Address to the Australian Automobile Association*

Peter Harris
Chairman, Productivity Commission

I'd like to thank the AAA for the opportunity to speak today.

It's an opportune coincidence that the Productivity Commission is out in the market with ideas for reform of key infrastructure at the same time as this conference.

Our draft report on infrastructure has four central themes:

- better process
- better institutions
- better pricing
- greater efficiency.

They don't sound too surprising for a Commission report.

As often is the case, there is controversy in the detail.

Process

We like good process at the Commission. Process that is efficient, effective, transparent and credible.

My predecessor Gary Banks said only last year in the Stan Kelly lecture:

> Nevertheless, recent history tells us that good process and the discipline it provides — on rent-seeking and on policy-making generally — cannot be taken for granted.

And so it is in infrastructure.

*Address to the Australian Automobile Association Policy Forum *Infrastructure Solutions for the 21st Century* in Canberra on 25 March 2014.

We have found – possibly to no one's great surprise – that infrastructure project identification, development, selection, and design is regularly not done well in Australia.

Moreover, this process is increasingly the subject of pressures to find and fund iconic 'ribbon-cutting' projects, at times with dubious returns to the community.

This is reinforced by the seductive appeal to our political leaders of closing an infrastructure gap, though such a gap is not easy to define or measure beyond lists – well-intentioned lists, no doubt, but nevertheless not robust project assessments of the kind our draft Report advocates.

The appeal of lists has in turn created an intense focus on how to find the money to fund more infrastructure.

Together, these trends are likely to weaken the quality of infrastructure investment in Australia if not addressed. Our draft report attempts a comprehensive response to them. across all major economic infrastructure.

Nothing said in our draft Report is meant to discourage governments from taking a more active role in seeking to provide better infrastructure. The case for providing new infrastructure investment in response to consumer willingness to pay is not in question.

Even institutions often not seen in this debate such as the Reserve Bank have supported the idea that governments might focus more effectively on infrastructure investment.

But that is a little different to simply calling for an immediate increase in investment in infrastructure. Such calls can come at the cost of two vital considerations:

- whether we ***must*** indeed invest, rather than adapt or substitute efficiency choices
- and if we must invest, what is the full ***range*** of choices we have to invest in?

The caution in our draft report arises because, on the basis of the evidence in front of us, we strongly doubt the capacity of current processes to identify consistently the projects that might most benefit society.

A comprehensive restructure of the infrastructure processes – by States and by the Commonwealth – designed to meet a set of standards for quality in project identification, assessment and selection, would consequently seem to be advisable before we embark on the desirable course of improving infrastructure.

This need not take long to put in place. It will not delay major projects.

It will require the regular and routine publication of those assessments, early enough and with enough substance so that both private sector investors – superannuation funds, private equity, financial institutions – and the general public can assess what is being proposed and how they are expected to participate.

This model would attempt to demonstrate succinctly to the public what costs may be imposed on them, as well as what benefits may be gained.

Thus a hypothetical electricity reliability upgrade that was forecast to increase in system reliability by 1 per cent, in return for a $100 increase in annual bills, would be published before the project was endorsed.

And another hypothetical guarantee of water via desalination in the event of a major drought, in return for another $100 increase in annual bills would also be published before the project was endorsed.

Similarly for broadband, or for toll roads or other land transport projects.

Looking back, it is not too difficult to imagine the benefit of such an improvement in process. The wisdom of hindsight can surely help us frame our future plans better.

Some – not all – State jurisdictions and government enterprises already have the capability of doing many of the things we see as necessary improvements, but lack the obligation to do so.

The question is thus not so much about capability. It is also about consistent behaviour and a commitment to upgrade process if indeed private finance is to be attracted to supplement public funding in a way that yields value for money to the whole community.

The Commonwealth itself can also improve.

As primarily a funder of infrastructure, it could adopt the same standards and insist on observing them within its own processes, plus wherever it funded others to undertake projects. And it could apply this as well wherever it was faced with the need to act as approver, on regulatory grounds – for example, in electricity.

