take good policy settings across the board, coupled with the hard work of planning and developing infrastructure projects and seeing them through to delivery, that will make the difference.
- The money is there to invest in projects so long as we have well-developed project pipelines, efficient project approvals processes and well-designed procurement practices that facilitate private investment.
- The main focus in the report is on public infrastructure but there should also be greater recognition that the private sector is already investing in many of Australia's infrastructure sectors. A key message of the report should be that the private sector should be called upon to do even more of the 'heavy lifting' in infrastructure provision in future through supportive policy settings.
- The implication in some sections of the report is that the key problem is one of excessive investment in infrastructure. That's generally not the view of business or the customers of infrastructure services, particularly when they experience congestion, declining service quality or higher costs from deficient infrastructure provision.
- In the absence of a comprehensive infrastructure audit there will continue to be debate on the existence and size of a national infrastructure deficit. This makes Infrastructure Australia's current audit task all the more important, a point that should be recognised in the report.
- There is little argument that Australia's growing economy and population will require significant new and upgraded infrastructure in the future. This report should recognise the extent of the future challenges and help policymakers decide the best ways to grow infrastructure capacity to meet those needs. The BCA in 2013 projected that infrastructure spending would remain above 4 per cent of GDP per annum over the next 10 years.
- The report is an opportunity to argue for the use of standards that can improve infrastructure decision making and increase accountability on three levels:
  - infrastructure service standards (e.g. targets for commuting times on major roads)
  - infrastructure procurement standards (e.g. timeframes, processes and documentation)
  - infrastructure performance standards (e.g. monitoring service quality and financial outcomes).
- The final report needs to come to some hard landings on the funding and financing tools that governments should utilise for infrastructure, as this was a key reason for the commissioning of the study.
- In the discussion on project costs, more emphasis is required on policies to lift project efficiency by improving workplace relations and approvals processes. The commission's recent study into major project development approvals processes needs to be better reflected in this report.

Key recommendations

- The BCA agrees with most of the commission's draft findings and recommendations and makes these suggestions for amendments:
  - Draft recommendation 7.1, in listing a number of areas requiring good governance for the provision and delivery of public infrastructure, should go further and:
    - describe the characteristics of good governance in each of these areas
    - add to the list a recommendation that infrastructure projects should be linked to a long-term strategic growth plan for a metropolitan or regional area.
  - Draft recommendation 2.1 makes a welcome and strong statement in support of ports and electricity privatisations. It should go further and set out the conditions under which government-held assets can be privatised in other economic infrastructure sectors like water provision, communications provision and road and rail transport.
- We think the report could go further in some areas:
  - The report should better acknowledge the role the private sector is playing in delivering infrastructure that has both public and private applications.
  - The report should discuss Australia's future infrastructure needs in the context of growth in the economy and population and ensure its findings are designed to increase the scale and quality of Australia's infrastructure capital stock needed to lift living standards.
  - There should be more attention given to policies that grow private investment. This can be through:
    - the development of regulated infrastructure markets that enable more private investment instead of direct provision by governments, while safeguarding the interests of consumers
    - governments designing public infrastructure investments for investment by the private sector
    - an explicit recommendation in support of unsolicited proposals processes.
  - As well as highlighting cases of poorly directed investment, the report should also explore why some good projects do not proceed due to bureaucratic delay or because of local opposition – meaning the wider community misses out on the benefits.
  - There should be advice on the use of infrastructure standards and measurement of performance against standards to hold governments and infrastructure providers accountable for the quality of infrastructure provided to the community.
  - To implement the road pricing recommendations, the report should recommend ways to bring the community along and appoint champions that can explain and promote the policy.
  - We urge greater support for recycling capital because it provides the community with assurances that funds will go into new and better infrastructure. This should not be inconsistent with the use of rigorous project selection processes that ensure the investments are in projects with high-net economic and social benefits.
  - A recommendation should be made to better align local government spending with national and state strategic infrastructure plans.
  - The report should include a section on the importance of making more efficient use of existing infrastructure assets by reviewing regulatory barriers to efficient use and considering options for better using existing infrastructure when considering new infrastructure investments.
  - To deal with skills shortages on infrastructure projects, there should be a recommendation to remove unnecessary regulatory burdens on the 457 visa scheme (e.g. labour-market testing).

