

Inquiry into Infrastructure Planning and Procurement

*Submission to the House of Representatives
Standing Committee on Infrastructure and
Communications*

Civil Contractors Federation (WA Branch)



**CIVIL CONTRACTORS
FEDERATION**



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Introduction

Civil Contractors Federation WA thanks the Committee for the opportunity to contribute to this inquiry. Our submission focuses on the issues of infrastructure planning, provision and funding, specifically addressing two of the questions in the Terms of Reference.

1. Are local, state and federal governments adequately considering the infrastructure challenges that they face and do they have long term plans in place to deal with those challenges?

Planning by State Government

Most Western Australian Government departments, agencies and government trading entities that are involved in infrastructure delivery have medium to long-term plans in place (although not all are published). While these plans are valuable, a “whole of government” approach to long-term infrastructure planning is needed to ensure infrastructure planning and provision is evidence-based.

CCF WA recommends the development of a comprehensive long-term Infrastructure Strategy – with a 15, 20 or 25 year framework – that reports on the current state of our infrastructure, identifies the infrastructure that needs to be built, and uses a preliminary cost/benefit analysis to prioritise that infrastructure.



We also recommend an independent State Infrastructure Agency be created to coordinate and produce this Infrastructure Strategy. In the Strategy, the Agency will also explore and recommend reforms needed to Government planning, procurement and approvals processes that may be needed to facilitate the delivery of infrastructure most efficiently.

The Strategy will present clear economic benefits to the state: although the relationship between infrastructure provision and economic growth is difficult to quantify, it is undisputed that every dollar spent wisely on infrastructure translates directly to increased productivity. By helping to ensure that infrastructure is delivered in a timely, effective, efficient way, an Infrastructure Strategy ensures the productivity benefit to the State is maximised.

The WA State Election in 2013 demonstrated the extent of the politicisation of infrastructure in WA, and the need for an objective assessment of infrastructure priorities. During the election campaign, the major parties presented opposing plans for the rail network and for a major stadium. Neither plan had been prepared with the rigour expected of such major commitments of public funds.

WA's Economic Regulation Authority, in the Draft Report of its Inquiry into Microeconomic Reform in Western Australia, summed up the current process by which the State Government allocates funding for capital works:

“In the annual budget round, agencies and Government Trading Entities (GTEs) compete for the limited funding pool available for government projects. In the absence of competitive markets for its goods and services, this process serves a vital role in allocating funding to those projects that provide the greatest benefit.”

CCF WA believes the bidding process as described above is deeply flawed and cannot lead to effective and efficient infrastructure provision. Nor can it ensure projects that provide the greatest benefit will be preferred. The current process may lead to disproportionate investment in social infrastructure, which is more likely to win voter approval – as evidenced by the State's recent huge spending on education and health infrastructure. A more effective way to ensure funding is allocated for the greatest benefit is for all projects to be prioritised by an independent, stand-alone advisory body.

The New South Wales government's statutory agency, Infrastructure NSW (INSW), provides



a worthy model for WA to examine and adapt. While INSW's role in developing a 20 Year State Infrastructure Strategy and Five Year Infrastructure Plans is important, it undertakes a number of other important functions including to:

- Review and evaluate proposed major infrastructure projects by government agencies or the private sector and other proposed infrastructure projects;
- Assess the risks involved in planning, funding, delivering and maintaining infrastructure, and the management of those risks;
- Provide advice to the Premier on economic or regulatory impediments to the efficient delivery of specific infrastructure projects or infrastructure projects in specific sectors;
- Provide advice to the Premier on appropriate funding models for infrastructure.

CCFWA believes a similar body is needed in WA to provide the review, assessment, and advisory functions listed above. While it is still relatively early days for INSW, we note the recent comments from its Chairman Graham Bradley and CEO Jim Betts:

“It is clear from our discussions across government and the private sector since taking on our roles at Infrastructure NSW in mid-2013 that there is a high regard for the added value that this agency provides.”

