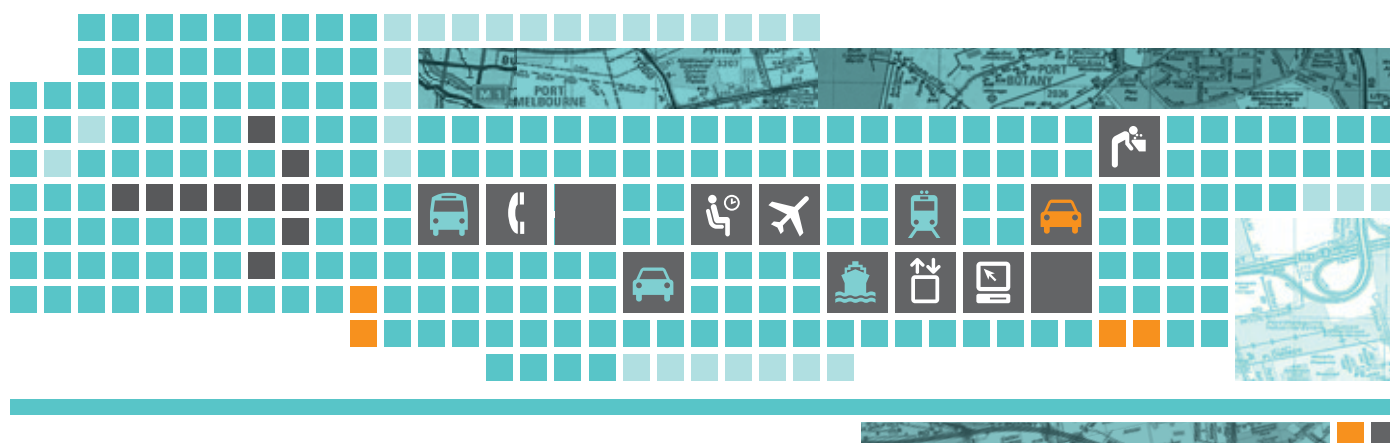




INFRASTRUCTURE ROADMAP FOR REFORM



Business
Council of
Australia





INFRASTRUCTURE ROADMAP FOR REFORM



This paper, *Infrastructure: Roadmap for Reform*, comprises a paper prepared for the Business Council of Australia (BCA) by Mr Rod Sims, Director, Port Jackson Partners Limited, titled 'Revitalising Infrastructure Reform', preceded by a Foreword by the President of the BCA, Mr Michael Chaney AO.

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FOREWORD

The Business Council of Australia (BCA) continues to advocate a comprehensive and integrated reform agenda to address current and future challenges faced by the Australian economy so Australia can maintain and build on its current prosperity.

Our goal is for Australia to rank among the top five OECD economies in terms of living standards by 2012. This is both an essential and achievable goal: essential to ensuring all Australians can share in the benefits of a prosperous country, and achievable provided we work to sustain strong economic growth through a renewed reform agenda that builds on the benefits of reforms made over the past two decades.

The BCA has identified a set of reform standards essential to the next stage of Australia's economic growth and which reflect the detailed research and policy development undertaken by the BCA over recent years. These reform standards relate to infrastructure, productivity, participation, workplace flexibility, climate change, federal-state relations, innovation, and education, skills and training.

Australia's infrastructure, including ports, road and rail transport systems, water, energy and accessible and fast broadband, are the building blocks for future growth. But our economy has expanded beyond the capacity of key infrastructure. As a result, Australia continues to be at a crossroads in terms of addressing current infrastructure needs and developing sufficient infrastructure capacity to meet future growth.

The problems and barriers that have resulted in an infrastructure-constrained economy are well known: poor governance and planning arrangements and poor policy choices. Despite recognition and some action by governments, the response to Australia's infrastructure challenges continues to be piecemeal. For this reason the BCA has identified a set of key reforms urgently required. They are:

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- The development of fully operational national markets for transport (freight and passenger), water and electricity.
 - The elimination of regulatory impediments to investment in, and efficiency of, the provision of electricity, urban and freight transport including ports, and water.

- The establishment of a cross-jurisdictional framework for appropriate, timely, and coordinated investment in infrastructure to meet future growth needs (this should include prioritised road and rail investment in line with freight and population growth projections).
 - A focus on the development of a quality broadband system with comprehensive access for businesses and households.
 - Regular and transparent audits of the state of current infrastructure and risks.
 - The development of a national approach to policies related to climate change.
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In light of the importance of these key reforms, the BCA Sustainable Growth Task Force, chaired by Rod Pearse, worked with Rod Sims of Port Jackson Partners Limited to consider the policy options to best ensure these reforms. The accompanying paper, 'Revitalising Infrastructure Reform', provides a clear roadmap for the implementation of infrastructure reform over the next four years and will be used as the basis for assessing the future infrastructure policies of all political parties.

The BCA recognises that in an election year, lifting policy horizons and committing to major reforms is a challenge. But if we are going to build on Australia's prosperity and establish the conditions to pass this prosperity on to future generations it is in election years that strategic vision and discipline must come to the fore. Australia cannot afford for elections to be another reason for political parties not taking the hard decisions necessary to sustain and pass on prosperity.

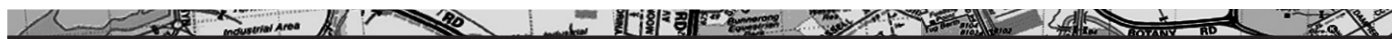
Mr Michael Chaney AO
President
Business Council of Australia



REVITALISING INFRASTRUCTURE REFORM

Rod Sims
Director
Port Jackson Partners Limited

Paper prepared for the
Business Council of Australia
September 2007



OVERVIEW

The Business Council of Australia (BCA) commissioned the author to outline a strategy for infrastructure reform in Australia. The BCA intends to use this strategy to help assess and influence the infrastructure policies of the two main political parties, and to gain clear commitments and timelines for action over 2007–10.

