ECONOMICS, POLITICS AND INFRASTRUCTURE*

Gary Banks AO

Transcript: Infrastructure Partnerships Australia Annual Infrastructure Oration

(STARTS)

It is an honour to have been invited to deliver the IPA's *Infrastructure Oration* for 2017 at such an auspicious event.

There is no shortage of issues of relevance to infrastructure about which one could 'orate' in these interesting times. My intention until a few weeks ago had been to focus mainly on the *economic* side – infrastructure's important contribution through productivity growth to raising the living standards of all Australians. I was going to remind you of the gains from the structural reforms of the 1980s and 90s, and what it took to get them. And I'd intended to then revisit the 'to do list' I compiled in 2012, at the end of my tenure at the Productivity Commission, to see how it was faring five years on.

Much reform still to do

As some of you may recall, that 'list' was prompted by a remark by Glenn Stevens, who, when asked at a 'summit' in Brisbane what could government do to raise Australia's productivity, replied, "*well the Productivity Commission has a long list of things to do. … Go get the list and do them!*" This caused a bit of confusion among journalists present as to the existence of an actual list. The RBA Governor meant of course that the Commission had produced reports over the years with

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recommendations yet to be implemented. But the resulting clamour seemed worth capitalizing on!

The list turned out to be quite long. The infrastructure section included recommendations for better decision-making processes, governance arrangements, pricing and regulation; along with other specific reform proposals for transport, communications, water and energy – all evidence based and stress tested under the Commission's public inquiry processes. Their common message to governments could be summarised most simply as a need for better spending, regulation and management of infrastructure services, with greater reliance on market incentives.

It quickly became clear in revisiting my 2012 'to do list' in recent weeks that its relevance had not diminished – on the contrary!

For example, in a 2014 report, the Productivity Commission identified a (still) 'urgent need' to overhaul processes for assessing and developing public infrastructure and to reform its governance, including further privatisation of assets where this had already proven beneficial and improving regulatory frameworks. In its 2016 Plan, Infrastructure Australia called for better planning and coordination, investments based on evidence-based priorities, along with better management of existing assets, including through private ownership and cost-reflective pricing of services to users. And of course, Infrastructure Partnerships Australia continues to be a strong advocate for all of these things and more.

As a number of reports have shown, policy issues of relevance to infrastructure extend well beyond 'infrastructure policy' *per se*. Other sections of the 'to do list' that if addressed would enhance the performance of economic and social infrastructure, include reforms to achieve more flexible labour market arrangements, a less distorting and punitive taxation system, and more efficient regulation in key areas such as planning/zoning and the environment. Within the last category, the Mandatory Renewable Energy Target received special mention.

An energy sector in disarray

While developing remarks along these lines, my train of thought was repeatedly diverted by the unfolding energy 'crisis'. Even by today's standards, the misleading, disingenuous and partisan nature of the energy policy 'debate' seemed to have plumbed new depths. So be it, I thought, it's no longer my job to call out such things. But then a state premier went and made the following observation:

"*We've got market failure. We know there is an investment strike. The private sector just isn't building power generation."*

I must confess that this took the wind out of my sails -- if you'll pardon the analogy. The electorate was being told by a political leader that the problems they were experiencing – high prices, failing supply and costly emergency measures – had nothing to do with the government. It was the fault of the *private* sector and its perverse refusal to invest in power generation.

Abraham Lincoln's warning that governments can't fool all of the people *all* of the time is once again being tested.

The inconvenient truth is that the increasingly high prices for increasingly unreliable electricity are a direct consequence of the increasingly high utilization of renewable energy required by government regulation.

Energy markets are admittedly complicated things. However the logic is unassailable that if a cheap and reliable product is penalised, while expensive and less reliable substitutes are subsidized, the latter will inevitably displace the former. No amount of sophistry, wishful thinking or political denial can change that basic economic reality.

Changing the mix of energy use away from low-cost but emissions-heavy fossil fuels has of course been the *whole point*. While Australia's own actions can have no discernible impact on global carbon emissions, let alone on Australia's climate, there is broad support for the idea that playing our part is a precondition for a joint international endeavour that could. This requires a leap of faith, but it is a legitimate policy objective, even if a particularly costly one for this country given its resource endowments.

