



Getting Western Sydney Going

*Financing the infrastructure needs of
Western Sydney*

**Prepared for the Western Sydney Regional
Organisation of Councils Ltd (WSROC)**

October 2010



LateralEconomics

CAPABLE, INNOVATIVE, RIGOROUS

Government deception about what it can and cannot afford has become so ingrained in the community that the front page of a paper of record takes it for granted that governments can no longer afford to fund the construction of roads.

Former NSW Auditor General Tony Harris



Prologue ¹

NSW cannot be a growing state, and Western Sydney cannot meet the needs of its strongly growing population with the financial structure of a retired couple.

Lateral Economics considers that economic reform in Australia – at least in so far as it has been pursued – has been a triumphant success. It has been a major factor in reviving Australia's relative economic fortunes in the 1980s: one that propelled us through the Asian crisis over a decade ago, although the dividends from reform have been gradually fading. Economic reform was built on simple and compelling principles, even where they affronted the 'economic commonsense' of many ordinary Australians as they did when tariffs were cut.

Having made so many strides away from the economic populism of our past, in one area governments have expended substantial efforts to take public understanding backwards by appealing to commonplace economic fallacies. A number of Australian governments have committed themselves to zero or arbitrarily low debt targets.

A sharp reduction in public investment has followed. And when faced with the reality of what their targets meant in practice, governments have in fact exceeded their low debt targets. In this situation they have retreated to the next most plausible benchmark of fiscal rectitude, AAA credit ratings.

Yet just as arbitrary debt restrictions imposed upon a household or a firm would be a recipe for its long term impoverishment (at least relative to what it might otherwise achieve) this is also true of the public sector – and obviously so. Indeed, as households have borrowed more and more, there is a particular perversity in arbitrarily constraining the borrowing of the entity that enjoys the lowest cost of borrowing – the government.

This is at a time when NSW is groaning under the weight of a widely recognised infrastructure crisis and shortly after it has been mired in controversy for having shifted the costs of infrastructure development off its books – with effects now perceived as ranging from unpleasant (requiring substantially higher tolls than would otherwise be the case) to moderately disastrous as in the case of the cross-city tunnel.

If it means anything, fiscal conservatism should mean prudently building the net worth of the public sector and doing so in a measured, prudent way – that is at an acceptable risk. In an environment in which some infrastructure assets typically enjoy a rate of commercial return well above the cost of borrowing (not

¹ Lateral Economics would like to thank Tony Harris and Jeremy Goff for comments on an earlier draft.



to mention additional returns to society and environmental amenity), borrowing should be encouraged up to the point at which further borrowing would constitute an unacceptable risk. This is how public companies and most Western Sydney households are run.

However if it were just a matter of repositioning some swinging pendulum towards 'more debt' Lateral Economics would join forces with the debt hawks. Though we should borrow more, we hold fast to the kernel of wisdom embodied in the populist aversion to debt.

Choosing and funding major infrastructure investments will always present acute problems in political economy. The public likes to see infrastructure built and politicians can make themselves popular by announcing their own projects. But if that infrastructure is debt financed it is paid for in the future – after the next election on which politicians are focused.

However the populist aversion to debt has not avoided this dilemma of short-termism. Indeed the commitment to AAA has been the short term goal around which NSW politicians have contorted all sorts of artificial schemes to bring private investment into public infrastructure and so push debt off their books. So much so that rating agencies are now taking the constraints such projects impose into account in determining credit ratings.

And as this has gone on, the citizens of NSW are realising that their long term interests have still fallen victim to short-termism. The politicians of the last twenty years have served their own short term electoral interests by mortgaging their constituents' future.

Their constituents are now paying. True they are not paying as much public debt interest as they would be doing if the course we are advocating had been followed. But they are paying inflated tolls on roads, heavy mortgage re-payments reflecting the lack of land release and the loading of infrastructure charges onto that land that is released. And they are paying with their time as they wait at peak hour in traffic that has slowed to a crawl. Indeed, these problems explain no small part the below average economic growth of NSW itself since these policies took hold.

For this reason Lateral Economics argues that if the NSW government is to move towards more a more rational approach to managing it's balance sheet, it must do so by *institution building*. Just as we built national institutions to deliver monetary policy from short-termism, so we can and should do the same for the management of the NSW Government's balance sheet.

That means the development of institutions to provide independent, expert, regular and public advice to governments on the management of its balance sheet provided by the Auditor General or some new independent statutory office, such as an Office of Budget Responsibility. Such a body would



provide advice on the level of debt and the management of the government balance sheet as a whole. And it would also include advice on the wisdom of individual infrastructure projects to ensure that taxpayers' money was used on the projects that offered the best returns as determined by independent cost benefit analysis.



Table of Contents

PROLOGUE	I
TABLE OF CONTENTS	IV
INTRODUCTION AND OVERVIEW	1
1. THE INFRASTRUCTURE FUNDING GAP	5
2. INFRASTRUCTURE NEEDS IN NSW AND WESTERN SYDNEY	8
3. TRENDS IN FINANCING INFRASTRUCTURE INVESTMENT	12
<i>The rise in private investment</i>	12
4. PUBLIC, PRIVATE PARTNERSHIPS	17
5. GETTING WESTERN SYDNEY GOING: AN INDICATIVE COUNTERFACTUAL	21
6. A BETTER TRADEOFF	25
<i>Indicative financial analysis of the costs and benefits</i>	27
<i>The Commonwealth should be more involved</i>	28
7. IMPROVING GOVERNANCE IN INFRASTRUCTURE INVESTMENT AND THE MANAGEMENT OF GOVERNMENT BALANCE SHEETS	29
BIBLIOGRAPHY	31



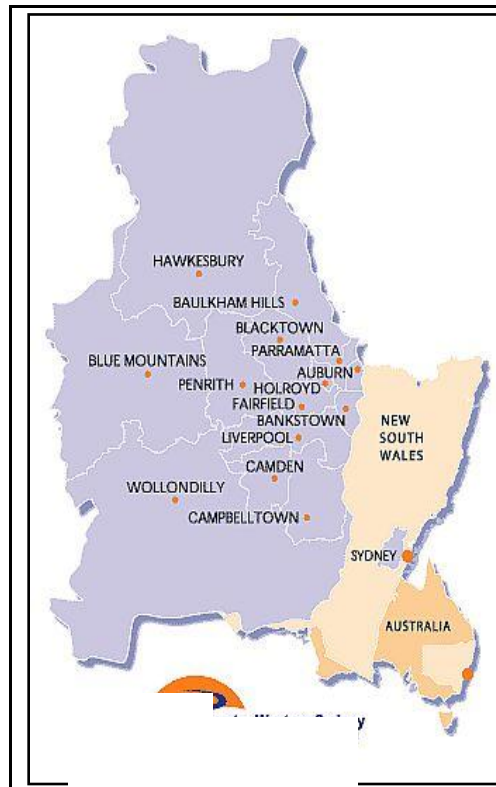
Introduction and overview

This paper was commissioned by the Western Regional Organisation of Councils (WSROC) to consider the infrastructure needs of Western Sydney and the funding response necessary for those needs to be met.

The greater metropolis of Sydney is in many ways two cities in one. There is the coastal city stretching from Newcastle to the Illawarra, and the inland city of the plains and the adjacent towns of the Blue Mountains.

From a number of perspectives the debate concerning Western Sydney has focussed on its regional nature. However, from the viewpoint of addressing the critical lack of economic infrastructure, Western Sydney is more properly considered in this study as a city within a city.

Figure 1: Western Sydney, NSW, Australia



As a city of 1.85 million people, Western Sydney is larger than the capital cities of Perth and Brisbane, and Australia's largest non-capital city which is the Gold Coast. Western Sydney's population is expected to reach 2.93 million



in 2036, a substantially faster rate of growth than the rest of the greater Sydney area.²

Therefore it is in Western Sydney that governments – national, state and local - must deliver growth in jobs, housing and incomes whilst securing levels of environmental and civic amenity that Australians expect.

The projected level of population growth in Western Sydney will generate demand for 400,000 additional jobs and 300,000 homes. In addition, the NSW Government has identified the major infrastructure requirements of the city of Western Sydney in its rolling ten-year State Infrastructure Strategy (2008 - 2018).

In the wider debate about Australia's infrastructure needs, and in particular the infrastructure crisis in NSW, great attention is being paid to identifying infrastructure investment deficiencies and needs.

As welcome and necessary as that is, there is still too *little* attention devoted to the public policy question of how to finance and govern these future investments. This paper addresses this question, in the interests of the people of Western Sydney.

Australia in general and Western Sydney in particular, are currently suffering the ill-effects of having their balance sheets managed by default rather than by design.

With the emphasis on minimising public debt and an increasing reliance on private investment, NSW has paid the price in lower growth than would have otherwise been the case if there had been more adequate investment and had it been more appropriately financed.

The issue acquires a new urgency given the way in which the critical policy questions are spinning off into unproductive political debate around population growth rather than a frank debate on how best to service the infrastructure needs of Western Sydney, whatever its population.

The case for greater investment in infrastructure in Western Sydney, and the way forward in governing and financing it, is made in this paper.

It is said that what gets measured gets done and the critical argument in this report is that our focus on lowering or minimising debt, being easily measured has been delivered. Alas it has simply resulted in governments swapping financial surpluses for infrastructure deficits.

² These population projections are sourced from the NSW Government Bureau of Transport Statistics at Statistics, at <http://www.transport.nsw.gov.au/tdc>.



These infrastructure deficits are now manifesting themselves in lower economic growth, ageing and inadequate physical and economic infrastructure such as bridges, roads and ports. Emerging infrastructure capacity constraints are strangling future growth opportunities and sending investment and people to other states and countries. In addition to these hard economic impacts, infrastructure deficits are undermining the amenity of life in Western Sydney, and making its citizens fearful of future growth and immigration.

There is a better trade-off and it is one that has been recently adopted in Queensland to address the needs of the South Eastern corner which is not dissimilar to Western Sydney in its needs as a population growth corridor.³ In its 2010-11 Budget, the Queensland Government stated that it would continue its investment in the largest infrastructure program in Australia, as well as looking at how it can deliver infrastructure outcomes earlier and “within the context of a constrained financial environment” (Queensland Government (2010), p. 11). Treasurer Andrew Fraser said that he had taken the “conscious decision” to give prime importance to the need to preserve the capital program (2009)).⁴

Had a decision such as this been made by NSW in the last two decades, that is had it chosen to fund the toll roads that now encircle Sydney, Lateral Economics’ indicative modelling indicates that it would have acquired ownership of a stream of revenue with a net present value to itself which we estimate at \$12.8 billion, at the cost of initially increasing its borrowing by \$7 billion. In other words by taking on a little more risk it would have set itself up to increase its net worth by around \$5.8 billion. By 2009-2010, over 60 percent of the original borrowing would have been paid off leaving free cash flow to the budget of \$379 after interest payments and even after provisioning for further principal repayments. In the unlikely event that NSW suffered a credit downgrade as a result of funding such projects then the project would still have been very worthwhile.

