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Wrong way, go back: mega project funding muddle

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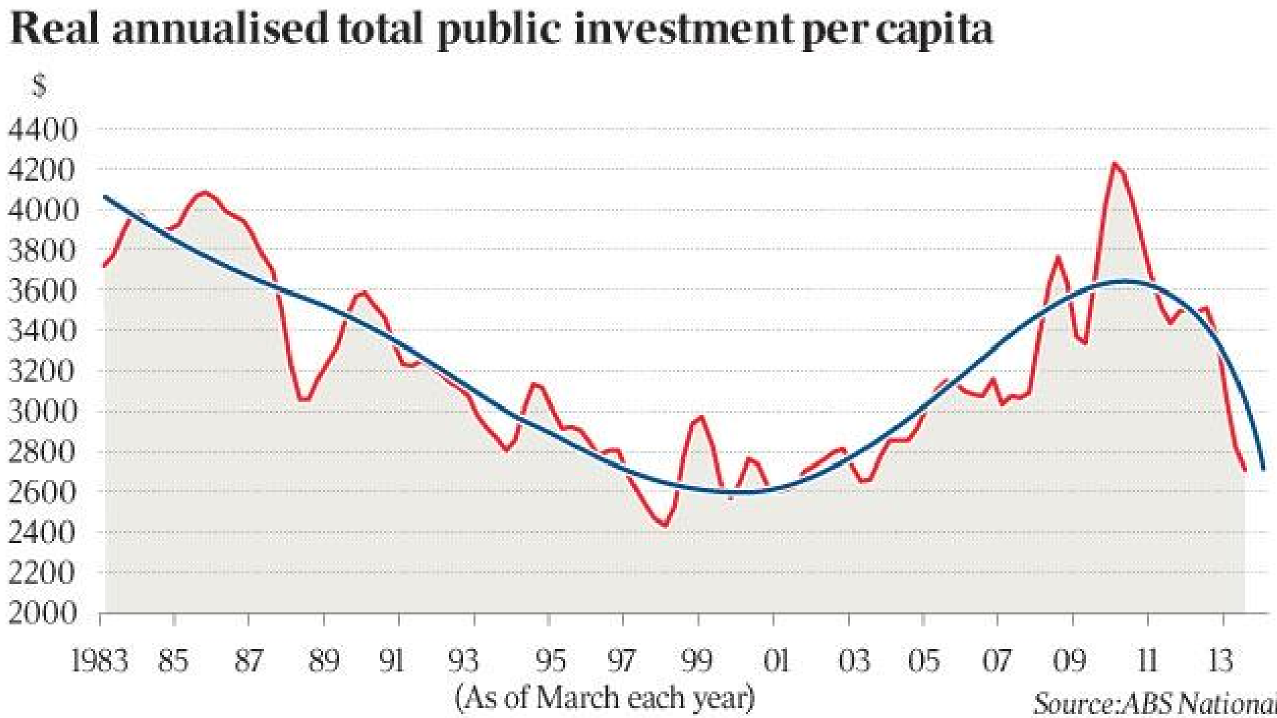

Illustration: Oliver Reynolds Source: TheAustralian

AUSTRALIAN cities are suffering a double blow: despite ambitious project announcements, public investment has fallen as governments try to rein-in spending; but as infrastructure costs continue to climb each dollar of that investment is yielding less and less relief to frustrated commuters.

With fiscal constraints here to stay, new approaches are needed if our transport systems are to cope with rapid population growth.

Much attention has focused on increasing the funding available for capacity expansion. In NSW and Queensland, state governments are selling "mature" assets such as ports to finance major transport projects.

The theory is that private investors are eager to own infrastructure with predictable cost and revenue characteristics, but shy away from risky ventures such as new motorways. Given that constraint, "capital recycling" can allow governments to fund higher-risk projects by disposing of assets that have reached the stage at which risks are lower.

This approach's attractions are obvious to governments that face limits on how much debt they can issue without further jeopardising credit ratings and borrowing costs. But there are substantial dangers as well.

