Chapter 6

Infrastructure

6.1 Infrastructure is a means for the delivery of goods and services that promote prosperity, growth and wellbeing. Infrastructure is an essential input to virtually all economic activities. Ensuring that infrastructure is adequate, allocated to the right areas and used effectively reduces economic costs and contributes to more efficient production.

6.2 Australia is particularly dependent on efficient infrastructure and investment due to its size and population dispersion (road, rail, airports and communications), its climate (water and electricity) and its reliance on trade (ports).

6.3 In 2005, the Productivity Commission estimated that infrastructure sector reforms up to 2005 had increased Australia's GDP by 2.5 per cent.[1] Again in 2005, the Export and Infrastructure Taskforce, chaired by Dr Brian Fisher, reported that there were immediate export infrastructure constraints caused by Australia's role in supplying the global commodities boom, but that these were localised in nature.[2]

6.4 The Organisation for Economic Co-operation and Development (OECD) 2006 *Economic Survey of Australia* found that infrastructure market reforms undertaken under the National Competition Policy were largely a success. However, the OECD emphasised that there remains 'unfinished business' to raise productivity and reduce bottlenecks in all sectors, but most pressingly in water markets, where little progress has been made to date.[3]

6.5 This chapter examines the current state of infrastructure, and the factors which have impacted on the effectiveness and efficiency of significant recent investment by the states in infrastructure development. It then examines the role of Public-Private Partnerships and of the Commonwealth in infrastructure provision and development.

The current state of infrastructure

6.6 The adequacy and serviceability of the existing infrastructure pool was commented on by a number of witnesses, who in general took the view that infrastructure development, as well as maintenance of the existing pool, had lagged. Treasury officials submitted that the average age of Australia's public sector infrastructure has been rising since the 1970s.[4] The committee notes that the average

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1 Department of the Treasury, *Submission 25*, p. 15.

2 Department of the Treasury, *Submission 25*, p. 15.

3 Department of the Treasury, *Submission 25*, p. 15.

4 Mr Tony McDonald, General Manager, Department of the Treasury, *Committee Hansard*, 25 July 2008, p. 77, drawing from 2008–09 Budget Paper No. 1, Statement 4, pp 4–8.

age of that infrastructure is now approximately 20 years,[5] and that Australia's infrastructure lags behind the average of leading advanced economies in terms of its ability to support economic activity.[6]

6.7 Dr Vince FitzGerald, observed that across the country, underinvestment by state governments in critical infrastructure has led to economic capacity constraints:

> …we were underinvesting in infrastructure and we are paying for that now. We have rising congestion on our roads; we have increasing congestion in even the public transport system; we have a backlog of facilities, and not simply current services, in health; and so on... [I]n my opinion, we are playing catch-up, as is the nation generally. We have got stresses and strains in the export infrastructure…[B]ulk export infrastructure is the most obvious area that we see occasionally highlighted in the media, but it is also right in the metropolitan regions of Australia, whether you are talking about Brisbane, Sydney, Melbourne, Perth, Adelaide or perhaps Hobart—certainly in the bigger cities. In today's service economy era, when the transport of goods and people around those regions is what makes the economy go, we clearly have backlogs. Having strong infrastructure investment programs is overdue, frankly.[7]

6.8 Dr Steve Thomas MLA, Shadow Treasurer in Western Australia, pointed out the shortcomings in infrastructure in key economic locations such as Karratha:

> The hospital struggles and transport issues are significant. The era of opportunity for Western Australia might pass us by without us being able to put the infrastructure in place that would develop those resources well into the future.
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> …
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> Most of the iron ore royalties go to the state. The state government has to some degree dropped the ball on this over time. Oakajee, for example, which is just north of Geraldton and will be the mid-west iron ore port - a brand-new port which will be developed and built by the private sector - was first mooted a decade ago.[8]

6.9 Mr Terry Mills MLA, Opposition Leader in the Northern Territory, commented that:

> Although there has been an increase in infrastructure spending in recent years, much of this spending has been aimed at repairing an ageing asset base…[M]uch of the infrastructure is reaching its use by date….Many roads, schools, hospitals and other assets now need work. There will be a

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5 2008–09 Budget Paper No. 1, Statement 4, pp 4–8.

