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HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON PRIMARY INDUSTRIES AND REGIONAL SERVICES

Reference: Infrastructure and the development of Australia's regional areas

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HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON PRIMARY INDUSTRIES AND REGIONAL SERVICES

Wednesday, 22 September 1999

Members: Fran Bailey *(Chair)*, Mr Adams, Mr Andren, Mr Horne, Mr Katter, Mr Lawler, Mr Ian Macfarlane, Mr Leo McLeay, Mr Nairn, Mr Secker, Mr Sidebottom and Mr Cameron Thompson

Members in attendance: Mr Adams, Mr Andren, Fran Bailey, Mr Lawler, Mr Ian Macfarlane, Mr Nairn, Mr Secker and Mr Cameron Thompson

Terms of reference for the inquiry:

The House of Representatives Standing Committee on Primary Industries and Regional Services will inquire into and report on the role of infrastructure in assisting the economically sustainable development of Australia's regional areas. The committee will, among other matters, consider and make recommendations about:

. deficiencies in infrastructure which currently impede development in Australia's regional areas;

. factors that would enhance development in these areas, including the provision of infrastructure such as energy, transport, telecommunications, water supplies, and facilities that deliver educational, health and financial services;

. the potential for development in regional areas;

. the extent to which infrastructure development would generate employment in regional Australia;

. the role of the different levels of government and the private sector in providing infrastructure in regional areas;

. planning, coordination and cooperation in the provision of infrastructure in regional areas; and

. the benefit to the national economy of developing regional infrastructure.

WITNESS

Committee met at 5.03 p.m.

ARGY, Mr Fred (private capacity)

CHAIR—I declare open this hearing of the House of Representatives Standing Committee on Primary Industries and Regional Services in its inquiry into infrastructure and the development of Australia's regional areas. This is the fifth hearing of our inquiry.

I welcome Mr Argy and advise him that committee public hearings are recognised as proceedings of the parliament and warrant the same respect that proceedings of the House of Representatives demand. The witness is protected by parliamentary privilege in respect of the evidence he gives before the committee. The witness will not be asked to take an oath or make an affirmation. However, he is reminded that false evidence given to a parliamentary committee may be regard as a contempt of the parliament. The committee prefers that all evidence be given in public. But should the witness at any stage wish to give evidence in private, he may ask to do so and the committee will give consideration to such a request.

Mr Argy—Just for the committee's information, I am semiretired, but I am a visiting fellow at the Australian National University and a former public servant.

Mr ADAMS—Of Treasury?

Mr Argy—Yes, I worked for many years in Treasury.

CHAIR—We have received a submission from you and have authorised its publication. Before we begin our questions, would you like to make a short opening statement to the committee?

Mr Argy—Thank you. I will be quite brief and perhaps just highlight my main theme. I have in many of my writings argued for a more active regional infrastructure policy. By this, I mean not only one which responds to evident infrastructure gaps and bottlenecks and deficiencies, as you would expect to occur in some growing dynamic areas like south-east Queensland, but also one which seeks, through strategic infrastructure investment, to create new opportunities for competitive development and employment in regional areas. That is what I mean by an active infrastructure policy.

At the moment, there appear to me to be several impediments to such a policy. The first, in my view, is an insufficient recognition, especially amongst many economic policy advisers, of the economic as well as the social externalities—the wider economic spin-offs, if you like—from a better spread of regional industrial and employment opportunities across the nation. I think also there is an inadequate recognition of the fact that a lot of this regional imbalance that we have is, in good part, a function of market imperfections, market failure, information deficiencies, labour immobility, wage rigidities and so on. That is the first point I would like to make—that it makes good economic sense, as well as social sense, to try to even out the spread of employment opportunities.

The second point is that I do not think there is adequate machinery for federal-state regional infrastructure planning. The third impediment is the lack of, I believe, a sound uniform national system of evaluation, application and prioritisation of infrastructure projects, one which assesses regional externalities on a consistent basis. As I see it, the fourth problem is that there are distortions at present in the risk sharing process between government and the private sector when it comes to infrastructure investment. I believe that this is due in part to tax impediments to join ventures and to an element of short-termism with a lot of our financial institutions. Incidentally, I do not believe—and we can talk further about this—that the present tax reforms will do much to help the short-termism problem. The other problem, which I have stressed a lot in my papers, is what I believe to be excessive aversion to government borrowing—excessive fiscal conservatism. These are the main points which I would put to you, and I am happy to discuss them with you.