Detailed comments on the draft report

Australia's future growth demands more recognition in the report

The report should start with the view that there is not enough investment in infrastructure in Australia. There is a need for a greater acknowledgement of Australia's future economic and population growth and the implications for the quantity and quality of infrastructure provision.

The findings and recommendations should ideally be framed in the terms of the policies needed to increase the nation's infrastructure capital stock in line with the economic and population growth anticipated over the next 40 years and beyond, so that living standards can continue to increase. Based on modelling by Deloitte Access Economics, the BCA projects that in the decade ahead, infrastructure spending will be above 4 per cent of GDP, totalling over $760 billion in real terms.

There will be increasing demand for infrastructure due to our population rising to close to 40 million by mid-century, a doubling of freight and passenger traffic, rapid take-up and technological development in the communications sector and significant growth in demand for water and energy requiring new generation facilities and transmission networks.

The infrastructure policy recommendations need to help Australia make better judgements about how we will ensure both the level of investment and the efficiency of investment required to meet our needs in the future.

A related issue that does need to be considered is the looming investment gap due to the decline in resources investment in Australia. The International Monetary Fund has lowered its projections for growth in Australia from 2.8 per cent to 2.6 per cent in 2014 and from 3.0 per cent to 2.7 per cent in 2015. Unemployment is forecast to remain at over 6 per cent. In 2013, the BCA pointed to a projected, cumulative decline in the engineering construction sector of $39 billion over three years and the opportunity to redeploy resources from resources investment into new productivity-enhancing infrastructure projects.

The commission has questioned claims by proponents of an 'infrastructure deficit' in Australia, but has not sought to answer this question itself, which is perhaps a missed opportunity. The report states that "if there is an infrastructure deficit, it is not because of a fall in infrastructure investment" (pp. 49–50). This is taking a very short-term historical view of infrastructure spending. While it is true that recent spending has been relatively high, for many years we experienced much lower levels of spending on infrastructure. Some of the recent spending has allowed us to catch up to compensate for earlier periods of low investment. We should ward against dips in infrastructure spending occurring again.

The commission argues that "additional investment is not always the best solution" (p. 58) and that it is possible to improve utilisation of existing infrastructure. We agree with this assessment in the case where there are regulatory or other barriers to the efficient use of infrastructure that can be removed. However, the commission's consequential argument that "congestion charging for roads in peak periods can reduce congestion by reducing demand" does raise a concern. Actively seeking to "reduce demand" may be a valid policy choice in some circumstances but it is not without significant costs in a growing economy. Purposefully limiting the community's access to services can be particularly harmful to both efficiency and equity and should only be considered once all efficient options to augment supply have been exhausted.

Encouraging governments to implement projects and policy reforms in the national interest

The report makes some strong points about the importance of good project selection processes and illustrates examples of investments that were probably not warranted based on a considered analysis of the costs and benefits.

However, the commission should also recognise that there is a flipside that many good and needed projects have not been delivered. This may be because of bureaucratic delay, or Australia's governments have directed spending to less productive purposes or they have not been prepared to support projects that face strong opposition from minority interest groups.

This problem of good projects not proceeding should receive more attention in the final report and recommendations should be made to encourage governments to actively support projects that are in the national interest.[1] The same problem applies to difficult policy reforms. For example, the road pricing reforms in the report will require governments to make the effort to engage with the community to explain the long-term benefits of a new approach and address concerns.

