# Addressing the Infrastructure Needs of Regional Australia

**A submission to the**
**House of Representatives Standing Committee**
**on Primary Industries & Regional Services**

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This submission argues that infrastructure has a key role to play in the development of regional Australia. It provides the basic building blocks for economic growth and employment.

While the viability or otherwise of regional infrastructure generally conforms to standard investment theory, there are subtle factors at play that must be understood by policymakers.

## *Background*

The economic and social problems facing some of Australia's regional communities - Newcastle, the Latrobe Valley, western NSW, the Spencer Gulf, the Wimmera and Mallee etc. - have been subject to considerable media scrutiny in recent years. However, there is ongoing debate as to whether these regions are capable of recovery of their own accord, or whether they are long-term basket cases.

Some interesting insights have now come to light, courtesy of the Commonwealth Government, the States, and the Australian Council for Infrastructure Development (AusCID) in association with institutional investors such as the AMP, Commonwealth Bank, Macquarie Bank and the NAB. Over the last two years, they variously examined 68 regional investment proposals via a series of 18 workshops in places like Mildura, Traralgon, Kalgoorlie, Townsville and Dubbo.

While the rationale of the exercise - named the Institutional Investor Information Service (IIIS) - was to determine the scope for institutional investors to play a greater role in the development of Australia's regions, it provided excellent insights into the role of infrastructure in regional Australia.

My company, Australian Project Developments Pty Ltd, was contracted by AusCID to organise the workshops and summarise the discussion of the projects. After the first two or so workshops we realised that these discussions were providing excellent insights into why some projects progress, and others do not. Since investment in such projects is the essential starting point for regional economic growth, we believe that our findings must be understood by policymakers. We therefore provide this brief analysis as a public service.

## Important Background

The report by **McKinsey & Co., 'Lead Local Compete Global'** (1994) observed that regions have been regarded as the poor relation in the mainstream economic debate, notwithstanding the fact that it is increasingly regions that compete - not countries. The study noted that business investment was the main driver in terms of regional job growth, despite the job shedding (capital deepening) that can accompany new investment. Their essential conclusion was that while a myriad of things influence the level of job-creating investment in regions, some common success factors stand out:

- Encouragement of local leadership
- A focus on the key issues - of which the investment environment, and the determinants of demand, are the starting points
- A search, and then replication, of 'best practice' investment initiatives.
- An understanding of the need to reduce investor uncertainty.

McKinsey-type issues surfaced continually in the context of the infrastructure and related projects considered at the IIIS workshops.

## Economic and Social Infrastructure

It is important at he outset to define what we mean by infrastructure. While there are many distinctions, we believe that a two way split is the easiest way to think about it.

'Economic' infrastructure - particularly energy facilities, airports, water and communications - has been the main thrust of the privatisation debate so far. The massive change underway in these markets, as a result of government policy initiatives to facilitate private sector ownership and competition, has meant that major investors have been mainly concentrating on the big ticket projects.

'Social' infrastructure (schools, universities, hospitals etc.) has traditionally been a public good. Apart from underpinning economic infrastructure, it is an indicator of the long-term prosperity of a region. If governments haven't the confidence to upgrade community facilities, investors are wary. Social infrastructure is the glue that holds a regional community together. For simplicity's sake, defence facilities as a public good might also be assigned to this category - their role in regional development can be very powerful.

As privatisation extends into new areas, it will be important for governments to better understand the interaction between economic and social infrastructure in regions. The overall picture is roughly as follows:

- Privatisation is well underway in rail, electricity, major airports, major ports, communications.
- The second wave of privatisation will be focussed on pipelines (eg. gas, water), transport terminals, water treatment, irrigation, sewerage, bulk/cold storage facilities.
- A mix of public and private will continue in roads and bridges, prisons, telecommunications, hospitals, other health facilities, schools, research and development centres, business incubators, tourism facilities, museums.
- Defence expenditure will remain in public hands.

### The seven constraints

The institutional investors who assessed the attractiveness to them of the 68 regional projects concluded that there were seven constraints. I should stress that they are generic constraints - they do not apply to every project.

