# An integrated national approach to investment in local and regional infrastructure

Submission to the Productivity Commission's Public Infrastructure Inquiry

Regional Australia Institute, January 2014



REGIONAL AUSTRALIA INSTITUTE

# Executive Summary

The stock of public infrastructure in regions outside the major cities plays a critical role in our economy and the delivery of essential services. Regional infrastructure supports the efficient functioning of local economies; connecting goods, services, knowledge and people to each other, and enhancing economic and social opportunities.

Regional public infrastructure also links regions to regional cities, and regional cities to our metropolitan areas, helping to build a more flexible, integrated, diverse and responsive national economy.

As with all types of infrastructure in Australia there is a significant and widespread deficit in regional and local infrastructure which is a significant challenge to policy makers.

However, it is the limited understanding of the benefits that flow from regional infrastructure which restricts good policy the most in this area. The relative returns on investment from existing funding streams and the potential benefits from further or alternative investments in regional and local infrastructure remain unclear.

The fragmented structures under which regional and local infrastructure issues are managed at the national level also serve to further undermine our ability to deal with infrastructure needs in this area.

In this environment, the Productivity Commission (the Commission) has been asked to undertake a wide ranging review of options to improve structures for infrastructure provision, financing and funding as well as the effective management of costs.

It is crucial that the Commission considers the relative impact of strategic weaknesses in the infrastructure system (such as institutions, policy structures, program arrangements and information) as well as the technical and project orientated aspects of the Terms of Reference.

It is not at all clear that simply doing a better job of managing infrastructure projects will provide a foundation for the best outcomes in the future. There is also a pressing need to ensure that the right projects are selected across all levels of infrastructure.

To ensure returns on infrastructure investment are optimised, the Regional Australia Institute (RAI) encourages the Commission to consider the likely benefits of two reforms:

1. *An integrated **national infrastructure investment framework** that is focussed on rigorously measuring community infrastructure needs and the success of all levels of government in meeting these over time; and*

2. *A **systemic national response to the local infrastructure deficit** that supports the existing application of Commonwealth funding with the facilitation of private investment, capacity building and improved information***.**

# Introduction

The RAI welcomes the opportunity to provide a submission to the inquiry. The specific terms of reference to which this submission most closely relate are:

2. *The rationale, role and objectives of alternative funding and financing mechanisms, including:*

    e. *The roles of the Australian Government, the States and Territories, Local Government and the Private Sector in the implementation of these mechanisms, and the relationship between each of the parties.*

6. *Comment on other relevant policy measures, including any non-legislative approaches, which would help ensure effective delivery of infrastructure services over both the short and long term.*

This submission refers primarily to infrastructure investment at the regional and local level with a focus on maximising the return on investment at the national level, as well as for regions and communities.

## About the Regional Australia Institute

Independent and informed by both research and ongoing dialogue with the community, the RAI develops evidence-based policy and advocates for change to build a stronger economy and better quality of life in regional Australia – for the benefit of all Australians.

The RAI was specifically formed to help bridge the gap between knowledge, debate and decision-making for the potential and future pathways of regional Australia. It exists to ensure local, state and federal policy makers, researchers, business and members of the community have access to the information they need to make informed choices about the future of regional Australia.

## Definition of Regional Australia

The RAI defines regional Australia as the non-metropolitan areas of the nation that lie beyond Australia's major capital cities and their immediate surrounding suburbs.

## Submission Contacts

Jack Archer – General Manager, Research and Policy
02 6260 3733, 0438 398 802 jack.archer@regionalaustralia.org.au

Vanessa Barnett – Manager, Policy
02 6260 3733, 0423 624 255 vanessa.barnett@regionalaustralia.org.au

# National Infrastructure Investment and Regional Australia

Infrastructure bottlenecks can be a significant barrier to commercial activity throughout the economy. Bottlenecks have been demonstrated to reduce long term growth by up to three per cent per annum.[i]

With limited resource pools, large distances to cover and the same systemic infrastructure needs of more densely populated capital cities, the efficient provision of infrastructure in regions is inherently more difficult to achieve.

