



## **INFRASTRUCTURE FUNDING UNDER THREAT**

**Yes, really!**

**Part One:**

*“Wait a minute!” you say, “how can you argue that infrastructure funding is under threat when we have never had it so good? When every country and every political persuasion is convinced that we should be spending more on infrastructure?”*

And that is just the problem! Read on....

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## **EDITORIAL: INFRASTRUCTURE FUNDING UNDER THREAT**

When I started writing this I intended it as a single issue - but it grew!

It grew both in the number of issues I wished to cover, and in the importance of these for the future of our infrastructure and the communities that depend on it.

So I have decided to expand it to two issues, of which this is part one.

As Asset managers we have so long argued for increased infrastructure funding that the present circumstances may be seen as the silver lining to the economic cloud. But let us not waste this opportunity to do good! And that means dealing with the following threats to infrastructure funding success:

**The threat of wastage** - frittering away infrastructure spending on 'make work' schemes that add to future costs but do little for future benefits.

**The threat of escalating community costs (especially if not measured) and**

**the threat of corruption** - encouraged by using PPPs without strict accountability structures.

**The threat of ignorance** - the threat of not learning from experience because information and outcomes have not been available and/or has not been well analysed and vigorously debated.

**The threat of tunnel vision** on the part of social and environmental enthusiasts who do not understand the flow on from their proposals  
and

**The threat of unrealistic expectations** on the part of the executive arm of government and the population in general. (And this last one could seriously damage us in the longer term.)

The first step to improvement is to identify and recognise the dangers. But if we stop there, we might as well have not even started! In Part 1 I look at the threats arising from wastage, escalating community costs, corruption and ignorance. In Part 2 I look at the last two threats - tunnel vision and unrealistic expectations and present a proposal for dealing with all of these threats to the future success of infrastructure funding.

Your comments, ideas, doubts, criticisms and suggestions help me enormously!

*Penny*

**1. The threat of frittering away infrastructure spending on make work schemes that add to future costs but do little for future benefits.**

## **Infrastructure and Economic Recovery**

### **The Principles and the Message**

The American Society of Civil Engineers (ASCE) *has got it right!* Consider their statement of PRINCIPLES:-

**ASCE believes that all projects supported by an economic stimulus investment must meet the following fundamental criteria:**

- \* Projects must create and sustain employment increases;
- \* Investments must provide long term benefits to the public (such as congestion relief);
- \* Long term maintenance and upkeep needs of all infrastructure projects - existing and new - must be taken into account; and
- \* To ensure accountability and transparency an auditing program must be established to review the program and measure desired outcomes.

**As the investments are made, proper attention must be paid to the prioritization and selection of these projects to ensure that the criteria are met. The following principles should guide selection decisions:**

- \* The project should deliver measurable improvements in public health, safety and quality of life;
- \* The project should provide substantial, broad-based economic benefit;
- \* The project should be designed and built in a sustainable and cost-effective manner, and proper consideration must be given to life-cycle costs; and
- \* The project should have a significant environmental benefit such as area restoration, improved air quality through reduced congestion and better watershed management through eliminating vulnerabilities in a system.

This is an excellent statement of the issues around infrastructure - the need for economic, social and environmental sustainability - expressed in simple language that anyone - organisations, electorate and elected members can understand.

Let us follow their lead! We do not need to waste time tinkering with wording but can promote this message, just as it is, to our customers and elected members.

### **Consider what the ASCE did. We can do the same!**

*“Shortly after the 111th Congress was sworn-in on January 6th, ASCE lobbyists went to Capitol Hill and discussed ASCE’s Principles for Infrastructure Stimulus Investment with a Senior Policy Advisor to House Speaker Nancy Pelosi. The meeting was a follow-up to a letter sent by ASCE President Wayne Klotz to Speaker Pelosi in December announcing the principles and urging their adoption.*

*Pelosi’s Advisor expressed appreciation to ASCE for developing the investment principles and commended ASCE for its ongoing education and advocacy efforts on behalf of America’s infrastructure. Pelosi’s staffer expressed the need for grassroots communications with Congress on the stimulus package. With the new Congress now seated and the stimulus package on a fast track, ASCE urges you to contact your elected officials now. Write your federal legislators now!*

*While it is uncertain as to when the Senate will act and when a final bill will be ready for President-elect Obama’s signature, it was clear that the House of Representatives will act quickly on stimulus legislation.*

(information from the ASCE blog - see <http://blogs.asce.org/govrel/?p=57>)

If you are a member of an infrastructure related organisation, why not take this message to your executive and media people?

### **And we can do better! We can take action to develop the tools and standards we need to make it work.**

**Tools** that provide accountability; tools that can measure and monitor longer term performance; tools that help us envision the longer term consequences of actions so that a fully informed view can be taken; tools that enable us to measure *outcomes* such as ‘measurable improvements in public health, safety and the quality of life’. We have tools that can project default life cycle expenditures but this is clearly no way near enough!