CHAIR—Perhaps we could start with your concept of this national assessment and national strategy for infrastructure. How would you see that working?

Mr Argy—I think the first need is for the relevant federal and state agencies to collate information about infrastructure needs, infrastructure opportunities across the nation, and to disseminate this information. I say that because one of the problems is that a lot of the investment funds or super funds do not seem to be aware of some of these infrastructure opportunities.

The second thing that is needed is more and better strategic planning and coordination, and more coordinated financial planning too. I should mention in this context that EPAC, in one of its reports on infrastructure, did recommend that there be an infrastructure advisory committee to help coordinate the regional prioritisation process. So I think there is a need for more gathering and dissemination of information, better strategic planning and coordination and financial coordination.

CHAIR—You refer to cooperation between different levels of government. We have received a submission from AusCID and looked at the evidence produced from the regional workshops they have held. One of the obstacles to investment that they identified was exactly what you are saying: this lack of strategy, getting a project to that ‘investor ready’ status.

I wonder whether you could suggest a way in which a strategy, like the one you are suggesting, could be got to work with a certain level of expertise included in it. At the moment there seems to be quite a bit of evidence that at the local government level, certainly within regional areas, that expertise does not exist. If we had a model like that, what could be put into it to make it work so that we were not just getting wish lists of what projects were wanted for an area?

Mr Argy—That is a very good question which I do not have a full answer to. I think the first step is to get together a central body, like this advisory committee that EPAC recommended some years ago, and do a kind of an audit of what the gaps and problems are and the needs and efficiencies. Then, in a more active way, to try to draw attention to opportunities that are available across the nation. No doubt having regard to the fact that we are a federal system, we would want to ensure that every state had at least some opportunities to offer.

CHAIR—But, if there were to be a national audit, would you see it being driven by the federal level of government?

Mr Argy—I think a lead role is essential from the Commonwealth there.

CHAIR—I want to flesh this out a little more. You also make mention that, in the work you did for the south-east Queensland area, the clustering of development was a very successful model. We have seen examples of that—Bunbury over in Western Australia I think impressed the committee members. If you were to have a national audit where you identified, for example, areas of road infrastructure, water, power, telecommunications, would you then apply that to regions where there was the best chance of developing a cluster of development rather than just looking at perhaps one area for roads, to give an example?

Mr Argy—Yes, I do not think it is very productive to try to help every regional town that happens to have a high level of unemployment. Clearly, you are looking at regions that have the potential to become economically viable but that are not yet at the take-off stage. It is almost like the old infant industry argument, only applied to a region, where they need some government assistance at the start. I am talking of a broad region, not just a couple of towns. That region then would become the focal point for attracting jobs and for attracting also the unemployed at the fringes of the region. The towns at the fringes themselves might not perhaps benefit from such a regional strategy, but people would be able to commute to these places or travel to them perhaps on a secondment basis.

CHAIR—You mentioned in your opening remarks that the tax reform will not be sufficient to address—if I understood you correctly—the investment for infrastructure. Does that include what was released yesterday?

Mr Argy—I think what was released yesterday is very commendable in many respects but, like every tax package, there are pluses and minuses. One of the minuses unfortunately is that, by taking away accelerated depreciation—which I must say that, in principle, I fully agree with—and by changing the focus of capital gains tax, removing indexation and averaging and reducing the rate, the bias that already exists towards short-term investments, because of the intense competition between the various investment funds, will probably, if anything, intensify.

I would also add that, if there is implementation of the proposal to offer fund members the option of switching from one fund to another—and it is still in the early stages and has not been implemented as yet—that will further increase the competitive pressures on investment funds and superannuation funds to perform on a yearly basis and may well further increase the short-termism problem which has always concerned me. The bottom line is that infrastructure, which tends to have a long-term payback return, may well suffer from that, and particularly regional infrastructure where the risks are perhaps a bit greater.

Mr ANDREN—Following up on that point, I notice in your submission the statement that the:

> . . . in-built presumption against public borrowing . . . leads to many infrastructure investments . . . being financed by private sector equity and costing the community much more . . .

I also note your statement that:

. . . the public sector may and often does have lower effective capital costs . . .

