Evidence-based Infrastructure Investment

Keynote Speech

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Good afternoon. Thank you for inviting me to speak with you.

The theme of today's CEDA Transport Infrastructure Series is "evidence-based investment".

Evidence-based policy making has been prominent in public policy debates over the last few years.

Today, I would like to share with you some thoughts about how evidence is used in the context of making investment decisions about infrastructure.

Let me begin, however, with a few observations about the state of our infrastructure in general.

State of Play

We all appreciate that infrastructure makes an important contribution to national productivity. Improvements in infrastructure can underpin productivity and economic growth.

Well-targeted investment in physical infrastructure can facilitate other productive activities. For example, quality port and transport infrastructure allows Australian production to be moved around the country or exported, as well as providing a means for inputs to reach producers.

The Productivity Commission has estimated that improving productivity and efficiency to achieve best practice in energy, transport, infrastructure and other activities could, after a period of adjustment, increase GDP by nearly 2 per cent.

Recognising the importance of infrastructure investment, the Australian Government has allocated $36 billion to roads, rail, and ports over the six years through to 2014.

When discussing infrastructure investment, the concept of 'infrastructure deficits' has been raised in the media.

I have to say that I don't think this is a particularly useful way to guide investment decisions by governments.

Rather, I think we all recognise the signs that our transport systems may not be working as well as they could.

We can see this in the increasing problems with traffic congestion in capital cities, and infrastructure bottlenecks, for example in some of our major ports.

I suspect that people who experience traffic congestion in our cities, or who need to travel long distances to access essential infrastructure, would strongly support this.

Businesses recognise that time delays caused by inadequate infrastructure add to their costs and reduce their productivity.

Unless we change our past practices, these challenges will only compound in the future, driven by increasing levels of demand.

As highlighted in the Federal Government’s Third Intergenerational Report, pressures are likely to come from:

- population growth;
- demographic change and an ageing population;
- greater urbanisation; and
- climate change.

Effectively addressing these challenges requires strong evidence-based planning.

Taking into account the impacts of increasing urbanisation, for example, is a particular challenge.

Australia is one of the most urbanised countries in the world, with estimates suggesting that over 88 per cent of Australians live in urban areas — a proportion which is growing.

Simply building more roads alone – as we have done in the past – will not be effective or sustainable.

Not only would this be extremely costly, but in many highly-developed cities like Melbourne and Sydney, infinite supply-side options are no longer really feasible.

Rather, part of the solution will be to explore ways of better utilising the existing stock of infrastructure.

In thinking about demands for greater investment, we should also consider more carefully other “non infrastructure-building” solutions.

For instance, measures including regulatory actions to increase the attractiveness of other transport options such as public transport.

The way forward...

The question is how can governments address the infrastructure challenges we face in a practical way?

I consider there are three main areas we should focus on.

First, I think we need to do a better job at identifying priority infrastructure projects.

Second, we need to explore ways to improve the operation of markets across our transport systems.

Third, we should examine ways to encourage and facilitate way for the private sector to play a more significant role in helping to meet the challenge of investing in, and maintaining, our transport systems.

I’ll address each of these areas in turn.

Better Prioritisation of Infrastructure Projects

Dealing with Australia’s infrastructure challenges will obviously require ongoing investment.

We should put our focus on supporting the right projects – that is, those that can deliver the highest net public benefits.

Historically, governments across Australia have tended to invest in new transport infrastructure on a largely ad-hoc basis, with a few notable exceptions.

Planning for investments has often failed to take into account important factors such as network effects, which has often undermined the objective of trying to address traffic congestion.

Recognising the need for more effective planning, the Government established Infrastructure Australia in 2008.

IA’s key role is to assist governments in better targeting the allocation of infrastructure spending towards the right projects.

It is also helping to drive the development of a long-term, coordinated national approach to infrastructure planning and investment.

The reform and investment framework used to assess projects considers the strategic alignment of projects, as well as their deliverability.