An agreement on those standards and tight commitment by all jurisdictions to them over time will improve not just the quality of project selection and development but also address one other matter dear to the hearts of many amongst the 109 submissions we received: how to get a pipeline of projects?

Our current view is that a pipeline will emerge and evolve naturally as a consequence of these proposed improvements to public infrastructure investment process, and in particular, the continuous – ultimately routine – publication of high quality project assessments.

This approach is quite different from that envisaged by some submitters to our inquiry, who have argued that a pipeline should not only exist, but be managed by a party or parties to ensure better project flow.

Those submitters were keen to use a pipeline to improve workforce planning; and take pressure off peaks in demand for infrastructure investment, as is evident in some of our work on costs.

The evidence shows some clear peaks in demand, and cost rises at these junctures have certainly contributed to the expensive nature of some infrastructure investment in Australia.

However, the Commission has not been able to identify how such a pipeline may be managed to achieve these objectives.

There is a natural instinct from most submitters to favour the use of a high-profile body, such as Infrastructure Australia.

However, the demand pressures that lift infrastructure costs and skill shortages appear to come from the combination of public investment and private investment.

Infrastructure Australia would have at best limited capacity to influence the timing or co-ordination of private sector infrastructure, including say LNG plants.

We may thus have to accept that while some co-ordination amongst public investors is potentially possible, a complete management of a pipeline of investment competing for limited skills and construction resources may not be practical; or indeed even wise.

In our hearings, we hope to hear more from submitters on this subject.

Institutions

The mention of Infrastructure Australia is quite important in another respect — namely the importance of institutions.

The identification of a party that can carry forward responsibility for reporting publicly on performance under the system we envisage is not optional. It is essential.

Our chief reform weapon in improving process is publication.

The chief factor in creating a pipeline is publication.

We need an institution capable of doing this, persistently, fearlessly.

Such a party must necessarily have close engagement with the States and Territories. States and Territories will in future, despite any improved involvement of private financing, still have responsibility for more infrastructure investment than the Commonwealth.

Local government, too, will be relevant – to freight corridors, as an example. States will have to help them.

Thus generally speaking, States will be the source for much of the material vital to a long-term improvement in retention, publication, evaluation and analysis of cost-benefit; and the use of benchmarking across the wide variety of infrastructure projects which we envisage as being covered by these reforms.

Some private owners of key public infrastructure — airports, ports, electricity, rail — should also be contributors to such a system. Co-operation with them too will be essential.

As we are reporting in late May, at a time when the current legislation covering Infrastructure Australia could still be in contention, our final report will need to look closely at what progress has been made in clarifying its future role.

Pricing

Let me now turn to pricing, the third of the four primary themes of the draft report.

The draft report proposes that governments take active steps to improve the use of prices that create a direct link between the infrastructure being provided and the users of that infrastructure.

Put that way, it sounds simple; and sensible.

But we know at a forum such as this how complex such reform is.

Our desire to recommend something that is complex is not driven by perversity.

If simple options, tax rises for example, were indeed simpler and just as efficient, we would not resile from them.

But taxes generally do not improve the allocation of resources, while market prices generally do. Thus the improvement in selecting projects that is likely when people are made aware what they are likely to have to pay for an asset and what they can expect in return is a sound mechanism to improve allocation of resources.

In addition, pricing offers a means to improve the use of private financing options – including superannuation funds as investors, to take an example that has been actively raised with us – because prices would create revenue streams that are clearly available for a wider variety of assets than under current arrangements.

Today, there is no real controversy over ensuring greater clarity in directly pricing the use of water assets or electricity assets or rail assets.

There is however controversy over considering how the concept could apply to roads, even though some toll roads (on the East Coast) are well accepted.

This controversy has ensured that, for a while, this subject is again a matter of public discussion.

We welcome that.

I say 'again a matter of public discussion' because of course it has been raised previously, both by the Productivity Commission and by the Henry Tax Review.

