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## Dispelling the Myths

If you, as a Strategic Asset Management advisor, are captured by the prevailing myths and do not have a clear head, the chances are that your organisation will not have a clear head either.

In this issue we tackle two prevailing myths

- “Governments do not have enough funds to build and maintain infrastructure and so have to resort to the private sector”, and
- “Market forces are best”

The Russian President, Gorbachev, is famous for banging his shoe on the lectern in order to impress a point. He believed that if you say something loud enough – and long enough – people will believe you. Sadly, he may be right. That is how the myths proliferate.

However, neither one of these myths is ‘right’. They may be true in some cases and not true in others, so it is important to have your wits about you and to consider each case on its merits. If you do not, you risk failing as a strategic asset manager and ruling out of consideration options that would be beneficial for your organisation and for your stakeholders

What other myths are currently infecting us?

### See also

**117** Why Strategic Asset Management is Optional and a Part-time job.

**119** The Five Strategic Asset Management Tasks

**120** Which would you choose?

*Consider and Enjoy!*

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## **Myth: Governments do not have enough funds to build and maintain infrastructure and so have to resort to the private sector.**



*Don't discard the idea of borrowing to fund infrastructure too readily.  
- Nor Accept it too readily!*

### **“Reducing the size of the Government Debt is an option”**

It is simply not a true statement that Governments do not have enough funds to build and maintain infrastructure. Reducing the size of the government debt is an option that Governments have chosen. It has not been forced upon them, except as a consequence of their prevailing ideas. Economists have argued that internally held debt is not a danger to Governments, only money owed overseas.

### **“Taxpayers not given a choice”**

The Government can borrow – generally at a low rate of about 4-5% - and fund infrastructure directly out of tax revenues; or it can contract with the private sector to provide and pay a rate of about 16-20% return on capital. Both are financing options. Given a choice, tax payers would probably rather pay 4-5% than 16-20%. But they are not given a choice.

### **The ‘Private Sector is Cheaper’ Argument**

Why does the Government choose the high finance cost option over the lower finance cost option? The arguments are generally that the private sector is more efficient. In simplistic terms, if it costs the government 95 (+5 for interest) = 100 and the private sector can provide for 75 (+20 for return on capital) = 95 then the community is better off.

### **Several elements are missing from this simple comparison.**

- (1) It assumes that the service provided by the private sector is equivalent to the service provided by the public sector.
- (2) It ignores the valuable role that stable, long-term, government bonds once provided in the finance market, a market choice that is now lost.
- (3) It ignores other ‘market corrections’ that the Government may need to engage in to ensure that the returns to the private sector are as high as promised. (cf closing non-toll roads to force traffic onto toll-paying roads)
- (4) It makes assumptions about the transfer of risk which are unproven—and in a number of cases, just simply wrong. Many of the PPP have run into difficulties, most famously the Latrobe Hospital contract that, at the time, won high praise in the international financial press.

### **Governments also argue that reducing debt raises their credit rating and lowers the cost of interest.**

This is an interesting argument since the normal way of expressing debt is the ‘risk free’ rate (ie long term government bonds) + the risk component attributable to particular investments. In other words the ‘risk’ premium paid by the Government is essentially

## **Myth: Governments do not have enough funds to build and maintain infrastructure and so have to resort to the private sector. (cont.)**

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nominal only and worked out by Treasury economists according to arcane formulas that have a high element of 'guesstimate'. This is not true for local government but is true for State and Federal Governments that have been the chief protagonists in this financing method. Economists like it because it appears to be 'commercial' and thus 'preferred'. (Incidentally, HIH and Enron were also 'commercial'!)

### **Political Reasons**

There are also political reasons why State and Federal Governments have adopted PPP.

- (1) It puts the pricing decision at one remove from the Government.
- (2) Selling community assets enables the incumbent government to access funds that would normally not be available until much later.
- (3) Recent disclosures have shown that 'up front' payments to government in return for higher ongoing prices have enabled governments to secretly tax their constituents.

Economist John Quiggin writing on "Australian Policy Online" refers to the recent change of heart on the sale of the Snowy Mountains Hydro Electric Scheme because of massive opposition by the community, says

"The debate surrounding the proposal revealed the continuing appeal of the 'pot of gold' theory of asset sales, notably to the advocates of the sale, many of whom regard themselves as economic rationalists. When the deal fell over, commentators referred to the loss of a 'war chest' the Bracks Government might have used to fight the forthcoming election campaign. The very terminology is redolent of the 18<sup>th</sup> century ideology of mercantilism, definitively refuted by Adam Smith in the "Wealth of Nations".