This paper outlines the infrastructure policies that are required if Australia is to continue to maintain high rates of economic growth. The provision of modern, world-class energy, transport, water and communications infrastructure at lowest cost is essential to the competitiveness of all sectors of the economy. Indeed, if the strategies outlined here are followed it is estimated that, over time, Australia's GDP will be boosted by around 2%, or by around \$20 billion per annum.

The BCA's original report in March 2005 on the problems facing Australia's infrastructure was initially met with denial by governments. Since then, however, there has been a growing recognition of the problems, including by all governments. The problems have also been highlighted by the OECD and the International Monetary Fund in their regular reports on the Australian economy.

At one level Australia's infrastructure problems can be seen in bottlenecks at our bulk and container ports and at 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 coordinated planning, a confusion between government roles (as policymaker, regulator and service provider), and sometimes misguided regulation.

There has been progress in the 30 months since the BCA released its original report on Australia's infrastructure problems. Governments are now significantly boosting their expenditure in an attempt to 'catch up' the past underspend, which is pleasing. In addition, the Council of Australian Governments (COAG) announced a National Reform Agenda covering some issues in relation to energy and transport, and there have been important announcements on water and broadband communications.

There is, however, a significant amount left to do, and there has been slow progress in the implementation of some of these recently announced policies.

The 2007–10 infrastructure agenda outlined in this paper includes both foundation and sectoral strategies for Australia's infrastructure; identifies the key enabler to allow the agenda to be adopted and implemented; proposes a regular review mechanism to enhance accountability; and specifies what success will look like in terms of the outcomes we are seeking to achieve. The foundation strategies, the key enabler and the review mechanism are outlined in Exhibit 1 and the full agenda is summarised in Exhibit 2.

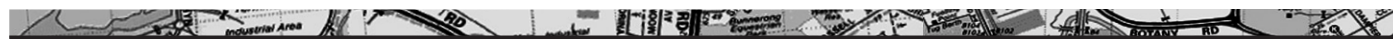


EXHIBIT 1: FOUNDATION STRATEGIES FOR AUSTRALIA'S INFRASTRUCTURE

<ol style="list-style-type: none"> 1. Effective national (not state-based) infrastructure markets, including national or uniform regulation 2. Market-based prices that send the appropriate signals to consumers and suppliers (cover long-run marginal costs, reflect time of use) 3. Public investment processes that are integrated across governments, forward looking, based on consideration of all options and favour projects with the highest (and published) benefit cost ratios 4. Effective competition in all contestable (non-network) market segments 5. Private ownership as the preferred model in all contestable market segments 6. Regulation of infrastructure that does not discourage investment seeking to meet expected demand 	<p>KEY ENABLER</p> <ul style="list-style-type: none"> ■ Effectively functioning Commonwealth–state relations through COAG or other national institution <p>REVIEW MECHANISM</p> <ul style="list-style-type: none"> ■ Policy and condition audits to be conducted by the Productivity Commission every two years
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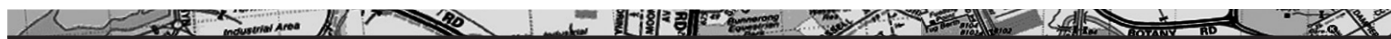
It is worth highlighting the key enabler. Success requires a well-functioning federal system, which we do not currently have. COAG meets infrequently, there is little current focus on timelines for concrete action and there is insufficient emphasis on outcomes. In addition, with the end of the competition policy payments to the states, the Commonwealth has lost a practical mechanism to drive reform. The BCA has outlined the need for a well-functioning federal system where responsibilities are clearly allocated across the different levels of government, and where COAG meets regularly with a clear work program.

Finally, and even if the decisions reached do not reflect all that is advocated in this paper, clear implementation

steps are required with timelines for their achievement, and there needs to be a focus on the outcomes or key performance indicators (KPIs) we are seeking to achieve.

The National Competition Policy reforms benefited Australia enormously. Indeed, they have contributed significantly to the dynamism, flexibility and growth of Australia's economy in recent years. This infrastructure agenda, if adopted, will do likewise. As the BCA has stated, Australia should now adopt the policies to ensure high economic growth into the future so we can continue to make our own luck.