**Standards** that provide common audit procedures for all projects (whether public expenditure or PPPs - see next article); standards that enable comparison of projects in terms of their public benefits.

### **This should be where our action now is.**

#### **Other ideas, disputes, suggestions?**

My thanks to Professor Gordon Sparks of the University of Saskatchewan for drawing my attention to this work of the ASCE,

## **2. Threat of escalating community costs and corruption encouraged by use of PPPs without strict accountability structures.**

### **INFRASTRUCTURE AND ACCOUNTABILITY**

(keeping down the community costs,  
avoiding the corruption)

Theoretically PPPs should enable the Public Sector to concentrate on determining the objectives and permit the Private Sector to use its initiative in determining the means. In practice, in Australia, this has not been the case.

We can lay the blame on private sector greed but it is more productive to realise that it is the lack of clear public sector guidelines for expected outcomes, transparent reporting, and a strict accountability structure that allows both private greed and public corruption to flourish.

**Note: Where objectives and performance measures are public and transparent both in intention and achievement, PPPs can work well.** Take the South Australian Water Outsourcing Contract in 1996, much vaunted at the time as the largest non IT PPP in the world! The Government made it clear that it expected two outcomes - maintenance (or increase) of standards but at reduced costs, and development of the local water industry. They laid down clear guidelines for developments in the water industry and arranged for an independent third party, the Australian Statistics Bureau, to collect the information that would determine success or failure. Quality asset management performance standards were also laid down and annual strategic AM plans required.

(for details on this project, see Philippe Laval: The Adelaide Contract, contribution of outsourcing to sustainability, available online at [www.pecc.org/community/papers/sctf-shanghai-2003/adelaide-laval.pdf](http://www.pecc.org/community/papers/sctf-shanghai-2003/adelaide-laval.pdf) )

**Where there are no clear objectives, no transparent performance guidelines and measures, and where there is secrecy under the claim of 'commercial in confidence', however, the outcomes can be very different.**

Consider the well publicised case of Sydney's Cross City Tunnel Project.

(An excerpt from "The Guardian" 19th October 2005)  
**Sydney's private road tunnel disaster, by Peter Mac**

#### **An example of Escalating Community Costs**

"Horrified NSW taxpayers have discovered that under a Private Public Partnership contract they will have to make huge compensation payments to the private operators of the new cross-city traffic tunnel if the number of motorists using it does not rise, or if future improvements in public transport adversely affect the level of use.

There is mounting public rage over this deal. Initial street and lane closures associated with the tunnel have already created major traffic disruption, and are bankrupting small businesses around the city's William Street entry point.

Angry motorists have refused to use the 2.1 km tunnel because of the exorbitant \$3.56 charge and have opted to use the normal road system, even if this involves traffic jams and longer travel times.

To counter this, the state Labor Government has proposed blocking off streets (described most inappropriately as "traffic calming") in 12 suburbs around the city, and in several streets in the city itself, in order to force the public to use the tunnel.

Moreover, street lanes which have been closed in order to direct cars into the tunnel entry can only be opened up in the future on the payment of an undisclosed amount of damages to the operators by the government (i.e. the taxpayer). Wording to this effect is apparently included in the tunnel contract, which has still not been made public."

### **And public corruption**

"... In Melbourne, the controversial Committee for Melbourne report claimed that financing the construction of freeways by government could not be justified, because it was "imprudent given recent fiscal consolidation and debt reduction". In plain language, they claim that the private financing involved in most Private-Public Partnerships will cost the public less. However, two of the members of the Committee for Melbourne have been involved in major PPP deals in that city, including the disastrously expensive Citylink road system.

In complete contrast, a report by the Allen Consulting Group concluded recently that infrastructure financed by public debt was cheaper than the alternatives. As Kenneth Davidson in The Age put it, "the PPP option allows the financial consortiums that set up these structures to earn at least twice the amount they would earn if they bought government bonds to finance these projects."

The disastrous Cross City Tunnel contract was signed by the NSW ALP Government, which has become indelibly associated with deals with big developers and major construction firms. That government was headed by Bob Carr, who has now left parliament and has been hired as a special consultant by Macquarie Bank, described by Anne Davies in the Sydney Morning Herald as "the biggest private funder of public infrastructure in NSW" and "likely to bid for large infrastructure projects including the planned desalination plant and the M7 (expressway)".

### **Public Awareness**

Last week Ms Rhiannon commented: "We now know that the public are the big losers in the Cross City Tunnel contract. It is shocking that this government agreed to compensate the tunnel operators if public transport impacts on the tunnel's traffic flow. ... The people of NSW were betrayed when this secret Cross City Tunnel contract was signed."

And she concludes "The only good that may come out of this debacle is that people have been alerted to the dangers of public-private partnerships."