**Asset sales - an election 'war chest'**

### **Unthinking Acceptance of Public Debt is not the answer**

Current debate is now challenging the supremacy of the PPP as an efficient pricing and funding mechanism and promoting the reinstatement of public debt.

Some of the arguments are well founded, but others simply position debt as the answer to current financing difficulties, as if it were costless. It can be too easy to make the assumption that the future will benefit and therefore the future should pay. A closer look at some of the proposals needs to be taken to ensure that the future WILL benefit, and also to consider whether the future will be ABLE to pay. An ageing and declining population will reduce both the future benefits and the future ability to pay.

But debt is a very useful tool for Strategic Asset Managers and we should not be in a hurry to throw it away.

## Myth: Market Forces are Best

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The argument against public borrowing often takes the shape of arguing that 'market forces are best' and that, therefore, we should use the market wherever possible.

### An economists' argument

This argument is usually promoted by, and favoured by, economists. I am an economist but I see considerable flaws in the simple minded statement that market forces are best.

### Market willingness

Markets are supposed to be an aggregator of the 'willingness' of the market to buy and sell. This is fine for consumer goods where the consumer is the one paying and the one who benefits. But this is not true for public goods (goods like public education, public health, public transport) where there is no natural link between the amount of tax paid and the willingness of the population to support a particular public expenditure.

**Martin Feil, a tax and industry policy consultant, writing recently in *The Age***, took up the cudgels for public borrowing even more strongly, claiming that 'our failure to borrow to create infrastructure for the future is an act of economic vandalism'.

"Our conundrum has been that we want low taxes but we also like balanced budgets and freedom from debt. This contradictory outcome has been achieved by running down government payments for infrastructure maintenance and new infrastructure.

The changes have been attractively packaged and presented as a rational and cost-effective process. The tollways are faster, and the utilities have eliminated cross-subsidies. The workforces have been dramatically reduced.

But there are hidden costs. The state provides social service benefits (from our taxes) to those who are retrenched and cannot find full or even part-time employment. Additional costs are imposed on those who choose not to use tollways and find the creation of a tollway has destroyed previously efficient transport paths. Regional users have generally been losers from privatisation. Governments chronically underfund public schools, hospitals and transport.

**We may want to help the old, the poor, the weak, and those disadvantaged by distance, but the free play of market forces means that we only look after ourselves.**

Infrastructure is a word that covers an enormous array of goods and services that are the bones, blood, sinews and muscles of our society and our economy.

The choice between public and private borrowing for the creation of operating assets is a no-brainer decision. We will have to pay the public debts created but we will pay a lot less than the price of private financing marked up by excessive financial intermediary margins. "

**A return to public financing and public provision of services will enable us to be more 'community aware', but this does not mean recklessly borrowing and spending.**

Regardless of how we finance future infrastructure the Strategic Asset Manager must do the checks and balances to show that the population will be there both to benefit from it and to maintain/finance it. **Ageing and declining populations will mean that many of our normal presumptions in favour of 'building for the future' must be rethought!**

## Strategic Asset Management—Why it is OPTIONAL

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### Ask yourself:

What difference would it make if the next big technological breakthrough – anywhere - failed to happen?



**Answer:** No difference to the way we do things now – but an unimaginable difference to the way we could be doing things in the future. Because we do not know what the breakthrough would have been, we cannot miss it. And although our future lives will, in fact, have been diminished by its absence, we won't know.

What difference would it make if good strategic asset management fails to take place in an organisation?



**Answer:** The same!

There will be no difference to the way we do things now – but an unimaginable difference to the way we could be doing things in the future. Because we do not know what we would have done with the strategic asset management input, we cannot miss it. And although our future lives will, in fact, have been diminished by its absence, we won't know.

### For Technology

The gains for those organisations that do invent and adopt new technological breakthroughs are great. For this prosperity to take place, someone has to take something on trust. They must be prepared to put time and effort and resources into the breakthrough. And, sometimes, (perhaps many times) the efforts will fail: because new technology is high risk.

### For Strategic Asset Management

The gains are also great for the organisation is better able to develop its vision, consider the options, communicate with its stakeholders, implement operational asset management programs that do what it needs them to do, and keep track!

**Optional—BUT  
the gains are great and  
all the risk is upside risk!**

## Strategic Asset Management—Why it is a PART-TIME JOB

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### Reason 1: Multi-disciplinary

Strategic Asset Management is multi-disciplinary.

Therefore it needs a team.

Very few organisations are large enough to be able to sustain a full time team without line responsibilities.