All that having been said, the public’s concern about fiscal laxity is not only well founded but, particularly in contrast to the fiscal profligacy we see around the world, a great public asset. The value of this approach could not have been better illustrated than during the recent global economic crisis, when the fiscal conservatism of governments over the last twenty five years had put Australian

³ According to the South East Queensland Regional Plan 2009-231 the population is projected to increase from 2.8 million to 4.4 million people between 2006 and 2031.

⁴ This is not an endorsement of fiscal irresponsibility, nor particularly of the Queensland Government’s fiscal management which only recently emphasised the importance of a AAA credit rating and has come to accept the lower rating as the lesser of two evils, rather than as part of a deliberately chosen long term strategy. See Gruen, N, “Bligh can give Queensland bragging rights”, *The Age*, 26th Feb 2009”, <http://www.theage.com.au/business/bligh-can-give-queensland-bragging-rights-20090225-8i16.html>



government budgets in an exceptionally strong position from which they could stimulate the economy and thus avoid recession.

For this reason, any move towards higher debt-funded investment in infrastructure should not be – nor even be suspected to be – a simple lurch towards fiscal profligacy, complacency or pork-barrelling. Properly done, moving towards a more balanced understanding of managing the public balance sheet – moving to a better balance between monetary and physical assets – should be done in the context of *further* building Australia's and NSW's now enviable reputation for fiscal prudence.

To bring about this new paradigm requires that additional debt-funded investment in economic infrastructure be accompanied by institutional development as follows. We should:

- continue to run operating surpluses except during cyclical economic downturns; and
- build the institutions capable of entrenching a culture of prudence and integrity in the investment of such funds in infrastructure. This requires that major decisions not be made except pursuant to public, independent, expert advice.
- Major decisions would include decisions about either:
 - the level of borrowing, investment in physical infrastructure and other major aspects of managing the public balance sheet; and
 - any specific, major infrastructure investments.

The rest of this paper is in six parts. In Sections 1-4 we draw on the research and themes in the major reports available in the Australian literature on infrastructure investment. We have drawn on a number of significant (institutional and organisational) reports and authors in the ongoing debate.

In Sections 1 and 2 we review Australia's and NSW's infrastructure needs respectively. Trends in infrastructure investment are discussed in Section 3 while in Section 4 we explore models of private financing of new infrastructure and in particular the growth of the public-private partnership model. The conclusion is that there are a number of economic reasons why private investment cannot do much of the heavy lifting in providing the necessary infrastructure that will be essential to improving our comparatively poor productivity performance and its future economic growth prospects.

Sections 5 and 6 explore the trade-offs between investment in infrastructure and fiscal policy, and propose a better trade-off. Section 7 outlines more independent governance models for the management of public infrastructure investment.



1. The infrastructure funding gap

At one level Australia's infrastructure problems can be seen in bottlenecks at our bulk container ports and our intermodal hubs, inadequate rail systems, congestion on our urban roads, struggling public transport, water shortages in our cities, over-allocated rural water systems and an (increasingly acknowledged) straining electricity network. At a deeper level, however, we see the drivers of these problems in a lack of effective national infrastructure markets, inappropriate infrastructure pricing, often poorly co-ordinated planning, a confusion between government roles (policy, maker, regulator and service provider), and sometimes misguided regulation

Business Council of Australia (Business Council of Australia (2009), p. 12)

Australia's underinvestment in infrastructure and the problem of emerging capacity constraints are well documented. It is a talking point in the popular press ⁵ and figures prominently in more substantial contributions to the national debate, for instance in several reports in recent years by the peak industry group, the Business Council of Australia, and other industry groups including the Property Council of Australia, the Australian Council for Infrastructure Development and Infrastructure Partnerships Australia.

The BCA's most recent report reiterates a number of key themes:

- notwithstanding the increased spending in recent years, Australia's track record is of public sector investment underspend, poor investment signals to commercial enterprises and poor use of the infrastructure we already have;
- there is an imperative for greater infrastructure investment, to sustain Australia's economic growth record; and
- there are three policy imperatives, namely the need for pricing and market reforms, improved planning or targeting of priorities, and transparent reporting of the measurement of progress against targeted service level benchmarks.

In its conclusion to its 2009 report the BCA suggests that there is:

a massive future infrastructure agenda of great importance and significant complexity. Decisions by the Commonwealth and COAG over the next few years can determine the future performance of Australia's infrastructure, and

⁵ See for example (Duffy (2008)) (Sexton (2010)) (Ferguson & Hewett (2009)).



therefore the positive contribution or otherwise that this vital sector makes to our future prosperity (Business Council of Australia (2009a) p. 24).

Other reports have also sought to quantify the problem (see Box 1).

Box 1: The national infrastructure investment task

Research released by Citigroup in 2008 found that the national infrastructure investment task over the next ten years exceeds \$770 billion ((Citigroup Economic & Market Analysis (2008)).

Similarly, an ABN-Amro 2008 report forecast that up to \$455 billion needs to be spent over the next decade with around \$14 billion worth of public-private partnership projects (PPP) reaching financial close over the next two years alone ((ABN-AMRO Equities Australia Limited (2008)).

The costs of meeting Australia's infrastructure needs could increase under a carbon pricing regime. A KPMG report, commissioned by Infrastructure Partnerships Australia (in conjunction with Bilfinger Berger Australia) identified the impacts of the Carbon Pollution Reduction Scheme (CPRS) on the costs of meeting the currently identified infrastructure gap in the areas of energy and transport. Based on current estimates, KPMG found that the cost of closing the infrastructure gap in those key sectors would be more than \$120 billion once a CPRS is imposed⁶.

Since coming to office in 2007, the Rudd/Gillard Labor Government has taken some initial steps towards acting on these imperatives. In 2008 the Australian Government appointed both an infrastructure minister in Anthony Albanese and created an independent, Commonwealth Statutory Authority called Infrastructure Australia (see Box 2).

⁶ This report is cited in Infrastructure Partnerships Australia (2008).



Box 2: Infrastructure Australia

On 20 March 2008, the Federal Government established Infrastructure Australia to develop a strategic blueprint for unlocking key economic infrastructure bottlenecks and modernising the nation's transport, water, energy and communication assets.

The Infrastructure Australia Council's membership was announced in May 2008 and is in the process of completing an audit of nationally significant infrastructure; developing an Infrastructure Priority List; and advising on the removal of disincentives to greater private investment in public infrastructure.

This work will inform the Federal Government's allocations for the \$20 billion Building Australia Fund and provide a source of funding for infrastructure investment nation-wide.

At the time Minister Albanese said that the creation of Infrastructure Australia was an important step towards addressing the capacity constraints identified by the Reserve Bank.

In a similar vein the Federal Treasurer, Wayne Swan made the following comments, to an infrastructure conference in September 2008:

We are approaching the point where much of the large amount of public infrastructure put in place in the 1950s and 1960s will need to be renewed or replaced.

And when it comes to the ability of infrastructure to support economic activity, Australia is below the average of leading advanced economies - based on the index derived by the World Economic Forum in its Global Competitiveness report (Hon. Wayne Swan (2008) p.).

In its first report to the Government, Infrastructure Australia identified a number of projects as a priority at a cost of \$60 billion, excluding those projects whose costs are yet to be estimated. In response, the Commonwealth announced funding for these projects of \$8.7 billion - a funding gap of well over \$50 billion (Business Council of Australia (2009a), p.12).

At the same time, according to the BCA, spending on infrastructure by the State Governments is expected to decline from the relatively high levels of recent years.



2. Infrastructure needs in NSW and Western Sydney

Table 1 GSP Growth NSW

Table 1: Comparative growth rates in different states (GSP/GDP)		
GSP, Chain volume measures - 2006-07	Annual growth	Average annual compound growth rates (1996-97 to 2006-07)
	%	%
Victoria	2.7	3.4
Queensland	4.9	4.8
South Australia	0.8	2.7
Western Australia	6.3	4.4
Tasmania	2.1	2.7
Northern Territory	5.6	4.3
Australian Capital Territory	5	3.6
Australia	3.2	3.5
Source: 5220.0 - Australian National Accounts: State Accounts, 2006-07 available at http://tinyurl.com/2wrgfv		

For over a decade NSW's growth has been disappointing (see Table 1) and it appears likely that underinvestment in infrastructure is amongst the causes. Part of that malaise has been managing the state in order to minimise debt rather than to optimise economic outcomes.

The NSW Government submission of June 2008 to Infrastructure Australia identified \$140 billion in infrastructure needs – some to catch up and the remainder as critical to future economic growth. In its most recent Budget (2010-11), the NSW Treasurer committed \$62.2 billion over the four years to 2013-14, slightly less than half of what is needed.

According to the Greater Western Sydney Economic Development Board, the 2008-2018 State Infrastructure Strategy and NSW Government Submission to Infrastructure Australia in June 2008 outlined extensive investment that it



planned for Western Sydney over the next decade (see Box 3) (Greater Western Sydney Economic Development Board (2008)).

Box 3: Major infrastructure planned for Western Sydney

- North West Rail Link
- South West Rail Link
- Parramatta to Epping rail line
- Extension of the M4 and expansion of the M5
- Southern Sydney Freight Line
- Enfield intermodal terminal
- Improved rail infrastructure between Enfield & Port Botany, and development of the Moorebank intermodal terminal
- The \$220 million Western Sydney Recycled Water Initiative for all new homes and to provide water for agriculture and industry users
- Significant growth in the region will place higher pressure on electricity supply and on health infrastructure, including the need for major redevelopment of major redevelopment of Liverpool, Auburn and Nepean Hospitals.

In the case of land transport for example five major transport projects have been identified – three rail projects (the North West Rail Link, the South West Rail Link and the Parramatta to Epping rail line) and two road projects to four more lanes to the M5, and building a long tunnel from Strathfield at the M4 to cut exit congestion.

