



Australian Government
Attorney-General's Department

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Attorney-General's Department Submission

Productivity Commission Inquiry into Public Infrastructure

Context

1. Many Australian communities experience repeated disruptions from flood, cyclone and fire events. These events damage both private property and public infrastructure. The growing urbanisation of our coast line and mountain districts near our cities, and economic growth in Northern Australia have combined to increase our exposure to natural disaster risk. Since 2007, natural disasters have claimed more than 200 lives and directly affected hundreds of thousands of Australians. Deloitte Access Economics estimates that the total economic cost of disasters for 2012 alone exceeded \$6 billion. It predicts total economic costs will double by 2030, and will 'rise to an average of \$23 billion per year by 2050, even without any consideration of the potential impact of climate change'¹.
2. Under the Natural Disaster Relief and Recovery Arrangements (NDRRA), the Australian Government will provide over \$12 billion in financial assistance to the states and territories to assist in rebuilding communities damaged by natural disasters that have occurred since 2006. By the end of 2015–16, it is estimated that \$10 billion of this assistance will have been spent on restoring essential public assets—mostly roads. With future events not yet taken into account, there is the potential for significant growth in this expenditure.
3. The risks posed by extreme weather events could be mitigated in part by designing new infrastructure to withstand extreme weather conditions; building protective infrastructure (such as levees); or by building back assets to a disaster-resilient standard, to avoid repeated damage. The benefits associated with investing in disaster mitigation are widely accepted, and include a reduction in loss of life, improved community safety, a reduction in damage to property, speedier recovery, and a reduction in the cost to the national economy. The 2002 Council of Australian Governments Review conservatively estimated that for every dollar invested in flood mitigation, more than two is saved².
4. The issues raised in this submission will likely overlap with issues to be considered in the recently announced Productivity Commission Inquiry into Natural Disaster Funding Arrangements.

¹ Deloitte Access Economics, *Building our nation's resilience to natural disasters*, commissioned by the Australian Business Roundtable for Disaster Resilience and Safer Communities, 2013, p 8.

² Department of Transport and Regional Services, *Natural Disasters in Australia: Reforming mitigation, relief and recovery Arrangements 2002*, prepared on behalf of the Council of Australian Governments High Level Group on the Review of Natural Disaster Relief and Recovery.

Natural Disaster Relief and Recovery Arrangements

5. State and territory governments (states) have primary responsibility for managing disaster recovery within their jurisdictions. The states and territories receive financial support from the Commonwealth via the *Natural Disaster Relief and Recovery Arrangements* (NDRRA).
6. States determine the type and level of relief and recovery assistance following a disaster, and are responsible for delivering the assistance. The types of relief and recovery assistance that may be cost-shared and the criteria are detailed in a ministerial determination (the NDRRA Determination). Based on the states reaching certain thresholds of expenditure, the Commonwealth may reimburse up to 75 per cent of the costs of delivering eligible assistance measures.
7. The NDRRA includes two specific assistance measures that relate to public infrastructure: the restoration or replacement of an essential public asset to its pre-disaster standard³; and the restoration or replacement of an essential public asset to a standard more disaster-resilient than its pre-disaster standard (betterment)⁴. As a general condition of this assistance, the NDRRA requires that a state have reasonably adequate capital or access to capital to fund liabilities or infrastructure losses before being granted access to funds, including through commercial or state insurance or reinsurance (refer section on 'insurance for road assets' below)⁵.

Definition of an essential public asset

8. Since 2012, the NDRRA Determination defines an essential public asset as:⁶

an asset of an eligible undertaking that the state considers and the Commonwealth agrees:

- a) is an integral and necessary part of the state's infrastructure which is associated with health, education, transport, justice or welfare; and
- b) would, if lost or damaged, severely disrupt the normal functioning of a community; and
- c) would, if lost or damaged, be restored or replaced as a matter of urgency.

³ NDRRA Determination, clause 3.3.1(a).

⁴ NDRRA Determination, clause 3.6.6.

⁵ NDRRA Determination, clause 4.5.1.

⁶ NDRRA Determination, clause 3.6.1.

An 'eligible undertaking' is:⁷

- a) a body that:
 - i) is one of the following:
 - ii) a department or other agency of a state government; or
- b) established by or under a law of a state for public purposes (for example, a local government body);
and
- c) provides community, social or economic services free of charge or at a nominal charge well below the costs of production.