EXHIBIT 2: PROPOSED INFRASTRUCTURE ACTIONS AND OUTCOMES BY 2010			
REVIEW MECHANISM Policy and condition audits to be conducted by the Productivity Commission every two years			
Foundation Strategies	Key Sectoral Strategies	Key outcomes or KPIs	
<ul style="list-style-type: none"> ■ Effective national (not state-based) infrastructure markets, including national or uniform regulation ■ Market-based prices that send the appropriate signals to consumers and suppliers (cover long-run marginal costs, reflect time of use) ■ Public investment processes that are integrated across governments, forward looking, based on consideration of all options and favour projects with the highest (and published) benefit cost ratios ■ Effective competition in all contestable (non-network) market segments ■ Private ownership as the preferred model in all contestable market segments ■ Regulation of infrastructure that does not discourage investment seeking to meet expected demand 	<ul style="list-style-type: none"> ■ A NATIONAL ELECTRICITY MARKET <ul style="list-style-type: none"> ■ Appropriate regional boundaries; national approach to transmission investment ■ National climate change response (stop picking generation 'winners') ■ Remove all price caps; rollout smart meters ■ Private ownership of generation, retail 	<ul style="list-style-type: none"> ■ Market-determined generation investment, adequate reserve margins ■ Emissions trading by 2011, phase out renewable energy schemes ■ Low network congestion costs ■ Appropriate investment location signals ■ Time-of-use pricing 	
	<ul style="list-style-type: none"> ■ COMPETITIVE, DYNAMIC URBAN WATER MARKETS <ul style="list-style-type: none"> ■ Disaggregate into monopoly and contestable supply components; establish national access regime ■ Introduce competitive supply; allow private ownership ■ Set prices that reflect the cost of new supply ■ Allow rural to urban trading 	<ul style="list-style-type: none"> ■ Responsible water use with minimal water restrictions ■ Competitive supply options in each capital city 	
	<ul style="list-style-type: none"> ■ RELIABLE RURAL WATER <ul style="list-style-type: none"> ■ Buy back water to end over-allocation ■ Remove all impediments to water trading ■ Establish real time water accounting systems and registers ■ Price access to irrigation infrastructure to reflect its true costs 	<ul style="list-style-type: none"> ■ No/few rural water surface and groundwater systems under stress ■ More efficient water use (little wastage) ■ Smooth functioning water trading market 	
	<ul style="list-style-type: none"> ■ UNCONGESTED URBAN TRANSPORT <ul style="list-style-type: none"> ■ Introduce congestion charging into our major cities ■ Ensure better integrated road systems ■ Invest in urban public transport; integrate rail/bus links ■ Have private operation of public transport 	<ul style="list-style-type: none"> ■ Lower/stabilised congestion costs in each city ■ High on-time public transport performance, with little overcrowding 	
	<ul style="list-style-type: none"> ■ SUFFICIENT CAPACITY IN A NATIONAL FREIGHT MARKET <ul style="list-style-type: none"> ■ AusLink corridor study investment proposals funded by all governments cooperatively on the basis of benefit cost ■ Extend investment to integrate with and upgrade our ports and intermodal facilities ■ Price high productivity trucks, and those that carry our grain, appropriately ■ Introduce national rail/road regulation ■ End obsolete port operation rules ■ Permanently free up coastal shipping 	<ul style="list-style-type: none"> ■ Improved road and rail freight travel times ■ High on-time schedule reliability ■ No major bottlenecks 	
KEY ENABLER Effectively functioning Commonwealth-state relations through COAG or other national institution	<ul style="list-style-type: none"> ■ VERY HIGH SPEED BROADBAND <ul style="list-style-type: none"> ■ Stimulate rollout to achieve expected productivity gains ■ Allow effective access to facilitate competition in service provision 	<ul style="list-style-type: none"> ■ Top quartile OECD very high speed broadband penetration ■ Effective competition 	



INTRODUCTION

The Business Council of Australia (BCA) continues to advocate the benefits of high (4% per annum) economic growth in Australia. In the BCA's *2007–08 Budget Submission: Passing on Prosperity*, the BCA argues that: '... Australia should commit to a national goal of lifting its living standards into the 'top five' band of the world's developed economies by 2012.'

The BCA has undertaken considerable work to determine what is required to drive high growth: major reforms to the tax system, regulatory frameworks, infrastructure, productivity and workforce participation and skilling. The BCA focus on infrastructure began with the March 2005 publication, *Infrastructure Action Plan for Future Prosperity*, which found that, as a result of poor institutional arrangements and policy choices, Australia's infrastructure is in need of expansion, reform and repair to address this major constraint on future growth.

Since that publication, and in many ways driven by it, Australia has had a fascinating debate on infrastructure reform. As a result we are seeing some increased expenditure on infrastructure and wide agreement that Australia can do much better in this area.

In its April 2007 publication, *Policy that Counts*, the BCA stated that Australia is at a crossroads in terms of its infrastructure development as a result of poor institutional arrangements and policy choices.

The BCA has now commissioned this paper to help influence and achieve specific commitments to infrastructure reform over the coming months. The purpose of this paper is, therefore, to outline a future infrastructure agenda for 2007–2010 in relation to electricity, water, transport and telecommunications. This paper:

- Explains why infrastructure reform is important.
- Elaborates on why there has been so much concern in relation to the nation's infrastructure.
- Briefly outlines the progress that has been made, particularly over the last 30 months.
- Most important, outlines an agenda for the 2007–10 period.

This paper has been kept short and accessible. More details and statistics can be found in a range of publications by the author, the BCA and the other organisations that are mentioned here.

THE IMPORTANCE OF CONTINUING INFRASTRUCTURE REFORM

Efficient and sufficient infrastructure is fundamental to any economy. The capacity and effective operation of electricity networks, transport and communication systems and water supply have a direct effect on the competitiveness of all Australian businesses. Infrastructure has very significant multiplier or 'knock-on' effects to the other sectors of the economy; alternatively put, a lack of infrastructure performance will be quickly felt everywhere.

This self-evident truth is reflected in the level of benefits from past infrastructure reforms and the expected benefits from future reforms. Even apparently modest reform steps can have a large pay-off for the wider economy.

In its 2005 *Review of National Competition Policy Reforms* the Productivity Commission found that reforms over the previous decade in selected infrastructure areas had boosted Australia's GDP by 2.5%. The sectors examined closely mirrored those being considered in this paper: energy, water, transport, ports and telecommunications.

In its February 2007 report, *Potential Benefits of the National Reform Agenda*, the Productivity Commission found that further, quite specific reforms in only energy and transport (not water or communications, and excluding urban congestion issues) could boost GDP by 0.43% per annum. With this as a starting point, and building on previous work, the reforms outlined in this paper could boost GDP by around 2%, or \$20 billion per annum, as shown in Exhibit 3.