IA was initially tasked with identifying a list of priority infrastructure projects for consideration by governments.

After assessing over 600 submissions, IA developed an initial priority list of ten projects that were considered capable of delivering the highest net public benefits.

This type of detailed analysis helps to build the case in favour of quality infrastructure investments and has arguably led to better decision making by governments.

The Government has announced funding for eight of the ten ‘priority’ projects and six ‘pipeline’ projects on IA’s first priority list from the Building Australia Fund.

Of the projects named on the updated 2011 IA Priority List, I note that Queensland has nine projects including the $2.8 billion upgrade to the Bruce Highway; and the Brisbane Cross River Rail project.

As IA continues its work, it is guided by seven key themes for action that it sees as addressing Australia’s main infrastructure challenges.

Chief amongst these is “transforming our cities”, which looks to increase public transport capacity in our cities and making better use of existing transport infrastructure, including road networks.

Acknowledging the vital function of IA, the Government provided an additional $36 million in this year’s Budget to enhance its role in planning and advising governments and the community on infrastructure investment opportunities.

Its mandate has also been expanded to include the production of an enhanced priority list to identify projects through top-down analysis of nationally-significant infrastructure needs, only considering projects that exceed $100 million, are flagship, or demonstrate unique national interest characteristics.

The private sector has often claimed that the creation of an investment pipeline would deliver benefits in terms of certainty.

The government has tasked the Federal Department of Infrastructure and Transport with creating a National Infrastructure Construction Schedule which also helps meet that objective. The construction schedule will be a database containing information on planned and tendered infrastructure projects with a capital value of $50 million or more funded in whole or in part by the government sector in Australia. It will cover all sectors and jurisdictions.

The construction schedule is notably different from IA's priority list as it is a schedule that provides the private sector with certainty as to which projects Governments have committed funding too, as opposed to projects which would be worthwhile *future* investments. That is, the projects on the IA Priority List.

At the same time, work is also being undertaken on effective planning. IA is continuing to develop national strategies, such as the National Ports Strategy and the National Freight Strategy.

This type of planning and consideration of projects – such as intermodal terminals to improve the efficiency of the freight logistics task – will make an important contribution to improving Australia's productivity and prosperity.

This is especially true in light of current projections about the doubling of freight volumes between now and 2030.

As I mentioned earlier, urbanisation will present significant challenges and demands on urban infrastructure.

Work has already started in this area with the release earlier this year of the discussion paper, *Our Cities: Building a productive, sustainable and liveable future*.

The paper sets out the Federal Government's thinking on a national approach to urban development, and the challenges we need to address if we are to make our cities more productive, sustainable and liveable.

In all of these initiatives the Australian Government is working cooperatively with State and Territory governments to ensure a nationally-consistent approach to produce the most effective outcomes.

Infrastructure Spending in Queensland

On the topic of choosing worthwhile projects, I'd like to briefly touch on one potential project here in Queensland that is an example of how the right infrastructure can potentially boost productivity.

The so-called CopperString project is a proposal to construct a transmission line to connect the Mount Isa region with the National Electricity Market near Townsville. It is a project on the IA priority list.

The project has the potential to deliver economic stimulus to the area, including employment opportunities as a result of project construction and commissioning.

The project could also open up significant economic opportunities for North and North West Queensland by providing an electricity connection path for renewable energy projects.

Co-locating the sites suitable for large scale solar, wind and geothermal generation with a grid connection avoids the problem of remoteness associated with many potential renewables sites in inland Australia.

This is the type of infrastructure that could also allow small mines to access electricity at a lower cost than through their own diesel or gas fired generation.

So, the Commonwealth is working with the Queensland Government and private sector partners to deliver this project because it sees potential benefits on multiple levels.

The Federal Government has committed significant funding from 2012-17, subject, of course, to the project meeting certain conditions.

As well as Copper String, the Federal Government is committing to further projects in Queensland.

Over $8 billion of the $36 billion worth of funding I mentioned earlier will be spent on upgrading and maintaining Queensland’s land transport infrastructure.

