

2014-106119

8 APR 2014

Mr Peter Harris AO  
Chairman  
Productivity Commission  
Locked Bag 2  
Collins Street East  
Melbourne VIC 8003

Dear Mr Harris

I welcome the opportunity to respond to the draft Productivity Commission report on Public Infrastructure.

The report sensibly outlines the issues associated with infrastructure funding, financing and procurement. It provides a number of potential options and solutions. The NSW Government broadly agrees with most of the recommendations and is well progressed in implementing many of the initiatives outlined in the report.

The Commonwealth and State Governments could be more ambitious in improving infrastructure investment across all levels of government and there are significant opportunities to do the following:

- more clearly define Commonwealth/State roles and responsibilities on infrastructure;
- base future Commonwealth funding on the attainment of agreed outcomes-based *National Infrastructure Standards*; with funding provided on a program rather than a project-to-project basis;
- develop principles around the Commonwealth fully compensating States for their asset sales, and potentially adopting a “locked-box” approach to Commonwealth funding from asset recycling;
- develop a road funding governance framework that explicitly links road user derived revenue with the cost of efficiently running the road network, initially using existing revenue streams from fuel excise tax and registration; and
- move as quickly as possible to implement an Intergovernmental Agreement on Heavy Vehicle Charging and Investment.

The infrastructure sector is thriving in NSW. This will provide substantial benefits for citizens and businesses in the years ahead.

The following pages outline in more detail the initiatives proposed above for further work by the Commonwealth and the State. Since the election of my Government, NSW has made great progress in strategy, prioritisation, financing and execution of infrastructure. This has led to a significant acceleration of investment, at improved prices.

If you would like further information please contact Simon Draper, Executive Director, State Productivity

Yours sincerely

**Barry O'Farrell MP**  
Premier

## NSW Government Submission Productivity Commission Inquiry into Public Infrastructure

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### Roles & Governance

NSW supports reform of Commonwealth / State infrastructure governance structures that clarifies the division of responsibilities between the Commonwealth and States to ensure an efficient allocation of resources, higher standards and better projects at lower cost.

The role of the Commonwealth is not clear in relation to major infrastructure projects that are the remit of the State and Territory governments. This creates a risk of duplication of effort and disagreement over project priorities within a broader network context, leading to a delay in implementation and delivery.

NSW recognises that the Commonwealth has its own regime for evaluating the economic benefits of projects. Therefore NSW does not seek to restrict Infrastructure Australia from undertaking independent assessment of project priorities. However, Infrastructure Australia's assessment of priorities should seek to align Commonwealth investment with the efficient and coordinated delivery of integrated network priorities.

Infrastructure Australia's principal role should be assurance that States' and Territories' assessment of infrastructure priorities is derived from appropriate processes and institutions to deliver high quality infrastructure outcomes.

The role of the Commonwealth could be clarified to comprise the following:

- assess **priorities for and secure delivery of Commonwealth infrastructure** (defence, telecommunications, airports);
- **contribute funding** to productivity enhancing **projects of States & Territories** (example roads of national significance) that cannot be funded from users alone, recognising externalities and the vertical fiscal imbalance in financial capabilities of States and Territories;
- support and incentivise high **standards of governance** and decision-making by all jurisdictions;
- lead development of **information systems and benchmarking** to support project best practice and assessment, including data collection across all infrastructure sectors, publication of key indicators including project budgets and outcome, input costs, factor productivity, Benefit Cost Ratios (pre and post) to enable tracking of performance improvement and domestic and international benchmarking;
- **capability development** - facilitate sharing of lessons, standard forms of agreement and methods to use nationally to enable consistency for industry.

The role of the States & Territories could be clarified to comprise the following:

- establish **sound governance for infrastructure** planning, including standard based strategy, planning, assessment approvals and procurement;
- **determine investment priorities** for **State and Territory infrastructure** (roads, rail, energy & water) in accordance with standards;
- **contribute funding** to projects within the jurisdiction that cannot be funded in full by users, drawing on proceeds of asset recycling and other sources of funding;
- **procurement and delivery** of State / Territory projects, including through PPPs.