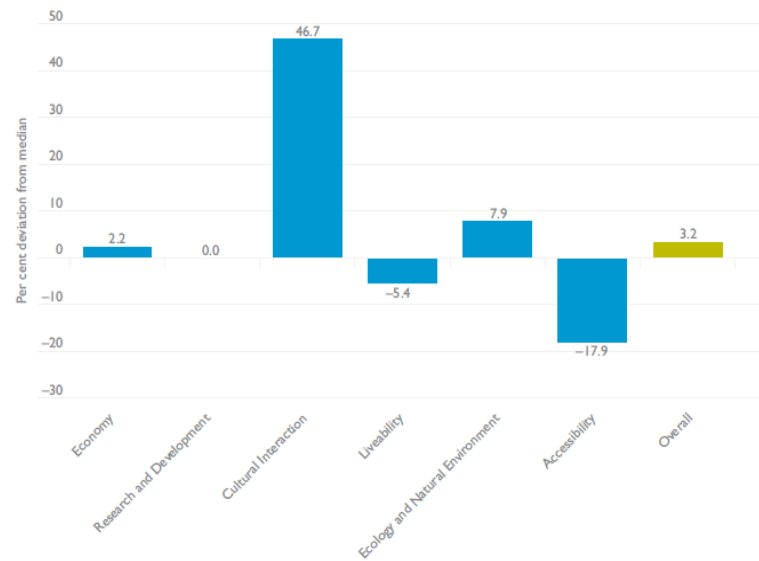
A properly integrated public transport network is a key priority for the residents of Western Sydney. Every day, 80 % of western Sydney residents battle through traffic to get to work. Around 30 % must travel to the city to work. Traffic on the northwest motorway, the M2 and M5 slow to a crawl and at peak times on the M4 the average speed is 27km/h.

"You can't condemn people to travel 50, 60 or 70km every day, to go to work, to go to the city," said Christopher Brown, managing director of the Tourism and Transport Forum. "Western Sydney residents are as mad as hell and they're not going to take it any more."

In a recent benchmarking of the state of Australian cities, Infrastructure Australia referred to the *Global Power City Index* which ranked Sydney alongside other world cities on a range of measures. In those areas in which infrastructure plays its most important roles, economy, liveability and particularly accessibility, Sydney's ranking was barely above average, somewhat below average and well below average respectively.



Figure 2: Ranking of Sydney, deviation from the global medians



Source: Power City Index (GPCI) 2009

Infrastructure Australia (2010b), State of Australian Cities. 2010, p. 14.

Since 2008 the NSW Government has shelved its commitment to the North West Metro and the South West Rail Link that it had proposed in its submission to Infrastructure Australia. In its place the NSW and Federal governments are currently reviewing a new proposal for a West Metro rail system between Sydney and Parramatta. This project will include significant consolidation of residential, commercial and industrial activity around existing infrastructure with a new high frequency, high speed (30 minute journey) rail system.

Clearly, growth in the economy and population and the aging of the infrastructure stock is driving the need for greater infrastructure investment – in the city of Western Sydney, in NSW more generally and nationally.



There is no doubt that there is a substantial amount of funds available to finance infrastructure type investments. A significant component of the investor base finds high-yield, low-volatility assets to be an attractive class of investment. . . .

But these funds are attracted by the nature of the assets being borrowed against, not the particular identity of the borrower. There is no external reason that the government could not tap the same pool of funds to finance an infrastructure asset. One reason that has been proposed in this regard is the reluctance of governments to increase borrowings on their balance sheets. If this prevents government from financing infrastructure development itself, then it should be recognized that the use of private sector financing is the result of a blanket government policy, rather than a proper financial assessment.

Professor of Finance, Stephen Gray (2007, p. 13)

It appears that the sizeable infrastructure funding gap identified in this section of the report is not due to a shortage of capital. Australia has access to a large pool of domestic funds, including well over \$1 trillion in superannuation funds, in addition to overseas sources of funds, as indicated by the significant inflows on Australia's capital account which are amongst other things funding a boom in mining investment.⁷ Moreover, the credit ratings of our governments, government enterprises and major corporations are such that the cost of capital is unlikely to cause otherwise viable projects, to be considered uneconomic.

An arbitrarily determined fiscal policy is determining the level of infrastructure investment and crowding out the rational alternative which is to make infrastructure investment decisions, as a firm would make its investment decisions, based on a proper financial assessment of the relative costs and, benefits of the various options and the need to ensure prudent risk management.

We elaborate on this choice further in the next section, as well as describing the increased role of the private sector, and the necessary limitations of that role in financing infrastructure investment.

⁷ See for example (Bright (2010)).

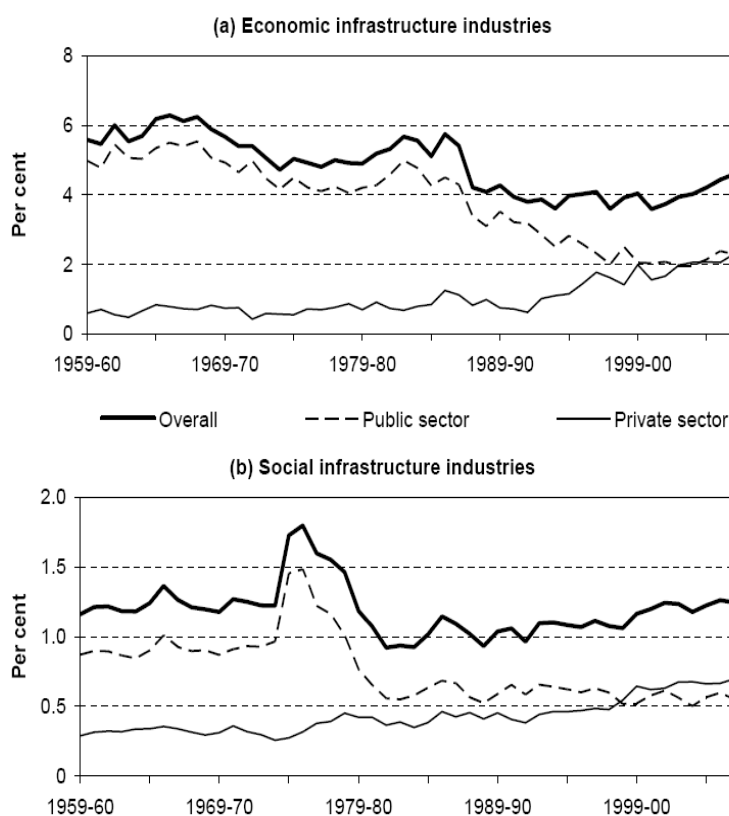


3. Trends in financing infrastructure investment

The rise in private investment

Australia's total infrastructure investment trended downwards from the 1960's onwards, rising again somewhat in the past decade. A working paper by the Productivity Commission has identified these trends, as well as changes in the composition of economic and social infrastructure and the relative contributions of the public and private sectors. These are shown in Figure 3.

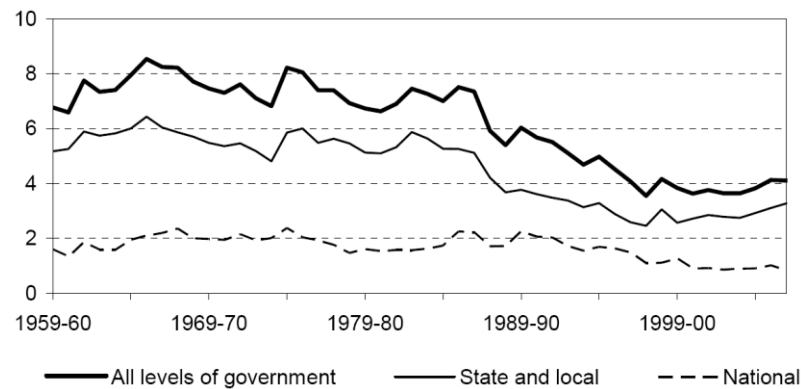
Figure 3 Trends in infrastructure investment



Source: Productivity Commission Staff Working Paper, March 2009, 'Public Infrastructure Financing: An International Perspective', page 28

As Figure 3 shows, nationally, the ratio of private sector infrastructure investment to national output (GDP) has risen steadily, both for financing economic and social infrastructure. The downward trend in public sector investment in infrastructure is evident at national as well as state and local levels (Figure 4).



Figure 4 Trends in public infrastructure investment

Source: Productivity Commission Staff Working Paper, March 2009, 'Public Infrastructure Financing: An International Perspective', page 28

The trend increase in private investment is likely due in part to changes in fiscal policies in Australia, implemented from the mid 1980's onwards. Importantly, this included the transfer of some infrastructure to the private sector as well as the setting of fiscal policy targets for low or no debt.

In the 1990s more stringent ideas of fiscal responsibility following on from fiscal excesses of the 1980s and fiscal difficulties in the recession of the early 1990s led, for example, to the NSW Government introducing the General Government Debt Elimination (GGDE) Act 1995, and a decade later in 2005, the Fiscal Responsibility (FR) Act 2005.⁸

Both these acts set debt targets over the medium to long term.

While the GGDE Act set a short term target of returning the budget to surplus, in the medium term the NSW Government committed to a sustainable level general government sector net debt while for the long term it committed to eliminating net debt for the general government sector by 30 June 2020, and to eliminate total state sector unfunded superannuation liabilities by 30 June 2030.⁹

While the earlier act explicitly identified the goal of maintaining a credit rating as high as possible, the FR Act does not. However, the maintenance of a AAA credit rating is part of the NSW State Plan and figures prominently on the NSW Treasury website in its budgetary reporting, as in this statement in the 2010-11 Budget papers.