This factor however, does not justify the simple assumption that returns on investment are automatically lower in regions and that, as a result, regional level infrastructure should be considered a lower order priority. The average range of return to the economy through infrastructure investment will vary depending on a number of dynamic variables. These variables include the asset class, private investor sentiment, wider economic conditions and government debt.

**The role of infrastructure in regions:**

1. Promotion of exchange of people, resources, knowledge and technology between different sectors of economy.
2. Improve socio-economic conditions and income generating capacity.
3. Facilitate physical connectivity and the interaction of goods and services across and between regions and nations.

*(Bhattacharyay, 2008)*

Regional infrastructure is often a critical path within the national infrastructure network that is overlooked. For example, the 'last mile' issues which face livestock producers (whereby, there are poor connections to the state or federal transport network,) mean that the full benefits of extensive investment in improved state transport systems are inhibited.

In times of scarce resources, it is important to have a robust understanding of the investments which will yield the largest return on investment measured against comprehensive social and economic measures and the diverse Australian economy.

## The current infrastructure investment system

Responsibility for differing infrastructure is divided between all tiers of government (Table 1). As well as Commonwealth program funding, infrastructure in regional Australia is provided for by different means depending on the asset class, the project size and the perceived economic benefit.

These variables determine which tier/s of government (or the private sector) have responsibility for infrastructure and what their role is in its provision.

*Table 1: Division of responsibility for infrastructure funding among the tiers of government*[ii]

| Level of government | Economic infrastructure | Social infrastructure |
|---|---|---|
| **Commonwealth** | Aviation services (air navigation etc)<br>Telecommunications<br>Postal services<br>National roads (shared)<br>Local roads (shared)<br>Railways (shared) | Tertiary education<br>Public housing (shared)<br>Health facilities (shared) |
| **State** | Roads (urban, rural, local) (shared)<br>Railways (shared)<br>Ports and sea navigation<br>Aviation (some regional airports)<br>Electricity supply<br>Dams, water and sewerage systems<br>Public transport (train, bus) | Educational institutions (primary, secondary and technical) (shared)<br>Childcare facilities<br>Community health services (base hospitals, small district hospitals, and nursing homes) (shared)<br>Public housing (shared)<br>Sport, recreation and cultural facilities<br>Libraries<br>Public order and safety (courts, police stations, traffic signals etc) |
| **Local** | Roads (local) (shared)<br>Sewerage treatment, water and drainage supply<br>Aviation (local airports)<br>Electricity supply<br>Public transport (bus) | Childcare centres<br>Libraries<br>Community centres and nursing homes<br>Recreation facilities, parks and open spaces |

The Commonwealth Government influences the provision of infrastructure investment in three main ways:

- Specific purpose payments (SPP's) to the States (and to Local Governments transferred through the *Local Government (Financial Assistance) Act 1995*);
- Investment by government business enterprises (GBEs) and by departments and agencies (e.g. NBN Co.); and
- Framework policies, such as Auslink.

While there has been a reduction in Commonwealth Government involvement in GBEs over the last 10-15 years, there has been a gradual increase in involvement with specific purpose payments and framework policy investment for the transfer of money between the States and Local Governments.

Because of the nature of the framework, policies guiding investment, particularly the analytical and institutional focus on a small number of specific major projects, infrastructure in regional Australia requires injections through specific purpose payments. The breadth of guidelines under these payments dilute the extent to which they deliver effective outcomes.

