CONSULT AUSTRALIA

Infrastructure funding:

The Good, The Bad and The Extremely Unhelpful

This discussion paper has been prepared by Consult Australia to stimulate debate on new and innovative ways to fund infrastructure. Australia is presented with an opportunity to consider new funding frameworks that would contribute to significant improvements in infrastructure, support our population growth, and deliver lasting economic benefits.

THE OPPORTUNITY

Infrastructure provision has lagged population growth in Australia for more than three decades. If we are to seize an advantage in what is the fastest growing region of the world's economy, obstacles to the development and delivery of infrastructure must be overcome.

The benefits of infrastructure investment to our productivity are clear, as is the growth in a world-class domestic professional services sector supporting these developments.

It is important to realise that any investment in infrastructure must be focussed on the medium to longer term, rather than merely a short term boost to the economy.

It is also clear that investment in infrastructure is not without its challenges. It is important that any investment is free from political considerations and focussed primarily on the longer term benefits the infrastructure would provide if we are to reap the most benefit from the investment.

With targeted intervention, there is an opportunity for governments to enhance productivity and moderate the extremes of the boom/bust cycle that has characterised infrastructure investment in years past.

Additionally, infrastructure projects must be financed. It is here the real opportunity lies. However there has been limited capacity from government to invest in productivity boosting infrastructure.

"Infrastructure spending has a role to play in sustaining growth and also in generating confidence"

Glenn Stevens, Former Governor Reserve Bank of Australia 10/06/15

A stubborn approach by government to not risk the AAA credit rating and simplistic platitudes regarding debt has potentially impacted on our ability to build the infrastructure of the future.

With low borrowing costs, 10-year bond rates at near historic lows, and a triple A credit rating, Australia is well placed to deliver the productivity enhancing infrastructure we so desperately need. It is critical that we capitalise on this once in a generation opportunity, support local industry and invest in productivity for the medium and long-term.

Additionally, there are a number of infrastructure funding and financing mechanisms emerging around the world that can provide sound and proven revenue streams to support infrastructure delivery.

"Infrastructure is a crucial input into strong, sustainable, long term growth."