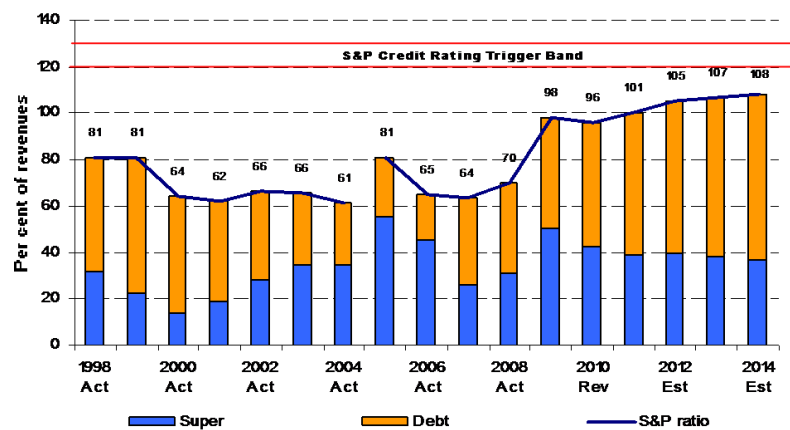
The Fiscal Responsibility Act 2005 sets out both medium-term and long-term fiscal targets and principles for budgeting in New South Wales. In

⁸ The legislation can be accessed at <http://www.legislation.nsw.gov.au/>.

addition, maintaining a Triple A credit rating is a priority of the State Plan. It is within this legislative and government policy framework that the budget is set each year (Budget Papers, 2010, No.2.2, page 2)

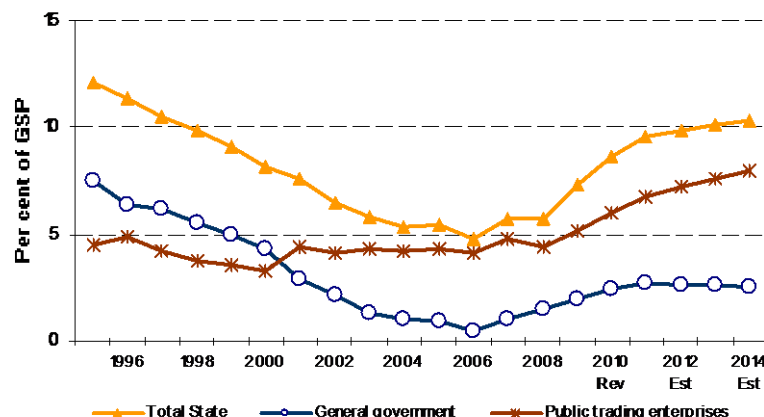
The significance of the targets is evident in the NSW Government reporting of its fiscal strategy performance in the 2010-11 Budget. Figure 5 overlays the budget forecasts with what it advises to be the Standard and Poors credit rating trigger band, as a ceiling beyond which the NSW Government, under current policy settings, is not prepared to go.

Figure 5 Net Debt and Unfunded Superannuation Liabilities as a share of Total Revenue (non-financial public sector)



Source : NSW Government (2010b), p. 17

Figure 6 Net Debt as a ratio to GSP, non financial public sector



Source Budget Paper No 3, p.

It is timely for WSROC to raise these issues. The statutory five yearly-review of the FR Act is due during 2010-11, with a report to be tabled in Parliament by June 2011. The objectives of the review are to assess 'whether the policy objectives of the Act remain valid and the terms of the Act remain appropriate for securing those objectives.'

The cost of the ceiling on borrowings imposed by the AAA credit rating, means that a significant part of the current infrastructure needs of NSW cannot be funded, within the span of the current budget and forward estimates.

The NSW Government has increased its borrowings for infrastructure investment in recent years, notwithstanding the FR Act debt targets, which include maintaining 'general government underlying net debt as a share of Gross State Product at or below its level as at 30 June 2005'

Details of the capital spending program are set out in the Treasurer's annual Infrastructure Statement (Budget Paper No 4) which in turn is linked to the State Infrastructure Strategy (SIS). The SIS is a rolling 10-year plan for infrastructure projects to support service delivery. It was first published in 2006 and is updated every two years.

According to the NSW Treasurer the current edition of the SIS (2008-2018)

...shows that \$140 billion is to be invested in new and upgraded infrastructure over the next ten years. This funding is to come from the NSW annual budgets, borrowings, and Public Private Partnerships (PPPs). It is estimated that between 10 and 15 percent of the State's future capital expenditure is to be procured through PPPs (NSW Government (2010c)).



This means that the remainder of the infrastructure investment will go unfunded at least until 2013-14, unless the private sector is able to finance the shortfall. In part because of the rapid growth in their market share in total infrastructure investment, and despite some well publicised project failures (see Johnson (2010) and (Phillips (2007)), some may expect that PPPs could continue to rapidly expand their share of total investment, given the infrastructure funding gap. However, as we go on to argue below, greater private investment in infrastructure can only and should only take up a small amount of the infrastructure investment task. The heavy lifting can only effectively be done by government.



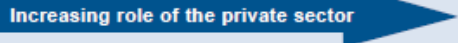
4. Public, private partnerships

The trend increase in private funding of public infrastructure through the 'Public Private Partnerships' model in Australia has occurred also in the US and the UK (in the UK the term used is the Private Finance Initiative or PFI).

The traditional way in which infrastructure has been built, with governments funding and the private sector contracted to complete most if not all of the project design and physical building was a public private partnership. However, today the term PPP is commonly used to connote some greater level of private involvement in the delivery of infrastructure services than this traditional model. In particular, in addition to private building of the infrastructure, there is also private *funding* of that asset.

The typical PPP involves is an arrangement where a private firm (usually a consortium) contracts with a public sector agency to finance, design and construct (or refurbish) a facility under a time and cost-specific contract. Following construction, which is undertaken and financed by the consortium, services are provided under a long-term contract. With the government making ongoing payments for 'infrastructure services' the private partner uses the resulting revenue stream to repay debt and interest, fund operations, deliver contracted services and provide a return to equity investors. Payments are typically not made until the asset is commissioned and operational.

Figure 7: The PPP spectrum

	Increasing role of the private sector 			
Private party role	Infrastructure services only	Infrastructure and ancillary services	Infrastructure and partial private-to-public service delivery	Infrastructure and service delivery to users
Government role	All public-to-public services	Delivery of core public services	Delivery of core public services	No operational role
Example	Public buildings	Non-core hospital services, non-judicial court services	Community facilities linked to educational facilities (e.g. after-hours usage)	Roads, rail, port facilities, car parks

Source: Partnerships Victoria, *Public Service Comparator*, 2001, p. 4.

Historically the main PPP projects (by value) in Australia and overseas have been transport-related. However, PPPs are increasingly being used in social infrastructure such as hospitals and schools. Australian PPPs have been used for delivering projects such as major toll roads, hospitals, prisons, schools, utilities and sporting facilities.



Box 4 How successful is the Australian PPP model?

According to KPMG many aspects of the Australian PPP model are world leading. It has attracted strong interest from the domestic and international markets, as indicated by many other countries seeking to learn from the Australian experience and the number of major international companies that bid for Australian PPP projects.

A report by the OECD in 2007 ranked Australia as the world's most mature PPP market, ahead of the UK and Canada, though Canada has gained in reputation and number of transactions in recent years.

Nonetheless compared with international norms, Australia's failure rate of PPPs is significantly higher at 7% compared with below 1% of total projects, as assessed by rating agencies.

Explanations of these problems in Australia include the incidence of underbidding, over-optimistic forecasts, and inadequate risk allocation.

Estimates of the size of the Australian PPP market vary, as do projections of future take up of PPPs. Infrastructure Partnerships Australia reported in 2007 that PPPs share of gross fixed capital formation projected for 2008 was in the vicinity of 10% to 15% compared with around 4% four years earlier.⁹

There are number of general limitations on the potential increased share of PPPs (and other specific purpose vehicles) to facilitate private investment in infrastructure.

The research into the effectiveness of PPPs has demonstrated that some forms of PPP are more suited than others for a particular task. For example, with respect to the use of BOOT schemes,¹⁰ the Private Infrastructure Task Force Report said this:

In the broad, BOOT-type structures are likely to be least beneficial for road and urban rail projects. They are advantageous for long distance rail and for utility services such as electricity and water. But for utility services it is possible that privatisation of networks might offer even greater gains. This is particularly so if competition can be introduced through, for example, breaking up generation or distribution.

⁹ A number of studies confirm a market share of between 10%-15%, at the national level, although it varies from state to state and from year to year - see the Productivity Commission (2009), p. 143 and the Victorian Parliamentary Inquiry (2006).

¹⁰ "BOOT" refers to the process by which a road is built, owned, operated and ultimately transferred from the private sector builder to the government after some previously agreed period.



The nature of the contractual relationship between private and public sources of funding, ownership and governance of infrastructure should optimise the contribution that each can bring to each phase of an infrastructure investment project – being design and construction, financing, operation/management and ownership.

The private sector has important advantages in building the main physical, construction components of infrastructure and in some aspects of management. Most of these advantages are accessed from the 'old' model of PPPs in which private contractors design and/or build infrastructure which the public sector funds with managers who are notionally from the public sector nevertheless free to sub-contract and outsource any number of constituent tasks that management and maintenance may require.

There are a range of areas in which the private sector may enjoy practical advantages over the public sector. Thus private firms may be better at managing the interface between the infrastructure and its various uses – as for instance in allowing a school to be used out of hours for non-school purposes. They may have been more successful in ridding workplaces of restrictive practices. And politicians may be more comfortable allowing road tolls where they can be justified as repaying a private investor than they would be justifying tolls on a publicly built road.

In each case if, for other reasons the public sector would otherwise be the better funder, owner and governor of the infrastructure, the 'first best' answer in each case would be to reform public sector practices to remove the obstacles to good practice. If this is impossible, a PPP, while sub-optimal, may nevertheless be the best option available.

There are a number of specific difficulties with the PPP model.

- PPPs usually entail a higher cost of capital than if the risks were carried by the general government budget and investment were financed via public lending.
- Complex financial contracts, involving commitments to future payments, may reduce transparency, requiring strong institutional checks. Further though politicians face incentives to borrow to fund popular programs only to be funded by citizens some years later, this temptation remains the same with PPPs, except that, in addition to the bearing of costs being delayed, those costs are pushed 'off the books' of government, enabling politicians to distance themselves even further from the most transparent course of action.
- The inherent long-term character and complexity of PPP contracts itself may have adverse effects on the effectiveness of competition, as fewer firms are able to make a bid, and contracts must be



able to accommodate changes in future need which are inherently difficult to foresee.

- Further, governments may agree to constrain their own future planning options in ways that they cannot fully understand until the relevant amount of time has passed. Indeed, sometimes they may agree to constrain themselves in ways that are resented by the community immediately their effects are felt, as occurred with the cross-Sydney tunnel.
- As far as large-scale infrastructure is concerned, achieving co-ordination among alternative routes and means of transport is crucial and having a range of different private owners may entail complicated and costly negotiations to accommodate changes.
- Further, insofar as the government may ultimately be held responsible for outcomes, the transfer of risks to private contractors may be partial, with the government having to step in if something goes wrong. Where this occurs the government gets the worst of both worlds, paying a high price for what appears like risk transfer, only to discover that the risk has not been effectively transferred.
- Transparency can be impaired with major aspects of huge contracts, including billion dollar price tags being commercial in confidence. This creates the scope for corruption and for the perception thereof. It has been a matter of public note that the former Premier of NSW now enjoys an attractive position with Macquarie Bank – one of the largest beneficiaries of PPPs in NSW.
- The complexity of PPPs is a bane to private competitors to participate, with the preparation of competing bids, only one of which can be selected, costing many millions of dollars each. Further the public servants negotiating contracts are often inadequately skilled, resourced and remunerated in the financial transactions to which they are agreeing on the public's behalf.