Quantum of NDRRA funding to infrastructure

Expenditure on restoration or replacement to pre-disaster standard

9. The majority of NDRRA expenditure is for the reconstruction and restoration of essential public assets to their pre-disaster standard. For the decade 2006–07 to 2015–16, it is estimated that the Commonwealth cash outlay to states will exceed \$12 billion for events that have occurred to-date, with nearly \$10 billion (over 80 per cent) attributable to essential public assets⁸. From 2013–14 to 2015–16 the Government's estimated cash payments to states will account for nearly half of this (\$6 billion) of which around 85 per cent (\$5 billion) is for the reconstruction and restoration of essential public assets⁹.

Expenditure on betterment

10. 'Betterment' refers to the restoration or replacement of an essential public asset to a more disaster-resilient standard than its pre-disaster standard. Betterment was introduced in the NDRRA in 2007. Where a state seeks NDRRA funding to build back a damaged eligible asset to a better standard, the state must seek an agreed commitment from the Commonwealth to contribute to the cost of the betterment works; that is, the additional cost to increase the disaster-resilience of the asset from the standard asset reconstruction or restoration cost. Betterment policy requires states to demonstrate the costs and benefits of the infrastructure investment to the Commonwealth, and the Commonwealth has the opportunity to assess investment and project risks and prioritise the expenditure.

⁷ NDRRA Determination, clause 3.6.4.

⁸ Definition for 'pre-disaster standard'.

⁹ 2013–14 Mid-year Economic and Fiscal Outlook. This estimate includes the expected cost of disaster events that have occurred; it does not include a forecast for future events. NDRRA payments to the states are expected to be discharged over the forward estimates.

11. Betterment proposals must demonstrate cost-benefit to all three levels of government. This can be problematic as it requires an agreed estimate of potential future risk and possible expenditure. Betterment has historically had a limited uptake (one project has been agreed at a maximum Commonwealth cost of \$0.78 million), although in early 2013, the Australian and Queensland governments agreed to share equally the cost of an \$80 million betterment fund for local government-owned assets damaged by flood, storm and cyclone events of early 2013. This fund was agreed under the assistance measure for extraordinary impacts from a disaster (Category D of the NDRRA) and is governed under the *National Partnership Agreement for Natural Disaster Reconstruction and Recovery* (NPA) between the Australian and Queensland governments. Betterment is likely to be considered as part of the Productivity Commission Inquiry into Natural Disaster Funding Arrangements.

Trends in NDRRA Expenditure

12. As the majority of the Government's NDRRA expenditure is directed to the restoration or replacement of essential public assets, it is important to consider recent trends in this expenditure.

13. Payments to states and territories under the NDRRA are made from the special appropriation outlined in the *Federal Financial Relations Act 2009*. Expenditure is driven by demand and the Commonwealth's financial liability is uncapped. Due to the volatile nature of disaster spending, no provision is made in the Budget for future disasters—forward estimates only provide for events that have already occurred.

14. Existing funding arrangements for natural disasters present a significant fiscal risk for the Commonwealth. For example in the 2010–11 Budget, NDRRA expenditure was projected at \$816.9 million over the forward estimates; however, actual expenditure over the same four years was \$8.3 billion. The \$5.6 billion estimated to rebuild and repair public infrastructure following the 2010–11 Queensland floods and Tropical Cyclone Yasi was funded by spending cuts, the national flood levy and delaying some infrastructure projects.

15. Even once events have occurred, expenditure is still volatile, particularly year to year. The Department collects NDRRA expenditure data from states to coincide with the Federal Budget reporting cycle, which provides some level of certainty to support the Government's budget planning processes. However, as a result of new natural disasters each year over 2010–11 to 2012–13 for example, the Government was required to budget around \$9 billion across the forward estimates in new costs—approximately \$6.1 billion from 2010–11 disaster events; \$1.2 billion from 2011–12 disaster events; and, \$1.8 billion from 2012–13 disaster events. Significant changes across years also occur as a result of delays in state claims for reimbursement or due to delays in state

recovery expenditure. These are most often related to infrastructure project delays, including those caused by the occurrence of further natural disasters or natural events such as drought. Some states have also indicated that market factors such as the limited availability of skilled labour in rural and remote areas place pressure on project progression.

Infrastructure investment under the NDRRA— decision-making and risk evaluation

16. The NDRRA is established on the principle that states are best placed to determine relief and recovery needs in response to the impact of a natural disaster within their jurisdiction. Since December 2012, the NDRRA has provided that, where the total cost of an asset reconstruction or restoration project is less than \$1 million, states may determine whether a disaster-damaged asset is an essential public asset for the purpose of the NDRRA. Before December 2012, states could make this determination regardless of the project cost. States' determinations for recovery assistance, supported by an unqualified audit report automatically commit the Commonwealth to providing financial assistance, without Commonwealth consideration of project or investment risks. However, the Commonwealth has the ability under the NDRRA Determination to seek further information from the state to ensure compliance with the guidelines; the Commonwealth can refuse reimbursement if it does not consider the asset to be an essential public asset.