Examples include the *Roads to Recovery* program where spending has totalled $4.12 billion dollars over the last 13 years.[iii]

The Regional Infrastructure Fund (RIF) which, with allocated funding of $6 billion, was designed to '*invest the proceeds of a resurgent resource boom to address urgent infrastructure needs, while supporting the mining industry, boosting export capacity and developing and growing regional economies*' *(DRALGAS, 2008)* and the Regional Development Australia Fund (RDAF) was established to support regional wellbeing and economic development through capital infrastructure projects, including the construction of new infrastructure and the refurbishment or renovation of existing infrastructure.

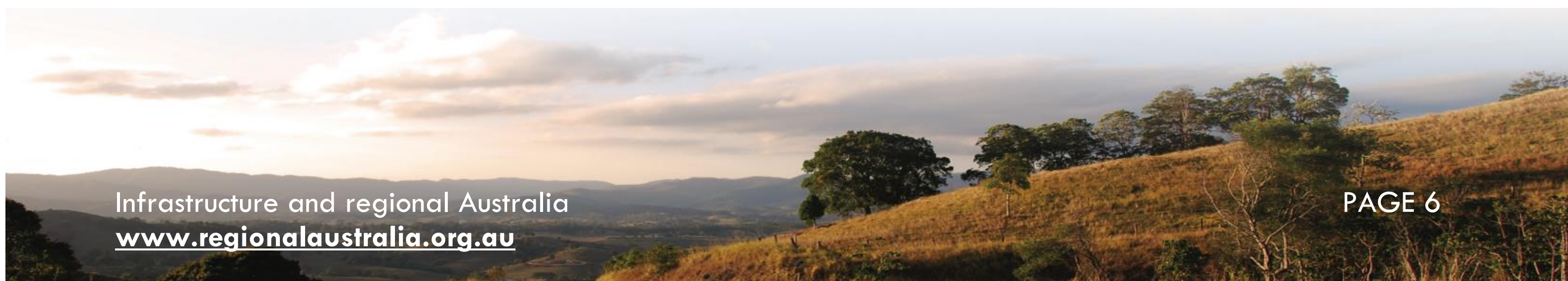
While it is difficult to measure precisely, Commonwealth spending in regions appears to be on the rise. In the 2012-13 financial year, the Commonwealth transferred an estimated $2.645 billion to Local Government in 2012-2013 compared to $2.306 billion in 2007-2008[iv]. Investments such as those described above, the National Broadband Network (NBN) and others will further add to the aggregate investment being delivered by the Commonwealth for regional and local infrastructure.

The most appropriate level of funding and investment in regions is difficult to assess under the current system of funding allocation. With little monitoring of outcomes and often broad guidelines, identifying which project presents the largest return on investment may not be obvious.

As a result, regional infrastructure suffers from a restrictive policy design, usually relying on vague criteria and competitive application processes as means to guiding investment decisions. In this environment, decisions risk responding to regional skill in grant seeking as much as to demonstrated genuine need and return on investment.

The establishment of ad-hoc programs subsidiary to the national infrastructure agenda and also provides little certainty for local government, local investors and regions seeking to take responsibility for local progress.

It must be acknowledged, however, that within this environment there has been marked improvements in the efficient planning and supply of infrastructure over the last decade. Infrastructure Australia's reports to the Council of Australian Governments (COAG) and



subsequent reforms, such as COAG's National Access Regime and Infrastructure reform are representative of the substantial progress made in this space.[v]

In 2011, COAG agreed on three new Intergovernmental Agreements on heavy vehicles, rail and maritime safety. The agreements were landmarks in national transport standards and were intended to significantly reduce the number of regulators. The heavy vehicle reforms alone are estimated to be worth up to $30 billion to the national economy over a 20 year period[vi].

The current Inquiry represents the opportunity to continue to build reform momentum and extend its reach more meaningfully into the realms of local and regional infrastructure policy.

# Reform Options

The RAI sees two reforms as providing significant opportunity to improve the returns from future national investments in regional and local infrastructure.