Even if all these matters could be effectively addressed, PPPs are likely to remain essentially a boutique solution to specific infrastructure issues with one problem or another making it inefficient for PPPs to fund most of Western Sydney's major infrastructure needs¹¹.

¹¹ For further reading on Australian PPPs see bibliography, including Committee for Adelaide Roads, Deloitte Research (2007), Quiggin (2006) amongst others.



5. Getting Western Sydney going the traditional way: an indicative counterfactual

One of the best ways to demonstrate the wisdom of the path being proposed is to ask what might have been had we pursued the kinds of policies we are proposing over the last few decades. What if some or all of the privately funded roads in NSW had been funded by State borrowing with tolls equivalent to those that obtained under private stewardship? Lateral Economics produced an indicative simulation of such a counterfactual. We conclude that, had the NSW Government borrowed to invest in Sydney's toll roads rather than the private sector, in 2009-10 dollars, over the course of building these roads it would have acquired ownership of a stream of revenue with a net present value which we estimate at \$12.8 billion,¹² at the cost of increasing its borrowing by \$7 billion.

The difference between these two figures is \$5.8 billion. NSW has taken on more risk to be in this position and it would be appropriate for it to assess the value of the asset using a somewhat higher rate of return than the bond rates it is paying lenders. The economic literature is not conclusive about how to account for the appropriate return for risk. We would argue that the appropriate figure should be, as Grant and Quiggin (2003) suggest at around 0.5% and if this were the case the state's net worth could be regarded as having increased by just \$4.6 billion for having funded the roads.¹³

Further, given the amount of time that has passed since many of these projects were commenced, by 2009-2010, only \$2.7 billion of the original \$7 billion would remain to be paid off. This means that in the last financial year there would have been free cash flow to the budget of \$379 million after interest payments and even after provisioning for further principal repayments. This figure would continue to grow strongly reflecting the combined effects of increasing revenue and declining interest payments on debt attributable to the project.

Because these road assets earn such a generous commercial return, we think it very unlikely that taking on the additional debt to fund them would have led to a credit downgrade – as a similar amount of additional government debt might have done for assets that did not generate a commercial return. Further, had this occurred, we think it

¹² This is the sum of the revenues of all projects expressed as a net present value at the commencement of each project in constant 2009-2010 dollars. The discount rate used is a real discount rate of 4.1 percent corresponding to a nominal rate of some 6.60% which in turn was derived from NSW 10-year government bond rates weighted according to when the various toll roads were completed (and assuming that the various debts involved were regularly refinanced at 4-yearly intervals at then-prevailing bond rates).

¹³ The *expected* net value of the project remains \$5.8 billion but a charge 0.5% of the borrowings is being imposed on the project to cover the insurance cost of things not working out. By the same token, things may work out better than expected.



exceptionally unlikely that the investment would be continuing to depress NSW's credit rating, given how strongly cash positive it had become. Nevertheless, it is worth noting that if there was a credit downgrade today, it would increase the interest cost of the debt, not just on the \$2.7 billion remaining debt attributable to the roads but over the whole of the net debt on the government's balance sheet which is around \$36 billion.

If the interest cost of this debt were to rise by 0.15% which it can be argued is the cost of Queensland's credit downgrade (see below) the cost to the budget would be \$58 million dollars. More conservatively, if this cost was 0.4% the cost would be \$155 million annually. Even here not only would the NSW government be in possession of increasingly valuable assets, but even taking into account the total interest cost of any credit downgrade the projects would be contributing between \$225 million and \$321 million to the NSW Government's 2009-10 bottom line which figure would rise over time.¹⁴

Alternatively, under the counterfactual scenario of government ownership, tolls could be abolished on individual toll roads after each had broken even.

Table 2: Estimated financial years in which the net present value of toll roads first turn positive

<i>Toll road</i>	<i>Financial year</i>
SHT	2013-14
M4	2000-01
M5	2001-02
M2	2015-16
ED	2002-03
CCT	2020-21
M7	2030-31
LCT	2021-22

Source: Lateral Economics

Another option to illustrate the improved efficiency of public provision of road infrastructure would be to halve tolls in 2011 and then index them to inflation to maintain their real values. Under this scenario the net present value — although reduced — would still be sufficient to cover the interest cost of moving from a AAA to a AA rating,¹⁵ though as we have indicated, we think this extremely unlikely.

¹⁴ In the discussion so far we have not accounted for the cost of a credit downgrade over the life of the project. We did so in one scenario which assumed that the cost of a credit downgrade was 25 basis points. In this scenario the extra servicing cost had the effect of reducing the estimated net present value of the toll roads by some \$609 million dollars (in constant 2009-10 prices). More generally, based on NSW Government debt figures for the period 2000 through 2012, the extra debt servicing costs would have amounted to just over \$1 billion. Even so, the net present value of the toll roads would have remained comfortably positive — at in excess of \$4 billion.

¹⁵ Refer previous footnote.



Table 3: Economics of NSW toll roads
(Financial years, % and \$m in constant 2009-10 prices)

Item	SHT	M4	M5	M2	ED	CCT	M7	LCT
Debt servicing charge(b)	86	0	0	120	0	103	180	101
Net revenues(c)	108	106	162	140	82	102	171	98
Free cash flow (equal to net revenues less debt servicing charge)	22	106	162	20	82	-1	-9	-3
Proportion of debt paid off (%)	86.9	100	100	76.2	100	32.8	23.5	25.1
Proportion Of revenues earned (%)	65.0	100	63.5	40.6	32.0	19.0	18.3	14.3
NPV in 2009-10	384	0	863	1107	919	442	308	426
First year in which annual revenues exceed annual costs(d)	2002-03	1996-97	1997-98	2004-05	2001-02	2011-12	2015-16	2012-13
Year in which toll road paid off (e)	2013-14	2000-01	2001-02	2015-16	2002-03	2020-21	2030-31	2021-22
2009-10								
Costs(a)	1198	534	821	1332	133	667	1647	630
Revs(g)	1546	1044	2363	2398	1351	1099	1919	1048
NPV at end of concession period(f)	348	510	1542	1066	1218	432	272	418

Notes: (a) Historical construction costs converted to 2009-10 prices using implicit price deflator for non-dwelling new engineering construction published by the ABS. Costs sum to \$6.962 billion (representing the full cost of constructing all the toll roads in 2009-10 dollars).

(b) Debt servicing charges are the estimated interest costs of servicing the loans to cover construction costs where the period of the loan is assumed to extend from the end of the construction period through to the year in which each toll road is estimated to be paid off (i.e. the entries in row 10 of the table). (See note f for the interest rate used to calculate annual interest costs).

(c) 2009-10 net revenues — equal to toll revenues minus estimated toll road maintenance costs — based on an Ernst & Young report downloadable from Infrastructure Australia at http://www.infrastructureaustralia.gov.au/public_private_partnership_related_reports.aspx. Net revenues sum to \$969 million in 2009-10.

(d) Entries in this row are the estimated year in which the estimated net revenues first exceed annual debt servicing costs.

(e) Entries in this row are the estimated year in which the net present value (NPV) of each toll road falls to zero (after which toll revenues — if continued — could be used to reduce general government debt). (See note f for the interest rate used to calculate annual interest costs).

(f) The base case (nominal) discount rate used to produce the estimates reported in this table are derived from NSW 10-year government bond rates weighted according to when the various toll roads were completed (and assuming that the various debts involved were regularly refinanced at 4-yearly intervals at then-prevailing bond rates). This rate was 6.60% which was turned into an equivalent real (i.e. inflation-adjusted) rate to apply to the various constant-price estimates of costs and revenues by using the implicit price deflator for non-dwelling new engineering construction published by the ABS. These estimates sum to \$5.806 billion.

(g) NPV of total revenues (summing to \$12.768 billion).

Source: Lateral Economics



One of the central takeouts from this discussion is that *there is a dynamic relationship between AAA ratings today and AAA ratings tomorrow*. Too excessive, and arbitrary focus on reducing debt today can not just compromise economic growth, but also the State's revenues, operating result and net worth and through that it's credit rating in the future. Accordingly prudence requires that decisions on today's debt levels be made on well informed and thought out financial grounds, rather than according to arbitrary formulas or phobias.



6. A better tradeoff

Obviously other things being equal, holding a credit rating of AAA is attractive. Indeed, for as long as the NSW Government is in debt, the AAA credit rating will generally be bankable in the form of a lower cost of debt. In addition, as the NSW Government points out, there may be external benefits from having such a rating – for instance the AAA rating may offer some fillip to the confidence in NSW domiciled firms, though this would likely be somewhat marginal unless outside of some devastating deterioration in the government's fiscal position.¹⁶

But the world is full of tradeoffs and it is best to make such tradeoffs by deliberation. The alternative is the current procedure which is to determine an important policy matter arbitrarily, by 'feel' as it were, adhering to a policy that has been determined without regard to careful financial analysis. We are unaware of any financial analysis according to which the NSW Government has considered the relative costs and benefits of having a AAA rating and chosen its course according to that analysis. Yet had directors of a public company decided upon managing their company's balance sheet in such a way, they would have been negligent in their duty – perhaps actionably so.

There are a number of costs of maintaining the NSW Government AAA rating, when there is a significant infrastructure investment deficit. These include lost economic services and economic growth, the higher cost of funding such services through the private sector and the loss of social amenity that may attend underinvestment in infrastructure.

The increase in funds available to the government from being prepared to countenance a move from AAA to a AA rating,¹⁷ as Queensland has done, is very substantial. These funds are then available to invest, including in infrastructure, to the ultimate benefit of the government's balance sheet and for the support of higher rates of economic growth.