Considerations for public infrastructure delivery models

Insurance for assets—disincentive to private ownership or operation

17. In 2012, the Australian Government undertook a review of state insurance arrangements for essential public assets (the Insurance Review) to assess whether states have reasonably adequate capital or access to capital to fund liabilities or infrastructure losses to mitigate state and federal government financial liability under the NDRRA¹⁰. The Insurance Review found that the majority of states and local governments have insurance in place for non-road assets that mitigate the financial exposures of tax payers under the NDRRA¹¹. However, despite the availability of generally well-developed commercial insurance arrangements to protect non-road assets, there remains a significant gap with respect to the insurance of road assets¹². Noting that the disaster risk profiles

¹⁰ Department of Finance and Deregulation, *Review of the Insurance Arrangements of States and Territories under the Natural Disaster Relief and Recovery Arrangements (NDRRA) Determination 2011* (Phase 2 report), 2012.

¹¹ Ibid p 8.

¹² Ibid p 10.

may differ markedly between states, Victoria and the Australian Capital Territory are the only states that have insurance cover for their road assets.

18. Investigation into the availability of commercial insurance for road assets and non-traditional insurance options at the time of the Insurance Review found that:

- the appetite and capacity of traditional insurance arrangements for road assets in Australia was insufficient,
- non-traditional insurance options are limited in their availability and, even if available, may not be cost-effective, and
- risk transfer options for road infrastructure may not present a viable solution for all jurisdictions in Australia.

19. As a result, the Australian Government effectively acts as the default insurer for road assets for natural disaster events through the NDRRA. No premiums are required and states potentially contribute only a quarter of the restoration cost. In contrast, the private sector must factor in the full cost of insurance where it is available, make other financial provision, or determine that projects are commercially unviable due to an apparent lack of available insurance.

20. The apparent lack of insurance options for Australia's governments indicates a potential barrier to private ownership and operation and may also represent unaccounted risk in funding and financing models for infrastructure more generally.

21. Careful consideration is also required of any cost-benefit analysis to ensure that when comparing options for private or government funded and owned road infrastructure the effect of the NDRRA as a hidden subsidy is not overlooked.

22. The NDRRA determination excludes provision for commercially operated public assets. If the risk to commercially operated public assets by disasters is not mitigated through insurance or otherwise, competitive neutrality could be compromised and the risk of restoring such assets could be transferred to government. It is important that such exclusions remain, whether through the NDRRA or other payments.

Conclusion

23. Under the NDRRA, the Australian Government has a longstanding commitment to assist states with the financial cost of natural disaster relief and recovery—especially the restoration of essential

public assets. Under this arrangement, the Government is effectively an insurer of last resort for the states and assumes an uncapped contingent liability.

24. The significant amount of NDRRA expenditure on public infrastructure should be taken into account when considering the optimum arrangements for investing in national infrastructure. In this context, there is potential for better coordination or consolidation of infrastructure restoration under the NDRRA and other infrastructure investment decisions across all levels of government and the private sector.
25. The principle that the owners and operators of public infrastructure are generally best placed to manage risks to their operations remains sound. When implementing these risk management strategies, owners and operators of public infrastructure should ensure that the risk is not simply being displaced to other levels of government or the Australian taxpayer. In the case of public-private partnerships, parties should explicitly consider the potential disaster risk and structure the partnership agreement accordingly.
26. In the case of state-owned road assets, the apparent lack of viable insurance remains a risk for all levels of government, and could pose a disincentive for private investment in new road infrastructure. Given the dynamic nature of insurance markets, states should regularly monitor insurance and other risk management options for road assets to ensure that the public's exposure is minimised.
27. In addition to acquiring appropriate insurance, there would be benefit in considering private-public partnerships to support proactive investment in infrastructure that mitigates disaster risk.
28. While this submission focusses specifically on the NDRRA, the Productivity Commission's Inquiry into Natural Disaster Funding Arrangements is likely to examine the full scope of national expenditure on disasters and make recommendations towards a more sustainable balance between mitigation and recovery. It is possible that these recommendations and the Government's response to them will alter the way in which NDRRA operates, potentially creating flow on effects to the development and restoration of public assets.