For example, the $2 billion Gateway Upgrade Project is the largest bridge and road project in Queensland’s history.

In addition, the Government has also committed $434 million from the Regional Infrastructure Fund for six projects in Queensland.

The Australian Government has not been alone in advancing infrastructure investment and reform.

I note the recent work the Queensland Government has done with significant asset sales including the Port of Brisbane, Queensland Rail freight business and the Queensland Motorways.

These sales should help to deliver considerable flow on productivity benefits to the state and the nation more broadly while freeing up scarce capital for investment elsewhere.

Obviously, investment in infrastructure has been an important issue for Queensland in light of the devastating floods that swept through the state earlier this year.

While some existing projects have been delayed to support the reconstruction effort, the Australian Government remains committed to delivering those projects once reconstruction has been completed.

Well Functioning Infrastructure Markets

Let me now move on to the second area where governments should focus their efforts - well functioning infrastructure markets.

Well functioning, competitive markets are efficient at allocating resources, facilitating change – and as signals for investment.

Transport markets are certainly imperfect, leading to problems in terms of pricing, overuse by consumers and under-provision of goods and services by the private market.

These imperfections have led to governments taking the lion's share of responsibility for making transport infrastructure investments around this country.

Arguably, as a community we have arrived at this point largely because governments and transport users have traditionally regarded transport infrastructure as if it were a "public good".

Public goods have certain characteristics — consumption of the good by one individual does not reduce availability of the good for consumption by others — no-one can be effectively excluded from using the good.

This has encouraged consumers to overuse the system due to a lack of direct price signals. This, in turn, has led to the demand for infrastructure being higher than it needs to be.

Simply building more roads without explicitly considering efficient pricing mechanisms just isn't feasible.

In the past, this approach has simply encouraged more people to use our roads.

Expansion and modification of the current system to deal with congestion – including the tradeoffs involved – is a conversation that the whole community needs to be involved in.

This conversation needs to occur – particularly in light of forecasts that suggest continued strong demand for transport infrastructure.

I would argue that our road network shouldn't be thought of as a pure public good.

Indeed, Australian governments have already started to introduce market signals into transport infrastructure, principally through user charges. This is helping to better balance supply and demand for transport infrastructure.

But we can do so much more. As flagged earlier, in addition to selecting projects that can deliver high net public benefits, we also need to make better use of existing infrastructure.

The COAG Road Reform Plan is an important step that governments across Australia can take towards creating better functioning transport markets more broadly.

The reform will provide better price signals for transport freight infrastructure providers and users to enable us to meet more efficiently the forecast growth in the national freight task.

It includes consideration of pricing options, their feasibility and industry impacts to ensure the more efficient, productive, safe and sustainable use of freight.

This reform plan is designed to produce a heavy vehicle pricing system that would enhance efficiency and productivity in this country.

Last Friday COAG noted the progress that has been made so far in developing the road reforms and that a final feasibility study is due to be delivered to COAG at the end of the year.

If the plan is successful, I believe it will lay the foundation for the next steps in improving the operation of transport markets in Australia more broadly.

Furthermore, last Friday COAG also endorsed national regulators and regulations for heavy vehicle, rail and maritime sectors. This agreement will help boost productivity by streamlining regulations that have plagued transport firms working across borders.

Infrastructure Finance Working Group

The third area where governments should focus is in relation to maximising opportunities for the private sector to contribute to meeting the infrastructure challenge where it can add value.

Governments will always be a key player in infrastructure investment.

Particularly for projects that can deliver high net public benefits, but may not deliver acceptable commercial returns without some level of government involvement.

However, we need to recognise that there will often be cases where privately-provided infrastructure is necessary and desirable.

Private sector involvement in public infrastructure development can improve efficiency through greater accountability, cost effectiveness, financial discipline, competition and improved risk allocation.

In recent years, there have been increased opportunities for private investment in infrastructure – in particular, where the private sector can anticipate an acceptable return on its investment, for example, airports and ports.