To some degree, that runs counter to current economic orthodoxy about the efficiency of the market and so on. But I guess that relates back to the answer you have just given, that there is that imperative for short-term returns. Is that what you are alluding to there?

Mr Argy—Yes. Perhaps I could elaborate my views on this. These externalities, which I have emphasised a lot in my various papers, are spin-offs or returns to the economy as a whole which are not captured by the investor. Therefore, national benefit cost ratio is higher than the private benefit cost ratio. To close that gap between the two you need government assistance. But, of course, the government can still channel its assistance through private financiers, private institutions and entrepreneurs, and I have no objection whatsoever to that. In fact, you can develop new infrastructure with the large part of the risk being borne by the private sector but with some input from government in the form of subsidies or risk-sharing arrangements. That is not a problem at all, and it is perfectly sensible to adopt that route at times.

But my problem is that, by adopting an extremely conservative fiscal stance at all levels of government—federal and state now—we are starting with a presumption always that private sector ownership is better than government ownership, that the private sector is more capable of managing the ownership risk than the public sector. In my opinion, this is not correct in many cases. When you allow for that, it means that often the effective capital cost adjusting for risk is higher for the private sector than it is for the public sector. I suspect that that has been true of a lot of these urban road projects.

In that situation, I cannot understand why a government should not be able to borrow and finance such a project, even if it means running a cash deficit. This term ‘cash deficit’ has become very emotional—‘A government should not be running a cash deficit; after all, you have to balance the books.’ But a cash balance means zero borrowing. No government these days, except perhaps in Australia as far as I can see, has a long-term policy of running zero cash deficits—in other words, no public sector borrowing at all. It seems to me that, if the public sector can manage the risk of a project better than the private sector, it should own this project and it should finance this project. It should not be afraid to run a so-called cash deficit.

The cash deficit, as you would know, is the difference between revenue and total spending; that is recurrent spending and capital spending. Most governments in the world accept the need to balance recurrent spending and revenue; but they accept that governments are entitled to borrow for productive investment purposes, provided that they have a sensible balance sheet to begin with. Australian governments, with hardly any exception, do have very strong balance sheets. Their debt levels are extremely low. If you look even at their net worth—and I know it is very hard to assess that—generally their net worth is very good. So there is no financial reason why they cannot incur additional debt. If I were a shareholder in a corporation that said, ‘There shall be zero borrowing,’ irrespective of whether we have good investment opportunities or not, I would want to take my shares right out of there and go into another company, because that is simply irrational.

CHAIR—The debate about funding of infrastructure has tended to be public versus private. Do you think we will see the day where we will get a partnership between both public and private? There are some such projects in Australia, but they are the exception rather than the rule.

Mr Argy—Yes. I think at present there are one or two tax impediments to risk sharing, in particular sections 51AD and division 16D. Many reports have been written about this, and most of them have ended up inconclusively because these are provisions which are designed to stop tax abuse. No-one wants to do away with provisions like that if it will open up new schemes for tax avoidance. But, in the process, we are making it difficult for governments to go into partnership with the private sector through various lease arrangements and the like. There is a bit of a problem there, but I do not think it is an insuperable problem. I think there is a lot of room, yes, for more partnership between government and the private sector, with the government bearing those risks which it is best able to manage—the regulatory risks in particular—and the private sector bearing the commercial risks or semicommercial risks. That to me is a very fruitful partnership.

Mr IAN MACFARLANE—Can you give us an example of how that partnership gets put together in terms of government and private sector investment?

Mr Argy—I think the initiative would have to be at the government level to identify a project in a particular region.

Mr IAN MACFARLANE—Let's pick a project, say, a freeway and go from there.

Mr NAIRN—Brisbane to Toowoomba, for example.

Mr Argy—It would identify a project in a particular region that had a very high benefit cost ratio for the nation but would require it to run at an operating loss for a while. Therefore, it is not attractive to the private sector per se. So the government could try to arrange a structure which allowed it to inject some equity perhaps without dividends for a while so that it would reduce the effective cost of capital for the enterprise or it could inject an operational subsidy into the thing. It could agree to bear, in exchange for an appropriate return, some of the regulatory risks.