6 2008–09 Budget Paper No. 1, Statement 4, pp 4–9.

7 Dr Vince Fitzgerald, private capacity, *Committee Hansard*, 19 May 2008, pp 35–36.

8 Dr Steve Thomas MLA, Shadow Treasurer for Western Australia, *Committee Hansard*, 12 June 2008, pp 4 and 6.

> need to borrow substantially for infrastructure augmentation into the future.[9]

6.10 Mr Kim Wells MP, Shadow Treasurer in Victoria, presented a range of statistics to the committee showing that hospitals, schools and water infrastructure in Victoria were attracting insufficient investment. In relation to water, Mr Wells submitted that:

> I think the Melbourne water authorities deliver a good service; the reality is that there is not the infrastructure to support them. We have pipelines that are crumbling. We have lack of infrastructure. If the infrastructure were in place, like the [desalination] plant, it would assist the water authorities. But we are not seeing that at the moment. There are lots of promises and plans, but we will wait and see what occurs over the next couple of years.
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> …
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> I think water authorities should pay a dividend, but I also think that some common sense should be applied. If your infrastructure is crumbling around you, you should be able to say to the water authorities, 'That dividend will be reviewed or suspended,' to allow the water authority to use retained earnings to build that infrastructure.[10]

6.11 Mr Wells also submitted that major road funding had been neglected by the Victorian Government, and that this had resulted in economic losses:

> We have spent less per head on construction than any of the other states has. Obviously, you would expect Western Australia and Queensland to spend more than us, but in Victoria we do not seem to spend the money on roads, bridges or tunnels. We do not build things or fix things. As a result… for anyone travelling on Melbourne roads—the Calder, the Monash or the eastern—there is gridlock. It is costing us and our economy millions and millions of dollars because we are having trouble moving our products and our personnel around… on our main roads, in the morning peak, traffic travels at around 20 kilometres per hour and, in the afternoon peak, we travel at around 35 to 40 kilometres per hour.[11]

6.12 Dr Bruce Flegg submitted that the Queensland Government under Premiers Beattie and Bligh had not completed one major road project since 1998, and was trying to build infrastructure at the top of the economic cycle when it was most expensive.[12] This was a theme running through the evidence of a number of witnesses, some of which is discussed later in this chapter.

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9 Mr Terry Mills MLA, Leader of the Opposition for the Northern Territory, *Submission 39*, p. 5.

10 Mr Kim Wells MP, Shadow Treasurer for Victoria, *Committee Hansard*, 19 May 2008, pp 15–16.

11 Mr Kim Wells MP, Shadow Treasurer for Victoria, *Committee Hansard*, 19 May 2008, pp 8–9.

12 Dr Bruce Flegg MP, Shadow Treasurer for Queensland, *Submission 37*, p.3.

6.13 Recent increases in infrastructure spending by the states and territories followed a prolonged period in which they placed very low priority on infrastructure investment. Treasury submitted that state net capital investment in the total public sector has more than doubled in recent years, rising from around $11 billion in 2005–06 to $23 billion in 2007–08. It is projected to peak at $32 billion in 2008–09 and then moderate to around $24.5 billion in 2010–11.[13]

Strategic management of infrastructure development

6.14 The need to invest in infrastructure has not been lost on states and territories, and one reason for the deterioration in their fiscal position in recent years has been their sharp increase in infrastructure investment. This section examines the factors that have affected the success of state and territory investment in infrastructure over recent years, and the impact it has had on the broader economy.