## A Better Basis for Commonwealth Funding

Current discussions between the Commonwealth and States/Territories on infrastructure funding focus on asset recycling and related agreements. Asset recycling is a worthwhile criterion that NSW supports as one vehicle for Commonwealth funding. However, further work is needed to foster better governance standards for infrastructure investment.

As a complementary and sustainable method of allocating other Commonwealth funding, outcomes-based *National Infrastructure Governance Standards* could be developed and agreed by governments. Over time, the Commonwealth could tie an incrementally increasing percentage of future Commonwealth funding to attainment of the Standards from (say) 2015/16.

Initial priorities for Standards could be selected and developed from the following:

- *servicing strategy* - needs assessment and priority setting within and between sectors and regions;
- *investment planning* - consideration of alternatives, use of pricing, creating competition, good project definition upfront;
- *project prioritisation* - transparency, independent advice, benefit cost assessment and other methodologies to demonstrate maximisation of public benefit;
- *efficient environmental assessment and consent practices* – timeliness, analytical quality, avoidance of jurisdictional duplication, appropriate consent authority, focus on community engagement and environmental impact mitigation;
- *ex post reviews* of projects to gather lessons and evaluate outcomes;
- *efficient asset utilisation* – access regimes and third party pricing arrangements;
- *efficient corridor identification and preservation* – minimise costs to the community, promote ongoing economic activity and use that avoids sterilisation, zoning over acquisition where possible;
- *effective procurement* – bid costs, contribution to a competitive construction market, outcome specifications, project management, contingency management, optimal private sector engagement;
- *funding and financing* best practice use of public vs private sources and methods, promotion of user pays.

NSW is well advanced in developing many of these Governance Standards (see Attachment A). For example, the Government has already endorsed a 20-year State Infrastructure Strategy (SIS), drawing on an independent assessment of the State's long term infrastructure needs undertaken by Infrastructure NSW.

The SIS, which is being implemented through annual 5-year Infrastructure Plans, identifies and prioritises the delivery of critical productivity enhancing public infrastructure for NSW. The SIS will be revised at least every 5 years.

Further clarity on the division of responsibilities between the Commonwealth and NSW will ensure a more efficient allocation of resources, higher standards and better projects at lower cost.

## A “locked box” approach to Commonwealth funding from asset recycling programs

NSW proposes that Commonwealth funding used to incentivise asset recycling be provided in the form of block or program funding, rather than project specific funding. However, the Commonwealth needs assurance that its funds are being properly applied to suitable infrastructure projects. To address both goals, NSW proposes wider adoption of its “locked box” infrastructure funding model.

Future Commonwealth funding should be directed to Restart NSW and similar funding instruments in other jurisdictions. The NSW Government established Restart NSW under the *Restart NSW Fund Act 2011* to fund a range of high priority future infrastructure projects in NSW.

Infrastructure NSW is responsible for independently assessing projects and making recommendations to the NSW Government for use of the funds to ensure they are allocated where they are needed most. The Treasurer approves funding in response to the recommendations. The objective of Restart NSW is to improve the economic growth and productivity of the State by funding essential infrastructure based on objective and independent assessment.

Currently, payments into the fund come from windfall tax revenues, Waratah bonds, asset sales and any other voluntary contributions from a government agency.

Future funding by the Commonwealth into Restart should reflect the defined Commonwealth role as discussed above, and should recognise that some projects would have wider economic benefits extending to other States (e.g. interstate highways and international gateways). The Commonwealth’s funding should also recognise that well-chosen projects will contribute to higher future Commonwealth tax revenues (company tax and income tax).

Under a locked box and block funding approach, Commonwealth contributions to projects would be provided using a formula linked to the project’s contribution to the national economy. Leaders from both State and Commonwealth Governments will be able to highlight their Governments’ proportional financial contributions at the project level.