Unfortunately, governments often seem to be ending up with the short end of the stick. They bear the effective regulatory risk in the end, yet they do not get returns that match the risks. I am not a great one on institutional mechanics, if I may say so, so I cannot go into it in great detail. But it would seem to me that it would start at the government level with them bringing in the private financiers through a competitive bidding process and seeing if they can arrange a partnership between the two.

Mr IAN MACFARLANE—Are you familiar with the term 'shadow tolling'?

Mr Argy—Yes.

Mr IAN MACFARLANE—Is that a feasible option?

Mr Argy—It can be a feasible option, yes, with a lot of roads. Often, charging an actual toll may not necessarily be the best way to achieve the optimal traffic allocation that you want.

Mr IAN MACFARLANE—To my understanding, shadow tolling really is just that the company borrows the money and the government pays it back. What is the advantage in that vis-a-vis the government borrowing the money and obviously servicing the debt itself?

Mr Argy—I am not sure that I quite see shadow tolling in that. Sure, I do not believe that governments should accept the risk without the return. As I said earlier, if there is some risk involved in a project I do not believe that the government should accept to bear this risk unless it has some share of the returns. But I am afraid I did not quite answer your question perhaps because I did not fully understand it.

Mr IAN MACFARLANE—I am just going to this point that you are talking about: the aversion of government to borrowing and the fact that governments want to run budgets that are in surplus—or our government does, anyway. In terms of some of the infrastructure development that we need to do right across Australia, particularly in the area of roads, it has been suggested that one way to do that is for companies to bulldoze roads, borrow the money and build the roads, and then the government pays them off with an annual payment which eventually returns the ownership to the government.

Mr Argy—Yes, various BOOT schemes they are called.

Mr IAN MACFARLANE—They are a little different in so far as the only way the company that builds the road can get a return is to have the government buy them out. They do not charge a toll per se.

Mr Argy—Sometimes they do charge a toll and sometimes they do not. But often these are various build, own and operate schemes, with the ownership eventually being transferred back to the government after 20 or 30 years. These sorts of schemes do involve tolls and the private sector gets its return from the tolls, as with City Link in Melbourne.

Mr IAN MACFARLANE—If I may just interrupt: the reason I was ruling out tolls is that the federal government has an aversion to tolls on national highways, and our coverage is particularly in the area of national highways.

Mr Argy—Yes, you could have shadow tolls. But, in a case like a national highway where the benefit cost returns are very high to the nation and it would require a lot of regulation by the government, I do not believe that either the capital costs of the private sector or even the efficiency gains from the private sector—given that it will be a semi monopoly—would be sufficient to warrant private ownership; that is, the combination of capital costs and efficiency together would not point to private ownership but rather might point to government ownership in that case.

Mr IAN MACFARLANE—How do you identify to a sceptical Treasurer the actual dollar benefits of infrastructure investment? I note from your report reference to 'capital investment encouraging corporate investment in other industries or in creating business,' et cetera. How is that done?

Mr Argy—This is very much part of a science now called cost benefit assessment, cost benefit evaluation.

Mr IAN MACFARLANE—Do you think governments do that well?

Mr Argy—At the moment, there is no consistent approach to assessing infrastructure projects. Different states use slightly different techniques. This is one of the reasons for my suggesting that there needs to be more coordination, and that would be one of the roles of this national infrastructure advisory group. But this can all be refined and it would not be hard for Treasury as it does basically believe in benefit cost analysis. In fact, it was a strong advocate of that approach back in the 1960s; it was one of the first to argue for a systematic cost benefit analysis. So Treasury would have no technical objection to it.

A lot of the economic and social benefits from, say, a national highway are rather hard to estimate, and some judgment would have to go into it. In the end, perhaps you may have to adjust the discount rate, if you like, in a rather judgmental way rather than trying to precisely quantify all the externalities. For example, a highway is a piece of regional infrastructure that eases congestion and pollution in the cities; that reduces vehicle operating costs and travel time for business as well as for individuals; that reduces vehicle damage and, hence, repairs and maintenance costs; that reduces the health effects from accidents and pollution, and so on—all of which enhances efficiency in the cities, but those benefits are very hard to quantify. There are techniques these days though that try to get closer to quantification than we have ever been able to.