Timing

6.15 The committee heard that the recent surge in infrastructure spending by the states and territories is symptomatic of a general pattern of not anticipating and responding in a timely and effective way to infrastructure needs. Rather, infrastructure problems were allowed to reach breaking point before corrective action was taken.[14]

6.16 Due to State Government inactivity in recent years, there is an urgent need for investment in infrastructure, much of which should be provided by the private sector. However, increased infrastructure spending by states and territories at a time when unemployment was very low, and demand for skilled labour strong, strengthened inflationary pressures in the economy and, in all likelihood, crowded out worthwhile private sector investment. This impact was not lost on Reserve Bank of Australia Governor Glenn Stevens, who was quoted by Treasury officials as saying that:

> Ideally [the investment] would have been done five years ago when the miners did not want to do it at the same time, but it was not. It still has to be done and, yes, that is a factor at work in the economy along with very strong private demand and along with…large foreign stimuli... So there are a lot of things that are basically giving us quite a strong demand picture. Those infrastructure spend things are one, but only one among a number.[15]

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13 Ms Marisa Purvis-Smith, Manager, State Finance and Reporting Unit, Department of the Treasury, *Committee Hansard*, 25 July 2008, p. 63.

14 See also, for example, Mr Henry Ergas' evidence before the committee in Canberra, private capacity, *Committee Hansard*, 25 July 2008, p. 45.

15 House of Representatives Standing Committee on Economics, Finance and Public Administration, *Committee Hansard*, 17 August 2007, p. 14.

6.17 Increased spending has also had a hand in fuelling labour market shortages and steeply increased construction costs.[16] Thus, in the case of roads, estimates suggest that construction costs per completed road kilometre are up by as much as 30 per cent in an 18 month period, meaning that the community is getting far less for the outlays than it would have had the spending been better timed.[17] On this point, Mr Ergas was unequivocal:

> …[H]ave state governments, on balance, acted in a way which increased or reduced those inflationary pressures? I would say they have acted in a way which increased those inflationary pressures and have done so in a manner that could have been avoided had they pursued a more stable approach to the key spending decisions.[18]

6.18 Officials from the Treasury acknowledged the impact that the sudden additional demand from states has on the economy:

> If…the economy is in a position of full capacity, very simply you are saying that the aggregate demand in the economy is more or less equal to the supply potential of the economy. It is clear…that the investment by the states in public infrastructure is adding to aggregate demand. [This investment in infrastructure] will add to aggregate supply in time, but not immediately. It adds to aggregate demand before it adds to aggregate supply.[19]

6.19 State government representatives in at least one jurisdiction rejected the contention that infrastructure had not developed in a timely fashion. Western Australia's Under-Treasurer, Mr Tim Marney submitted that:

> I think…our planning for infrastructure has been reasonably robust and there have been some investments in capacity which have been long term. If I went back to our advice at the time, probably it would have been, 'Yes, maybe that's a bit early' and it has proven to be timely, so I think that it has been quite strategic of government to place greater emphasis on expansion of the productive capacity of the economy as opposed to recurrent spending on an ongoing basis.[20]

6.20 It would appear that the states were in a good position to increase their investment earlier than they did. The committee heard that in 2005–06, for example, the states and territories received $47.4 billion more revenue than they had received in

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16 Evidence from representatives of the Reserve Bank of Australia was that public spending, insofar as it contributes to total spending in the economy, contributes to inflationary pressures. Dr Tony Richards, Head of Economic Analysis, *Committee Hansard*, 24 July 2008, p. 20.