Role of the Federal Government

Last year the Federal Government announced it would task Infrastructure Australia with developing a 15-year pipeline of major infrastructure projects to be revised every five years based on national, State and local infrastructure priorities. Infrastructure Australia would also analyse the cost-effectiveness and financial viability of all Commonwealth infrastructure expenditure exceeding \$100 million; and regularly publish cost-benefit analyses for all projects being considered for Commonwealth support or investment.

CCFWA supports the intent behind these proposals but believes the assessment and prioritisation of infrastructure projects is primarily the role of the State and Local



Governments. This view is supported by the Federal Government's National Commission of Audit, which (in its Phase One Report) proposed that two key principles should apply when determining the roles of Governments and reducing duplication between levels of Government:

"Under the principle of subsidiarity, policy and service delivery should, as far as practicable, be devolved to the level of government closest to the people receiving the services. This recognises that sub-national governments are likely to have greater knowledge about the needs of citizens affected by their policies. It allows programmes to be tailored to meet community needs.

Governments should also operate at their natural levels. Policy oversight for national issues should go to the Commonwealth with responsibility for regional and local issues predominantly going to State and Territory governments.

Under the principle of sovereignty, as far as practicable, each level of government should be sovereign in its own sphere."

CCFWA believes the Commonwealth's current role in selecting major and minor infrastructure projects for funding is not in accordance with the principles of subsidiarity and sovereignty.

As the National Commission of Audit noted in its Phase Two Report:

"For most infrastructure, the users and beneficiaries reside within a particular State, and the State Government is in the best position to assess the merits of a particular project in providing services to the local community. The States should therefore retain primary responsibility for delivering infrastructure."

The National Commission of Audit recommends that the current practice of the Commonwealth funding specific projects through targeted programmes be replaced by pooled funding to States:

"Funding could be provided in a single pool and allocated to the States on a formulaic basis including appropriate funds for maintenance and disaster mitigation. While the formula would need detailed work it could be based on a simple approach, for example taking account of



population, size of road network and geographic area.

Financial Assistance Grants paid to local governments through the States as untied local roads grants, which totalled \$349.3 million in 2013-14, should also be included in this arrangement.

The Commonwealth would not be involved in the selection of projects.”

CCF WA welcomes the National Commission of Audit proposals outlined above, which would significantly reduce Commonwealth-State duplication and red tape. We recommend that the Commonwealth Government ends the current practice of tying its infrastructure funding to specific projects and leave the decision-making to the State and Local governments best placed to make those decisions.

This would of course mean a reduced role for Infrastructure Australia in the area of project selection. Infrastructure Australia could still play a vital advice and oversight role, however, for example advising the states on best practice in procurement and funding mechanisms, and ensuring the States are applying a sufficient level of rigour to project selection, including published cost-benefit analyses.

2. How can Australia increase or deepen the competitive market for infrastructure provision and funding in Australia?

‘De-bundling’ of project packages

The Productivity Commission’s Final Report into Public Infrastructure contained a number of proposals which we commend to the Government, including the recommendation that governments further explore opportunities to encourage more competition, and thereby receive greater value for money, by ‘de-bundling’ major projects into smaller packages for the purpose of procurement.

In the final report of its Inquiry into Public Infrastructure, the Productivity Commission recommends:



“For larger and more complex projects, government clients should pre-test the market to gain insights into possible savings from packaging the project into smaller components, reducing the level of risk borne by any one contractor, and promoting greater competition by relatively smaller construction companies.”

If projects are too large or complex, only a very few suppliers have the capacity to bid, which cannot be optimal for a client seeking value for money, or for the sustainability of the contracting market.

CCF WA believes there are several adverse impacts upon SMEs and taxpayers generally arising from combining projects into larger packages:

- anti-competitive outcomes which ultimately result in a higher cost of construction; and
- increased labour costs which ultimately flow to other industry participants.

While smaller contractors are utilised as subcontractors on ‘bundled’ major projects, it is our experience that a major contractor may use a smaller contractor as a 90 day, zero interest finance facility by delaying invoice payment. Consequently, for these reasons, many smaller contractors choose not to work with the larger contractors.