## Reform option one: An integrated national framework for infrastructure investment

In the twentieth century, the positive relationship between infrastructure investment and economic growth prompted large investments in infrastructure across the world. In more fiscally tight times, with significant competition for resources, this relationship must be better understood.

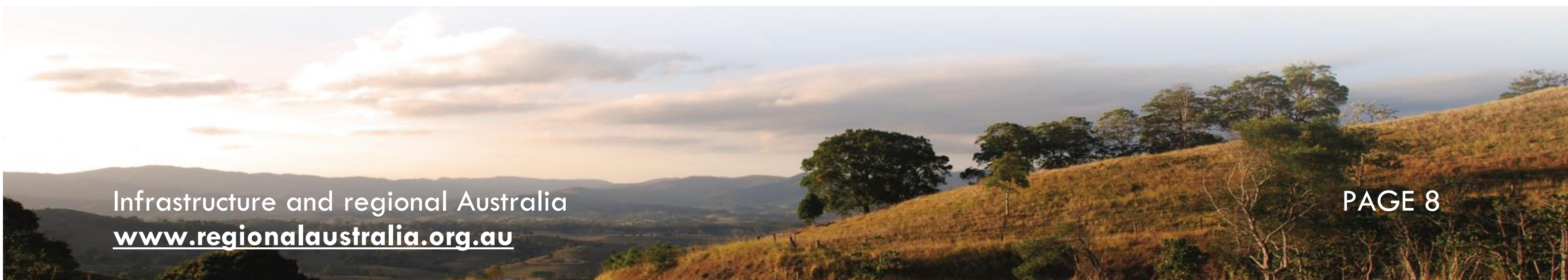
With rapid changes in our economies and societies and with greater understanding of the functions and roles of infrastructure, it is now possible to further refine the management, funding, financing and perceptions of infrastructure. Such refinements bring with them the opportunity for efficiency savings in public spending and, most importantly, to optimise outcomes for communities and the nation.

A significant constraint on the effectiveness of national infrastructure investment is the lack of effective integration between types and levels of infrastructure investments as well as the limited breadth of consideration for community needs.

Determining the adequate infrastructure investment across Australia requires a sophisticated appreciation of the complexities of infrastructure as a complete system as well as the intricacies of its parts at a local, regional, State and national level.

With limited resources, the way in which governments strategically target investments to maintain, extend and maximise the use of existing infrastructure stock is central. These are as, if not more, important than the effective prioritisation of new projects and should form part of any strategic investment framework.

The maintenance of existing infrastructure stock is vital in enabling the efficient functioning of the infrastructure network. The strategic upgrade of existing public resources can unleash growth potential and provide strong returns on investment.



Significantly greater value for money can be achieved by simply looking at what already exists and the ability to reduce and/or delay backlogs and investments. Maximising and extending asset life alone can reduce backlogs by 5.6 per cent while more effective prioritisation (such as a national system) can bring about reductions in the order of 7.5 per cent.[vii]

Infrastructure Australia has recommended the establishment of a single national fund for the strategic allocation of infrastructure resources[viii] (see Text Box). A single national fund would involve a more robust prioritisation method, whilst seeking ways to make the most of infrastructure stock. In this regard, it could be expected to make significant headway in the infrastructure backlog alone.

The RAI notes that this type of approach has been adopted as best practice internationally, with similar mechanisms successfully operating in Chile for over three decades and more recently in Canada and the United Kingdom[ix].

Integrated national systems in other countries have been found to address many of the concerns that arise from the inherent complexities of infrastructure. This has included tools such as third party decision making and quality assurance, comprehensive yet simple assessment, universal and transparent prioritisation as well as improved return on investment.

Such tools are purposefully designed to be non-exclusionary, capacity building and produce enduring social and economic benefits.

**Infrastructure Australia's National Reform Proposal**

There is over a hundred billion dollars worth of Commonwealth Government investment for economic infrastructure, across the nation building program, NBN development, community infrastructure grants, clean energy funding, and grant programs for water, energy and regional infrastructure.