CHAIR—Let's just stay with that example of a highway between Toowoomba and Brisbane—and I know that it has received national press coverage because there have been many accidents on that road and it is very dangerous to transport goods on it. I come back to your original concept of having a national audit and an assessment of the needs for infrastructure. Say, for example, that that highway between Brisbane and Toowoomba, as well as many other roads, comes up in our audit. Are you saying that, in the cost benefit analysis, you develop a model where you assess, for example, how much produce is transported on that road, how many large vehicles of different size mass use it, what the social benefit are in the reduction of accidents and pollution, et cetera? In developing the cost benefit model, could you develop it to go across your national audit and assessment strategy?

Mr Argy—Yes.

CHAIR—Then only those projects that come up and score a high rate within your model are the ones to be funded.

Mr Argy—Quite so, because national and financial resources available to governments are limited and scarce, and obviously they have to try to ensure that they are deployed to best advantage. That is why I am advocating always a national system of prioritisation. The priorities would be set by doing assessments of individual infrastructure projects which take account of these wider economic and social benefits.

I have mentioned the economic benefits in easing congestion in the cities, but there are also externalities to the extent that it helps to develop the region and to create new employment opportunities in the regions. You have a whole set of new externalities which, even at the macro-level, for example, reduce the rate of unemployment that we can sustain without inflation. One of the things that is holding up our national unemployment rate is what economists call ‘structural and long-term unemployment’. That is, in good part, a result of regional imbalances in employment opportunities. If you could spread these employment opportunities more widely, you are improving the potential growth rate of the economy and the level of unemployment that you can sustain without inflation. We then can add up all these benefits.

Incidentally, I think there are also economic benefits from greater equality of opportunity. Economists love to talk about level playing fields, but you cannot have a level playing field unless you have equality of opportunity. That is why I think this is important not only in terms of adequate education and health infrastructure but also in terms of an adequate spread of services across regions.

Mr ADAMS—What is your view about the argument that wages or welfare benefits should be lower in some regions; what sort of rationale promotes that?

Mr Argy—Let me say first that I do not think infrastructure alone will be enough to achieve the kind of regional development that you might be striving for; you would also need other complementary measures. I believe that, if you reduced wages in the regions, you might well make it more attractive for industry to set up there. I certainly have no argument as an economist with the logic, if you like. But personally, because I believe that this might increase inequalities of income and wealth across the nation, I find it unacceptable—but they are my values perhaps that I am putting on the table more than my economic ideas—and I would prefer to achieve the same end by using labour market programs, including regional wage subsidies. That would achieve what you want to achieve, which is to reduce the labour costs in regions of high unemployment but with a long-term economic potential.

Mr ADAMS—Otherwise we might end up with these irregularities, say, in high levels of unemployment—perhaps because that would be where the housing was or where the employment was. That employment has now gone, but we still have those high levels of unemployment in that region, so you would have that imbalance. If you lowered the wages in that region, wouldn’t you just end up with the same imbalance?

Mr Argy—Undoubtedly you would help the employment situation, you would even out the employment situation, but you could worsen the problem of inequalities of income and wealth between the big cities and the regional areas.

Mr LAWLER—Perhaps I could make a comment first: if you were to take out the Dubbos, Toowoombas and Waggas, I would dispute that the cost of living is lower in the country than the city.

Mr Argy—Yes, I did not mean to suggest that it was, I am sorry.

Mr LAWLER—It was just about the concept. You answered a lot of my questions in the discussion about the superhighway. In developing infrastructure, I would imagine that in some cases the best end result would be if the government were to finish up with ownership of the project. But there would be other major infrastructure projects where the government would finish up walking away with some sort of dividend, the private sector would take it over and the government would then roll that on to something else. Firstly, would you agree with that? Secondly, what are the types of projects that would be more suited to one than the other?

Mr Argy—If you can have a reasonably competitive market operating or you can effectively regulate that market without too much cost, in terms of both administration and efficiency, then at that end of the spectrum I would like to see the private sector owning, operating and managing the project. At the other end of the spectrum, if you are talking about a fairly monopolistic situation with horrendous regulatory implications and where the government would have to give all sorts of assurances and safeguards to the private sector against changes in regulation, I would say that almost certainly the economics would work out in favour of public ownership. In between, there are all sorts of other possibilities where a combination of public and private would probably achieve the optimal outcomes.

Mr IAN MACFARLANE—If I can just squeeze in a question on that point: in regional Australia what beats private ownership of transport infrastructure is the traffic volume because there are simply not enough vehicles on the road. It is not so much regulatory; it is actual volume. How do you get around that?