17 Concept Economics, *Submission 42*, p. 9.

18 Mr Henry Ergas, private capacity, *Committee Hansard*, 25 July 2008, p. 51.

19 Mr Tony McDonald, General Manager, Department of the Treasury, *Committee Hansard*, 25 July 2008, pp 69–70.

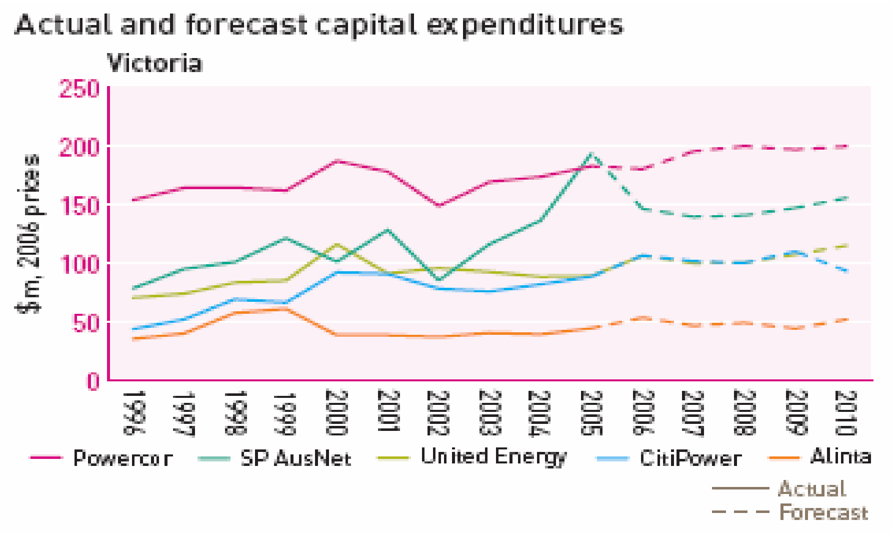
20 Mr Tim Marney, Under-Treasurer, Western Australia, *Committee Hansard*, 12 June 2008, p. 26.

1999–00 (or $22.1 billion more in real terms) and yet only $2.1 billion of this was devoted to the net acquisition of non-financial assets.[21] This was despite the fact that during that time it was clear that significant capacity shortages in state and territory infrastructure had developed.

Inconsistency leading to poorer service provision

6.21 The volatility of state government infrastructure investment is also notable when contrasted with infrastructure investment by private sector providers. An example provided to the committee concerned the levels of capital expenditure undertaken by electricity distributors in Victoria, where infrastructure is privately-owned, and Queensland, where it remains public, over the past decade. Whereas the privately-owned Victorian businesses engaged in a relatively steady upward trend in investment, expenditure patterns in the state-owned electricity distribution sector in Queensland have been much more volatile, with relative stagnation in investment prior to 2003–04 followed by high levels of 'catch up' investment from 2004.[22]

Figure 6.1—Capital Expenditure by Victorian Electricity Distributors, 1996–2010

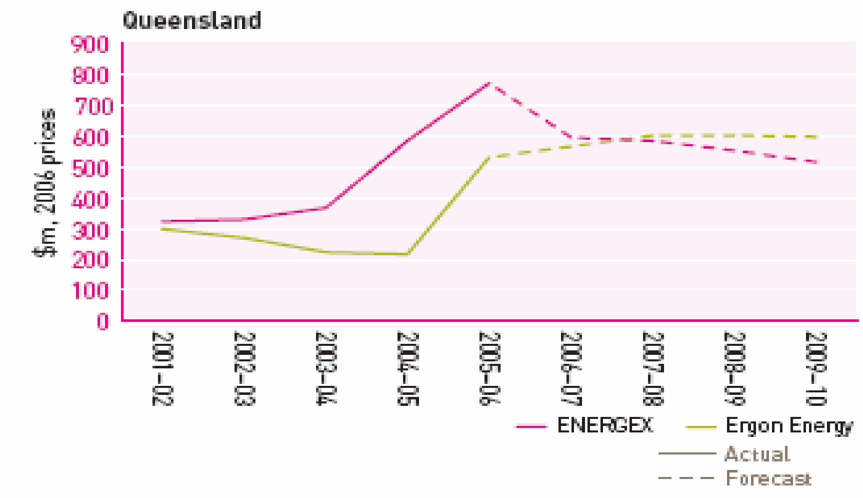


Source: Australian Energy Regulator, State of the Energy Market Report 2007, p. 154.