These Commonwealth funds and investment sources have overlapping purposes, different assessment frameworks, and different decision making mandates.

The impacts of these varied approaches include inefficient program costs, less transparency over how funding is administered and allocated, variable levels of rigour, and inconsistent value for money outcomes.

Consolidation of Commonwealth funding sources into a national infrastructure fund with a single assessment and prioritisation process would transform the quality and efficiency of infrastructure spending and public transparency.

It would mean that across different types of infrastructure, only the best projects – the ones that make a positive contribution to Australia's economy – would be funded and delivered.

A single assessment and prioritisation framework – Infrastructure Australia's reform and investment framework – will ensure all major projects are informed decisions, supported by a sound economic case, and tested with a robust, independently assessed cost-benefit analysis.

It would also ensure Australia moves away from a project-by project view of infrastructure development and focuses on big picture national priorities.

The ultimate outcome would be much better use of available funding, and greater benefits for every dollar spent. Australians should expect no less.

From a national fiscal perspective, rational, incisive and transparent approaches to public debt-funded investment are important determinants of credit ratings. They also provide a systematic method of determining greatest return on investment and avoiding investments which represent poorer returns.

The RAI encourages the Commission to consider the likely return on investment from improvements to the institutional framework for managing national infrastructure investment. It also encourages the improvement of information available with regard to the national infrastructure system, its strengths and weaknesses, and the relative return on investment from different types of investment over time.

## Integrating regional infrastructure investment into a national system

Artificial separation of infrastructure through funding and programming fails to comprehend the complexity of infrastructure systems.

An increasingly sophisticated national system for investing in major projects is currently supported by a range of generic national programs and potentially fragmented investments at the state and national level.

This fragmented approach is the result of policy efforts being focussed on abating the recurrent regional infrastructure demands that emanate from poorly developed frameworks, rather than investing in policy design which considers the best mix of investments across all the options available to an investor across all asset types, sizes and locations.

Developing a more sophisticated national system, including consideration of regional infrastructure, would deliver two clear benefits; those derived from adopting a functional approach to infrastructure in order to optimise investment outcomes; and those which come from directly addressing the policy complexities and inefficiencies which plague regional infrastructure provision.

Although different classes of infrastructure operate in differing ways they essentially perform one or more functions including aiding transaction costs, aiding production, providing for quality of life and increasing capital stocks.[x]

A robust, national framework underpinned by strong analysis of needs and opportunities should understand the fundamental functions of infrastructure in the economy and society, including the role that regional infrastructure plays in fulfilling these functions.

The design of the current national investment system is limited in its treatment and consideration of these functions, particularly the consideration of regional infrastructure.

Assigning resources without considering a functional perspective impedes on the full use of an infrastructure network. A national system which explores this aspect of functionality and the vital role that regional infrastructure plays in those functions (as well as all other types of infrastructure), is likely to appreciate and realise the full economic potential of the infrastructure network and optimise productivity through considered and rational investment.

Consideration of 'regional' in a national infrastructure system not only optimises investment decisions and outcomes nationally, it also offers an opportunity to significantly improve upon the current approach to regional infrastructure, and address the fragmentation, crudeness and politicisation that typifies regional infrastructure investment.