Mr Argy—That is because that particular region has not yet reached the take-off stage, as I call it, where it can be economically viable and can sustain this sort of infrastructure on a commercial basis. If the government had confidence in the long-term viability of that region—and governments in any case take account of these broader economic and social benefits which the private sector does not—then it could step in and finance this sort of infrastructure or it could let those in the private sector finance it but share the risks with them, depending on the circumstances.

Mr NAIRN—Would an example of that sort of public/private partnership be what we saw on the highway north of Newcastle; it is effectively done with government borrowings, but the project is totally planned, built and maintained—I think it is maintained for a 15- or 20-year period—by the private sector? Therefore, the risk that the private sector is putting into it is that risk analysis as to the standard of road effectively that is built in the first case for whatever price it can win the tender at but knowing that it has to maintain it for that period of time. Would you see that as being an example of this public/private partnership?

Mr Argy—Without knowing the details of this particular project, it sounds as though it could be in the sense that the private sector is very good at managing, operating and maintaining projects. But, if you have a semi monopoly and you have a situation where regulation is essential, the government might be better off bearing the ownership risk. So, yes, in that case, the government would effectively borrow to finance the project and then put out to competitive tendering the various stages—design, management, operation—of the project.

Mr NAIRN—With this, the tender was not in various stages; it was for the total project.

Mr Argy—That has advantages too.

Mr NAIRN—We want to go from here to here; you come up with the best way to get from here to here to a certain standard, design it, construct it—

CHAIR—Maintain it.

Mr NAIRN—and you make sure that it is maintained.

Mr Argy—Yes, there are symmetries sometimes that suggest that there are advantages there.

Mr SECKER—I presume you were talking about Keynesian economics where government borrows for capital works. Would you suggest that there be a ratio limit of capital or borrowings to income?

Mr Argy—First, I would just say that, in this particular context we are debating here, I am not really talking about Keynesian economics which is concerned with short-term management of the economy. I am well aware, as most economists are, that fiscal policy has lost some of its punch as an instrument of short-term management. So Keynesianism, in that sense, is not as widely accepted any more in the profession.

But what I am saying is that, over the economic cycle as a whole, over a medium term period of seven or eight years, governments should be allowed to run a cash deficit in the sense that they should finance some of the capital spending out of borrowings. After all, this capital spending will create assets which will be there for future generations, so why shouldn't the effective servicing cost of that be spread across generations? Why should this asset be paid out of revenue in the year when it is being created? It seems to me quite illogical for governments to argue for zero borrowing over the economic cycle.

I just thought I would clarify that. I am not talking about short-term fiscal deficits because I would not advocate a fiscal deficit at this present stage of the economic cycle; I think a fiscal surplus makes a lot of sense.

Mr SECKER—What about the borrowing ratio?

Mr Argy—Many countries, including the UK for example, have a policy of saying that you can run a cash deficit—in other words, a public sector borrowing requirement—equal to about two or three per cent of GDP over the economic cycle. Provided that you have reasonable economic growth in that period, that should not in any way create an imprudent balance sheet for the government.

Mr SECKER—If it is only two or three per cent, it is not a problem. But if it starts getting up towards 10 per cent, which is what happened previously—

Mr Argy—Of course and, please, I hope I have not suggested for a moment that I am looking at that sort of thing. I am talking about reasonably moderate cash deficits with public debt rising more or less in proportion with GDP. But we have a situation now where all the state and federal governments are pursuing cash balances—that is, zero borrowing—where they are wanting to reduce public debt to zero in the long term. I am suggesting that that is a nonsense proposition, to put it crudely.

Mr CAMERON THOMPSON—I am looking basically at the same area, the same stream anyway. You speak of a cash deficit. In relation to that, having a deficit would result in an increased cost of funds for the government and would apply to all government borrowings. I just wonder how familiar you are with the existing state of the Treasury and the budget, and so on. Can you tell me, on some sort of point basis, how much extra we would be looking at paying for existing borrowings on top of the borrowings for the project itself, whatever that might be, and how much that would add to the balance sheet?

Mr Argy—I am sorry, but are you suggesting that increasing borrowing will bump up interest rates and the costs to the government?

Mr CAMERON THOMPSON—It will result in an increased cost for funds.