The resulting costs and difficulties have been greatly compounded, however, by governments choosing a policy path that is essentially anti-market, one violating basic principles of demand and supply. The energy crisis is self-evidently not the result of *market* failure but of *government* failure.

The 18th century literary sage Samuel Johnson remarked that 'a man is never more innocently employed than when engaged in making money'. The actions of private investors are not hard to understand. They will generally not invest in a project unless the returns are likely to be sufficient to cover the costs and provide an adequate return on their capital -- given the risks involved and the alternatives on offer. Following regulatory interventions, returns from fossil fuel generators have gone down, while the risks of investing in them have gone up. I suppose the consequent reluctance to invest could be called a 'strike', if one needed an emotive term, but it is really just a rational response to the forces at work.

Unlike government enterprises, private companies cannot be relied upon to provide cover for a government's policy mistakes. In that light, the SA Treasurer's lament that privatising ETSA was "the worst policy blunder in the history of South Australia" may have not only been a big call, but more revealing than intended. Not to be outdone, the new Secretary of the Australian Council of Trade Unions has triumphantly declared that "experiments in privatisation have *failed*!".

From bad policy to worse

In blaming the private sector for Australia's energy problems (and I note the new ACCC inquiry into alleged misdemeanours by electricity retailers) there is a real risk that the policy mistakes that led to it will be compounded by further policy mistakes, rather than leading to corrective actions that acknowledge regulatory error. We seem destined to end up in a third or fourth best world, as economists express it, when the first or second best were well within reach.

Thus we observe at the Federal level the threat of regulatory intervention to withhold gas exports for domestic use – while at the same time state and territory governments ban or curtail exploration and production. We even see governments re-entering the energy business. South Australia is to spend a lazy half billion on a new gas generation plant. The Commonwealth is contemplating investing in clean coal generation using its $5 billion northern infrastructure fund, the Minister responsible declaring "the only people who can get rid of sovereign risks are the sovereigns!". And while finance has never been scarce for viable energy projects in the past, the government is now planning to fill the gap caused by regulation through the previously derided Clean Energy Finance Corporation. Moreover it is proposing to establish a more general infrastructure financing vehicle within the Prime Minister's own department (which a recent IPA submission depicts as "solving the infrastructure problem we don't have and ignoring the one we do").

Then there was the dramatic announcement of a 'nation building' expansion of the tri-governmental Snowy Scheme that had been rejected as uneconomic in the 1980s. Whether or not this Utopia-like initiative can be justified on today's numbers, it seems clear that any thought of privatising such a politically attractive asset has become a thing of the past. Following the WA election, Western Power must also take its place on the privatisation 'no go' list.

To add to the irony, we are seeing a new wave of interventions to help the very firms which emission reduction policies were intended to drive out of business. The Portland aluminium smelter, perhaps the most intensive user of electricity in the country – an operation requiring heavily subsidized power even when it was cheap -- has received substantial additional taxpayer support to help forestall the inevitable. And, following belated recognition of the implications of the closure of the Hazelwood power station, there was considerable pressure on the Federal Government to deploy taxpayers' funds to keep it open. While this did not eventuate, it would be surprising if the country's other base-load generators did not have claims for assistance bolstered as a result, especially given the precedent in Europe.

Part of a broader (anti-productivity) trend?

The intervention spawned by the failure of energy/carbon policy accordingly looks to become a self-perpetuating process. It is disturbingly reminiscent of the conventional industry protection dynamic of times past, in which assistance to import-competing firms imposed costs on downstream users and exporters, who in turn demanded (and often received) assistance of their own. In the end it became apparent, even to supposed beneficiaries of the system, that 'protection all round' was a chimera, responsible instead for a decline in industry performance and in the living standards of Australians.

More disturbing still is the fact that such interventions have not been confined to energy markets, with bad old policy habits re-emerging more widely. The headline act in this respect would have to be the NBN, which continues to affirm the wisdom of doing the numbers before announcing the policy. Then there is the saga of our home-made submarines, built with home made steel, which seem set to rival the Collins Class fiasco, but at even higher cost – especially given the grim energy outlook in the favoured state. Coastal shipping and its heavily unionised workforce continue to benefit from the renewal of anti-competitive regulation at the cost of farmers and miners. And we have just had the re-regulation of Queensland's sugar industry. Meanwhile, on the trade front the anti-dumping regime has been made even more protectionist (in a rare instance of bipartisan agreement), and future reductions in our trade barriers have become contingent on reciprocal offerings by foreign governments, rather than for the domestic gains on offer.