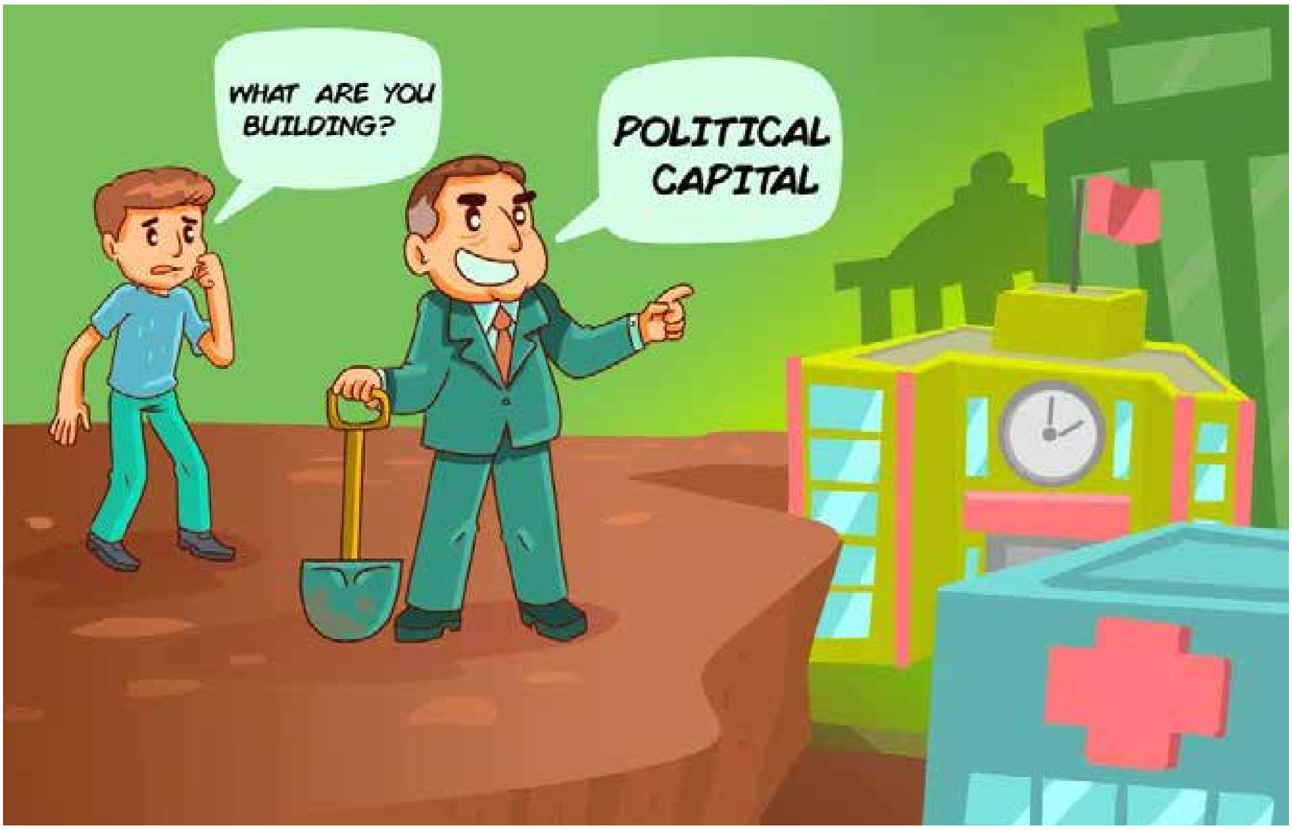
John Fraser Treasury Secretary 26/02/16

Infrastructure, though not always well articulated in broader public debate, can either be funded through public finance (taxes/debt), or user charges. This might be supported by asset sales, or asset sweating, but ultimately it is the tax-payer that foots the bill in either scenario.

Alongside effective funding streams, innovative financing mechanisms should be structured to support infrastructure projects and to deliver more equitable, value-for-money outcomes for governments.

Public Private Partnerships, including for example value capture and bond banks, provide new opportunities to leverage greater private sector investment across a range of projects.

Consult Australia does not consider any single financing or funding policy will by itself provide a stand-alone solution to the substantial challenge for governments, however all options present opportunities for reform. To that end, some key issues for further consideration are outlined:



LEVERAGING GOVERNMENT BALANCE SHEETS TO DRIVE PRODUCTIVITY

Increasingly challenging for governments of all stripes, where budget bottom-lines have become more politicised, is the identification of projects worthy of public financing. In this context governments must reconsider the extent to which surplus-driven budgets and unquestioning dedication to AAA credit ratings limit opportunities to invest in long-term productivity-enhancing infrastructure.

This is not to say the Consult Australia supports unconstrained spending and deficits, but rather spending with a demonstrable return to the taxpayers.

The 'fiscal populism' that now characterises governments' approach to debt is at the expense of much-needed infrastructure investment.

> **"However, debt should be a fundamentally important ingredient of any national infrastructure program, deployed to projects that can be justified in terms of their longer-term economic and social returns, which ensure that debt is serviced and repaid."**

Dr John Hewson AFR 19/05/16

The connection between decision making supporting infrastructure investment and the willingness for governments to leverage their credit rating should not be underestimated.

Ultimately a bi-partisan approach to public infrastructure investment, supported by transparent, independent, expert advice, is essential to support a more sophisticated debate about budget policy.

This approach will deepen the public's understanding of the benefits of government debt in funding public infrastructure, and apply a high level of rigour, accountability and transparency to the decision making process.

“Australian governments have embraced the notion that all debt is bad, but most of the time debt is only bad if it’s used to fund recurrent expenditure”

Nicholas Gruen, Lateral Economics, Inside Story 23 November 2010

OVERCOMING INSTITUTIONAL RESISTANCE: VALUE CAPTURE

Overcoming institutional resistance to more innovative policy solutions will be critical to delivering new financing mechanisms. It is important to realise that not every tool available to governments will be appropriate for every project. Nonetheless steps should be taken to ensure all options are available so they can be used where appropriate.