The Productivity Commission report on Public Infrastructure states that this would be “superior to the Commonwealth prescribing which projects should be undertaken” by States. It would put an end to the problems that have occurred in the past (e.g. where NSW and the Commonwealth had rival plans for extending the urban rail network).



## **Industrial Relations**

On 1 July 2013, the NSW Government's 'Implementation Guidelines to the NSW Code of Practice for Procurement' in the building and construction industry commenced operation. The key elements of the Guidelines are a proactive management of workplace relations to ensure projects are delivered on time and on budget with real value for money for the NSW Government and taxpayers. The Guidelines establish a compliance regime comprising a Construction Compliance Unit (CCU) within NSW IR to monitor and enforce compliance by way of investigation and audit work.

One of the main points noted by the Productivity Commission's draft report is that a significant sample of enterprise bargaining agreements (EBAs) reveals inexplicable variations in terms and conditions, potentially excessive powers for some union officials and constraints on workplace flexibility that are inimical to productivity.

Since its establishment, the CCU has developed a database of approximately 1,180 EBAs currently operating in the building and construction industry. The CCU has reviewed a number of these and has noted that there could be improved productivity in the industry if there was an increased focus on continuous improvement. In the context of the NSW Guidelines, this may be exemplified by the participants adopting efficient and productive work practices, reporting actual labour productivity data and including commercial incentives that address and reward productivity.<sup>1</sup> Often EBAs contain provisions that, on their face, appear to limit the opportunity for productivity improvement.

For example, clauses in EBAs that prescribe ratios of employee numbers or restrict efficient performance of work are industrial relations issues that place constraints on improving productivity in the industry. Similarly, vague terms in EBAs that 'commit' to continuous improvement without having appropriate practices in place, serve to diminish any real focus on productivity.

The NSW Implementation Guidelines seek to encourage enterprises with a workplace culture that promotes value, quality, innovation and competitiveness. In the NSW Government's view this remains an area capable of significant improvement by the building and construction industry.

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<sup>1</sup> Other activities may include: the attraction, recruitment and retention of suitable direct labour; how enterprises overcome the issue of skills shortages and manage training and competency assurance as well as matters dealing with the efficient use of sub-contract employees and organisational awareness in terms of safety, productivity and continuity of operations.

## Attachment A – Proposed Standards in Transport portfolio

Priorities	NSW Transport Examples
<p>Servicing Strategy</p> <p><i>Needs assessment and priority setting within and between sectors and regions</i></p>	<ul style="list-style-type: none"> <li>• The NSW State Infrastructure Strategy (SIS) broadly sets out the needs assessment and prioritisation for infrastructure at a strategic level.</li> <li>• The SIS is linked to the NSW Long Term Transport Master Plan (LTTMP), which details how customer needs will be met from an infrastructure and service strategy perspective.</li> <li>• The LTTMP provides details across regions and transport modes, and is further supported by individual regional and mode specific planning documents.</li> </ul>
<p>Investment Planning</p> <p><i>Consideration of alternatives, use of pricing, creating competition, good project definition upfront</i></p>	<ul style="list-style-type: none"> <li>• Demand management pricing is utilised by the Opal Card as it provides off peak discount travel on trains to reduce peak demand on the rail network.</li> <li>• <i>Sydney's Rail Future</i> plan is being delivered in stages, targeting operational efficiencies and network efficiencies. Existing assets will be better utilised to delay the commissioning of major new infrastructure.</li> <li>• Transport projects are subject to a concept design that assists in clarifying the scope of projects prior to procurement. Tenderers are often able to submit alternative compliant tenders which contest the concept and propose alternative, innovative solutions.</li> </ul>
<p>Project Prioritisation</p> <p><i>Transparency, independent advice, benefit cost assessment and other methodologies to demonstrate maximisation of public benefit</i></p>	<ul style="list-style-type: none"> <li>• Infrastructure NSW offers independent advice on projects and priorities, and has its own board and legislation.</li> <li>• Transport for NSW (TfNSW) in conjunction with NSW Treasury and Infrastructure NSW have established a 'Gateway' project development and selection process that requires a clear demonstration that public benefit will exceed the cost of a given project.</li> <li>• Independent assurance reviews of the business case and procurement reviews are performed to ensure transparency for decision makers and to verify completeness and accuracy of the project development process.</li> </ul>
<p>Efficient Environmental Assessment and Consent Practices</p> <p><i>Timeliness, analytical quality, avoidance of jurisdictional duplication, appropriate consent authority, focus on community engagement and environmental impact mitigation</i></p>	<ul style="list-style-type: none"> <li>• NSW and the Commonwealth have signed a Memorandum of Understanding to reform environmental assessments and approvals processes over the next 12 months.</li> <li>• NSW has recently negotiated a bilateral assessment agreement under the <i>Environmental Protection and Biodiversity Conservation Act 1999</i> which establishes a single assessment process for the majority of projects which require both NSW and Commonwealth approval.</li> </ul>