It is recommended that the final report include recommendations to help governments to address political and other barriers to delivering needed projects and policy reforms by:

- concentrating on the positive case for the wider community of getting infrastructure delivery and operation models right
- emphasising that political leadership will be imperative to implementing good infrastructure projects as well as the infrastructure reforms that the commission says are needed in its report
- setting out a clear and simple narrative for politicians to use to make the case for infrastructure projects and policy reforms that are in the national interest.

Shift to private investment in public infrastructure

The report should recommend policies that can grow private investment in infrastructure. As the report acknowledges, private investment can deliver better capital efficiency and reduce the pressure on stressed government budgets.[2] But the policy frameworks need to be in place to enable this to happen.

It should do this first by advocating for the development of market-based infrastructure policy frameworks that can enable a shift from public to private investment over time. Recommendations should be made to develop regulatory frameworks so that governments can privatise their infrastructure businesses while ensuring consumer interests are also safeguarded. Draft Recommendation 2.1 makes a welcome and strong statement in support of ports and electricity privatisations. It should also say more about the regulatory frameworks that are needed so that government-held assets can be privatised in other economic infrastructure sectors like in water provision, communications provision and road and rail transport.

The other way private investment should be encouraged is by designing all public infrastructure projects for private investment. There should also be an explicit recommendation in support of governments developing unsolicited proposals processes to grow opportunities for private businesses to recommend worthy investments in infrastructure that are typically provided by governments, such as major road projects.

One of the reasons given for government involvement in infrastructure – “for equity reasons”(p. 53) – is questionable. Equitable access to infrastructure can be achieved through other means including through a community service obligation payment. The commission says later in the report that it has itself advised the use of community service obligation payments to fund non-commercial functions undertaken by government trading enterprises (p. 86). The same arrangements can be put in place for access to privately provided infrastructure.

Infrastructure standards and accountability

The use of standards is worthy of more detailed advice in the final report. Better use of standards on a number of levels would help to strengthen accountability of governments and infrastructure providers and lift overall infrastructure performance.

1. It should be added to the list of ‘shortcomings’ of government project selection on p. 81.
2. On p. 86 the report says that where assets are publicly owned “the incentives for efficiency not being as strong as for private firms, and in general capital is not as efficiently deployed”. On p. 53 it states: “It is important that governments recognise the role of the private sector in the provision of such infrastructure and not discourage or crowd it out”.

Standards can be set on a number of levels:

- Standards for the infrastructure services that the community and the economy needs. For example, for transport services by establishing acceptable travel times in urban environments, or the time taken for trucks to travel to/from a port. Establishing these service standards can set benchmarks by which to compare projects and indentify projects of greatest need.
- Standards for project procurement. For example, standards for defining the outcome required:
  - the process for calling for an expression of interest
  - timeframes for setting a shortlist of qualified providers (e.g. three months) and then call for binding tenders (e.g. six months)
  - the process for getting to a best and final offer, where necessary. The final report should spell out in detail how these standards should be defined.
- Standards to establish the criteria and processes against which the infrastructure project will be judged once it is operating; for example, the quality of service, access arrangements for the facility or ongoing price setting regulation and cost of capital where there is economic regulation of the asset.

The commission's report does make reference to the use of standards in two areas, both of which would benefit from more detailed advice on how standards should be set or used and what constitutes best practice:

- The report says that good governance arrangements should include "clear and transparent public infrastructure service standards" (p. 16).
- The report says the Australian Government should require state and territory governments to agree to standards "relating to major project procurement and risk assessment" in return for funding (p. 262).

Project pipeline

The commission has stopped short of recommending the publication of a project pipeline. Instead it argues that the package of reforms in the report should be sufficient to define an effective ongoing pipeline of work.

It is agreed that the key emphasis should be on the outcome – which is the rolling provision of high-quality projects for the private sector to invest in and deliver efficiently on behalf of the community.

We would argue that there remains merit in publishing a rolling pipeline to provide industry with the certainty to invest and as a better way to ensure continuity of investment plans across the political cycle.