“Value capture is something we should look at with all major infrastructure projects”

Philip Davies CEO Infrastructure Australia AFR 14/12/16

In the case of Value Capture, institutional resistance, and/or a lack of awareness of potential benefits may be one of the major barriers to implementation.

It is encouraging that the Federal Government and State Governments are beginning to embrace the notion of value capture, or value sharing.

Value capture should play a bigger role in the funding mix and done right provides the opportunity to deliver a fairer way of contributing to infrastructure.

RECYCLING CAPITAL

Asset sales have helped government release funds for new infrastructure investment. However, the politicisation of asset sales has come at the detriment of delivering critical infrastructure for Australia.

While traditionally treasuries have not been in favour of hypothecation, it is clear that where public assets are concerned this is an important tool through which projects can be delivered with broad public support.

ROAD USER CHARGING

A comprehensive debate regarding the full application of road user charging, including the development of a national scheme, is long overdue in Australia. Reliance on traditional fuel excise as the key revenue tool to fund infrastructure is internationally recognised as having limited longevity, with diminishing reserves and increased fuel efficiency curtailing revenues.

It is encouraging to see that the Australian Government has embraced Infrastructure Australia’s recommendation that cost reflective road pricing for light vehicles should be further investigated. The commitment to undertake a study into the potential benefits and impacts of cost reflective pricing for light vehicles on road users is long overdue.

There is no doubt the implementation of any systemic approach to user charging is a long-term goal and contingent on the hypothecation of revenues to infrastructure projects. To achieve those goal governments should consider international experience, understanding the barriers to implementation and developing pilot schemes to support community engagement and understanding.

"It could provide a more efficient way to raise road funding than the existing cocktail of fuel excise, registration fees and general revenue, which do not directly correlate with the costs individual users place on the system or the levels of investment required"

John Fraser Treasury Secretary AFR 29/02/2016

CREATING NEW MARKETS FOR PRIVATE INVESTMENT

Recent uncertainties associated with infrastructure funding, planning and governance for major infrastructure projects have negatively impacted those firms involved in these projects, and industry confidence more broadly.

The simple fact is that there is just not enough funding available under current Commonwealth and State government arrangements.

Despite the challenges there is no shortage of opportunities to better leverage government funding of infrastructure through the development of policy levers that facilitate greater private sector investment.

“The finance community has generally indicated that it is only too willing to provide and finance public infrastructure projects where it has assessed the projects to be commercially viable”

Productivity Commission Report Public Infrastructure 14 July 2014

Compared with most other countries, Australia has a high proportion of private infrastructure financing supplied by the private sector.

The Austrade publication *Why Australia Benchmark Report 2015* on investment in Australia shows Australia is a very positive place to do business.

“Australia remains, in BMI’s opinion, one of our favourite long-term markets among developed states, offering an attractive combination of vast growth potential (stemming from the infrastructure sector) and low risks in the operating environment.”

Business Monitor International, Australia Infrastructure Report, February 2012

THE CHALLENGE

Australia has a significant challenge ahead to ensure infrastructure provision in the transport, energy, water and communications sectors, and social infrastructure, keeps pace with growth and helps to lift productivity.

Australia is already feeling the impacts on employment and growth following the decline in the mining and resources sector. This decline can be partially offset by new infrastructure investment.

Furthermore, Australia’s population is expected to grow to over 30 million by 2031, with the vast majority of this population residing in our major cities.

In order to ensure that our cities support our quality of life, and evolve as productive places of jobs and economic growth, infrastructure investment must meet the future needs.

The significant challenge facing governments is the declining capacity of government budgets and balance sheets to fund new infrastructure that will be required into the future.

OPTIONS TO CONSIDER

Infrastructure assets that are included on government balance sheets can be better used, or provide leverage to stimulate new funding:

- **Lazy Assets:** identify balance sheet assets that are underutilised, and realise their value by sale or alternate government use;
- **Privatise infrastructure:** sell existing infrastructure to private sector to finance new investment (e.g. Telstra, Queensland ports & rail; M4);
- **Transit Oriented Development (TODs):** recognise the need for higher density development, and focus on transport nodes to reinforce transport efficiency while achieving viable patronage (e.g. airspace development at rail nodes);

- **Urban Sprawl:** retain existing urban footprints and increase urban densities to reduce urban sprawl in a model of multi-centred cities with reduced trip lengths;
- **Change Mode and Time of Travel:** shift the transport focus from individual private travel to public travel in more efficient vehicles; allowing greater throughput on existing infrastructure and greater use of non-peak periods.