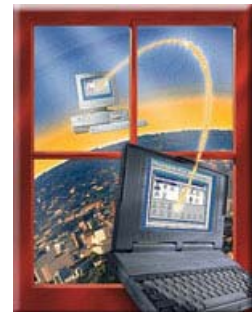
**This makes it a part time job for all involved**

Even in those organisations that do boast a strategic asset management team, it is commonly found that they will also be engaged on other corporate tasks such as change management and education. These other tasks then take on deadlines or line responsibilities so that again the non-urgent/optional strategic asset management work becomes a part-time job.

### Reason 2: A window on the world

Strategic Asset Management cannot be done in a vacuum. If we try to disengage it from the realities of operational asset management it ceases to be informative. It is the asset managers' hands-on knowledge of what is possible and the consequences of taking different actions that makes them so valuable as advisors.

As an illustration of removing advisors from the source of their hands-on knowledge, we need look no further than the problems that are now arising for contract managers in assessing the value of contracts now that they no longer have practical experience in the field to help them to judge by. Knowledge can so quickly become out of date.



Thus it needs to be a part-time job

#### **A business case is an exercise in strategic asset management!**

When I was running the International Asset Management Competitions, there was one organisation that won more awards than anyone else. They were consistently outstanding performers. When I went into that organisation, the asset management team were always keen to tell me what new things they were working on – and each time they explained their new work in terms of the *strategic benefits for the organisation!* Without exception! The reason for this was not difficult to find. Their CEO would not let them proceed unless they could provide a great business case.

## 5 Strategic Asset Management Tasks

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No matter what else is done as an asset manager, the **strategic** asset management tasks are those that **help to shape change**.

The way I see it, there are five of these:

1. **Help Decision Makers give expression to their vision.**

Vision statements start life as very vague, motherhood, statements. They need to be 'fleshed out', given some substance. This is not an exercise in setting 'projects', or 'targets', but rather a way of helping stakeholders to understand the vision by giving it more form.

2. **Generate Options and Examine Consequences**

This is the next step in the process. In SAM 193 we considered this important issue of generating options and examining consequences when we considered how we might deal with ageing infrastructure. Each option will have different implications for the economic, social, cultural and environmental wellbeing of different groups and these need to be considered.

3. **Assist Decision Makers to verify the vision and the chosen options with stakeholders**

An extension of Task 2 as stakeholders need to be brought across not only the options but the multiple consequences of choosing them.

4. **Translate the Vision into a Strategic Asset Plan for implementation and action**

The difficulties asset managers often face in this task is proportional to the extent to which they have neglected tasks 1-3.

5. **Monitor and feedback.**

Change is continuous. The operational asset manager monitors *outputs*. (Did the asset do what we said it would?) The strategic asset manager monitors *outcomes*. (Did we get the service we wanted to get? Have our ideas changed?)

**Your solution?**

Achieving the 5 tasks when strategic asset management has the characteristics outlined in the previous two pages is a tricky job—how have you solved it?

## Which one will you choose?

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Last week, Alvin Ho, NSW Rail sent the following conundrum which, although it is not a decision on infrastructure, it is 'about infrastructure' and shows the danger of hasty decisions – and the difficulty of deciding what is the right choice. Something for Strategic Asset Managers to ponder.



A group of children were playing near two railway tracks, one still in use while the other unused. Only one child played on the unused track, the rest on the operational track. The train came, and you were just beside the track interchange. You could make the train change its course to the unused track and saved most of the kids. However, that would also mean the lone child playing by the unused track would be sacrificed.

Or would you rather let the train go its way?

**Let's take a pause to think what kind of decision we could make.**

Most people might choose to divert the course of the train, and sacrifice only one child. You might think the same way, I guess. Exactly, I thought the same way initially because to save most of the children at the expense of only one child was rational decision. Most people would make, morally and emotionally.

But, have you ever thought that the child choosing to play on the unused track had in fact made the right decision to play at a safe place? Nevertheless, he had to be sacrificed because of his ignorant friends who chose to play where the danger was.

This kind of dilemma happens around us everyday. In the office, community, in politics and especially in a democratic society, the minority is often sacrificed for the interest of the majority, no matter how foolish or ignorant the majority are, and how farsighted and knowledgeable the minority are.

The child who chose not to play with the rest on the operational track was sidelined. And in the case he was sacrificed, no one would shed a tear for him. The friend who forwarded me the story said he would not try to change the course of the train because he believed that the kids playing on the operational track should have known very well that track was still in use, and that they should have run away if they heard the train's sirens. If the train was diverted, that lone child would definitely die because he never thought the train could come over to that track!

Moreover, that track was not in use probably because it was not safe. If the train was diverted to the track, we could put the **lives of all passengers on board at stake!**

**And in your attempt to save a few kids by sacrificing one child, you might end up sacrificing hundreds of people to save these few kids.**

While we are all aware that life is full of tough decisions that need to be made, we may not realise that **hasty decisions may not always be the right one.**