How To Build Roads And Rails

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Potholes, late trains, steep fares, heavy tolls - since when did privatisation get us there faster? A new government report on funding transport infrastructure won't fix anything, writes Ian McAuley.

Australia's transport infrastructure is in a shabby condition. Urban road congestion already costs more than $9 billion a year and is projected (pdf) to cost $20 billon by 2020. Urban rail systems are similarly congested — decades have passed since any significant investment in the rail networks of Sydney and Melbourne.

Our interstate highways are a disgrace — the Sydney to Melbourne highway is still not quite complete and there aren't even firm plans to connect Brisbane and Adelaide to a proper road network.

As for passenger rail, apart from some investments in Victoria, our systems are out of the nineteenth century.

We are paying a high price for neglect, particularly the 11 years when the Howard government squandered its easy tax revenues on middle-class welfare while leaving our infrastructure to decay.

The present Government has boosted investment in transport infrastructure, but there remains a huge backlog, and the question arises about how the backlog is to be funded.

That should not be a major problem. Because there is such a backlog, the returns from such investment would be high — $2.65 for every dollar invested. Australian governments have ample capacity to borrow for productive infrastructure, and ample capacity to raise funds, through taxes or user fees, to repay that debt.

Simply re-applying indexation to fuel excise, which the Howard government abandoned in 2001, would raise up to $5 billion a year for road and rail projects. And a more comprehensive solution is offered by the Henry Review of taxation, which recommended user charges for all roads — rather than the mess we have developed with inequitable registration fees, cross-subsidies between different freight modes, and a distorting mixture of free and tolled roads.

Because transport networks operate as interactive systems, there is a strong case for public ownership and control so that the components can operate in unison. Rail freight terminals need to connect to ports and to urban roads. Metro systems need to integrate with long-distance train services. Road user charges need to be shaped to discourage congestion and to encourage use of public transport in peak times. Road charges and transport fares should be shaped to comply with environmental and equity considerations.

Public ownership and system control, however, does not to preclude the private sector from constructing infrastructure and from functions such as operating trains on publicly-owned networks.

The main case for public funding is that governments have the capacity to raise funds at low cost. While the private sector is struggling to get investment finance the present Australian Government long-term bond rate is around 3 per cent. Private investors, including superannuation funds, have lost their appetite for risk, but would be attracted to low-risk-low-yield government bonds.

In defiance of such orthodox economics however, the Government has released a major report "Infrastructure Finance and Funding Reform" which recommends that governments sell existing assets and open up the space for private funding mechanisms to fund the backlog.

It would be hard to conceive of a more expensive, inequitable, inefficient and environmentally damaging way to fund transport infrastructure.

Private infrastructure funding is expensive because private owners reasonably expect a commercial rate of return, which is much higher than the government bond rate, and they build in a premium to account for "sovereign risk" — the risk of changes in government policy. In addition each funding package incurs large underwriting fees.

It is inequitable and inefficient because the incentive for the private owner is to maximise profit in its own element rather than economic value across the system. For example a toll-road owner maintains high tolls which encourage vehicle operators to "rat run" on untolled roads, increasing noise, accident risk and air pollution. (Economists refer to such under-utilisation of assets as "deadweight loss".) A private rail operator has no incentive to run late night trains, even though the social benefits of such services may be very high.

The report acknowledges this problem when it says "Currently, user charges are levied on an ad hoc basis, which can result in a network with little apparent rationale for user charges, and contradictory signals for transport choices", but it goes on to recommend more of the same. Rather than recommending comprehensive user charges and network integration, it goes on to recommend more ad hoc project funding.

The rationale for privatisation is the "balanced budget" obsession. The report states "... the Australian Government is unique among Australia's governments, in that it has substantial capacity for additional borrowings on its balance sheet, within its AAA credit rating. However, it is unlikely that the Government will pursue additional borrowing given the Government's current fiscal strategy of returning the Budget to surplus in the short term." In other words, it is about the constraint imposed by a dysfunctional ideology.

The report even goes so far as to recommend that governments should subsidise the private sector by using governments' access to low-cost finance to prop up private expectations and to ameliorate private sector risk. It suggests, for example that public finance could absorb "greater financing or demand risks during the ramp-up stage" of projects, or more generally that governments could "provide financial assistance to reduce overall borrowing costs". That comes pretty close to some economists' definition of "crony capitalism".

The simple logic of our infrastructure backlog is that it has to be funded, and most probably with debt. (Theoretically it could be funded from current public revenue, as was the case in the 1950s and 1960s, but that would be a very slow approach.)

In terms of demands on capital markets, the only difference between public and private debt is that private finance is more expensive. Otherwise there is still the same demand on capital markets and the same national debt. The ideological stance is that debt is OK — so long as it's private debt, even if it is more burdensome to pay off than public debt.

We have been spooked by a public debt obsession, as if it is the cause of the world's financial problems. That's not the case. Rather, the problem is that in many countries, most notably Greece and Spain, public debt is not matched by productive public assets. In Greece public debt has been used to finance a generous welfare state while allowing tax evasion to flourish.

In Spain public debt has been used to support a pampered and poorly-regulated finance sector. Few people realise that Germany, the wonder economy of Europe, actually has higher public debt than Spain (80 per cent of GDP compared with 70 per cent of GDP in Spain). The difference is that Germany's debt has been used to finance productive assets — railroads, highways and metro systems, precisely the assets Australia needs.

We need to return to orthodox economics and accounting rather than devising ways to subsidise the finance sector. That means understanding the conventional role of government in providing public goods and managing networks, and realising, as any businessperson does, that a balance sheet has two sides and that the asset side deserves the same consideration as the debt side. Otherwise our future looks more like Spain's than Germany's.