EXHIBIT 3: ESTIMATED BENEFITS FROM PROPOSED REFORMS

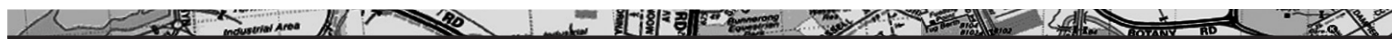
ARENA	RATIONALE	BOOST TO GDP
Energy and Transport	Productivity Commission estimate of benefits from National Reform Agenda (NRA) changes.	0.43%
Rural water	Based on the value of all electricity reforms, adjusted for water and electricity relative shares of GDP, as little analysis is available on benefits of these reforms. The rural water reforms appear as comprehensive as those undertaken in electricity.	0.5%
Urban water	Based on the benefits from past urban water reforms as estimated by the Productivity Commission. The future reform agenda should deliver at least similar benefits.	0.35%
Urban transport	Based on estimates of benefits from time saved at hourly wages, adjusted for size of proposed congestion charges.	0.38%
Additional energy reforms	Based on ACIL estimates of the benefits from the 2002 Parer reforms, less the benefits estimated for those energy reforms that are in the NRA.	0.36%
Communications	No current basis for estimate.	0%
		~ 2.00%

Source: See 'Reforming and Restoring Australia's Infrastructure', incorporated in the BCA *Infrastructure Action Plan for Future Prosperity*, March 2005, p. 93.

In addition to the direct benefits of infrastructure, the state of the nation's infrastructure can have important indirect effects. The current water shortages, for example, have led to calls to curb our economic growth. A perception of too many trucks on the road or straining electricity networks can also indicate to policymakers and the public that perhaps it's time we acted to slow the economy down.

Further, we can now see everyday evidence of the effects of infrastructure bottlenecks. Ship queues off our coal ports have seen workers laid off in our coal mines. Anticipated shortages of electricity and gas are having a material effect on company investment plans. Water shortages have curtailed rural, electricity and even industrial production.

Finally, and notwithstanding whatever views people have on the current bottlenecks, we need to address the fact that much of our infrastructure is ageing, and that high levels of spending on infrastructure will be needed in future simply to match our population growth and to facilitate the achievement of strong economic growth into the future. For this level of spend to occur, and for it to occur at the right times and in the right areas, we need further infrastructure reform.



CONCERNS WITH AUSTRALIA'S INFRASTRUCTURE

The BCA's original focus on the problems with the nation's infrastructure in March 2005 was originally met with denial and blame-shifting by governments. Since then, however, there has been a growing recognition of the problem, including by all governments.

For example, partly in response to the BCA's work, the Commonwealth launched a quick review of Australia's export infrastructure, which reported in May 2005. Among other things it found that 'without action to remove impediments to efficient investment in infrastructure, Australia's export potential over the next five to ten years risks being compromised'.

The two main international institutions that monitor the Australian economy have also focused on this issue. For example, in its *Economic Survey of Australia 2005* the OECD stated that: 'Infrastructure has held back export growth in some cases ... There is still further business in the reform of network (e.g. electricity, transport, communications) industries and inefficient use of water remains a major concern ... Co-operation between the Federal and State Governments will be crucial ...'

In its 2006 Article IV Consultation Report the International Monetary Fund focused on Australia's infrastructure problems and judged that infrastructure reform could lift productivity and incomes. The IMF talked about the need for an ambitious reform program covering export infrastructure, land transportation, electricity and water.

There have been longstanding problems facing each sector.

In **electricity** the essential problems are that we do not have an effective national electricity market, there are many barriers and distorted signals to investment in generation and transmission, and many consumers face poor price signals in relation to their use of electricity.

We cannot claim to have a national market while the electricity market regional boundaries must reflect state boundaries rather than the needs of the market, while transmission investment decisions do not adequately take into account competition benefits and are state-based, and while investment decisions on new generation in both New South Wales and Queensland inevitably focus on state-based rather than market-wide solutions. In addition, these problems flow on to a lack of sound locational decisions for investment by electricity users and producers generally, and

intrastate transmission investment decision makers find it difficult to assess the cost of congestion or the cost of redirection of generation to cover persistent transmission problems.

There are many barriers and distortions to investment in generation. There are various mechanisms used in all states to cap the prices household consumers pay for electricity; inappropriate policy responses to the greenhouse challenge see governments rather than the market determining the source of generation (e.g. a certain usage of renewables or gas is increasingly being required); and government ownership distorts the process for generation investment decision making in a variety of ways. The continuing confusion over whether or not there will be investment in generation in New South Wales, who by, and whether it will be coal or gas fired or based on renewable sources of energy provide an excellent illustration of this point. All of this is of great concern given that \$45–80b of investment is required by 2030 depending on the technology used. Without solutions we face the prospect of major under-investment akin to what has recently happened with urban water.

An additional concern is that household consumers do not face price signals to curb the growth in peak demand. The problem is that even more generation and transmission investment is required to cater for very high demand that occurs infrequently.

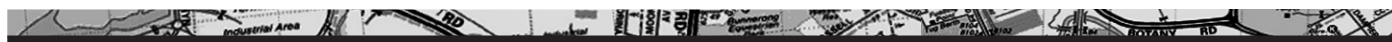
With **urban water** until recently there has been no new significant supply-side investment in 20 years, and furthermore none was contemplated.