21 Concept Economics, *Submission 42*, p. 6.

22 Concept Economics, *Submission 42*, pp 7–8. See also Mr Ergas' evidence, appearing in a private capacity before the committee in Canberra, *Committee Hansard*, 25 July 2008, p. 46.

Figure 6.2—Capital Expenditure by Queensland Electricity Distributors, 2001–02 to 2009–10



Source: Australian Energy Regulator, State of the Energy Market Report 2007, p. 154.

6.22 Mr Ergas argued that the failure of the Queensland Government to invest in a timely manner led to a serious reduction in the reliability of electricity supply, and that outages in 2004 induced the Queensland Government to establish an independent panel to review the service delivery of Queensland electricity distributors. A key finding of the panel was that the distributors had focused unduly on improving financial performance at the expense of undertaking capital expenditure and maintaining service quality at acceptable levels.[23]

Quality of investment

6.23 Separate from the problem of timing and service provision is the issue of selection of infrastructure projects to best serve the needs of taxpayers, requiring careful and rigorous cost-benefit analysis.[24] This was referred to by a number of witnesses as determining whether spending constituted 'quality' investment.[25] Mr Henry Ergas submitted that:

> Unfortunately, the states and territories disclose virtually no information about the evaluations undertaken of investment infrastructure programs. Taxpayers cannot therefore have any real confidence that the debts that are being incurred on major infrastructure projects will not simply require

23 Concept Economics, *Submission 42*, p. 8.

24 See, for example, Mr Tony McDonald, General Manager, Department of the Treasury, *Committee Hansard*, 25 July 2008, p. 69.

25 See, for example, Dr Tony Richards, Head of Economic Analysis, Reserve Bank of Australia, *Committee Hansard*, 24 July 2008, p. 18; Mr Mike Baird MP, Shadow Minister for Finance for New South Wales, *Committee Hansard*, 24 July 2008, p. 2.

> substantially higher taxes in the years to come, taxes not offset by a commensurate flow of benefits from the infrastructure projects undertaken.[26]

6.24 While inefficiencies in the allocation of infrastructure funds are nothing new, the problems they create have been aggravated by the very substantial investment by states in recent years. The committee heard that public disclosure of cost-benefit analyses of all government-funded infrastructure investment programs, regardless of jurisdiction, would increase accountability for what are significant taxpayer-supported outlays.[27]

6.25 A case in point is the Victorian Government's decision to spend over $700 million upgrading regional passenger rail services, and to do so without renewing the track with gauge-convertible sleepers. Mr Ergas considered that, for a very modest expense, the government forewent what could have been a significant feature of the project.[28]

6.26 Mr Kim Wells MP, Shadow Treasurer of Victoria, expressed his concern over the projects being funded by the government in his state:

> We would argue that if [debt] were being spent on issues of productivity then you would understand that it is less inflationary. We have asked the government for a full list of where they are applying this debt so we can have a better understanding of what they are building to fix things, because we do not see that at the moment.[29]

Management

6.27 As the scale of spending has increased, inefficiencies in the management of that spending have become ever more obvious. New South Wales is a case in point. The committee heard that in spite of a strategic plan for infrastructure in New South Wales in 2002, by late 2004, an audit of 88 of the key projects revealed $752 million in cost over-runs, one in four projects delayed, and one in ten projects suspended or abandoned. By May 2006, the same group of projects (with an estimated total project value of $11 billion), had reached timetable blowouts of around 40 years, and cost blowouts of $1.7 billion. An assessment of the 2007–08 capital works budget papers shows 187 projects delayed, 219 years of total delays and an overall blow-out of $2.6 billion.[30]

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26 Concept Economics, *Submission 42*, p. 9.

27 Concept Economics, *Submission 42*, p. 9.

28 Concept Economics, *Submission 42*, p. 11.

29 Mr Kim Wells MP, Shadow Treasurer for Victoria, *Committee Hansard*, 19 May 2008, p. 6.

30 Concept Economics, S*ubmission 42*, p. 9. Similar evidence was received, in relation to cost over-runs, from witnesses including Mr Kim Wells MP, Shadow Treasurer for Victoria, *Committee Hansard*, 19 May 2008, pp 7–8.