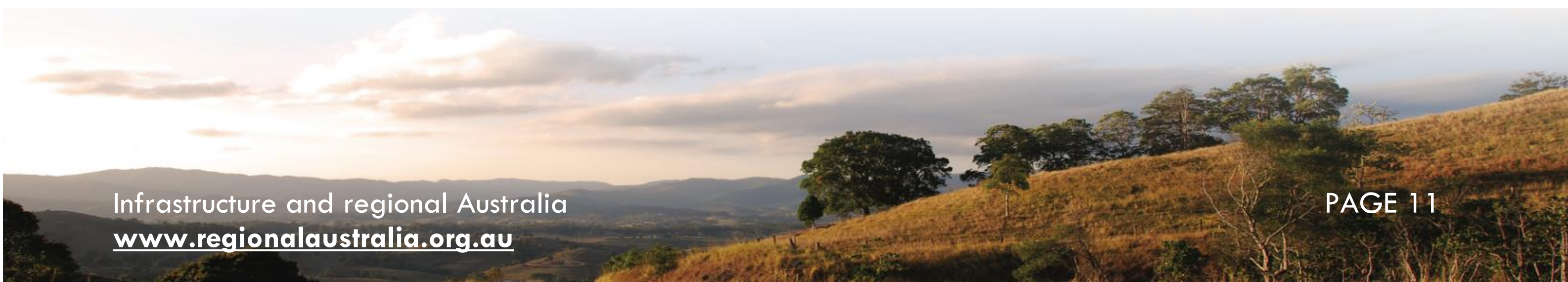
Most of the Commonwealth's regional infrastructure investment is contained in generic 'regional' initiatives, or other investments that are made as a sub-component (explicit or implicit) of issue based national programs. Within such an occasional and heedless system, it is arguable that regional and local investments suffer the most from a lack of effort in the assessment, prioritisation and the monitoring of outcomes at the national scale.

The first step in more aptly including regional infrastructure would be the enunciation of regional infrastructure rationales. Investment in regional infrastructures occurs for a number of complex reasons including the facilitation of economic activity, supporting quality of life, providing equitable service access for all Australian communities and maintenance of existing stock.

Current program approaches deal with this complexity by resorting to a catch all approach with limited effort applied in the policy design compared to other infrastructure areas. An integrated national infrastructure approach would provide the opportunity to move beyond this catch-all model of program design to one that is more sophisticated.

By considering these rationales and regional infrastructure goals in more detail (for example through a substantive regional infrastructure strategy), it would be possible to draw on information already available in a range of sectoral strategies, industry analyses and local/state work to rigorously and transparently assess needs and opportunities across regions.

The historically dominant role of politics in regional infrastructure is something that cannot be ignored. Reducing the potential for an unhelpful level of politicisation in regional infrastructure decisions by requiring regional infrastructure to compete alongside other rationales for investment will create a more level playing field. This will also build a more secure and certain environment for regions and build the public's confidence that this expenditure is both necessary and good value for money.



With the support of the reforms suggested in the following section, it would also be possible to systematically consider the efficacy and potential return on investment from the range of small local infrastructure initiatives that are supported over time as part of this nationally integrated approach. This would effectively integrate all scales of infrastructure into a coherent national system.

Greater effort in identifying where gaps exist (both between regions and within different types of infrastructure) and targeting investments effectively to the areas of greatest need and highest return is essential to improving returns from regional investment and attracting co-investment where feasible from the private sector.

The Commission should consider the extent to which a national system, underpinned by a functional approach that integrates regional and local level investments, will help to achieve the best outcome for public infrastructure, abate the recurring complications of the current approach and optimise return on national investment.

## Reform option two: A systemic national response to the $15 billion local infrastructure deficit

The local infrastructure deficit is well documented and estimated to have grown to $15 billion. Continued growth is predicted over time[xi].

To date, the Commonwealth has sought to alleviate this issue by injecting additional funds through measures such as *Roads to Recovery*. Despite this on-going effort the deficit continues to grow.

While further public funding from national, state and local sources is likely to be essential in overcoming the deficit, it is also essential that the systemic causes of the deficit are addressed and the rationale and focus of further investment well established.[xii]

In 2012, the RAI examined systemic reform options following another government review of the issue conducted by Ernst and Young.

It is clear from this work, its predecessors, and academic analysis, that solving the local infrastructure crisis requires an integrated set of reforms and the effort of all levels of government. The reform imperatives are to:

- Improve the ability of local governments to fund infrastructure from their own revenue;

- Ensure local infrastructure secures a share of national and state infrastructure investment that reflects its benefits to society; and

- Secure greater private investment in local infrastructure projects.