This was despite the fact that future water shortages could be predicted even before the worst effects of the drought became clear.¹

Another long-standing issue has been water pricing. In most centres it has not reflected the cost of the next supply increment, which means that poor signals are being sent in relation to water demand and supply.

Low prices, a lack of access to facilities, plus a number of regulatory issues all constitute barriers to investment in recycling. In addition, we have different state regulatory approaches to water, rather than a national approach (e.g. to water quality, as well as access).

¹ This can be seen in Exhibit 53 on page 75 of 'Reforming and Restoring Australia's Infrastructure'; note that the analysis was undertaken in late 2004.



The above problems can, in essence, be attributed to the ownership and industry structure of urban water supply. Since urban water supply is (virtually everywhere) a government-owned monopoly there is confusion between the objectives of those in the supply entities and the political agenda of governments. A competitive market and private ownership would have seen much earlier action on the above problems.

With **rural water** the key concern has been the over-allocation of both surface and groundwater systems. This reflects past poor water planning, which is made worse by inadequate metering and accounting systems, and which has been reinforced by low rural water prices which have encouraged waste rather than the careful management of a scarce resource.

In addition there has been slow progress on water trading. There remain many barriers to trade in the form of fixed trading limits, exit fees and local catchment structures and rules.

In **urban transport** we see high costs imposed on our economy by the congestion on our roads. The real problem, however, is the outlook for future congestion.

The most recent report by the Bureau of Transport and Regional Economics on this topic, *Estimating Urban Traffic and Congestion Cost Trends for Australian Cities* (December 2006), shows that congestion costs (principally longer travel times) are set to double in Australia by 2020. Their predictions are of major concern and can be illustrated as follows:

- While average Australian city congestion costs between 1990–2004 grew by 1.7% p.a., they are expected to grow by 2.6% p.a. between 2004–2020.
- Worse, the costs imposed by congestion at what are now considered 'peak' times are expected to become the standard through the working day.

With freight transport Australia faces longstanding issues. These can be seen in both obvious bottlenecks, and in inappropriate policy.

The freight bottlenecks are obvious: queues of ships off our coal ports, inadequate general cargo port capacity (e.g. container storage at Port Botany) and water depth (for example, at the Port of Melbourne), inadequate roads (for example, the Pacific Highway), under-investment in rail lines, pressures at many of our intermodal (rail/road) hubs and poor access to ports for heavy vehicles.

A recently completed House of Representatives Report, *The Great Freight Task* (July 2007), has also highlighted the many problems. In the Foreword to this report its Chairman, Paul Neville, said that:

'What we discovered, as we moved from port to port, was a pattern of ... infrastructure failures in the access to, or the operation of ports – a missing supply link, a lack of rail capacity, a need for bypass or ring roads, road and rail loops and the functionality of channels to cater for larger or more frequent vessels ... bold measures will be necessary ... The doubling of the freight task by 2020 looms even more ominously ...'

This report also stated that 'with almost a quarter of the freight task predicted to be moved by sea in 2020, it is essential to take into account the coastal shipping industry and its capacity to share the freight task ...'

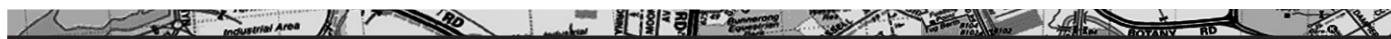
The policy problems are many. A lack of a national rail or road freight market with, for example, trains carrying numerous radios to be able to communicate in each state, and trucks being legal in one jurisdiction but not in another. In addition, we have the different policy treatment of road and rail in terms of user charging, investment criteria and funding. Of perhaps most concern is that the access prices paid by trucks are averaged across vehicle types such that large trucks are cross-subsidised by smaller trucks in their user charges, and that truck charging is poorly linked to mass carried and distance travelled.

As an example of the problems caused by inappropriate truck user charges note that, with good rains, Australia will struggle to transport its wheat crop. Governments are reluctant to let trucks on the roads to do this as they do not pay their way, yet low truck user charges makes rail freight unviable when it comes to transporting wheat.

In **communications** the key problem is Australia's low penetration and speed of broadband.

The latest cross-country statistics see Australia with broadband penetration levels below most other developed countries we like to compare ourselves to, and with download speeds well below most other developed countries.

There is debate over the ability to compare penetration and speed across countries, and Australia's broadband penetration levels have increased recently. What is clear, however, is that the world is moving to high penetration levels of very high speed broadband, and Australia must quickly examine the benefits of doing this as well.



RECENT PROGRESS

There has been progress in many areas. Perhaps the major benefit from the enhanced public focus and debate has been that the Commonwealth and state governments are now significantly boosting their expenditure on infrastructure to 'catch-up', and many are also streamlining their investment approval processes. One problem being faced by this catch-up is that it is competing in a strong economy for sufficient skilled resources to undertake the work.

In addition to this increasing spending, in February 2006 COAG announced a comprehensive National Reform Agenda covering, among other areas, aspects of energy and transport. Recently there have been additional policy announcements in relation to water and a very high speed broadband rollout.

Importantly, there has been a decision to implement an emissions trading scheme from 2011 with wide sectoral coverage, and which can link to other international schemes. This scheme will be accompanied by measures to assist investment in research and development in low emissions technologies and adaptation, and a renewed emphasis on energy efficiency. This policy framework addresses one of the key risks to future energy supply planning and investment.

It is worth now describing the recent progress in each sector, and overall.

In **electricity** there has been a lot of activity, but possibly little so far to show for it.

The Ministerial Council on Energy has been working hard on reform, and COAG commissioned a report on particular issues from its Energy Reform Implementation Group (ERIG).