<p>Ex-Post Reviews of Projects</p> <p><i>Gather lessons and evaluate outcomes</i></p>	<ul style="list-style-type: none"> <li>• NSW Treasury Guidelines and agency project management methodologies recognise the importance of post implementation reviews. They enable learnings to be recognised and provide a mechanism to determine whether a business case has been realised.</li> <li>• Through Infrastructure NSW, the NSW Government is regularly informed of the progress of all major projects. This independent status assessment and project health check function allows problems to be identified and corrected in a timely manner.</li> </ul>
<p>Efficient Asset Utilisation</p> <p><i>Access regimes and third party pricing arrangements</i></p>	<ul style="list-style-type: none"> <li>• An access regime is currently in place to allow third party operators to utilise the Sydney metropolitan rail network, facilitating freight and other long distance passenger train operators.</li> <li>• The existing asset can be put to economic use outside core passenger service hours and provide a means for services to operate on shared infrastructure.</li> </ul>
<p>Efficient Corridor Identification and Preservation</p> <p><i>Minimise costs to the community, promote ongoing economic activity and use avoiding sterilisation, zoning over acquisition where possible</i></p>	<ul style="list-style-type: none"> <li>• The SIS, LTTMP and draft Metropolitan Strategy for Sydney identified corridor protection as a priority.</li> <li>• The LTTMP identified 19 corridors. At present, seven are preserved, five are subject to investigation, three are related to projects under development and four are proposed for future investigation.</li> <li>• NSW is currently developing a Corridor Protection and Management Strategy to support these efforts.</li> </ul>
<p>Efficient Procurement</p> <p><i>Bid costs, contribution to a competitive construction market, outcome specifications, project management, contingency management, optimal private sector engagement</i></p>	<ul style="list-style-type: none"> <li>• Transport project procurement and delivery is led by a specialist Transport Projects Division. This allows for the development and ongoing continuous improvement of specialist procurement and delivery assurance functions.</li> <li>• Techniques used by Transport Projects to achieve effective procurement outcomes include: seeking industry input and market soundings, reduced duration of tender evaluation processes and adoption of tender minimum requirements and evaluation criteria.</li> <li>• The procurement processes are consistent with Infrastructure Australia's Benchmarks for Efficient Procurement of Major Infrastructure (June 2012).</li> </ul>
<p>Funding and Financing</p> <p><i>Best practice use of public vs private sources and methods, promotion of user pays</i></p>	<ul style="list-style-type: none"> <li>• NSW takes a pragmatic approach to deciding the appropriate funding and financing mechanism for projects. It continues to develop innovative methods.</li> <li>• NorthConnex is being funded by the NSW Government, Commonwealth Government and private funds. The tolled motorway is to be built and operated by Transurban and shareholders of the M7. The proposal was received as an unsolicited proposal, but included</li> </ul>