1. **Regional markets lack critical mass**

   Robust revenue streams are required to attract institutional investment to regional projects. Financiers search for sufficient users of a particular piece of infrastructure. However regional markets often lack critical mass. As one investor explained ‘economies of scale are the key….the cities have it….there seems to be a stigma on the rural sector which somehow must be overcome if the confidence of investors is to be gained.’

2. **Preponderance of ‘public interest’ in regional projects**

   Around 26 of the 68 projects examined have some degree of ‘public interest’ - that is, significant parts of the project benefit the community and not the investor. This leads to investors to ask 'Why should I pay the government’s way, and carry that additional risk?'

   An example is the Sydney-Canberra High Speed Train project, which has significant public benefits by way of reduced pollution and congestion for Sydney, increased road safety and urban amenity for the whole corridor, and huge regional employment benefits. Since these benefits accrue to the public (they cannot be readily ‘captured’ by the private sector), there are major doubts that this project can be 100% privately financed.

3. **The relevance of politics**

   Institutional investors are wary of some regional projects because they are political footballs. Apart from raising doubts both in the electorate and the investment community as to the intrinsic worth of a project, they cut across the effort to ensure that the projects are bankable.

4. **The Orphan Syndrome**

   Infrastructure projects of less than $20 million are not attractive to institutional investors - they will remain orphans unless they can be bundled into bigger projects. Part of the problem is the cost of tendering.

5. **Interdependence of Projects**

   Many regional projects depend on each other. An example is around Bunbury - where the container facility at the port, the expansion of Kemerton Industrial Park, the construction of the Kemerton power station, and various resource value-adding projects are inextricably linked. Institutional investors must be encouraged to pull it all together and capture the financial benefits.

6. **The Need to Understand Risk**

   The IIIS workshops illustrated why regional (and urban) projects hit the proverbial ‘brick wall’. The discussion on each project focused on the risk assessment categories used by institutional investors:

- **Construction risk** - the risks associated with design, cost overruns and construction delays can be substantial for capital-intensive infrastructure projects. There is evidence that these risks have diminished in recent years as a result of industry reforms implemented following various Royal Commissions and enquiries - however, major delays and cost overruns on projects such as BHP's DRI plant at Port Hedland provide a salutary reminder of construction risk.
- **Operating risk** - these stem from shortfalls in production and/or service, and in relation to managing staff, maintenance etc. It is difficult to quantify these risks - they may only become apparent once the project is fully underway.
- **Revenue/Demand risk** - this is the most important, judging by institutional investors' comments at the IIIS workshops. It concerns ensuring the existence of strong revenue flows in the out-years - the long-term decline in some regions make investors distinctly uneasy. Weaknesses in demand forecasting can also be costly due to the sunk costs involved.
- **Regulatory (policy) risk** - includes risks relating to planning and environmental requirements and competition policy (eg. aviation, water pricing). Notwithstanding the trend towards the privatisation of infrastructure assets, regulatory risk will remain due to the continuing role of government as a regulator in various forms.

There are also the qualitative aspects. The ‘gut feel’ of investors - in terms of political, social and environmental factors - can consign good cash flow projections to the rubbish bin. Governments do not fully appreciate the impact that their decisions (or lack of them) can have on investor confidence.

## 7. Thinking Outside the Square

Regional project proponents need to think outside the square, because relatively small impediments close down people’s thinking much too early. For example, the misreading of signals/feedback from government agencies has stalled potentially viable projects. Proposals going nowhere may need a stiff reality check and a different approach.

The role of local leaders was a cornerstone of McKinsey's recommendations. We agree with this, and can cite many instances of a positive correlation between the initiative, energy and attitudes of the region's community leaders on the one hand, and a region's ability to cut through red tape, win broader industry support, and basically 'run an agenda' to generate investment and jobs on the other hand.

A good example is in Gippsland where the efforts of Monash University, local companies and the 5-6 newly formed Councils to jointly address long-term job creation is being aided by an alliance between two former political leaders of opposing parties - Peter Nixon (National Party - Federal) and Robert Fordham (Labor - State). In this case, they are local leaders who also 'know the ropes' in dealing with governments, Ministers, and major investors.

## Overseas Experience

Recent overseas work dovetails nicely with the IIIS findings.