TAXATION REFORM

Identify opportunities to restructure the present consolidated revenue base to fund infrastructure:

- **Hypothecation:** new user revenues committed to service provision e.g. national health funding;
- **Full cost recovery:** ensure that users contribute the full costs of their travel choices;
- **External Costs:** include social and environmental consequences of travel in user charges, just as road safety is charged through insurance (e.g. economic delay charged through congestion charges, emission impact charged through carbon pricing targeting higher emission vehicles);
- **Corporate taxation:** rebalance taxation treatment of capital investment (CGT and depreciation) against recurrent expenditure (operational costs) to encourage long-term infrastructure investment;
- **Transport Pricing:** adopt appropriate technology for all transport modes to provide network-wide demand sensitive pricing to manage congestion and provide revenues for public transport.

PUBLIC FINANCE

Develop financial instruments to provide government with expanded sources of funds for infrastructure investment:

- **Tax Incremental Financing:** This allows a government entity to generate tax revenues based on increases in property values within a prescribed development area and use those revenues to fund the infrastructure and renewal projects that contributed to the property appreciation;
- **Employer Transport Levies:** Employers contribute to cost of transport in business location, based on the benefit to the employer of ready access for its employees to work e.g. levies in Ile de France;
- **Green Banking:** Establish a banking structure that allows contribution towards environmentally sensitive infrastructure investments from community and developments, including "compensatory" investments;
- **Infrastructure Bonds:** Continued development of specific Infrastructure Bonds to help private infrastructure investors access large pools of retail investment funds, such as from superannuation funds. This will extend current government support of simplified bond issuance and discounts on bond interest income.

PRIVATE FINANCE

Incentivise new sources for transport financing, including new Public-Private-Partnerships (PPP) and superannuation fund investment:

- **Direct tolling of new infrastructure:** This model continues the current theme of private debt/equity financed infrastructure retaining a period concession to directly charge users;
- **PPP funding:** Revitalise private-public partnerships reflecting the success of alliance infrastructure contracting, and providing rebalanced risk sharing.
- **Land Value Capture:** As with developer infrastructure charges, with the developer financing local improvements from the increased value.

AN INTEGRATED FUNDING FRAMEWORK

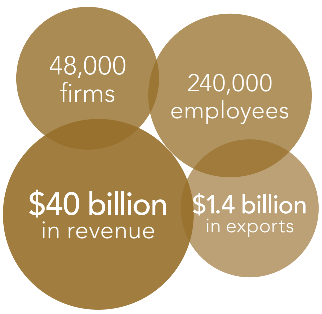
An integrated funding framework would provide confidence to implement city transport plans and much needed metropolitan and inter-urban fast rail systems, which would reduce car and air travel and reduce our carbon footprint.

Hypothecate new revenues to transport investment: Community support for funding reform will be vital. Hypothecating all revenues from new sources to transport investment in a transparent integrated framework has been shown to ensure that support.

Cost recovery: All transport users should cover the costs that they impose, with any cross-subsidies being the transparent result of overt policy decisions.

Road pricing and real public transport fares: This will provide additional revenues, to improve existing and support new public transport services and provide efficiency gains across all modes.

Phase out of indirect charges: Integrated funding across all new sources would include the reduced reliance on indirect taxes, improving funding transparency.



ABOUT US

Consult Australia is the industry association representing consulting firms operating in the built and natural environment sectors. These services include design, engineering, architecture, technology, survey, legal and management solutions for individual consumers through to major companies in the private and public sector including local, state and federal governments. We represent an industry comprising some 48,000 firms across Australia, ranging from sole practitioners through to some of Australia's top 500 firms with combined revenue exceeding $40 billion a year.

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