After all, if the private sector is wary of major infrastructure projects it is because the track record of cost and patronage projections is so poor. Sydney's Cross City Tunnel and the Clem 7 in Brisbane are stark reminders of how much can go wrong, with costs much greater, and usage much smaller, than initially claimed.

No wonder people putting their own money in harm's way demand high rates of return. But simply shifting risks to taxpayers doesn't make them disappear.

Sure, there are those such as the ACTU that believe low government bond rates mean hoisting risk on to taxpayers is virtually costless. From that premise flows an "anything goes" attitude to infrastructure investment. A moment's reflection shows that makes no sense.

For starters, all loans must eventually be repaid, so if government borrows $1 to build an asset users value at 50c the community is necessarily worse off. Wasting public money is stupid, regardless of bond rates.

But it is also wrong to confuse bond rates with the cost to taxpayers of financing risky projects. Ultimately, it is governments' coercive powers of taxation that allow them to borrow cheaply: like it or not, governments can compel us to pay their debts by reducing our own consumption.

So when governments undertake risky projects the economic cost is not the headline bond rate; rather, it is the compensation taxpayers require to offset the threat to their future wellbeing.

Properly measured, it usually turns out to be about as high, if not higher, than the compensation the private sector seeks for similarly risky ventures.

And if governments do an even worse job of assessing, managing and disclosing risks than the private sector then the burden on taxpayers is all the greater, as is the expected return offsetting it requires.

Capital recycling cannot therefore be an excuse for undertaking investments that would not survive rigorous scrutiny at a commercial cost of capital.

Yet our performance in selecting and delivering infrastructure projects remains far from stellar.

Rising infrastructure costs are one symptom of the problems. In today's dollars, each lane of the Sydney Harbour Bridge costs $36 million per kilometre; despite nearly a century of productivity growth, Brisbane's Gateway 2 bridge cost over four times that. And, even focusing on recent trends, cost overruns of 20 per cent to 30 per cent are widespread.

Cost escalation has been most pronounced for very large projects such as Melbourne's East West Link and the Cross River Rail in Brisbane. That partly reflects the sheer complexity of building infrastructure in densely developed urban areas, with tough environmental regulations, and community intolerance for loss of amenity, forcing reliance on tunnels where costs are as high as $200m per kilometre. And it also reflects the mining boom, which bid up the price of inputs used in major infrastructure projects.

But those factors should have made governments more cautious about "mega projects", which are especially vulnerable to undue optimism about costs and demand while favouring smaller-scale initiatives that address pinch points in a timely way. Instead, "mega projects" have been the flavour of the decade, often at the expense of ongoing maintenance and asset enhancement.

Doubtless, state governments' predilection for ribbon-cutting opportunities is partly to blame; but changes in commonwealth funding have accentuated the distortions. Years ago, the commonwealth used a formula to distribute the transport funding it provided the states. However, as its share of total outlays has risen so its approach to allocating assistance has become more discretionary.

That makes headline-grabbing projects more attractive to state governments, as they invariably rise to being issues in federal elections, winning endorsements from both sides of politics.

And when the resulting projects turn to custard, as they so frequently do, the hopeless blurring of responsibility between levels of government means few lessons are drawn.

No silver bullet can cure those pathologies. But reversing the trend to discretionary commonwealth involvement would help.

Some 80 percent of commonwealth funding goes to projects with limited national spill-overs; a purely formula-driven allocation of that funding would make state governments more accountable for infrastructure decisions, regardless of their ultimate funding source.

And, as well as increasing the pressure on state governments to perform, that would allow Infrastructure Australia to be abolished or restricted to the very few projects whose effects largely span state boundaries, further saving taxpayers' dollars.

Obviously, solving our transport woes takes much more than that. But placing commonwealth funding on a simple, predictable and transparent basis is a reform that could be implemented now. As the queues mount, our creaking infrastructure's angry users have every right to demand it.