### **But how long does it last - and what impact does it have for the longer term?**

The City Link Tunnel was a cause-célèbre at the time but once it is off the front pages, how long does the memory last? Just 3 years later private infrastructure companies are promoting the City Link as a success!

## **CAUTION**

We must be careful about making judgements about PPPs (and equally about solely Government funded projects) on the basis of those that turn out to be spectacular failures. But where can we turn for careful, considered, analysis? In other words how can we deal with .....

### **3. The threat of ignorance - of not learning from our mistakes, because of the lack of good quality data, monitoring and measurement - and analysis!**

## **The limits of Analysis**

**Are we doing enough by way of analysis and discussion?** There is no such thing as 'value neutral' academic research! Every researcher brings his or her values to the task, that is reasonable and valid. But to ensure that we are able to correctly interpret and to understand the full story, we need rigorous academic dialogue and debate - and I am not at all sure that we have it.

Here I look briefly at just two academic papers analysing the City Link and Lane Cove tunnel projects. Each chooses to focus on a different aspect. Geoff Phillips argues that both are 'Pareto Inefficient' meaning that while there are benefits to some, the costs to others are greater (and in this case, far greater.) Peter Phipps, looking at the same projects, admits the inefficiencies - but argues the standard economists line of transfer of risk. You may wish to ask yourself who really bore the risk of the City Link tunnel. OK, the original contractors went bankrupt, but who picks up the costs of that? Others speak only of 'revenue risk'.

Where is the dialogue and debate, the vigorous questioning that we need to ensure that we do not make the same mistakes again?

Consider the following:

#### **1. Geoff Phillips argues that the City Link and Lane Cove Tunnels are 'Pareto Inefficient' - meaning that the benefits for some are outweighed by the costs to others.**

In a paper for ASOR National Conference 3-5 December 2007, "Analysis of Sydney Public-Private Partnership Road Tunnels, Phillips says that "Despite the amount of public discussion, there has been very little in the way of objective analysis of the costs and benefits of these projects. This paper investigates the relationship between the toll price level, usage level and public benefit." He shows that while users of the tunnel may gain benefits, these benefits come at a large cost to others. He says:

**"It is commonly accepted that outcomes that are not Pareto Efficient are to be avoided,** and therefore Pareto Efficiency is an important criterion for evaluating economic systems and public policies. The use of road closures to improve the financial benefits to the operators of the Cross City and Lane Cove Tunnels was an essentially Pareto inefficient choice. There is a substantial disadvantage to one group of motorists while others may be better off. Projects which are Pareto inefficient are likely to give rise to public resentment and opposition.

#### **Expensive bus lanes!**

"The Lane Cove Tunnel will be financially viable with the final road closures. However, these road closures will mean that the only extra capacity will be the dedicated Bus Lane in each direction. **It is hard to see how one Bus Lane each way for two kilometres could be worth over a billion dollars.**"

**2. In his paper “Driving Alone - Sydney’s Cross City Tunnel”, Peter Phibbs, of the University of Western Sydney, says** The cross city tunnel in Sydney has been a fairly spectacular failure as a Public Private Partnership – the operating company has gone into receivership less than 2 years after the tunnel opening in August 2005. The tunnel, built at a cost of about \$800 million failed to attract the traffic required to meet interest payments. Even when use of the tunnel was free, the traffic did not approach the forecast traffic levels of 90,000 vehicles per day.

**The paper argues that the project was always a marginal one – the volume of traffic that needs to move east -west across the city is relatively small.** This fundamental problem was exacerbated by the high cost of the toll (\$3.56), the lack of traffic growth in the east of Sydney and the negative reaction of consumers against what they saw as Government attempts to force them to use the tunnel.

But he also argues that *“Whilst a major difference of this project compared to earlier PPPs is that the private partners bore most of the risk,* the actions of the Government in breaking the terms of the original contract will expose them to higher risks and financing costs in the future. The issue for the private infrastructure sector is that the public views the project as a dismal failure and hence their appetite for future PPPs may be diminished.”

### **Who really bore the risk in the case of the City Link Tunnel Contract?**

In return for a \$96 million ‘contribution’, the NSW Government signed up to a contract that required the Government to close off roads - and not open them up again on pain of large compensation - to maximise the return to the contractors. Contractors were allowed to increase the charge by 4% p.a. until 2012 and then by 3% until 20?? regardless of the level of inflation. This seems to be both a high level of protection against risk for the contractor and a high cost for the public.

However, the real point is that if the project is non-viable - and both academics agree that it is - who really bears the risk? The fact that the project was allowed to proceed - with considerable government support - is the issue that needs rather more debate.



**In Part Two I look at the threat of social and environmental ‘tunnel vision’ and the threat of unreasonable expectations - and I present a proposal for you on how we - as asset managers and policy advisors - may address these issues, improve the level of infrastructure decision making,**

**and avert future chaos.**

