

Martin Sheridan, 9 May 2014

Response to opportunity to provide public comment to draft report

I submitted to the previous request for public comment. I congratulate you on your thorough draft report of 11 April 2014.

Summary

- **State government ownership of infrastructure assets crowds out the private sector.**
- **Competing priorities prevent the State being as efficient as the private sector.**
- **WA needs to use sale of government assets as a means to balance its budget.**
- **Innovative solutions need encouraging: this means greater use of public-private partnerships, staging projects so that they run over several parliamentary periods, using existing government assets and land as collateral in State co-investment in private projects that also include social or other publicly value infrastructure.**
- **Proposals can be simplified by offering development rights for auction where the State has identified the need. A simple comparison can then be made as to whether the State can deliver a project more cheaply by adopting a reserve price.**
- **An independent "Investment Authority" is best placed to assess unsolicited proposals.**
- **Hypothecate road congestion charging and offer voluntary charging in return for reduced road taxes.**
- **The State has no role in subsidising electricity where viable markets exist. By extension, the State has no role in subsidising water services, transport etc where viable markets exist. The principle could extend into education and health: co-payments can be used to enhance services.**
- **Does a State need a AAA rating ?**
- **PPPs need modification and early termination options to protect governments in the event of changing demographics or demand patterns.**
- **Capital recycling as a viable PPP mechanism involving the granting of a concession to a third party operator.**
- **Transferring demand risk doesn't always guarantee off-balance sheet treatment of an asset or service in a PPP; nor should it. Disadvantages of PPPs are too often given too much weight – and politicised.**

Response to draft report

I make the following comments:

Page 12 - you note the higher level of per capita infrastructure spending. Australia is a large, sparsely populated country and therefore should expect higher per capita invested base and higher per capita costs. However the increased activity is not necessarily a result of that: as is demonstrated by the preponderance of State-owned power generation assets serving largely metropolitan customers and crowding out private supply. The State will always be less efficient than the private sector because of competing priorities. Given the State's budget position, an immediate sale of relevant assets is justified as well as a balanced revenue-operational expenditure budget.

I wholeheartedly support a review of how new infrastructure is selected. Too often decisions appear to be made on a less-than-robust assessment of costs and benefits. A formalised and de-politicised process would provide the necessary rigour. Greater use of Public-Private

Partnerships and incremental development of projects ("staging") could accelerate capital intensive but economically-enhancing investment. Staging has an additional benefit: a "good" project is of benefit whichever political party commences it. By staging projects, development occurs in a timely manner and smooths the release of projects to market. This avoids an excess of projects flooding the market in response to an electoral cycle and driving up prices because of commonality of timing of release.

Pages 13 & 14 – Department of Housing should expand private sector participation in low cost housing. This could be achieved by offering land free or at reduced rate to developers (the precedent exists: Department of State Development offers land as a contribution-in-kind to power developers in the Pilbara) or by offering development rights (for instance, tower blocks) in return for a developer delivering public transport assets (bus stations, rail stations etc) or other social infrastructure. The project would be awarded to the developer offering to pay the most for the right to develop the project.

In general, unless there is an overriding reason for the State to specify the form of project, the State should reduce its level of prescription of a project and simply publish a "concept design" and then seek development bids via a public auction. Lifecycle and functional aspects can be accommodated by specifying these in relevant technical conditions. Currently government agencies can be overly prescriptive. To avoid bidders incurring unnecessary cost, the State can publish its reserve price in advance.

The reliance of government on Probity Advisors and the concomitant commitment to integrity creates problems for the public sector when bidders offer "alternative" bids (bids that satisfy the intent of a called tender but perhaps not all stipulated conditions). This discourages their acceptance and, in turn, discourages bidders from submitting them. The problem is doubly so with an unsolicited bid (since no tender has been called for the public service has no mechanism to assess it). An independent "Investment Authority" or similar should be created (on an *ad hoc* basis if need be).

If road congestion charging is to be collected (and the current government appears to rule it out), the monies collected should be hypothecated to invest in other transport solutions that mitigate traffic congestion (improvements to the road network or increase rail or bus services). Consideration should be given to a voluntary traffic congestion charge: persons and businesses offering to pay a voluntary charge would be offered lower road tax costs or similar concessions. One problem with CBD charging in Perth is that many through routes require the CBD or environs to be trafficked. Careful consideration would need to be given to the extent of the charging area and re-routing existing through routes.

Electricity tariffs should be adapted to a time-of-use basis. To ensure equity, a common tariff could apply for an initial level of power consumption, after which time-of-use charges would apply. Increased use of "distributed systems" should be encouraged: these favour less environmentally damaging methods (such as wind, solar etc) of power generation and would encourage innovation. It is extraordinary that a State as wealthy as WA continues to subsidise the provision of electricity. The government should move to indicate a definitive point in time when subsidies will cease for all those except where there is no reasonable market mechanism.