The Ministerial Council on Energy has been working on a number of fronts and has announced, for example:

- The introduction of national regulation of the National Electricity Market (NEM), with many exposure drafts of the proposed rules.
- The proposed rollout of smart meters, subject to more cost benefit testing and agreeing common technical standards.
- The removal of caps on electricity prices paid by households, subject to further assessment of the level of competition in each market.

The problem with the latter two announcements is that, despite considerable study, more tests need to be met, and some states are disassociating themselves from the MCE position.

The ERIG review made many useful recommendations, for example as follows:

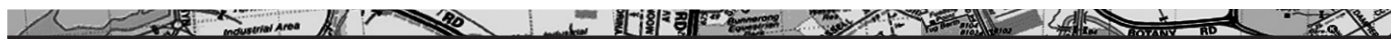
- All energy assets should be disaggregated and privatised, especially in the retail and generation sectors.
- Retail price caps should be removed without any further assessment of the level of competition.
- The scope of the current congestion management review should be enlarged to allow it to consider more options for addressing this issue (e.g. by having more regions).
- There should be a single market operator rather than one for electricity and another for gas.
- There should be a new national planning function to undertake transmission planning residing within the market operator (NEMMCO, to become the Australian Energy Market Operator, or AEMO).

In relation to the last two recommendations, the MCE agreed to establish AEMO as the single electricity and gas market operator and to give an enhanced transmission planning role to the AEMO so that it could identify transmission constraints taking a NEM-wide view. It is important to understand, however, that this AEMO function can only indicate problem areas; it cannot direct that investment occurs.

It is also important to note that the recently completed Owen Inquiry report recommended the sale of the New South Wales Government-owned retail and generation businesses.

An unfortunate development has been the enhancement of various schemes at the state level that see governments determine the generation technology that should be used, particularly in relation to renewable energy. It is to be hoped that, with both sides of politics now supporting an emissions trading scheme, such schemes will be progressively wound down. They are inconsistent with emissions trading, which seeks to set a single price on carbon and let the market determine the most appropriate form of abatement activity.

The government's recently announced 'Australia's Climate Change Policy', which has been supported by the BCA, appears to endorse such a wind down. This policy in essence adopted the recommendations of the Prime Ministerial Task Group on Emissions Trading.



The key issue is whether the Commonwealth and state governments will be able to translate these findings into integrated funding commitments to optimise the system. While we now know what investments need to be made, we do not know whether the required funding and cooperation will be there to see the projects become a reality. The current condition of Commonwealth–state relations is a cause for pessimism.

On the transport policy issues the Productivity Commission in its December 2006 report, *Road and Rail Freight Infrastructure Pricing*, found that ‘current pricing and regulatory arrangements are hampering the efficient provision and productive use of road and rail infrastructure’. They were particularly concerned at the under-charging of large trucks due to the averaging of truck user charges across vehicle types, the need for more mass and location-based truck user charges and the current disconnect between road revenue and spending decisions. In response, COAG has authorised another National Transport Commission review of heavy vehicle charges. It will be interesting to see what action COAG eventually takes in response to the commission’s findings.

Progress towards regulatory harmonisation has been made, but slowly. Progress has been made in relation to mass limits and national rail safety legislation, but we still have six rail safety regulators in Australia.

Recently there has been considerable activity on **communications**, particularly in the run-up to the coming federal election.

Both sides of politics are embracing what would appear to be a step change in terms of Australia’s penetration of very high speed broadband.

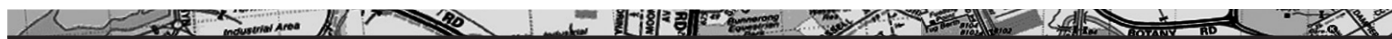
The ALP has announced a \$4.5 billion contribution to competitive proposals for the rollout of widespread fibre to the node. The government has already provided a \$1 billion contribution essentially to wireless broadband in rural areas, and has established a task force of high-level officials to conduct a tender process for an urban broadband rollout based around the extent of coverage and the regulatory safeguards required by the potential investors.

At a **cross-infrastructure sector** level there have been some disappointments and concerns.

Perhaps the key disappointment has been the results of a series of audits by each jurisdiction of their infrastructure that were announced by COAG, and completed earlier this year. The objective had been to assess current asset condition and performance, determine future infrastructure needs, and identify any regulatory or policy impediments to the required investment. These objectives were not met, as the audits provided little useful information. This failure by governments to conduct useful audits means, for example, that legislators and the media do not have their attention drawn to actual or potential infrastructure weak spots (which is why urban water and rail investment has been neglected for years), and it means that the private sector cannot see the coming likely investment opportunities. The BCA had been calling for regular audits to be undertaken by an independent body, the Productivity Commission. Self-assessment rarely works well.

The key concern going forward is the deteriorating relationship between the Commonwealth and the states and an increasing confusion of roles. Infrastructure restoration and reform requires all three levels of government to plan and coordinate their policies and funding.

Finally, in March 2006 the BCA released a report, *Benchmarking the Progress of Infrastructure Reform*. It outlined a series of milestones to be met based on COAG’s own timetable, and the outcomes that need to be monitored to ensure results are being achieved from the proposed reforms. While there has been some progress against these milestones (see page 4 of *Benchmarking the Progress of Infrastructure Reform* for a list of the milestones) many target dates have not been met. On the available evidence, there has also been little improvement so far in the outcomes being achieved (see page 5 of that report for the target list of outcomes) from our infrastructure, but of course such progress takes time.