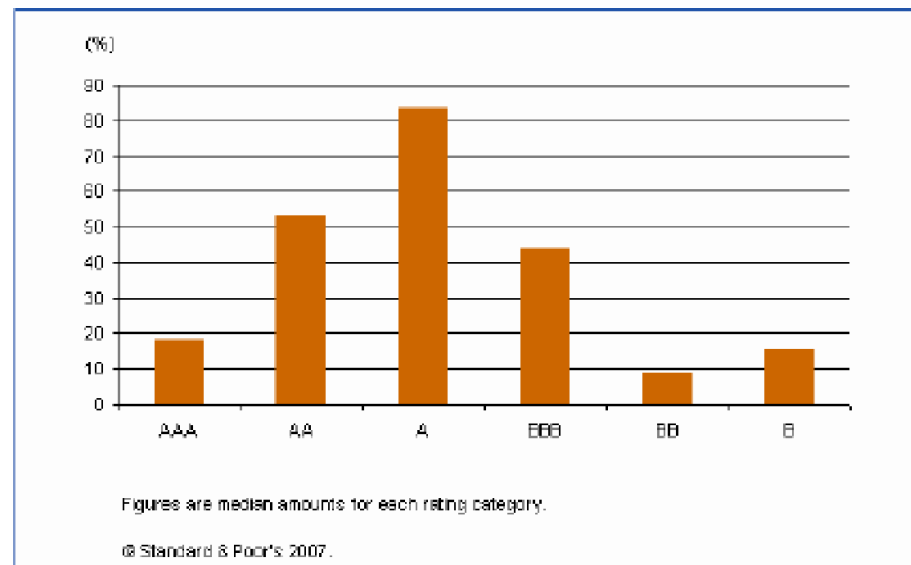
We can get an approximate idea of the increased quantity of funds by comparing the average amount of debt of AAA rated Local and Regional Governments (LRGs) and AA rated LRGs. AAA LRGs average direct debt is approximately 18%. But the average for LRGs with a AA rating is around three times higher at 53%.

¹⁶ See comment at http://www.treasury.nsw.gov.au/NSW_Triple_A.

¹⁷ We refer to this rating as AA for convenience to include the Aa1 rating by Moodys and the AA+ rating of Standard and Poor's. See Queensland Treasury Corporation at <http://www.qtc.qld.gov.au/qtc/wcm/connect/6c64bb00405313d09e959fdde7267cf5/Pages+from+Investor+Booklet+2010+09+30+Part+3.pdf?MOD=AJPERES&CACHEID=6c64bb00405313d09e959fdde7267cf5>.



Figure 8: Direct Debt as a percentage of Operating Revenues (2004-6)



Source: Standard and Poor's, *Rating International Local And Regional Governments: A Primer*, 2007

Here is Standard and Poor's description of a AA borrower:

An organisation rated 'AA' differs from the highest rated obligations only to a small degree. The obligor's capacity to meet its financial commitment is very strong.

Three rating agencies - Standard and Poor's, Moodys and Fitch Ratings – all adjusted Queensland's credit rating downward by one level in the first half of 2009. All cited the Queensland Government's 2009-10 budget and financial projections, while acknowledging "the challenges of providing services and infrastructure for a growing economy and population". All commented that the Queensland's economic outlook was stable and as Fitch Ratings indicated, Queensland retained "a very strong credit profile, and has ample resources to pay its debt." (Brisbane Times (2009b).

In its Review of the National Access Regime, the Productivity Commission (2001, p. xix) pointed out a critical asymmetry regarding the pricing of access to infrastructure:

Third party access and the resulting benefits to service users are only possible over the longer term if there is continuing investment in the essential infrastructure services themselves. On the other hand, while denial or monopoly pricing of access imposes costs on the community, such behaviour cannot threaten the continued availability of the services concerned. This asymmetry in potential outcomes highlights the priority that access regulation must give to ensuring that there are appropriate incentives for efficient investment.

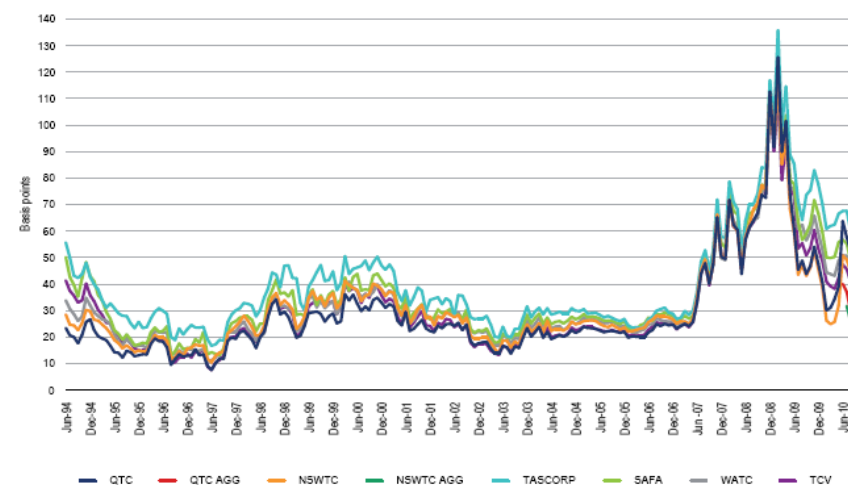


The same principle applies to the *funding* of infrastructure. Where infrastructure is needed, there may be more and less costly ways to fund it, but if it does not exist because certain funding options have been arbitrarily proscribed, its absence is likely to involve large (and growing) costs.

Indicative financial analysis of the costs and benefits

Clearly a worse credit rating tends to increase the servicing costs of outstanding debt. But how much? At the time Queensland's moving to a AA credit rating was reported the Treasurer Andrew Fraser expected the change to increase interest costs on Queensland Government borrowings by 0.4 %, or \$200 million in annual debt servicing costs (Barbeler, 2009). However as illustrated in Figure 9, since 2009, Queensland Government debt has traded between 10 and 15 basis points higher than NSW Government debt.

Figure 9: Domestic Australian Semi-Government bonds, respective margins to Australian Government bond rates



Average duration adjusted for maturities longer than two years.

Source : Queensland Treasury Corporation (2010), p.59

The costs and benefits of a step change in infrastructure investment for NSW can be identified. The costs can be calculated taking the higher interest cost on borrowings to Queensland of 15 basis points, as the cost of a credit downgrade on NSW Government issued debt. This amounts to slightly more than \$50 million per annum on \$36 billion of outstanding debt. More conservatively, if the cost of a downgrade is 0.4%, this would increase total interest costs by a little less than \$150 million per annum.

Against this, tens of billions of dollars additional investment in infrastructure could be funded. If this investment were in economic



infrastructure such as toll roads, not only would it be unlikely to trigger a downgrade, but it could yield direct commercial returns for the NSW Government which substantially exceeded the cost of debt including some reasonable allowance for the additional risk, at the same time as generating a dividend for the state in the form of higher economic growth.

In addition to the counterfactual explored in detail in the previous section, an illustrative thought experiment would be to harness the strength of the NSW balance sheet to move towards fully funding the state's \$28.5 billion dollar superannuation liabilities. Assuming conservatively that average returns over time exceed the cost of borrowing by 3.5% per annum the returns to investment would on average exceed the cost of borrowing by \$1 billion per year. Moreover given the liquidity of the investments in the superannuation fund and their returns to the government, we find it most implausible that such a strategy would trigger a credit downgrade.

Nevertheless even if it did, the cost of a downgrade would be a small fraction of the benefits thus generated. This still leaves the strategy improving the State's net worth by at least \$750 million dollars per annum. Of course the gains would not come steadily. There would be some years when the costs of borrowing exceeded returns in the portfolio. There could be some years when returns for the portfolio would be negative. But over any reasonable period of time the State would be ahead. And it would be demonstrating that the hard work that NSW put into the financial stability was not just sitting idle, but prudently building the foundation for stronger finances in the future.

The Commonwealth should be more involved

The Commonwealth should also participate much more vigorously than it has done so far, and where appropriate contemplate increasing its borrowing to fund infrastructure investment. The Commonwealth has

- a much stronger balance sheet (unsurprisingly given that so much infrastructure and government investment is undertaken by the states in providing basic services to the population).
- a much deeper and more efficient tax base. This means that
 - it faces lower costs of capital and risk bearing (this is also brought about by the size and liquidity of the market in its bonds)
 - it benefits much more from the ways in which infrastructure can generate economic benefits external to infrastructure projects. For each dollar of external economic benefit generated by some piece of infrastructure, the Commonwealth earns around twenty five cents in additional tax revenues against the state's five cents.



7. Improving governance in infrastructure investment and the management of government balance sheets

Lateral Economics acknowledges that what is being proposed is a substantial break from the past. Yet it is imperative that such a change not be - and not be seen to be - a simple swinging of the pendulum to lessen what on its face has been a laudable indeed historic commitment to very high levels of fiscal responsibility. The problems of disciplining governments to consider the long term while they navigate the short term remain substantial. But they cannot be solved with arbitrary limits on debt – indeed the recent period of ‘populist fiscal rectitude’ illustrates a variety of ways in which NSW policies have short-changed the future. It is not difficult to lower debt if one is prepared to let the infrastructure investment deficit blow out.

Thus, rather than simply dilute the arbitrary commitments to fiscal rectitude to which both political parties are currently committed, we must build the institutions to better discipline the political process to consider the long term. We should accordingly build the institutions to ensure that when governments consider infrastructure investments and how to fund them, both in aggregate and with regard to each specific major project, they do so in the context of a clear and publicly understood appreciation of the costs, benefits and risks of the alternatives before them.

In this vein the incoming British Coalition Government is establishing the Office of Budget Responsibility. The United States has the independent Congressional Budget Office to provide the Congress with independent economic analysis. But a wide range of leading economists around the world have proposed that we take this further and develop institutions which can deliver to fiscal policy some of the independence that independent central banks have delivered to monetary policy (See Appendix)

In this regard we propose what would be a modest step on the path towards more independent fiscal policy. We propose that an independent, expert agency report publicly on the cost effectiveness of government’s infrastructure investments, and the management of their balance sheets, including the mix of infrastructure and financial assets on those balance sheets. Such services could be provided by a new, purpose built institution, or delivered by existing institutions such as Auditors General.

Institutional changes are needed because clearly the ones we have relied on till now have failed. Though they continue to provide a valuable service in rendering the fiscal position of sub-national governments more transparent, independent credit rating agencies have nevertheless been shown to be compromised (handing out AAA ratings to securitised sub-prime



mortgage bonds many of which turned out to be worthless). What has been proposed would be like establishing an internal government credit rating agency, which as it grew in influence would itself enhance market confidence and reduce the likelihood of a credit downgrade.