On the positive side of the ledger, throwing good money after bad at the local assembly operations of foreign car companies seems finally to be drawing to a close, while some new claimants for taxpayer support (eg Qantas) were successfully resisted. But the balance of policy weight has tipped decidedly the other way.

Perhaps of most concern is the fact that there has been little or no progress in the policy areas likely to yield the greatest gains.

Industrial relations reform became another 'no go area' following the ill-judged Work Choices episode. This contributed to a change of government in 2007 that soon saw an anachronistic regime and its associated costs reinstalled. As you know, a Productivity Commission inquiry was finally launched in 2015, with the admirable intention of bringing an evidence-based case for reform to the next election. This did not transpire and the Commission's relatively modest recommendations have been almost wholly neglected, despite unprecedented attention to the politics in framing them.

In the case of taxation, the vision of the Henry Review and subsequent White Paper process for an integrated suite of systemic reforms, collectively yielding gains of up to 3 per cent of GDP, has been blind-sided by clumsy attempts at piecemeal changes that have either been reversed (the RSPT/MRRT) or heavily compromised (corporate tax). Meanwhile the GST remains the dog that hasn't barked, or at least not for long; whereas on the minor matter of the backpacker tax, Parliament laboured mightily to produce a mouse.

Reforms to social and other government spending programs have also been thin on the ground. Welfare changes to reduce disincentives to engage in training and work are needed for their own sake, but would also help fiscal repair and potentially free up funds for productive uses, including infrastructure. Instead, key proposals have languished or been rejected out of hand.

Then there is the spectacle of billions of dollars of new money being wasted in such programs as the now infamous VET Fee Help, Family Daycare and Rental Affordability schemes, all of which were plagued by corruption and failed in terms of their own stated objectives. Meanwhile a truly important and innovative national reform to help people with profound disability has been jeopardized by weakened eligibility criteria and the truncation of trials essential to its financial sustainability.

It also has to be said that, despite good work by Infrastructure Australia and its state counterparts, scarce public funding for infrastructure continues to be directed to areas of low economic but high perceived *political* payoff, such as expensive greenfield rail projects spanning regional electorates up the east coast.

Given more time I could give more examples – I have barely scratched the surface – but hopefully I have made my point: public policy development in Australia over recent years has been a sorry spectacle, with the energy imbroglio merely the latest instalment.

Back to the future?

There are countries for which policy dysfunction is pretty much the normal state of affairs. Think Africa, Latin America, or countries in Europe like Greece or, dare I say it, France. But that has not been the Australian experience; at least not since the program of structural reforms commenced some three decades ago -- reforms that contributed greatly to the prosperity that we have since enjoyed.

Before then, as many can hopefully still recall, Australia's policy experience was not too different from those other countries, with sectional interests trumping the public interest, turning bad policies into good politics. (Keating's famous remark about the 'banana republic' resonated so strongly for a reason!)

The transformation of Australia's economic performance from the 1980s did not occur by accident or good luck. It involved a deliberate strategy based on an understanding by political leaders that good process, sound public administration and effective political advocacy were essential in making a case for reform that would gain broad support.

These pre-requisites for good policy -- and its acceptance as such -- have been manifestly lacking more recently and the public's trust in government, any government, has sunk to all-time lows. For example, only 31 per cent of 6000 respondents to the respected 'Mapping Social Cohesion' Survey last year agreed that one could 'trust government to do the right thing most of the time'. And in a separate and earlier poll, 62 per cent of respondents said they 'would not trust government to manage tax reform'.

A loss of public trust in government is hardly surprising when citizens have witnessed major policy initiatives appearing out of the blue, programs announced before they are agreed (or even fully thought through), key stakeholders not being consulted, and reversals to previous policy positions occurring without justification or explanation.

Seeking causes

So why has this happened? More importantly, what can be done about it? One thing seems certain, maintaining the current policy trajectory is not an option; at least not if we wish to sustain high living standards for our burgeoning and ageing population.