The Productivity Commission also found that the industrial relations environment in the construction industry remains problematic and that Governments can use their procurement policies to drive reform and penalties if unlawful conduct should rise.

Larger project packages create an environment conducive to adverse union activity that has a far greater impact on the construction industry than would be the case on smaller projects. For example:

- The nature of the construction projects provides unions with significant leverage, which they sometimes abuse, e.g., businesses are exposed to large delay penalties, and high costs if construction work is interrupted at critical times;
- While the current system is designed to allow individual businesses to negotiate terms and conditions with their employees that suit the circumstances of both the business and employees, various pressures by the head contractor and the principal unions can



frustrate this. Greenfields agreement can result in the same wages and conditions across a building site for all contractors (even if they had enterprise agreements in place with different terms and conditions). That and other practices may lead to the adoption of implicit pattern bargaining (which leads to the same agreements across multiple employers on multiple sites) despite this this practice being outlawed; and

- ‘Sweetheart’ deals involving generous site wide enterprise bargaining agreements between some unions and head contractors reduces potential savings from using sub-contractors that have achieved lower costs by striking more commercially sound enterprise agreements.

The Productivity Commission found residual concerns that the infrastructure construction market diminishes competition in ways that would significantly inflate infrastructure costs. These concerns should be addressed by Governments through greater use of pro-competitive procurement policies.

Private sector funding models

Most public infrastructure projects that involve private sector funding are packaged as Public-Private Partnerships (PPPs), which generally comprise consortium members which provide equity finance, debt finance, construction and operation.

A submission to the Productivity Commission Inquiry into Public Infrastructure by Industry Super Australia identified structural issues with PPPs and proposed an alternative mechanism that would deliver better value for money.

The current PPP bid process produces a major misalignment of interests between the bid sponsors, who are short-term financiers and contractors and the equity investors who are brought into a deal by them. PPP bid syndicate leaders have been motivated by considerations other than the return to equity and the long term success of a project. Investment banks acting as bid sponsors have been compensated significantly towards the front end of the project and, in the absence of competition, are able to collectively seek to extract outsized fees tied to winning and financing a bid - so called fee leakage - which is



ultimately borne by government and tax payers. In addition, construction companies generate their returns from project construction and have little or no exposure to the investment once operations commence.

Industry Super Australia proposed an 'inverted bid' model, in which equity funding is first tendered competitively followed by separate bids for construction, operation/maintenance and debt finance. It says this model would encourage participation by Australia's superannuation funds in greenfields infrastructure projects. Another benefit would be to introduce greater flexibility into selection of the construction contractor or contractors:

The separation of the construction tender from financing means the most capable and best value contractors and lenders can be selected without compromise as each will not be tied to a particular consortium.

CCFWA has similar concerns about the structure of the PPP market in Australia. An analysis of contracted PPPs in Australia shows that the market has been dominated by a handful of consortiums. The current model leaves little room for innovation or flexibility in procurement of the construction contractor, including any potential for 'de-bundling' the construction contract to attract more bids.

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About CCF

The Civil Contractors Federation is the member-based body representing the Australian civil construction industry, providing assistance and expertise in contractor development and industry issues. Nationally, we represent more than 1,550 civil contractors and a further 770 suppliers to industry.

CCFWA members are involved in a variety of projects and activities including the development and maintenance of civil or “horizontal” infrastructure such as roads, bridges, railways, sewer, water and drainage pipelines, dams, wharves, and commercial and housing land development.

In the 2012/13 financial year, a record \$15.5 billion was invested in civil infrastructure construction in Western Australia – a six-fold increase in just over a decade, due in part to works directly related to the state’s “resources boom”, as well as an increased appreciation by governments of the economic benefits of infrastructure investment.

This remarkable growth in infrastructure meant that during the 2011/12 financial year, total civil construction activity in WA exceeded building construction for the first time. While civil construction activity is expected to moderate from the current peak, the sector will remain similar in size to the building industry – a dramatic turnaround from little more than a decade ago, when the building sector was double the size of civil.



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