It was also an action proposed last year by the Business Council of Australia in its Action Plan for Enduring Prosperity.

And it was a subject consistently raised by submissions to our inquiry.

Amongst the parties that are supporters in submissions to us of moving in some fashion towards direct road pricing are:

- Roads Australia, a grouping of private and public sector transport businesses and funders;
- the Bus Industry Confederation;
- the Australian Logistics Council, a grouping of large corporate users and suppliers of trucking services, again both public sector and private sector;

- the Heavy Vehicle Charging and Investment Reform initiative, operating under the auspices of the Council of Australian Governments; and
- Infrastructure Partners Australia, a pre-eminent group of infrastructure suppliers.

And of special significance today, the AAA advised of its support for appropriate user charging; and the establishment of a Transport Infrastructure Fund.

Your Submission makes a considered case for, amongst other things: 'the potential for a more direct system of user charging'.

As can be seen from the draft report, we see the same potential as you do.

I am hopeful that, after being raised a number of times in the past decade, the time may have arrived for a mature discussion of this option.

That does not, however, mean its immediate introduction.

The mere availability of technology that has moved this option from the hypothetical to the potential does not make the case for its introduction.

The draft report supports trials of telematics – and the involvement of organisations such as yours– so that those who do not know of the potential can see it in operation.

But, to repeat it, the technology is not sufficient in itself.

As the pre-eminent organisation representing motorists, you more than any other entity can assist governments and the public in the difficult task of stepping through this process.

In considering your participation in the remainder of our inquiry process, we would look to the AAA for a further contribution to the task of lifting public understanding, if we are to make a transition of this kind effective.

The role of institutions (Part 2)

There is another area where the AAA could assist this inquiry process.

One of our key final recommendations in the roads area is likely to cover institutional reform. Put more prosaically, the role of roads authorities, Transport departments and Ministers.

The successful implementation of past reform processes in transport and electricity and water — and other similar infrastructure areas — has been characterised by vesting reform responsibility in an entity with a singular focus on, and capability of, carrying forward the reform agenda.

For example, the National Road Transport Commission, in conjunction with the Australian Trucking Association, was established to pursue heavy vehicle reform.

The Australian Rail Track Corporation was similarly the vehicle for interstate freight rail reform.

Various Commonwealth and State Water Commissions served similar purposes.

And a range of smaller but nevertheless purpose-built reform ‘owners’ operated in other infrastructure areas.

A number of submissions to our inquiry similarly suggested the need for such an entity or entities, in the case of road funding and pricing reform.

Our draft report examines a number of models, built around the concept of a road ‘Fund’.

We see the essential first step as being to initiate reform by establishing a ‘Fund’– or an equivalent set of jurisdiction-based ‘Fund’ entities– as the reform vehicle.

This Fund or Funds would not be like the traditional large bucket of money.

Rather, we are thinking that it might be device which – at least in its initial years – is aimed squarely at improving the allocation of funds to road infrastructure.

It could do so by, amongst other things, creating across the nation the better development and selection processes that I outlined earlier, as applied to roads.

It could also review, along with representatives of governments but as an independent entity, the proposed funding allocation and prioritisations of roads agencies. Representation on its governing body from users (that is, people who currently pay via taxes and registration for roads) has the potential to significantly improve allocation decisions.

Methods could be developed under which the public – your members– were consulted, again publicly, about the proposed allocations.

And with a bottom line in the same succinct form as some hypothetical electricity and water examples I noted above.

Included in that consultation would also be the publication of detailed cost and benefit information.

It has been said that publication of such information has commercial-in-confidence issues. This is sophistry. Having written them myself, I know they need not raise such an issue.

Moreover, governments should be pursuing publication not only to inform their communities –a very worthy but easily ignored objective – but also to indicate their expectations from the market.

The UK now routinely publishes benchmarked expectations of the cost of a kilometre of lane widening or the laying of a new water pipe. It is convinced that it has driven infrastructure costs down via this mechanism. Certainly, prices from contractors have fallen.

These benchmarks are the key base level data for project cost analyses.