The RAI's assessment is that the establishment of a new organisation - *Local Infrastructure Australia* to take carriage of local infrastructure issues at the national level offers the best solution to national progress on each of these reform imperatives.

*Local Infrastructure Australia* has the potential to lead the system wide change that has been absent from the response to date on the local infrastructure deficit by providing services in three areas:

- Project pooling and private finance brokering;

- Advisory services to local governments on infrastructure development and management; and

- Consistent national information on local infrastructure needs and associated socio-economic benefits.

Among the benefits of this reform option is substantial investment in local infrastructure from the private sector through an increased capacity to meet and identify the needs of private investors. *Local Infrastructure Australia* would play an important role in both the pooling of projects and securing investment by creating well developed investment packages that are aligned to the investment criteria for large agencies such as superannuation funds.

Small councils in regional areas will also be supported to achieve best practice in their management and funding of infrastructure raising standards and in ensuring local resources are applied effectively to the problem.

Local infrastructure will also be better understood and positioned to compete for national and state infrastructure funding alongside larger state and national level projects in an integrated national system.

Importantly, the RAI's assessment is that the establishment of *Local Infrastructure Australia* can be achieved at low cost and low risk to the Commonwealth based on significant international experience. The small initial investment required could readily be drawn from existing regional infrastructure funding sources and on-going costs covered by its financing activities.

The attached RAI policy briefing and report provides significant detail of our analysis of the opportunity for systemic reform and the proposed *Local Infrastructure Australia* solution.

# Conclusion

The current state of infrastructure in Australia mimics that across much of the world, with rising labour costs and smaller budgets, yet increasing demand for services to ensure optimal local, regional and national productivity and the provision of basic needs infrastructure.

Maintaining the status quo in investment will only see an ever-increasing decline and deterioration of infrastructure, particularly in regional Australia, with a consequent decline in productivity and sustainability.

The current approach to infrastructure investment and governmental responsibility has led to large backlogs, inequitable capacity and a focus on large projects rather than systematic and effective investment across the infrastructure system to meet Australia's legitimate range of infrastructure goals.

As well as doing better in delivering and financing large projects, the Productivity Commission's Public Infrastructure Inquiry is an opportunity to identify and propose solutions to systemic and institutional issues in Australia's national infrastructure system with benefits for all levels of infrastructure investments.

Continuing the current approach is likely to lead to a weakening condition for the infrastructure which physically and economically supports the larger pieces. While smaller projects, maintenance of stock and equity based investments may lack the glamour of major projects, they are integral to everyday and long-term economic activity, command substantial resources in aggregate and underpin local, national and regional economies.

# Attachments

A. Regional Australia Institute, 2012 'Catalysing Local Infrastructure Renewal' (Policy Briefing)

B. Regional Australia Institute, 2012 '*Catalysing the renewal of local infrastructure in regional communities: The case for Local Infrastructure Australia*', (Report)

*See separately provided documents.*

# References and End Notes

---

[i] Calderon and Servén (2004) in Burgan *et al*. 2008.
[ii] Source: Adapted and updated from: Industry Commission, Impediments to Regional Industry Adjustment, Report No. 35, December 1993, pp. 227
[iii] BITRE, '*Public road-related expenditure*' 2006 update retrieved from http://www.bitre.gov.au/publications/2008/files/is_025.pdf and expenditure 2011 update http://www.bitre.gov.au/publications/2011/files/is_040.pdf
[iv] Using budget data from Commonwealth grants and direct funding to local governments
[v] McInerney, L *et al*, 2007, *Australia's infrastructure policy and the COAG National Reform Agenda.*
[vi] COAG 2008
[vii] McKinsey 2012 The $1trillion dollar infrastructure deficit
[viii] Infrastructure Australia 2013, '*National Infrastructure Plan June 2013*'.
[ix] Reference?
[x] Building on the work of Bhattacharyay 2008, The RAI describes four functions of infrastructure provision.