6.28 The situation appears similar in Victoria. Mr Kim Wells submitted that:

> …The cost of the channel deepening started off at less than $100 million. It is closer to $1 billion. The fast train started off at $80 million and they were going to get private involvement. That was just under a billion dollars. We had the situation of the West Gate M1 contract which went from $1 billion to $1.363 billion. We have a list of almost $5 billion of those sorts of cost overruns. It is of concern that poor financial management and poor contract management are costing this state. We do understand that there are cost increases over the life of a contract, but those cost blowouts are significant.[31]

Public-Private Partnerships

6.29 One approach that aims to improve efficiency in infrastructure investment involves greater reliance on Public-Private Partnerships (PPPs), which are claimed to import to infrastructure investment the discipline of private sector budget constraints. The assumption is that, since the providers of finance secure no gains from politically popular but commercially unviable projects, those projects that are not commercially viable will not be funded.

6.30 A number of witnesses pointed out that PPPs are not a suitable option for every infrastructure project. The committee heard that, while PPPs deliver on promises of efficiency in some cases, in others they fall short. Examples of difficulties with PPPs include the Airport Rail link in Sydney and, to some extent, the Sydney Cross-City Tunnel. The committee heard that both of these projects involved substantial renegotiation, which materially altered the effective risk allocation, highlighting the many difficulties involved in designing effective PPPs. These difficulties are reflected in the high transactions costs associated with establishing PPPs, with those costs usually being in the order of between 3 and 10 per cent of construction costs.[32]

6.31 Mr Geoffrey Anderson, appearing in his private capacity, elaborated on the rationale behind PPPs:

> The first thing is that you do not do a PPP because you get cheaper money. All treasury departments have quite specific guidelines for PPPs—which are publicly available— and they set hurdles that they have to jump over before they will agree to a PPP, which means the focus is then on taking on risk. Of course it is very difficult at times to actually contract out all risk. But I think governments are attracted to PPPs largely because they do have the opportunity to transfer as much risk as possible, particularly completion risk—and it is a big issue for governments to get buildings completed on time—and to get other risks associated with the construction of the project in somebody else's hands. I think it is a more complicated issue [than]

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31 Mr Kim Wells MP, Shadow Treasurer for Victoria, *Committee Hansard*, 19 May 2008, p. 7.

32 Concept Economics, *Submission 42*, p. 12.

> purely financial. For a state like South Australia, I think it also brings private investment, a commitment from people to bring business here. I think it is a way in which governments can be involved with the private sector. I think it is a way in which they can be assured they are going to get the right price and the right management process all the way down the line. It has advantages.[33]

6.32 Mr Anderson went on to say that, in his opinion, the use of PPPs differed depending on the political persuasion of the government. Mr Anderson observed that:

> What we are not seeing in PPPs in this state, because we have a Labor government, is the traditional PPP. The traditional PPP was that the company would build it and operate it and provide the service to the government. We are not seeing that because that involves a degree of privatisation which Labor governments are not prepared to accept—and maybe for good reasons—but we are seeing them largely as financial and construction instruments. A classic PPP was where the private sector would build the facility and staff it and provide the service back to the government.[34]

6.33 On aspect of PPPs requiring significant improvement is the quality of the contracts on which they are based, which according to the evidence do not ensure optimal performance. Moreoever, particularly for projects that are 'too big to fail', poorly designed PPPs may end up simply privatising profits while socialising losses.[35]

6.34 Associate Professor Graeme Wines also observed that PPP agreements typically operate over long periods of time, magnifying the need to assess risk comprehensively.[36] Associate Professor Wines also used the agreements entered into for the Cross-City Tunnel in Sydney, as well as the CityLink in Melbourne, as examples of contract terms that severely limited the scope for development of adjacent public roads. Indeed, these contracts actually resulted in restrictions for some adjacent roads, and these restrictions will continue for the period of the respective agreements. These restrictions have accordingly limited the policy options, with respect to road infrastructure in these examples, for the respective governments.[37]

6.35 The implications of the need for private sector entities to produce a positive return for shareholders over and above their higher interest costs must also be considered for any potential PPP projects, along with the higher interest rates usually offered to private sector borrowers.