Information Request 7.1 of the report asks whether private companies should provide information about their own projects to the published pipeline of projects (p. 233). The BCA has previously highlighted that the government's national infrastructure construction schedule pipeline does not collect information about private projects. Our reason for doing so is to highlight the gap in governments' understanding of system-wide infrastructure investment and how this should inform policy development in a range of areas relevant to infrastructure project delivery (i.e. workforce development policy, projects approvals systems, decisions about where to prioritise public infrastructure provision). Presently, government collects information on public and private investments on resources projects for its six-monthly publication of the Bureau of Resources and Energy Economics project list. We have sought to highlight that it might be useful for governments to avail themselves of the full set of information on infrastructure projects.

National Infrastructure Fund

The commission says that "at this stage the commission is not convinced of the desirability of a national infrastructure fund" but that it will "review the evidence on such funds and outline its views in the final report"(pp. 259–60).

There are several reasons to consider a fund approach at both the federal or state levels of government. A regular annual budget allocation into a dedicated fund can help to assure the community and industry that there will be a certain amount of funding each year on infrastructure, made through smoothed payments over time. As a consequence, there are potential efficiency gains from industry being able to manage an even workforce compared to a boom and bust pattern, and these efficiencies can flow through to lower project costs. Capital raised from asset sales can be deposited in a fund in order to be hypothecated at some future date to new infrastructure build. A fund can be established with rules to ensure that spending is only provided for projects that are of high merit, in particular by being linked to a strategic economic plan and which have passed a robust and transparent cost–benefit analysis.

Given the commission's concern for project selection, it might reconsider the merits of the use of a infrastructure fund with rules as a way to achieve more efficient spending. A dedicated infrastructure fund could be set up under the rules that the commission seeks to impose on fund recipients at the state government level in Recommendation 7.3.

Recognition of the benefits of vertical integration

In the commission's report (pp. 84–85) there is a discussion about vertical integration in infrastructure provision that highlights the potential for anti-competitive behaviour. The report should also acknowledge the potential benefits from vertical integration for innovation and efficiency and which need to be balanced against competition concerns when making policy decisions that affect market structure.

Cost basis for pricing infrastructure services

There is a discussion about the different cost bases for pricing infrastructure with economies of scale (pp. 124–125), but no conclusions are drawn. To benefit the debate, the commission should make findings about which basis is best to apply and under which circumstances.

Road pricing recommendations

The report's strong focus on new models of road pricing highlights that market-based reforms in the road transport sector significantly lag behind other infrastructure sectors and should be prioritised.

The BCA supports the commission's approach to reform of road pricing. The recent report by Infrastructure Partnerships Australia and automobile clubs also demonstrates wide support between road providers and road users for this type of reform.

There also needs to be a renewed effort to complete and implement the Heavy Vehicle Charging and Investment reforms at the Council of Australian Governments. As mentioned above, to implement road pricing reforms, governments will need to successfully deal with the challenges of designing new policies well and bringing the community along.

Australian Government role in funding infrastructure

On p. 153 there is a comment that the "Australian Government therefore has a critical role in providing efficient sources of government funding for infrastructure". This is a threshold policy issue that should be made a formal finding of the commission's review.

Recycling capital

There is some ambiguity in the commission's views on recycling capital that will be important to clarify in the final report given that federal and state governments are discussing this model at COAG.

The report says that "on balance the commission considers that decisions to privatise government-owned assets and invest in new infrastructure should be separate. There may be merit if there are genuine public benefits in linking a particular sale and purchase, but it should not be normal practice" (p. 210).

We support the concept of recycling capital as it provides the community with assurances that funds released from asset sales will go into new and better infrastructure. It is also a significant source of new infrastructure funding at a time when government budgets are stressed and it avoids the need to increase debt.

We agree that the reinvestment in new infrastructure should be subject to good practice rules of project selection, so that they are linked to a strategic plan and have been prioritised according to a rigorous and transparent cost–benefit analysis.