Mr Argy—This is a proposition that is debatable. We have seen increasingly over the years that, when the public sector reduces borrowing, all that happens is that the private sector fills the gap and increases its borrowing. That is good in a sense because it means that any contractionary effects from the public sector are offset by expansionary effects from the private sector. That is often the result of monetary easing. What we have had in recent years under this Howard government has been a combination of tight fiscal policy and a very accommodating, easing monetary policy. That combination has led to a lot more private sector borrowing, which has more than offset the decline in public sector borrowing. It is the total borrowing demands on the economy that determine interest rate levels, not just the public sector.

Mr CAMERON THOMPSON—I am talking about the cost of funds to the government; I am not talking about the private sector.

Mr Argy—Yes, but what the government pays for borrowing is determined by the level of interest rates across the economy.

Mr CAMERON THOMPSON—That is right.

Mr Argy—If the level of interest rates across the economy is not pushed out, then the government will not need to pay one cent more for its borrowing.

Mr CAMERON THOMPSON—What do Standard and Poors do in relation to government borrowings?

Mr Argy—These rating agencies are a bit of a problem because they do not assess governments in terms of their net worth, and that is what they should be doing in terms of not only their liabilities but also their assets. In other words, if a government is adding to its liabilities but is also adding to its assets, then its net worth is either stable or improving, and that should not affect the rating of the government at all.

Some rating agencies have a very narrow perspective of this and do sometimes react adversely to a government borrowing. But we are not talking about large scale borrowing here; we are talking about modest borrowing. I notice that even Standard and Poors on one occasion actually chided the Queensland government for not borrowing more than it was borrowing. The Queensland government has net financial assets; it has no debt—it has negative debt. This rating agency actually chided the government and said, 'Well, beyond this point, there is no particular advantage in not borrowing.'

Mr ADAMS—And you could be getting growth by doing so.

Mr Argy—Yes, that is right. It seems to me that, ultimately, we are talking about how much public investment you want in infrastructure compared with how much private investment you want in some productive activities—recreation activities, casinos and cinemas and so on. This is the choice that the public have.

Mr ADAMS—In Australia there is an argument that, if you use private sector money for infrastructure, you can build things much quicker. You can achieve a lot more of your roading, you can build a lot more energy outlets, you can do water resources, whatever, by getting this money into the system. We have not done much of that, but that is one of the arguments. Most of Australia's major infrastructure—in roading, energy and those sorts of things—was built by government borrowings; there are other parts of the world where that has occurred by the private sector. But most of Australia's major projects, really large projects, have had some government assistance. We are now into a situation of trying to get private sector money into infrastructure. Is it possible to get private sector involvement that would bring some of these developments on—bring them forward and build the infrastructure—quicker than if government were left to borrow funding or is that a fallacy?

Mr Argy—The reason for private sector funding often leading to an acceleration of the starting date for infrastructure development—that is, it speeds up the infrastructure project—is precisely the very issue we have debated earlier that governments have set themselves these zero borrowing targets or to the extent they do borrow, they want to make sure that it does not cause any strain on revenues at all in the short term. So these constraints on government have forced it to try to transfer off budget, if you like, the cost of infrastructure financing. If you start with the premise that the public sector shall not borrow full stop, then the private sector funds can speed up a lot of infrastructure development. But the question we have to ask ourselves is: in the end, by adopting this rigid, inflexible stance, are you getting the cost of this infrastructure at the right price?

Mr ADAMS—Does that go against the history of Australia, in that sense?

Mr Argy—It goes against the history of Australia, although I should say that the history of Australia perhaps is littered with a lot of excessive government investment. There were a lot of things that governments used to do which are better done by the private sector, and I think we have learnt a lot. To a great extent, the shift from public to private funding of infrastructure is a wholesome development that has a lot to be said for it. This is especially so where we are talking of risks that are of a semicommercial character, and the private sector can manage these risks best. But, like all fashions, I think that we have now swung from one extreme to the other extreme and that we have ended up with the wrong balance.

CHAIR—Where are we in that cycle?

Mr ANDREN—Evidence has been given to us by Mr Graham Timms of the Australian Council for Infrastructure Development. We asked him about a national blueprint, as such. It was a double-barrelled question. His response was much the same as yours. He said:

> The thing that terrifies us is that we will get sidetracked on massive overdevelopment projects such as, and let us name names, the Melbourne to Darwin Steel Mississippi . . .

projects that he believes are certainly not worth federal investment in. Given the federal system and the short-term political imperative, how are we ever going to develop this national audit, national blueprint, when it should last well beyond the life expectancy of any particular political persuasion?