In such cases, government subsidies are not required, and can distort resource allocation.

A key challenge becomes the need to find ways for governments to work with the private sector and increase opportunities for their involvement.

This year's Federal Budget included several measures designed to address barriers to efficient private investment in nationally-significant public infrastructure by:

- removing impediments to carrying forward losses in the taxation system; and
- ensuring the value of those losses are maintained over time by indexing them at the Government bond rate.

These measures were an important first step.

The Government has also established the Infrastructure Finance Working Group to explore ways to encourage greater private sector investment in infrastructure.

Significantly, the group brings together expertise from both the public and private sectors.

The aim of the group is to identify possible measures and make recommendations to government on ways to improve the financing of infrastructure, particularly by looking at ways to encourage greater private sector investment.

The group is currently undertaking targeted consultation with industry experts, state governments and others to explore financing options that can address some of the perceived barriers to greater private sector investment in infrastructure.

The work of the group is not being undertaken in a vacuum and there are linkages to other on-going processes.

For example, significant work is also being undertaken refining the Public-Private Partnership model under the National PPP Working Group.

PPPs continue to be an effective mechanism through which governments and the private sector can work together to deliver significant infrastructure projects.

We also know that here in Queensland, as well as in other states, there have been projects that have not met expectations – especially with regards to patronage forecasts.

Again, the Federal Government is leading efforts to improve these areas of concern to private sector investors.

The Department of Infrastructure and Transport, through the Bureau of Infrastructure, Transport & Regional Economics (BITRE), sponsored a conference earlier this year as the starting point for debate in this area. And Infrastructure Australia are examining ways to get greater certainty in this area.

An important message to take away from this discussion is that the Australian Government is clearly willing to encourage the private sector.

We recognise that the private sector, and the general public, share a concern about the respective roles of government and the private sector, and how the risks of infrastructure projects can be shared effectively.

This is the key issue with sharing risk.

Carbon Price and Infrastructure

Before I conclude, the event organisers asked me to make a few remarks about the potential impact the introduction of a carbon price may have on infrastructure.

A carbon price is expected to have only a minimal impact on infrastructure construction costs.

Most infrastructure construction inputs will not be affected by a carbon price. Inputs such as labour and equipment depreciation have no direct carbon cost.

Some inputs to infrastructure construction projects, such as cement, and asphalt, create emissions during their production, and will therefore incur a carbon price.

Economic modelling by Treasury indicates that the impact of the carbon price on the entire construction industry is expected to be less that one per cent in the first year of the scheme.

In fact, even up to 2015-16, carbon price costs associated with the construction sector are expected to be less than 1.5 per cent.

If some price increases are passed on, the overall impact on infrastructure costs will be very small, relative to other price fluctuations experienced by the industry.

Conclusion: The Need for a Public Debate – "Communicating the Imperative for Action"

Communicating the Imperative for Action, Infrastructure Australia's recent report to COAG, made a strong case for a far more open public debate about infrastructure funding, arguing that it's not possible to boost infrastructure investment without increasing taxes or asset sales, or by expanding user pays pricing.

I think the community is ready to engage in a more meaningful way about the tradeoffs that governments face when considering issues such as traffic congestion in our cities.

Governments in general probably need to be more explicit about the nature of the problems they are trying to address and the implication of various solutions.

It is obvious, however, that much work needs to be done in communicating with the public on many of these issues.

The time has come for governments and the community to engage in debates about what it is that we want our infrastructure to achieve.

Once we have had that discussion, it will be far easier to make sustainable progress into problems such as congestion and lack of planning.

Infrastructure Australia has furthered this debate in their most recent report to COAG.

While there is no silver bullet, and work is needed on several fronts, at the end of the day, we need to undertake the projects that offer the greatest net public benefits — the projects that enhance productivity and which ultimately lead to improved living standards for all Australians.

Once again, thank you for inviting me to speak with you today.

Thank you.