More importantly it would create the circumstances in which Western Sydney could aspire to get going once again, at the same time as building upon the proud legacy of economic reform in Australia rather than succumbing to weakness and complacency. It would allow us to face the future with optimism, rather than hunkering down, fearful of welcoming others into our community and preparing for our future by adopting the financial structure of a retired couple.



Bibliography

- ABN-AMRO Equities Australia Limited, 2008. *Australia Strategy*, 2 May 2008.
- Allen Consulting Group, 2003. *Funding Urban Public Infrastructure - Approaches Compared*, Report to the Property Council of Australia.
- Allen Consulting Group, 2005. *Infrastructure Investment for a More Prosperous Australia*, Report to the Government of Victoria.
- Allen Consulting Group, 2007. *Performance of PPPs and Traditional Procurement in Australia*, Report to Infrastructure Partnerships Australia.
- Applied Economics 2003. *Financing Public Infrastructure for Urban Development*, Report prepared for the Urban Development Institute of Australia (NSW), http://www.appliedeconomics.com.au/pubs/reports/rep03_infra (accessed 19 October 2010).
- Australian Broadcasting Corporation, 2006. *Four Corners*, edited transcript of an interview between Ticky Fullerton and Tony Harris, Former NSW Auditor General (1992-1999), 20 February 2006 at <http://www.abc.net.au/4corners/content/2006/s1573798.htm>.
- Ball, L, 1996. 'A Proposal for the Next Macroeconomic Reform.' *Victoria Economic Commentaries* 14: 1–7.
- Barbeler, David, 2009. 'Fallen credit rating to cost Qld \$200m,' *Sydney Morning Herald*, 21 February, 2009 at <http://news.smh.com.au/breaking-news-national/fallen-credit-rating-to-cost-qld-200m-20090221-8e0g.html> (accessed October 2010).
- Blackwell, Richard, 2010. 'New Brunswick hit with credit rating cut,' *The Globe and Mail*, 7 October 2010 at <http://www.theglobeandmail.com/report-on-business/economy/growth/new-brunswick-hit-with-credit-rating-cut/article1748480/>
- Blinder, A, 1997. 'Is Government too Political?' *Foreign Affairs* 76: 115–126.
- Bright, Greg, 2010. 'Infrastructure: how super funds are changing the world,' *Investment Magazine*, 08 February 2010 at <http://www.investmenttechnology.com.au/cover-story/infrastructure-how-super-funds-are-changing-the-world>.
- Brisbane Times Staff Reporters, 2009a. 'Moody's downgrades Queensland debt rating,' *Brisbane Times*, 21 May 2009 at <http://www.brisbanetimes.com.au/business/moodys-downgrades-queensland-debt-rating-20090521-bq99.html>



Brisbane Times Staff Reporters, 2009b. 'Qld suffers another credit rating downgrade,' *Brisbane Times*, July 20, 2009, at <http://www.brisbanetimes.com.au/queensland/qld-suffers-another-credit-rating-downgrade-20090720-dql2.html>

Business Council of Australia, 1999. 'Avoiding boom/bust: macro-economic reform for a globalised economy', Discussion Paper No 2.

Business Council of Australia, 2005. Reforming and Restoring Australia's Infrastructure.

Business Council of Australia, 2007. Revitalising Infrastructure Reform.

Business Council of Australia, 2009. Groundwork for growth building the infrastructure that Australia needs.

Business Council of Australia, 2009. Seizing the opportunity to reform and restore Australia's economic infrastructure.

Calmfors, L, 2003. 'Fiscal Policy to Stabilize the Domestic Economy in the EMU.' *CESifo Economic Studies* 49: 319–353.

Canning, David. The Contribution of Infrastructure to Aggregate Output, Department of Economics, Queen's University at Belfast, Belfast, Northern Ireland at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=629182.

Citigroup Economic & Market Analysis, 2008. *Australia's Infrastructure Supercycle*, 20 June 2008.

COAG (Council of Australian Governments), 2007. *Australia's Infrastructure National Overview Report*, http://www.coag.gov.au/meetings/130407/docs/infrastructure_reports_nat.pdf (accessed 1 June 2007).

Cohen, Jeffrey P. and Morrison, Catherine J, 2004. 'Public Infrastructure Investment, Interstate Spatial Spillovers and Manufacturing Costs,' *Review of Economics and Statistics*, May 2004, 86(2): pp. 551–560.

Committee for Adelaide Roads, 2004. 'Private Sector Investment in Roads,' Submission to AusLink, Adelaide Urban Corridor Strategy, at <http://www.car.asn.au/documents/SubmissionAdelaideUrbanCorridorStudy.pdf>.

Coombs, G. and Roberts C, 2007. 'Trends in infrastructure', *Economic Roundup (Summer)*, Commonwealth Treasury, pp. 1–16.

Debande, O, 2000. 'Private financing of infrastructure. An application to public transport infrastructure.' Paper prepared for the Sixth International Conference on Competition and Ownership in Land Passenger Transport.



- Debrun, X., Hauner D. and Kumar M, 2008. 'Independent Fiscal Agencies.' *Journal of Economic Surveys* Vol 23. No.1 pp 44-81.
- Deloitte Research, 2007. Closing the Infrastructure Gap: The Role of Public-Private Partnerships at http://www.deloitte.com/view/en_US/us/industries/US-federal-government/2ea59a17c900e110VqnVCM100000ba42f00aRCRD.htm (accessed October 2010).
- Di Marco, Katrina, Pirie, Mitchell; Wilson Au-Yeung, 2009. 'A history of public debt in Australia' *Economic Roundup*, Issue 1 2009.
- Duffy, M, 2008. 'A city on the edge of a nervous breakdown? Let me count the ways, *Sydney Morning Herald*, 2 February 2008 at <http://www.smh.com.au/news/opinion/a-city-on-the-edge-of-a-nervous-breakdown-let-me-count-the-ways/2008/02/01/1201801034782.html?page=fullpage>.
- Eichengreen, B, Hausmann, R. and von Hagen, J, 1999. 'Reforming Budgetary Institutions in Latin America: The Case for a National Fiscal Council.' *Open Economies Review* 10: 415–442.
- English, L, 2006. 'Public Private Partnerships in Australia: An Overview of Their Nature, Purpose, Incidence and Oversight' *UNSWLawJl* 46; (2006) 29(3) University of New South Wales Law Journal 250.
- Ernst & Young, 2007. The economic contribution of Sydney's toll roads to NSW and Australia, at [http://www.infrastructureaustralia.gov.au/files/Eco_contribn_of_sydney's Toll-Roads_EY2008.pdf](http://www.infrastructureaustralia.gov.au/files/Eco_contribn_of_sydney's_Toll-Roads_EY2008.pdf).
- Ferguson, A, & Hewett, J, 2009. 'Nation building funding crisis as private sector fails to find cash,' *The Australian*, 19 March 2009 at <http://www.theaustralian.com.au/politics/nation-building-funding-crisis/story-e6frgczf-1225689635490>.
- Fitzgerald, P, 2003. Review of Partnerships Victoria Provided Infrastructure, Final Report to the Treasurer at [http://www.partnerships.vic.gov.au/CA25708500035EB6/WebObj/PPPFitzgeraldreviewDec1/\\$File/PPP%20Fitzgerald%20reviewDec1.pdf](http://www.partnerships.vic.gov.au/CA25708500035EB6/WebObj/PPPFitzgeraldreviewDec1/$File/PPP%20Fitzgerald%20reviewDec1.pdf) (accessed October 2010).
- Goldberg, John L, 2006. 'The Fatal Flaw in the Financing of Private Road Infrastructure in Australia', University of Sydney 2006 at http://www.faculty.arch.usyd.edu.au/web/staff/homepages/pdf/johngoldberg_ATRF06_summary.pdf.
- Gordon, Cameron. Infrastructure in the 21st century economy, Overview and



Summary of Methods and Findings, at
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1090103.

Gramlich, Edward M, 1994. 'Infrastructure Investment: A Review:' *Journal of Economic Literature*, Vol. 32, No. 3 (Sep., 1994), pp. 1176-1196 at
<http://www.jstor.org/stable/2728606>.

Grant, Simon and Quiggin, John, 2003. "Public Investment and the Risk Premium for Equity" *Economica*, New Series, Vol. 70, No. 277, Feb. pp. 1-18: Stable URL: <http://www.jstor.org/stable/3548814>

Gray, Stephen, 2007. 'Financing Infrastructure: Public versus Private' in CEDA, 2007, *Sustainable Queensland*, Information Paper No 88, p. 13.

Greater Western Sydney Economic Development Board, 2008. 2008 Regional Economic Profile at <http://www.gws.org.au/page.asp?id=50>.

Gruen, N, 1997. 'Making Fiscal Policy Flexibly Independent of Government.' *Agenda* 4: 297–307.

Gruen, N, 2000. 'Greater Independence for Fiscal Institutions.' In *21st Annual Meeting of Senior Budget Officials*. Paris: OECD.

Harris, A.C., 2006. Submission to Senate Standing Committee Inquiry on Transparency and Accountability of Commonwealth Public Funding and Expenditure, at
http://202.14.81.34/senate/committee/fapa_ctte/funding_expenditure_06/submissions/sub07.pdf (accessed 1 June 2007).

Infrastructure Australia, 2010a. *State of Australian Cities 2010*

Infrastructure Australia, 2010b. 'Getting the fundamentals right for Australia's infrastructure priorities', Report to COAG
http://www.infrastructureaustralia.gov.au/files/Report_to_COAG_2010.pdf.

Infrastructure Partnerships Australia, 2008. Infrastructure Partnerships Australia, Australian Constructors Association & Australian Industry Group, Submission to Infrastructure Australia Discussion Paper 2: Public Private Partnerships October 2008.

Infrastructure Partnerships Australia, 2010. 'Funding for Sydney's Road, Rail Projects Important for National Productivity', Media Release, 11 August 2010.

Johnston, J, 2010. Examining 'Tunnel Vision' in Australian PPPs: Rationales, Rhetoric, Risks and 'Rogues'. *Australian Journal of Public Administration*, 69: S61–S73.

Keating, P.J, 2008. Ali Moore Interview with PJK, 'Commentary we had to have: Keating on rates, ratings and ratchets', at



<http://www.crikey.com.au/2008/10/07/commentary-we-had-to-have-keating-on-rates-ratings-and-ratchets/>

Korda Mentha, 2008. Media Release, 'Sold: \$700m Cross City Tunnel' at <http://www.kordamentha.com/downloads/NewsFiles/Media%20Release%20%E2%80%93%20Cross%20City%20Tunnel%20Group%20Sold.pdf>

KPMG, 2010. *PPP Procurement-Review of Barriers to Competition and Efficiency in the Procurement of PPP Projects*, May 2010.