1. The direct facilitation of transactions ie the exchange of livestock from a seller to a buyer;
2. The facilitation of more efficient production ie the provision of adequate and reliable energy, and productivity gains achieved through the increased rapidity of knowledge dissemination;
3. The capacity to generate incomes and improve socio-economic conditions to enable and encourage productivity, growth and investment, ie the OECD have demonstrated that halving the number of people without access to improved water sources would produce benefits nine times the costs incurred;
4. To add to the sum of public assets and capital stock which provides a gross economic asset for the wider economy ie public stocks and debt measures required for securing a good credit rating.

[xi] Urban Land Institute and Ernst & Young. *Infrastructure 2012: Spotlight on Leadership*. Washington, D.C.: Urban Land Institute, 2012.

[xi] Urban Land Institute and Ernst & Young. *Infrastructure 2012: Spotlight on Leadership*. Washington, D.C.: Urban Land Institute, 2012.

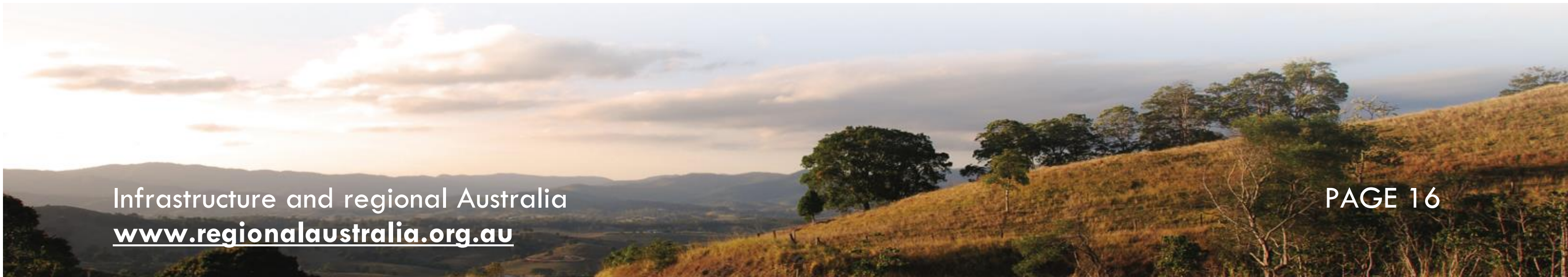
## References

Australian Government 2014, State-by-state funding allocations 2009-2014 retrieved from http://investment.infrastructure.gov.au/funding/r2r/ on 20 December 2013.

Burgan *et al*. 2012. *Public Investment, Productivity and Economic Growth - the Role and Contribution of Debt Funding*, report prepared for the Public Service Association of South Australia March 2012 Australia Institute for Social Research, University of Adelaide.

Bhattacharyay 2008, '*The role of infrastructure cooperation in economic growth and integration*', World Bank working paper 2009/05/27/3011.

BITRE, '*Public road-related expenditure*' 2006 update retrieved from http://www.bitre.gov.au/publications/2008/files/is_025.pdf and expenditure 2011 update http://www.bitre.gov.au/publications/2011/files/is_040.pdf



Mckinsey & Company, 2013. *Infrastructure Productivity: How to Save $1 trillion per year*, McKinsey Global Institute Infrastructure Practice.

McInerney, L *et al*, 2007*, Australia's infrastructure policy and the COAG National Reform Agenda*.

Regional Australia Institute, 2012 *Catalysing the renewal of local infrastructure in regional communities: The case for Local Infrastructure Australia*.

Urban Land Institute and Ernst & Young. *Infrastructure 2012: Spotlight on Leadership*. Washington, D.C.: Urban Land Institute, 2012.