Mr Argy—I think in many ways you have hit the nail on the head with the problem. A lot of the infrastructure decisions being made at present are very much in political and socio-political terms rather than in hard economic terms. That is why I want to see a consistent national method of evaluation of infrastructure which would systematise the various externalities that I have mentioned and bring them into the assessment of the benefits and costs in an agreed way. That would achieve a sensible order of priorities, and you would not get white elephants like the Melbourne to Darwin Steel Mississippi or whatever coming out of that because an independent advisory committee would be doing the evaluation of those projects. That committee would have to make sure that there was a spread amongst the various states. Also, it would demonstrate that certain projects would deserve higher priority than others simply in terms of their wider benefits and the fact that they would produce a better benefit cost ratio than even the private sector can produce.

Mr ADAMS—But wouldn't regions miss out totally if you were to analyse it in that way?

Mr Argy—No, not if you take account of these regional externalities that I have mentioned. There are a lot of benefits from spreading your employment opportunities across the nation. If you build those regional externalities into your benefit cost analysis, I am sure you would find that quite a few regional infrastructure projects would then rank high in priority.

Mr ANDREN—Your comments on micro-economic reform interested me because there is a lot of resistance building up in smaller regional areas to competitive tendering, for example, under the national competition policy. If we do not address those micro-economic issues, I guess you are saying that we will not have that social pool, that employment pool, that social dividend to deliver. Are you suggesting that the micro-economic reform is chipping away at the very infrastructure we are trying to support?

Mr Argy—Yes, I am a great believer in micro-economic reform, but the additional wealth that is generated by micro-economic reform should be spread widely across the nation. My fear is that a lot of the benefits of micro-economic reform are going to the top one-third of the community; the others are missing out and are very resentful. They feel alienated and isolated.

Mr ADAMS—And they might vote for One Nation.

Mr Argy—Yes.

Mr NAIRN—You spoke before about cooperation between the various levels of government. Do you see one of the big gaps and problems in regional areas as being a shortage of leadership in those areas? I do not mean necessarily political leadership; it can be a variety of leadership—community and business leadership—which, in fact, becomes part of the problem of coordinating those various levels of government and raising the profile of regional projects that really should have a much higher profile.

Mr Argy—I think it varies from community to community. Some regional communities do have the leadership qualities there and it is just a matter of the government organising that leadership potential—flushing it out, if you like.

CHAIR—But how does the government do that?

Mr Argy—In other areas the government has to interject the leadership into that area.

CHAIR—But how does the government do that?

Mr Argy—It is often done by inviting ideas at the regional level. Of course you will get, let's face it, a lot of hair-brained ideas coming out but you will get a lot of good ones, too.

CHAIR—It would be essential to have these ideas, and there is the point that Gary made about developing leadership at the local level to drive some of these projects as part of this national audit and assessment procedure.

Mr Argy—Yes, exactly; that is right. This national advisory committee would be inviting these sorts of ideas. Where it felt that the community was not equipped perhaps to provide these ideas, it would help to design them. Then it would do the collation process of looking at all these and no doubt disposing of about 90 per cent of them at stage one. Then it would focus on the remaining 10 per cent and decide on the order of priorities. Then it would do a comprehensive benefit cost evaluation to narrow the list down to a very short list.

CHAIR—Surely before you were tapped into the expertise at the local level, there would have to be some steps taken at the local government level to identify, for example, how much water was available, what level of traffic use the nearby highway and all of those sorts of issues. One of the problems that we have certainly received in evidence so far is that local governments do not have that information—some do, but only a small percentage.

Mr Argy—That is quite right. That is why we are not talking of inviting individual towns to put ideas up. There has to be some regional integration process where you bring a whole group of regional towns together and get them to provide the ideas. If you have this collective effort, you are more likely to get good results.

CHAIR—Thank you very much indeed for coming along today. We certainly appreciate it. Thank you also for the most detailed submission you provided to us.

Resolved (on motion by **Mr Lawler**):

That, pursuant to standing order 346, this committee authorises publication of the evidence given before it at public hearing this day.

Committee adjourned at 6.07 p.m.