	<p>competitive procurement of design and construction by an entity unrelated to the proponent.</p> <ul style="list-style-type: none"> <li>• NSW has six toll roads which have been fully or primarily funded by the user pays model. The motorways comprise the majority of the Sydney Orbital Network.</li> <li>• NSW has sought to recycle capital from mature assets into new projects, such as the lease of Port Botany and Port Kembla. These funds were invested in Restart NSW.</li> </ul>
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## Public Infrastructure

### Public inquiry - Terms of reference

I, Joseph Benedict Hockey, Treasurer, pursuant to Parts 2 and 3 of the *Productivity Commission Act 1998*, hereby request that the Productivity Commission (Commission) undertake an inquiry into ways to encourage private financing and funding for major infrastructure projects, including issues relating to the high cost and the long lead times associated with these projects.

Through this inquiry, the Commission is to conduct a broad ranging investigation into costs, competitiveness and productivity in the provision of nationally significant economic infrastructure and examine ways to: reduce infrastructure construction costs; address any barriers to private sector financing, including assessing the role and efficacy of alternative infrastructure funding and financing mechanisms, and recommending mechanisms and operating principles that may be applied to overcome these barriers; and, without limiting the generality of this reference, outline options to reduce construction costs.

### Background

Efficient public infrastructure plays a key role in a competitive and productive economy and the ongoing funding and financing of infrastructure development in Australia is therefore of critical importance.

The capacity of government to meet expectations for improved infrastructure services is always limited, and the use of financing options involving the private sector can reduce the call on government resources, allowing scarce public funds to be targeted in a more effective manner.

While alternative financing and funding models offer opportunities to reduce the immediate call on governments, it should be noted that the application of new models is not a panacea. Ultimately infrastructure can only be funded through taxation, borrowings or direct user charges. There are difficult trade-offs to consider given increasing demand and competing priorities.

### Scope of the Inquiry

In reporting on funding and financing and the scope for reducing costs for public infrastructure projects, the Commission is to analyse and develop findings on the following:

1. How infrastructure is currently funded and financed in Australia, including by the Commonwealth, the States and the private sector.

2. The rationale, role and objectives of alternative funding and financing mechanisms, including:
  - a. the full range of costs and benefits of different models
  - b. the issues and costs associated with the allocation of project risks, availability of finance, contracting arrangements and delivery models for construction projects
  - c. the disincentives to private sector investment
  - d. broad principles for the use of these funding and financing mechanisms
  - 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
  - f. creation of revenue streams to attract private sector finance; for example, through user charging, availability payments etc.
3. Consider the financial risks to the Commonwealth posed by alternative funding and financing mechanisms, as well as their possible impact on the Budget and fiscal consolidation goals.
4. Examine the cost structure of major infrastructure projects in Australia, including where infrastructure project costs have increased considerably, compared with other countries.
5. Provide advice on ways to improve decision-making and implementation processes to facilitate a reduction in the cost of public infrastructure projects, including in relation to:
  - a. measures to improve flexibility and reduce complexity, costs and time for all parties
  - b. access to the market for domestic and international constructors, including barriers to entry, and what effect this has on construction costs
  - c. 'greenfield' infrastructure projects.
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.

## **Process**

In undertaking this Inquiry, the Commission should take into account the work being led by the National Commission of Audit to examine the scope for efficiency and productivity improvements across all areas of Commonwealth expenditure.

The Commission is to undertake an appropriate public consultation process including holding hearings and inviting public submissions. It will consult with the State and Territory Governments in undertaking this Inquiry.



The Commission should release a draft report in March 2014.

The final report should be provided within six months of the receipt of these terms of reference.

The Government will consider the Commission's recommendations, and the Government's response will be announced as soon as possible after the receipt of the Commission's final report.

**J B Hockey**  
**Treasurer**

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