THE AGENDA FOR 2007-10

In formulating the forward agenda an approach has been taken that will be familiar to businesspeople. The agenda is, first, built around clear foundation strategies, which set the 'corporate strategy'. These then drive the sector or 'business unit' strategies which are further fleshed out to suit each sector, and measurable outcomes are determined. Perhaps of most importance, a key enabler is identified, which involves a well-functioning federal system. Finally, a review mechanism is proposed so that we will be able to address whether or not we are on track.

THE FOUNDATION STRATEGIES

There are six foundation strategies put forward here for Australia's infrastructure. They are quite specific, and reflect long experience in observing what does and does not work in relation to infrastructure policy and practice.

First, we need **effectively operating national (not state-based) infrastructure markets**, which would among other things involve national regulation.

- State-based markets impose arbitrary market borders, which lead to inefficient outcomes; the fragmentation imposes unnecessary costs on governments and industry.

Second, we must have **prices for infrastructure use that are market-based, appropriately reflect externalities, and send accurate signals to influence demand and supply** (such as covering long-run marginal costs, reflecting time of use).

- Poor pricing drives most poor infrastructure policy and outcomes. Users respond to prices: low prices will encourage high demand and low supply. Time-of-use pricing is required to even out network usage.

Third, we require **public investment processes that are well coordinated between governments, forward looking, based on consideration of all options, and which favour projects with the highest (and published) benefit cost ratios.**

- There will always be a role for public investment in so-called 'public goods' such as roads, ports, certain rail lines and other facilities.

Fourth, **there should be effective competition in all contestable (non-network) market segments.**

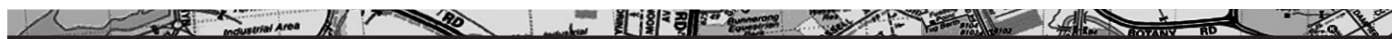
- Competition drives cost efficiency and consumer choice; a lack of competition drives the opposite.

Fifth, **private ownership of infrastructure is preferred in all of the contestable market segments.**

- Experience shows that the private sector is best at running businesses; the public sector's role should be setting policy and regulation.
- While some are uncomfortable with the private sector providing essential infrastructure services, we trust the private sector to build the cars we drive and to produce the essential food we eat, with the government establishing appropriate standards and regulating behaviour.

Sixth, **regulation of infrastructure should not discourage investment that is seeking to meet expected demand.**

- Australia's current regulatory approaches could be seen to work well with established infrastructure, but less well with new infrastructure being built to cater for uncertain demand or possible new customers.



THE SECTORAL STRATEGIES AND OUTCOMES

This section outlines the sector specific strategies and some of the outcomes we seek. The outcomes being sought are best summarised in Exhibit 2, and are not all repeated here.

In **electricity** we need to see a national market by 2010, where investment barriers and distortions are removed, where prices can give effective signals to demand and supply, and where we have more market-driven and less government-driven outcomes.

To achieve this, among other things, we need to see:

- More appropriate and dynamic regional boundaries drawn around key sources of generation or demand. This will drive better locational decisions for investment by electricity suppliers and users: currently, for example, a large electricity user has insufficient incentive to locate close to a source of generation and the additional costs of transmission arising from a distant location are largely imposed on others.
- A national rather than state-based approach to investment in the transmission network, and investment decisions based on factoring in the benefits of greater inter-regional trading and least cost considerations taking account of the available transmission and generation options.
- Full private ownership of the generation and retail sectors.
- A complete move away from picking energy generation 'winners', be it through renewable energy or gas, with all investment decisions made in the context of a comprehensive emissions trading system. This crucial point explains why an emissions trading system needs to be introduced as soon as practicable.
- The removal of all caps on household electricity prices.
- Significant progress in the rollout of smart meters for households.

In relation to **urban water** the key step is to change the ownership and structure of the urban water industry so that there can be no repeat of the performance of the past 20 years, and so that the market and not governments can determine our sources of water supply. We need to introduce competition and remove the 'politics' from water as much as possible.

The need for this is clear to business as they now need to take charge of their own provision of water; they have seen how a lack of supply can affect their businesses. Electricity generators in particular will need to do this, but so will other large users.

Of course, these moves need to be made carefully as they represent significant change and they would have few precedents overseas. Disaggregation is most appropriate in the capital cities; it may not work in the smaller regional centres. Likewise competition and a role for the private sector could apply in the first instance to large users, or to households with usage above particular levels.

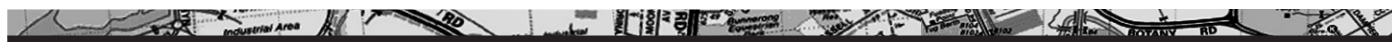
The likely requirements are to:

- Disaggregate water utilities into their monopoly (pipes) and competitive (supply and retail) components in the major cities and in major regional centres.
- Establish appropriate regimes for access to water pipes and other relevant monopoly infrastructure.
- Introduce national regulation of water (on access, water quality).
- Introduce competition into water supply, particularly for usage above certain levels, which can also allow businesses to pay more for reliable supply. Large users should also be able to trade their entitlements.
- Allow private ownership as much as possible.

The key role of governments in future should be to regulate, not to be responsible for supply.

Other steps will need to be taken:

- Ensure all water prices are usage based and reflect the cost of new supply increments (at least once certain levels of consumption are reached).
- End 'postage stamp' pricing where one price is averaged across a state or a large region, which discourages lower-cost supply options in outlying areas.
- Remove all impediments to water recycling (e.g. who owns the storm water, councils or water authorities?).
- Allow rural to urban trading so that Australia can utilise its water resources most effectively.



The end outcome, of course, is that water restrictions in our cities would, in future, be rare events.

In **rural water** by 2010 the essential objective should be to have taken most of the steps to address over-allocation. We should know the extent of the problem and have made significant purchases of water for environmental purposes.