The OECD argues that certain regions develop advantages that become self-sustaining and self-reinforcing with time. Dominant regions tend to attract business through a clustering effect. A sort of 'expansionist regime' becomes established, based on the exploitation of external economies in conjunction with innovation, skills development and an entrepreneurial culture. Conversely, the OECD argues that, in lagging areas, a downward spiral can commence, leading to population migration and a subsequent decline in investment and the quality of infrastructure, and related business activity. The dilemma facing governments is whether economic decline in particular regions is of:

(i) a long-term structural nature, in which case the policy response is to facilitate adjustment out of the industry (ie. pick up the pieces), or

(ii) a shorter-term cyclical nature, caused possibly by external shocks, thus requiring governments to work with other parties to rebuild or 'shore up' the regional economy.

Unfortunately the current Commonwealth-State industry policy framework is not well-placed to identify or deal with the above dichotomy, because it is focussed on a different set of issues viz. production efficiency, micro-economic reform, access to finance, export orientation, innovation and management skills. A spatial dimension is also lacking.

The gap between our policy stance and that of other industrialised economies is implicit in the findings of other experts such as Doug Henton (Collaborative Economics Inc., Silicon Valley) and Prof. Michael Porter (Harvard). They have noted the major policy shifts underway, and have redefined the roles for government at a national, state and local level. The emphasis is now on:

- ensuring the supply of high-quality inputs eg. educated citizens and physical infrastructure.
- promoting cluster formation, and pursuing competitive advantage and specialisation.
- systematically upgrading public or quasi-public infrastructure that has significant impact on many linked businesses.
- rethinking who does what in the economy, and opening up new public-private avenues for collaborative action.

It is worth dwelling on the clustering concept, since it embraces all of the above. The tendency for like-minded firms and talent to cluster in specific geographic areas has been recognised for many years. They do so to achieve synergy, facilitate business transactions and utilise hard and soft infrastructure. The seeds of a cluster can be sown by an investment in a piece of infrastructure, a government decision, a new technology, or a chance happening. Early commercial success leads to the entry of other players keen to be part of the action. This in turn feeds revenue streams to justify more infrastructure - the regional economy grows like an ice crystal.

Two local examples illustrate the point.

**The Hunter Valley around Scone** is home to a fascinating equine cluster. Some 70% of Australia's thoroughbred foals are born there. The area has a world-class infrastructure - race track, training tracks, equine research centre, convention centre and TAFE. It began decades ago with the vision and funding of local councillors and breeders. More recently, funding from State coffers and the Commonwealth filled in the infrastructure gaps. Now veterinary groups, feed suppliers, major local and Arab breeders/investors, hobby breeders and trainers variously compete and collaborate in a dynamic environment.

**Torquay in Victoria** is now a world-class centre for surfwear. The spark was a couple of surfers in the late 1960s who decided it was the place to start making surfboards. They began their enterprise in an old garage, expanded with a business grant from the Victorian Government, and eventually split into two competing companies - Quiksilver and Rip Curl. Then Oakley sunglasses located there, as did numerous parts suppliers. Various hard and soft infrastructure investments have sustained the growth of this cluster.

Other examples of dynamic clusters are the entertainment industry in Melbourne, food processing around Shepparton, and the defence industry in North Adelaide. The latter is a good example of how 'social' infrastructure can be leveraged into wider economic outcomes. A similar system of spinoffs should be possible at Eden NSW should the Defence armaments facility be relocated there.

### The Way Forward

So what does all this mean for Australia's regions? Based on our analysis of these projects, we offer the following suggestions.

First, a much better understanding is needed of the development capacity of regional economies and how to build competitive advantage. The overwhelming evidence is that while inherent resource endowmwnts are important, this is not the sole factor. Get-ahead regions tend to have a collaborative framework - where optimism is pervasive, where trust and cooperation influence feeds through into a can-do culture.

While the tendency is for governments, or local parliamentary members, to be at the fore-front of these processes, it is expecting too much. We believe that some of the key institutional investors and the energy/communications utilities, would agree to take on a leadership role if the Prime Minister and State Premiers were to tap on the right shoulders.

They could be working with governments and local players to develop those characteristics in communities where they are deficient - by looking at ways of upgrading infrastructure, resourcing regional development agencies, and working with local champions and players to work up their ideas. A greater understanding and emphasis on competitive advantage, with regular reality checks along the way, would assist regions to play to their strengths, and open up new avenues for collaboration.