If the final report maintains the argument that the proceeds of privatisation should not necessarily be recycled into new infrastructure projects, it will be important to demonstrate other practical approaches to meet the needs of the economy and the community for new and better infrastructure.

More efficient use of existing assets

The final report should argue that infrastructure project selection processes, discussed in Chapter 2, should always require consideration of whether there are alternative, less costly ways to grow infrastructure capacity by making better use of existing assets (e.g. through the removal of regulatory barriers to the efficient use of the asset) or by making incremental investments that lift capacity (e.g. by improving access links to major gateway infrastructure).

As a broader level, governments should regularly review regulations to ensure they do not unnecessarily impede the efficient use of infrastructure assets. The final report should highlight the key regulatory changes needed to increase the productive capacity and use of existing infrastructure assets.

Smaller projects and local governments

The commission should make a recommendation on how to create incentives to better align local government project priorities with state and national infrastructure priorities, for instance through the terms of intergovernmental funding agreements.

Project costs

The BCA is encouraged by Recommendation 8.2, which encourages governments to "fund the development an ongoing implementation of a detailed benchmarking framework for major infrastructure projects in Australia." This reinforces what the BCA has been saying for some time: that we need much better data about infrastructure costs and benefits so we can more effectively plan for and deliver the infrastructure we need.

The aim of the discussion on project costs should be to once and for all spell out what needs to be done to put in place policies to improve the efficiency of capital project delivery, for example through better:

- planning approvals – the recommendations in the commission's recent study on major project approvals processes should be brought into this report
- workplace relations – the recommendations in the draft report should include recommendations on how the workplace relations system can support higher productivity.

If we can get a better handle on the drivers of project input costs and address them through improved policy settings, we can get better value for money and lift productivity in the construction sector and across the wider economy.

The BCA has recently undertaken its own work in recent times on the growing costs of major capital projects and the underlying drivers of costs. There are two references to this work in the commission's draft report that invite a response.

First, the commission (p. 305) refers to the BCA when citing 'recent claims of extremely large cost differentials.' Our analysis sought to bring to light the best available evidence on cost differences between Australian and international projects in order to generate a discussion about policies needed to manage cost pressures. While acknowledging limitations with data and methodology, we concluded that this data showed Australia is higher cost for undertaking capital investment. We did not describe the cost differences as "extremely large" as described in the draft report, a description which suggests exaggeration. We also note the commission itself has been unable to assess the extent of inter-country cost differences and says that more work needs to be done.

Secondly, on p. 386 a case study is reprinted from a BCA 2013 report on the costs of the Brisbane Airport Link. The case study makes the point that higher amenity and safety standards over time have contributed to higher project costs. The commission then says that the BCA case study "ignores" any potential benefits from the new requirements and the community's willingness to pay. This is not an accurate representation, as the very next paragraph in the BCA report acknowledges just that point about the need to weigh costs and benefits:

> High standards for safety and amenity are unquestionably required in Australia, however, there may be merit in governments working with contractors to adopt a more judicious approach to identifying if the marginal benefits of adopting a higher standard outweigh the costs, which at times can be significant.
> *Securing Investment in Australia's Future: Report of the BCA Project Costs Task Force*, p. 34.

Workforce skills

The commission is right to highlight the "intermittent nature" of infrastructure construction as a factor driving skills shortages at times of high activity. In particular, these shortages are acutely felt in highly skilled professions such as the engineering profession.

The chapter, however, does not go on to make any formal findings or recommendations.

Broadly, in our view, the long-term response to dealing with dealing with workforce development requires actions to lift workforce participation, invest in skills training and retraining, enhance labour mobility and, critically, support temporary and permanent migration. Recommendations in these areas would be useful.

On migration, the commission should recommend the removal of regulatory restrictions on the use of 457 visas imposed since early 2013 that were not subjected to a proper Regulatory Impact Statement process. These include:

- the reintroduction of labour-market testing
- requirements including to confirm that a job position is a genuine vacancy in the business
- strengthening English language requirements
- clarifying the training requirements of employers.

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