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33 Mr Geoffrey Anderson, private capacity, *Committee Hansard*, 27 March 2008, p. 56.

34 Mr Geoffrey Anderson, private capacity, *Committee Hansard*, 27 March 2008, p. 56.

35 Concept Economics, *Submission 42*, p. 12.

36 Associate Professor Graeme Wines, private capacity, *Submission 17*, p. 3.

37 Associate Professor Graeme Wines, private capacity, *Submission 17*, p. 3.

6.36 The committee heard various reports of PPPs being misused by state governments. Queensland Shadow Treasurer, Dr Bruce Flegg MP submitted that the Queensland Government had mismanaged the use of PPPs to generate 'fast cash' rather than to generate economic efficiency and savings.[38]

6.37 A possible example of this kind of misuses was given by Ms Vicky Chapman MP, Deputy Leader of the Opposition in South Australia:

> The big picture items here in South Australia are prisons, schools and the $1.7 billion Marjorie Jackson-Nelson Hospital, which is really $1.9 billion because there is $200 million over in the transport budget to clean up the rail yards it is going to go on—so it is nearly a $2 billion project. These are big projects and, quite reasonably, the government looks at whether they PPP them, but we have done the exercise and the cost under their PPP model is going to bankrupt our grandchildren. That is the way we see it, and we are very concerned about that…[W]e say that on the government's own financing for $1.4 billion it could completely rebuild the hospital on the current…site. That is our proposal; that is our clear position.[39]

The proper role of the Commonwealth

6.38 A small number of witnesses commented on what they saw as the proper role of the Commonwealth Government in relation to the provision of infrastructure into the future. The prevailing view was that the Commonwealth had a role to play.[40] The effect of vertical fiscal imbalance puts the Commonwealth Government in a stronger position to fund large projects, and possibly to realise economies of scale. However, Mr John Nicolaou, from the Chamber of Commerce and Industry of Western Australia, put forward another reason for Commonwealth involvement:

> I think that both the Commonwealth and states have a responsibility. The states really are responsible for the basic delivery of key infrastructure because many of the deliverers of infrastructure are government owned entities, and certainly I agree with that. But in relation to infrastructure that is not owned by the state per se, I think that the Commonwealth can take a bigger role. We only have to highlight some of the perverse incentives that are created if the Commonwealth gets significant amounts of revenue and benefits from infrastructure provision while the states at the same time have to fund that infrastructure and get far less in terms of revenue. Clear examples of that are the infrastructure on the Burrup, and the Gorgon project when that comes on stream, and even the Ravensthorpe nickel project. Those are areas where the state has a responsibility to provide

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38 Dr Bruce Flegg MP, Shadow Treasurer for Queensland, *Submission 37*, p. 2.

39 Ms Vicky Chapman MP, Deputy Leader of the Opposition for South Australia, *Committee Hansard*, 27 March 2008, pp 22 and 24. Ms Chapman went on to note that the primary problem may lie with the management model, rather than the project's status as a PPP.

40 See, for example, Tasmanian Opposition, *Submission 32*, p. 2.

> common user infrastructure, but the majority of the revenue benefits go to the Commonwealth in terms of royalties, income tax and so forth.[41]

6.39 The committee finds some merit in this argument. It sees a legitimate role in some circumstances for the Commonwealth to accept a greater share of responsibility for infrastructure than it might have in the past. Whether the recently established Infrastructure Australia is a step in this direction will depend on how that body operates and on what principles.