Secondly, governments must find better ways of making their programs ‘hit the ground’. They must convert their political rhetoric - about empowering local leaders, facilitating and business-government partnerships - into consistent and coordinated actions. The three levels of government continually fail to coordinate their efforts. It is exacerbated by the raffle ticket mentality resulting from the proliferation of Commonwealth and State programs. Companies and individuals in the Bush are not well-versed in dealing with government - and information on a web-site is a poor substitute for face to face contact.

Thirdly, there is a need for greater ‘Strategic Focus’ by project proponents. This point was stressed by institutional investors at the IIIS workshops. Regional players must think on a broader scale, in order to link agendas, and address issues on a more concerted basis. This applies to projects of all sizes - some projects can be bundled to achieve a $50 million threshold for the institutional investors. While some regions use champions and 'ambassadors' to great effect, and market themselves as distinctive, profitable and vibrant localities, they still need to underpin their efforts with hard data.

Fourthly, governments must reduce the cost of tendering, and better appreciate how bad policy, poor coordination and slow decision-making impacts on project costs. Some officials have only a basic grasp of what constitutes ‘public interest’, and how to marry public and private sector objectives without compromising either.

Fifthly, institutional investors can assist by providing early strategic advice to proponents. The problem, however, is that are loathe to invest too much time and effort if this is passed to their competitors via open tendering procedures.

Sixthly, it must be understood that while private sector financing of certain types of infrastructure will increase over time, government must continue to invest in regional infrastructure where there is an identified public benefit.

It is therefore suggested that the Commonwealth should give serious consideration to the establishment of a Regional Infrastructure Investment Fund (or similar). In brief:

- Annual allocation of around $500-800m for possibly 4-5 years, drawn from the sales of Commonwealth infrastructure assets (a purity of logic)
- Funding to exclude current road funding and similar arrangements, and to be mainly available as one-off grants. It might involve the Commonwealth taking equity in a limited number of projects.
- Eligibility to be restricted to projects where a specific public benefit can be identified ie. private sector business ventures would be ineligible.
- Criteria would include the need for the project to facilitate regional best practice, sustainable jobs and export development, and evidence of matching funding from other key parties.
- Recommendations could be developed by advisory machinery comprising a mix of government officials and eminent, recently retired industrialists or luminaries, and perhaps a cross-party representation of Senators or Members. The recommendations might go to a Committee of Ministers whose portfolios have relevance to regional economic development. This would provide an inclusive, transparent process.

The above approach has a weakness in that it would feed the perception among the regional population of a paternalistic and power-based hierarchy in Canberra. It is thus only a 'half way' house to a full devolution model where regions would have annual budgets - and senior regionally-based officials, local MPs and local leaders - would decide expenditure priorities.

The required shift does not require a philosophical u-turn by companies or governments. Our policy prescription involves a better ways of putting regional folk into the loop, and responding better to their concerns. An industry/regional policy framework bedded in microeconomic reform and information dissemination is sadly limiting.

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Some of his recent analysis includes:
- 'Industry Clusters: a new approach to economic development in regional Australia' (AGPS, 1996).
- 'Sydney or the Bush - institutional investors' views of how to attract investment to regional Australia' (1998) - on behalf of AusCID)
- 'Turning Green to Gold' - the potential to generate clusters, investment and jobs in the Capital Region's environment industry (1998) - on behalf of DEETYA and the ACT Premier's Department.
- 'Gateway Island, Albury Wodonga - an action plan for generating investment and employment' - on behalf of Investment Albury Wodonga (1988).