By extension, subsidies should be rolled back on all government services where the private sector can create a reasonable market. Co-payments could be used to differentiate services beyond a minimum level. Examples include water services, transport and even education

and health. For instance, schools could offer additional curriculum items or resources in return for a small co-payment from all students attending the school. This would encourage specialisation. Emergency rooms could levy a small charge for attendance as a means of demand management during peak hours. This would enable the State to fund more out-of-hours GP clinics.

In section 6.2, you report that the state government is seeking to review its business model to enable it to recover a AAA rating. This suggests circular logic: the AAA rating is based upon the State's ability to match its revenue and costs, its assets and liabilities. If a balanced revenue-cost budget is achievable, and adequate net equity, the State will be assessed as AAA – it is a product of prudent fiscal management and a sound economic position. If the State, because of its natural resources endowments and its population's chosen policies, chooses other fiscal policies and objectives, it can still achieve balanced budgets over an economic cycle but might accept a lower credit rating and – hence – a higher cost of capital. A higher cost of capital has no direct effect on its revenue raising ability. A credit rating is largely result of a choice of fiscal policy for an entity such as a State. This is not the case for a company or individual.

Page 92 – social infrastructure PPPs need to be flexible to accommodate changing demographics and demand patterns. Governments should be careful to commit to long term obligations without having suitable options to modify the contract or terminate early.

Page 93, Table 13 – Capital recycling (the sale of a public asset to enable the use of the released funds for other capital investment) can also be a form of PPP when the asset is leased on a long term basis via a concession or similar. The net present value of the future revenues becomes a source of funds to the State.

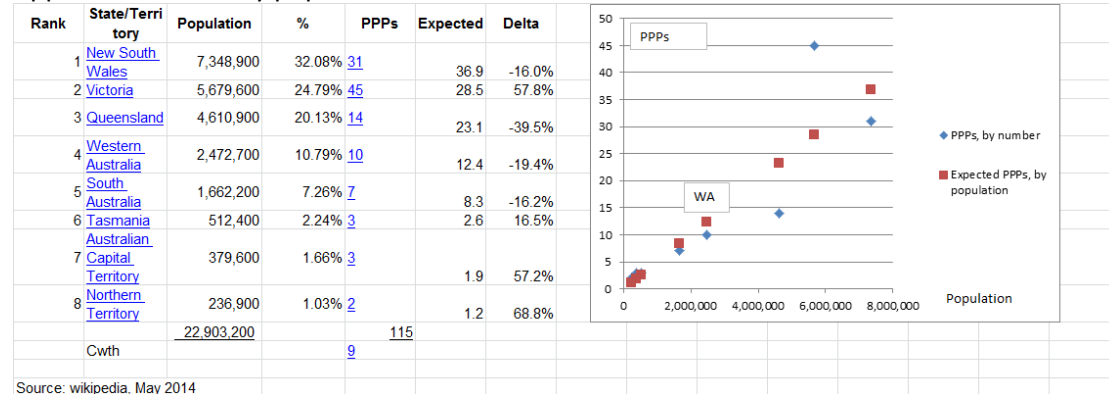
Page 94, Box 12 – although demand risk transfer may allow a PPP to be transferred off the government's balance sheet that assumes that, in the event of failure, the government does not have to step in to provide a solution, short or long term. In this regard, whether government likes it or not, it is still the provider-of-last-resort in many cases. And even if it is off balance sheet, markets may still perceive a residual liability, leading to an additional premium to the cost of capital. With regard to the disadvantages: using capped returns prevents private sector proponents earning economic rents. This is also in keeping with the annuity nature that should apply to a PPP: if government provides a service, the cost of that service is effectively and usually a long term liability akin to a debt. A PPP may remove a current period and long term cost from a government balance sheet, increasing net equity. Its reversion as a government liability usually reduces net equity but not as a single "hit" (as an equity "hit" would) but as a long term impost on the growth of equity ie a debt. By offering a concession, a privatisation (often a "dirty" word politically) is avoided.

Page 96, Table 14 – this table would be more informative if you reported the contracted PPPs on a per capita basis. See Appendix 1.

Pages 97,98 & 99 – you make a number of normative statements but without appearing to interrogate the detail: making comparisons between WA & SA without looking at the difference in demographics or other controlling factors; you report Acacia prison as having the lowest cost facility – but without noting the trend that lower costs come with higher populations (see Appendix 2; although the correlation is weak, the trend is apparent); the operator at Joondalup operates many health facilities. You cannot assume that the share price rise is purely the result of Joondalup. You note – table 16- the cost component

differences between WA and Australia but fail to note that, despite WA's higher costs in general, it has lower capital costs. One would expect a less efficient operation to attract higher costs of capital.

Appendix 1 – PPPs by population



Appendix 2 – Prison population versus operating costs