In addition, we need to take the required steps so that the water trading market operates smoothly and at lower cost. The water accounting systems and registers should operate in real time and be trustworthy, transparent and national.

Finally, water pricing as well as trading should provide the right signals for irrigation infrastructure use and investment. Care will be needed so that the government does not invest in infrastructure that would ultimately not be required if irrigators faced the right signals or once water has been traded.

With **urban transport** we need to see an integrated strategy that has COAG backing to avoid it being undermined. The strategy needs to include congestion charging, a better integrated road network, increased investment in public transport and private sector operation of public transport (as in Victoria).

As Commonwealth and state governments officials have found, congestion charging is the most effective means of addressing urban congestion. If travellers do not receive price signals, they will solve (or accentuate) the problem by queuing.

Australia has under-invested in urban public transport for many years. There is often overcrowding, poor frequency and travel times, and inadequate integration between rail and buses. As congestion costs increase, however, the benefits of higher investment levels should become more apparent (benefit cost ratios will increase further).

Finally, our public transport systems are largely inefficient. They have, for example, staffing levels and work practices that long ago ceased to apply in the private sector. It is now time to have private sector operation of public transport in Australia. We cannot keep to the current approach and expect improved results: too many attempts have been made to improve public transport efficiency with no tangible outcome. Governments should set policy and regulate, the private sector should operate. Governments can then focus on what they do best, not what they have shown over many years that they cannot do.

It is interesting to observe the current Melbourne urban public transport debate. A current operator Connex is facing penalties for not meeting minimal service levels (e.g. on-time running). This will provide a focus on the need for solutions that is difficult to imagine in a government-run-system.

With **freight transport** we need to see much better Commonwealth–state cooperation on investment planning and funding, better truck pricing and a range of related policy improvements.

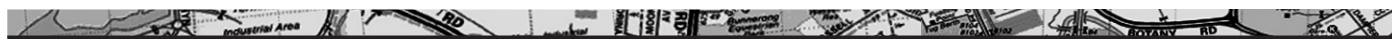
We need to see the AusLink investments funded and supported by both Commonwealth and state governments, and we need to ensure all investment decisions are integrated with the requirements of the container and bulk freight ports. We also need to see more investment in many of our ports to improve supply chain efficiency. That is, we need to see fully integrated transport planning and strategy, and an end to the past under-investment.

In terms of pricing we need to ensure that high productivity (that is, larger and longer travelling) trucks are charged appropriately. Not only will this help road/rail neutrality, it will facilitate having B Doubles and B Triples on our roads (why should governments let them on the roads if they do not pay their way in terms of road user charges?). Likewise we need to price appropriately the trucks that carry our grain, otherwise governments and councils will not allow their use and we cannot see whether rail is a viable alternative.

On policy, we need a regulatory environment that allows infrastructure owners to invest ahead of demand, we need uniform and single regulation to create a national freight market, and we need to end rules such that, for example, see Port Botany unable to accept trucks other than at times of peak road congestion.

Finally, we need to free up our coastal shipping arrangements to end the continuing threat of imposing higher cost Australian crewed vessels on all routes.

With **communications**, the key required steps are clear. We need a policy framework that can stimulate the investment required to match a clear view of the productivity and innovation advantages available from higher broadband speeds, a view of the competitive framework for access, and a statement on implementation timing.



THE KEY ENABLER

It is worth emphasising the key enabler to success. There will, of course, be others.

In essence, reform is not possible unless we have a much more effective working relationship between the Commonwealth and state governments. As the Chief Executive of the BCA, Katie Lahey, said in releasing the October 2006 paper, *Reshaping Australia's Federation: A New Contract for Federal-State Relations*: 'Over the past two years, it has been clear that many of the reforms the BCA is seeking ... can only be achieved through closer and more productive working relationships between federal and state governments ... One weakness of the Federation is that its current structures do not guarantee a proper focus on issues of national or common interest'.

The current structures see infrequent COAG meetings, a lack of transparency in relation to the agenda and of firm timelines for action, and inadequate focus on concrete outcomes.

In a speech given at the time of the launch of *Reshaping Australia's Federation*, the President of the BCA, Michael Chaney, said that '... we need to fix our dysfunctional system of federal-state relations'.

In the case of infrastructure, indeed we do. Rivers, rail lines and roads and electricity networks all cross state boundaries, yet historically both policy and service delivery have been purely state-based. We are moving beyond this but we have a long way to go and success will only come if the Commonwealth and state governments work together.

THE REVIEW MECHANISM

Finally, the agenda requires a review mechanism to ensure progress is occurring as expected. That is: are the strategies being implemented in a timely way; are the key outcomes or KPIs being achieved; and do adjustments need to be made?

In the March 2005 paper, *Infrastructure Action Plan for Future Prosperity*, the BCA stated that it '... believes it is essential that Governments put in place processes for transparent independent and regular assessment, monitoring and reporting of reform progress, and of infrastructure asset condition and performance'. The BCA later called for a 'policy and condition' audit to be conducted by the Productivity Commission every two years.

Australian businesses would never embark on a major reform program without a detailed and transparent review mechanism. Nor should governments.

CONCLUSION

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This infrastructure reform agenda is put forward for the consideration of all governments, but particularly the two political parties seeking to form the next Commonwealth government. It is to be hoped that the BCA and others can use its proposals to help assess and influence the policies that are and will be put to the electorate over the coming months.

While it represents a comprehensive and significant agenda, it is not unprecedented. It would amount to similar change to that brought about by the National Competition Policy of the early to mid-1990s.



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