## Projects considered at the IIIS workshops, during 1997 and 1998

| Water (20) | Project size ($m) |
|---|---|
| • Kalgoorlie – Esperance water pipeline* | 315.0 |
| • Kalgoorlie wastewater treatment plant* | 2.4 |
| • Kemerton Industrial Park – water supply (WA) | 16.0 |
| • Pokolbin water pipeline (NSW) | 15.0 |
| • Tandou/Menindee Lakes (NSW)* | 8.1 |
| • Tumut – Visy Paper mill - water requirements etc. | 30.0 |
| • Robinvale Irrigation & Drainage scheme* | 100.0 |
| • First Mildura Irrigation Trust (FMIT) Horticultural Expansion* | 250.0 |
| • Stanhope water treatment (Vic) | 4.0 |
| • Korumburra-Leongatha water works (Vic) | 10.0 |
| • Rosedale sewerage pre-treatment (Vic) | 5.0 |
| • Flinders Dam, Richmond, Qld* | 80.0 |
| • Lockyer Valley recycled water, SE Qld* | 350.0 |
| • Port Macquarie sewerage* | 30.0 |
| • Coffs Harbour/Clarence Valley water supply* | 102.0 |
| • Coffs Harbour sewerage* | 112.0 |
| • Upper Herbert Irrigation* | 220.0 |
| • FNQ Waste Management Facility* | 200.0 |
| • Dawson Dam (west of Gladstone)* | 120.0 |
| • Urannah Dam (near Mackay)* | 152.0 |
| **Transport hubs (4)** | |
| • Kalgoorlie – Boulder | n/a |
| • Maitland | n/a |
| • Dubbo rail freight* | 18.2 |
| • Wodonga freight centre | n/a |
| **Energy & Minerals (9)** | |
| • Kemerton gas-fired power station (WA) | 117.5 |
| • Oakagee Port - power station/port (WA) | 1,000,000.0 |
| • Western NSW gas-fired electricity generation | 50.0 |
| • Leongatha – natural gas reticulation (Vic) | 10.0 |
| • Energy Recovery from Biowaste (Queensland)* | n/a |
| • Derby Hydro Power (WA) | 125.0 |
| • Callide Power | 800.0 |
| • Marlborough Nickel (near Rockhampton) | 630.0 |
| • Gladstone Synthetic Rutile plant | 112.0 |
| **Marine (5)** | |
| • Jervoise Bay marine precinct (WA)* | 180.0 |
| • Bunbury Port container handling | 8.0 |
| • Twofold Bay port (NSW)* | 12.0 |
| • Port Welshpool Deepwater Port (Vic) | 30.0 |
| • Dampier Marine Services Industrial Estate | 50.0 |
| **Tourism & Urban Development (16)** | |
| • Port Kalbarri harbour/marina (WA) | 25.0 |
| • Honeysuckle (Newcastle) marina | 10.9 |
| • Ballarat Hotel/Convention Centre* | 25.0 |
| • Warrnambool Marine Centre* | n/a |
| • Mildura CBD & waterfront development | 116.0 |

| | |
|---|---|
| • Mildura marina | 50.0 |
| • Wodonga - Riverine Interpretative Centre* | 73.0 |
| • Panorama Cable Car, Townsville | 6.5 |
| • Spaceworld, Logan Shire, Qld | 10.0 |
| • North Ipswich rail precinct* | 45.0 |
| • Ipswich Rivercat | n/a |
| • City Hill, Coffs Harbour* | 30.0 |
| • Cairns Cityport (incl. marine) | 380.0 |
| • Fig Tree Health Resort (south of Cairns) | 60.0 |
| • Mungalli Falls (west of Innisfail) | 3.8 |
| • Keswick Island (near Mackay) | 7.0 |
| **Airports (3)** | |
| • Geraldton | 7.5 |
| • Learmonth | 9.1 |
| • Coffs Harbour | 16.0 |
| **Rail (2)** | |
| • Sydney – Canberra high speed train* | |
| • Ballarat-Geelong standard gauge rail* | 9.0 |
| **Forestry (4)** | |
| • Central Victoria Farm Plantations | n/a |
| • Plantations North East, Victoria | 220.0 |
| • Gippsland Plantations | n/a |
| • Softwood Sawmill, Ingham, Qld | 15.0 |
| **Agriculture/Mariculture etc (3)** | |
| • Kuruma Prawns, Abbott Point, Qld | 12.0 |
| • Killarney whiskey, SE Qld | 5.0 |
| • Bayview Seafoods, Taree | 4.0 |
| **Other (2)** | |
| • Murray River Crossings* | 105.0 |
| • Emmanuel Anglican School, Gladstone | 1.3 |

*** Prima facie evidence of some public good element.**