Munnell, Alicia H, 1992. 'Infrastructure Investment and Economic Growth,' *Journal of Economic Perspectives*, Vol. 6, No. 4 (Autumn, 1992), pp. 189-198 at <http://www.jstor.org/stable/2138275>.

New South Wales Government, 2008. Infrastructure Audit Submission to Infrastructure Australia, June 2008.

Nielson, L, 2005. Superannuation Investment in Infrastructure, Research Note no. 42 2004-05, Department of the Parliamentary Library, at <http://www.aph.gov.au/library/pubs/rn/2004-05/05rn42.htm>.

NSW Bureau of Transport Statistics <http://www.transport.nsw.gov.au/tdc> (accessed October 2010).

NSW Government Budget Papers, 2010a. Budget Paper No 2, Chapter 3, Fiscal Strategy.

NSW Government Budget Papers, 2010b. Budget Paper No 2, Chapter 7, Liability Management.

NSW Government Budget Papers, 2010c. Budget Paper No 4, Infrastructure Statement.

NSW Government, Office of Financial Management, 'Private Provision of Public Infrastructure and Services.'

NSW Government, State Infrastructure Strategy 2008-18.

NSW Treasury, 1988. Policy Framework: Government Trading Enterprises, Report prepared by the Steering Committee on Government Trading Enterprises.

NSW Treasury, 2006. Working with Government: Guidelines for Privately Financed Projects.

Parliament of NSW, 2006a. Public Accounts Committee Inquiry into Public Private Partnerships, Report No. 16/53 (159).

Parliament of NSW, 2006b. The Cross City Tunnel and Public Private Partnerships: Second Report.



- Parliament of Victoria, 2006. Report on Private Investment in Public Infrastructure, Public Accounts and Estimates Committee Report no. 240, Session 2003-06.
- Partnerships Victoria, 2001. Public Service Comparator.
- Phillips, Geoff, 2007. Analysis of Sydney Public-Private Partnership Road Tunnels, Paper for ASOR National Conference 3-5 December 2007.
- Productivity Commission, 2001. Review of the National Access Regime, Report no. 17, AusInfo, Canberra.
- Productivity Commission, 2009. Staff Working Paper, 'Public Infrastructure Financing : An International Perspective'
- Queensland Government, 2009. South East Queensland Regional Plan 2009 to 2031, <http://www.dip.qld.gov.au/regional-planning/regional-plan.html> (accessed October 2010).
- Queensland Government, 2010. State Capital Program, Planning and Priorities, page 11, at <http://www.budget.qld.gov.au/budget-papers/2010-11/bp3-2-2010-11.pdf> (accessed October 2010).
- Queensland Treasurer, 2009. Ministerial Media Statement, Saturday, February 21, 2009
<http://www.cabinet.qld.gov.au/MMS/StatementDisplaySingle.aspx?id=62898> (accessed October 2010).
- Queensland Treasury Corporation, 2010. 'Investor booklet, as at 30 September 2010: Part 3 - Queensland Treasury Corporation' at http://www.qtc.qld.gov.au/qtc/public/web/investors/!ut/p/c5/04_SB8K8xLLM9MSSzPy8xBz9CP0os3hzd_NqCydDRwN3DwsLA08LyyCLlIsQI3cfU_1wkA6cKgWMDCDyBjiAo4G-n0d-bqp-QXZ2mqOjoilABv0RGg!!/dl3/d3/L3dDb0EvUU5RTGtBISEvWUZSdndBISEvNI83RzdTOElxQTBHRzc4MEIPUUM3VkrPMjAwMA!!/.
- Quiggin, J, 1996a. 'Private investment in public infrastructure projects', *Australian Economic Review*, vol. 96, no. 1, pp. 51–64.
- Quiggin, J, 1997. 'The equity premium and the government cost of capital: a response to Neville Hathaway', *Agenda*, vol. 4, no. 4, pp. 475–85.
- Quiggin, J, 1998. (transcript) 'In the Public Interest? Conference at University of Technology, Sydney, March 1998.
- Quiggin, J, 2002. 'Private financing of public infrastructure', *Dissent*, vol. 8, pp. 13–7.



- Quiggin, J, 2004. Risk, PPPs and the Public Sector Comparator, *Australian Accounting Review*; Jul 2004; 14, 2; Accounting & Tax Periodicals, p. 51.
- Quiggin, J, 2006. 'Public Private Partnerships: Options for Improved Risk Allocation' *UNSWLawJl* 51; (2006) 29(3) University of New South Wales Law Journal 289 Regan paper,MR Reserach Report, Bond University.
- Quiggin, J, 2007. 'lemma's faliure', *Australian Financial Review*, and also see <http://johnquiggin.com/index.php/archives/2007/12/12/nsw-electricity-privatisation-a-quick-look/>
- Quiggin, J, 1996b. *Great Expectations: Microeconomic Reform and Australia*, Allen and Unwin, Sydney.
- Seidman, L, 2001. 'Reviving Fiscal Policy.' *Challenge* 44: 17–42.
- Sexton, J, 2010. 'Fix these problems for Sydney' *The Daily Telegraph*, 8 August 2010 at <http://www.dailytelegraph.com.au/news/sunday-telegraph/fix-these-problems-for-sydney/story-e6frewt0-1225902516084>.
- SMH Staff reporters, 2007. 'Tunnel vision,' *Sydney Morning Herald*, 25 June 2007 at <http://www.smh.com.au/news/national/tunnel-vision/2007/06/24/1182623748492.htmlwww.smh.com.au>
- Standard & Poor's, 2006. RatingsDirect — New South Wales Treasury Corporation, Research Brief, 19 December 2006.
- Standard & Poor's, 2007. Rating International Local And Regional Governments: A Primer, 2007.
- Standard & Poor's. Media Release, Outlook On New South Wales, Revised To Stable, On Strong State Budget.
- Taylor, Lori L. Does the United States Still Overinvest In Housing? Federal Reserve Bank of Dallas, p.
- The Hon. Wayne Swan MP, Treasurer of Australia, 2008. Nation Building and the Future Economy,' Address to the Infrastructure Association of Queensland Lunch, 9 September 2008.
- Transurban Holdings Limited, Annual Financial Reports and Statements to the ASX.
- Transurban, 2010. Media Release, 'TransurbanGroup has bought Sydney's Lane Cove Tunnel for \$630.5 million,' 10 May 2010.
- von Hagen, J. and Harden, I.J, 1995. 'Budget Processes and Commitment to Fiscal Discipline.' *European Economic Review* 39: 771–779.



Webb, R. and Pulle, B, 2002. Public Private Partnerships: An Introduction, Research Paper No. 1 2002-03, Department of the Parliamentary Library.

Wilkinson, J, 2010. Australian Federal and State Budgets – An Overview, NSW Parliamentary Library Research Service, Briefing Paper No 2/10.

Wren-Lewis, S, 2002. 'Fiscal Policy, Inflation, and Stabilization in EMU.' Mimeo, Exeter University.

Wyplosz, C, 2005. 'Fiscal Policy: Institutions Versus Rules.' *National Institute Economic Review* 191: 64–78.



Appendix: Proposals for developing more independent management of fiscal policy

Ball (1996), New Zealand	Enhance the contribution of fiscal policy to output stabilization	Adjust income tax rates across the board, and give instructions to the central bank.	'Macroeconomic policy committee' to include a senior civil servant of the finance ministry and the central bank governor	Unspecified
Blinder (1997), USA	Simplify tax code and minimize tax distortions	Decide specific tax policy matters delegated by the legislature and/or design tax proposals to be put to up-or-down vote	'Independent federal tax authority' staffed by non-political civil servants appointed by the president for a fixed term and only removable for a cause	Detailed explanation of decisions and public scrutiny of supporting material
Calmfors (2003), EU	Enhance the contribution of fiscal policy to output stabilization	<u>Model 1:</u> Enforce budget balance target pre-specified by parliament; <u>Model 2:</u> Provide stabilizing fiscal impulse by varying certain tax and expenditures established by parliament	Long-term, non-renewable appointments of established professionals by government	Appointments subject to parliamentary approval. <i>Ex post</i> evaluation (dismissal clause at qualified majority of parliament). Overriding clause by qualified majority of parliament
Eichengreen <i>et al.</i> (1999), Latin America	Preserve debt sustainability and prevent fiscal procyclicality	Set legally binding annual 'debt change limits' (DCL), which can be changed during the year. If budget violates DCL, the council can raise indirect taxes or freeze spending plans at levels of the previous budget	Members of 'national fiscal council' appointed by government for 9 years. Staggered appointments. Supplemented by professional staff preparing forecasts and analysis	Accountable to parliament. No agenda-setting power. Nominations subject to parliamentary approval

Gruen (1997, 2000), Australia	Enhance the contribution of fiscal policy to output stabilization while preserving debt sustainability	Vary tax rates across the board (through a 'fiscal parameter'), at short notice and without involvement of the legislature, but only within strict pre-defined bounds	Similar to central banks	Parliament can override decisions under certain conditions
Seidman (2001), USA	Enhance the contribution of fiscal policy to output stabilization	Implement periodic adjustments in taxes and spending relative to budget. Content of adjustment package pre-determined by legislature, while IFA decides magnitude and timing.	Members of 'fiscal policy board' would be appointed for long tenures. Alternatively, the Federal Reserve Board could also decide on fiscal adjustments	Legislature can override the council's decisions
von Hagen and Harden (1995), EU	Preserve debt sustainability	Set legally binding annual 'debt change limits (DCL)'. If budget violates DCL, the national debt board can impose across the board spending cuts	'National debt boards' appointed by government based on a list established by the board. Long tenures and staggered appointments	Accountable to parliament
Wren-Lewis (2002), EU	Enhance the contribution of fiscal policy to output stabilization while preserving debt sustainability	Vary specific tax rates (VAT, sales tax) for a limited time period and without involvement of the legislature	Unspecified	Unspecified
Wyplosz (2005), EU	Preserve debt sustainability	Enforce debt target pre-specified by parliament by setting legally binding annual budget balance targets on the basis of forecasts prepared by the council and binding in budget process	Members appointed by national government for fixed term. Long tenures (longer than legislature)	Accountable to parliament