Publication of cost:benefit assessments would not only continuously update the basis for benchmarking costs, it would enable one jurisdiction to learn from another.

Post-project evaluations of the costs and benefits could then also routinely be conducted. Today, they are usually absent, in part because we don't have the pre-project cost data.

..

When I referred a few moments ago to representation from users on these Funds, one thought is that they should be drawn from organisations who represent users. Organisations such as yours. And in the heavy vehicle industry. Appointees who by definition are independent of government.

You also have mechanisms for consulting the community.

The improved engagement process could allow drivers (the ultimate stakeholder) to then have a say on the infrastructure option chosen on his or her behalf.

Allocation of funding would go from being a remote *concept* to being quite a clear-cut *process*.

We have noted in the draft report that introducing such an approach is likely to need to be revenue-neutral – that is, no new charges would apply in the phased development of this concept, when the focus is on improved allocation.

And to convince the public of this, the Fund or Funds may need to have arrangements that are akin to hypothecation, a much-loathed term in fiscal circles.

Why would Treasuries, let alone Treasurers, consider the concept– no matter how benign the form?

One answer might be that the future prospect of a reform model that allows pricing to evolve is a better method of meeting needs for more and ever better roads. By comparison, fuel excise continues to fall in real terms and registration charges are equally sensitive.

We do not have hypothecation today. And there is no advocacy in our draft report for it. We merely note the probable need for a convincing form of revenue-neutrality.

But advocates of hypothecation should help the community recognise the growing weakness of the current system.

The combined removal of fuel excise indexation in 2001 and the rise in credits for fuel use for various groups has led to a growing gap between road funding on one hand, and excise revenue on the other.

We estimate that the removal of indexation has forgone around $13.5 billion in revenue between 2001-02 and 2011-12 (in 2011-12 dollar terms) — with annual forgone revenue now around $3 billion a year.

This has occurred despite a 20 per cent increase in total fuel used over the period.

The increased fuel efficiency of vehicles in the future is likely to add to this gap over time.

The new Fund or Funds would thus be aimed at achieving over time two objectives which should be at the heart of fundamental market reforms: improved allocation by direct link with those who are paying for the investments; and improved pricing structures in the face of weakening revenue sources.

Since the draft report's publication, I have been asked whether the alternative is not just to access some more private funding.

But as we indicate in our draft report, even with private funding, in the end either taxpayers pay for infrastructure through taxes, or users (along with other beneficiaries, in some circumstances) will have to do so.

Not for the first time, there is no magic pudding.

Efficiency

The final key theme of our draft report is efficiency.

Pricing reform is of course an efficiency improvement device in its own right, as is process and institutional reform. With these reforms, it is likely that less waste will occur and more funding should flow to areas of highest consumer need.

The remaining efficiency improvements lie in training, in setting occupational health and safety standards, in welcoming the introduction of new technologies, improving industrial relations behaviour in some locations, and in less risk-averse tender processes.

Some of these may seem minor by comparison to pricing, but there is little doubt that they are collectively a major impediment, particularly when seen from the perspective of removing barriers to entry for new competitors in infrastructure supply and construction.

Foreign construction firms, for example, find each of these to be notable factors in trying to enter this market.

And Australia is widely seen as an expensive place to build infrastructure. So we should not discourage competitive entry, even if inadvertently in pursuit of other risk averse outcomes. We expect to have some specific regulatory reform proposals in our final report.

Conclusion

Could I finish by drawing your attention to a key paragraph in the draft report.

We are conscious that our work is being done in an environment where governments are proposing to do more investment in infrastructure.

We feel the walls are moving around us, so to speak.

For that reason, may I finish on this note.

In reform, as in most things, timing is everything.

In the draft report, we say:

> It is possible that governments, having recently articulated a renewed commitment to infrastructure investment, may be called on to expand funding. The Commission advises caution in creating any model – fund, bank, guarantee facility or similar

proposition – prior to reforming the governance arrangements for project selection and delivery.

Thank you.