6.40 However, some evidence was received pointing to the need for caution in defining the role of the new body. For example Dr Steve Thomas MLA, Shadow Treasurer for Western Australia, said that he was:

> …hoping at some point that there will be an additional mechanism for the Commonwealth to engage in the construction of that infrastructure. We will look very carefully at Infrastructure Australia, the new group which is providing infrastructure. We will be watching that very carefully. If its agenda is to provide resources and infrastructure for high population density areas and if it ends up building roads between Brisbane, Sydney, Melbourne and Canberra and does not look at future proofing the country and investing in infrastructure which builds the country, in the north-west of Western Australia in particular, and also to some degree, I suspect, in Queensland and the Northern Territory, then Infrastructure Australia will be one of the great failures of Australian history. If it does the job that we think it should do, it may be one of the greatest success stories we have ever seen.[42]

6.41 The need to reform state government infrastructure decision-making was also addressed by Concept Economics:

> If Infrastructure Australia proves little more than a vehicle for transferring Commonwealth funds to state governments without reform of infrastructure decision-making and governance arrangements, it has the potential to merely waste taxpayers' money. Large-scale investment from a Building Australia Fund, or indeed from any other public sector source, does not absolve the Commonwealth Government of its responsibility for ensuring that state and Territory governments improve their decision-making processes and tackle pressing regulatory problems that, in some cases, are holding back commercial investment in much-needed infrastructure.[43]

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41 Mr John Nicolaou, Chief Economist, Chamber of Commerce and Industry for Western Australia, *Committee Hansard*, 12 June 2008, p. 40.

42 Dr Steve Thomas MLA, Shadow Treasurer for Western Australia, *Committee Hansard*, 12 June 2008, p. 4.

43 Concept Economics, S*ubmission 42*, p. 13.

Conclusion

6.42 The committee notes the sub-optimal state of the infrastructure pool across Australia, and makes the obvious point that it is crucial to get infrastructure investment right. Infrastructure assets are, by their nature, difficult to replicate, and some are natural monopolies. If development and renewal of infrastructure is mismanaged at government level, the resulting bottlenecks are likely to impose severe constraints on economic growth.

6.43 While the committee was pleased to hear that investment by states and territories has picked up over past two years, and that infrastructure renewal is taking place, it is concerned at some aspects of the investment. These concerns were captured by Mr Henry Ergas when he made the following remarks, citing two primary concerns with the way states had managed infrastructure spending in recent years:

> The first is with the timing of the expenditures and the management of the timing of the expenditures, and the second is with the quality of the expenditures. The issue with respect to the timing is particularly acute with respect to infrastructure in that we had a relatively prolonged period where, albeit with some variations between jurisdictions, the states and territories tended to reduce or severely constrain their infrastructure spending, and then following that period we had a period where there was almost a spending spree associated with catching up on the shortfalls that had accumulated initially. It is bad enough to have that kind of stop-go cycle, which under any circumstances increases costs unnecessarily, but even worse to have that stop-go cycle coincide with overall cyclical movements in the economy, which means that you, as it were, open the tap to the full just as the economy is going into what looks like a period of overheating or at least where labour markets and product markets are very tight. Hence, you accentuate all of the inflationary pressures underway in the economy. That in my view highlights a serious failure of policy.
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> On top of that you then have my second concern, which is about the quality of outlays. It is the responsibility of state governments to undertake significant long-term investments, and it is sensible for state governments to finance those long-term investments, including through borrowings. There is nothing inherently sinful or undesirable in that. But those borrowings essentially represent a tax liability for future generations or future periods, and hence the quality of the outlays is essential. If those are good quality outlays that will yield long-term benefits and enhance the productive capacity of the economy then future generations will find it easy to bear the associated tax burdens because productive potential will have increased at the same time as some costs have been deferred to the future. On the other hand, if those outlays do not expand productive capacity in the long term, if they are not worth while, then all that is really being done is to make future generations poorer than they would otherwise be.[44]

44 Mr Henry Ergas, private capacity, *Committee Hansard*, 25 July 2008, pp 38–39.