It is becoming commonplace to lay blame for policy dysfunction on the advent of the new media, with its pursuit of around-the-clock ‘content’, its love of conflict and its intolerance of deliberation and delay. One can readily see how it has contributed to the greater emphasis on ‘spin’, on tactics over strategy, and the short term over the long term.

It seems also to have contributed to the new ‘oppositionist’ politics, in which any initiative by an incumbent government is steadfastly opposed as a matter of course, almost regardless of merit. Points of agreement with one’s political adversaries can expect no media coverage, while opposing claims not only get an airing, they face little risk of detailed scrutiny, no matter how fallacious.

Oppositionism has been compounded by the rise of a new breed of independents in the Australian Senate, who revel in the chance to shape policy rather than merely review it, but have demonstrated little capacity for comprehending where the national (or even state) interest truly lies.

Worrying trends within executive government

However there are other developments within government itself, which in my view have weakened its capacity to handle these challenges.

Ministerial staffers have traditionally played a key role in turning good policy into good politics, with experts from each domain playing a part. But offices have become increasingly populated by young people with political career aspirations of their own and a concern mainly with ‘issues management’. The displacement of policy grunt with tactical flair has unfortunately coincided with this youthful cohort having a bigger say in what passes for policy development itself. (This is brilliantly lampooned in the two ABC TV series, *The Hollowmen* and *Utopia*, which to government insiders often seem more like documentaries than fictional comedy.)

At the same time, the ability of the public service to hold its own by ensuring, in time-honoured fashion, that political decisions can be adequately informed by analysis and evidence, has been seriously eroded. Systemic changes to enhance the 'responsiveness' of the bureaucracy to the government of the day have succeeded all too well in many cases. Politically aligned appointments and tenuous tenure seem to have taken their toll on the 'free and frank' advice that governments (and the public) need, as opposed to the advice that a particular Minister or Leader may want. This has been compounded by a serious loss of analytical firepower in departmental ranks, to the point where even the ability to quality-control the offerings of the ubiquitous consulting firms is often lacking.

A former federal minister once disarmingly declared in humorous fashion to a large assembly of public servants *'when we make our own mistakes, we need them to be well-informed'*. This seemed to me at the time a perfect encapsulation of the relationship between minister and public servant, and it still does. That it is no longer happening to the extent it should has heightened the political proclivity for policy error, especially under pressure from vocal interest groups or social media. Recent independent reviews of the Pink Batts, NBN and East West Link misadventures, have all found the public service missing in action (or worse). I would suggest that the environment policy failures behind the energy crisis constitute another example.

A new to do list?

In short, while reform has no doubt become more challenging today compared to the 'reform era', recent experience has convinced me that the capacity of government to prosecute it has actually declined. Restoring the core capabilities of the public service and establishing a more productive relationship between office and department are in my view preconditions for getting policy back on track.

So I will end this oration with a few items from a new ‘to do’ list to that end.

For a start, Ministers need to authorize (or re-authorize) public servants to provide the comprehensive advice needed for properly informed decisions. Recent history tells us that failure to appreciate the trade-offs inherent in different policy choices can yield unintended consequences in political as well as policy terms. (Arguably more than one leader has lost office as a result.) It would also help if every ministerial office had at least one senior staffer with strong policy credentials and some experience of government. And the reliance on focus groups to identify and test policy ideas needs to be abandoned in favour of broad and transparent consultation.

For their part, Departments need to re-establish a culture of ideas and respect for evidence. And they need to restore critical mass in policy analysis rather than contracting out their core business. They should also be more proactive in assessing issues and developing options, including by taking advantage of existing ‘due process’ provisions for screening regulatory proposals. Above all, they need to hone the neglected craft of ‘speaking truth to power’.

It all comes down to leadership

Well, despite my intention to speak about the economics of infrastructure I have ended up talking mainly about the politics that surround it. This is because I have become convinced that the biggest challenge we face in public policy today is no longer knowing what to do (which can be difficult enough), but how to get it done. The obstacles in contemporary politics and media have undoubtedly increased, but these are reflective of underlying changes in Australian society and are unlikely to change. The only path to the policy high ground lies within executive government itself, and the restoration of capabilities that served us so well in the past. I’m sure we’d all agree that this is ultimately a matter of leadership. But is that really too much to ask?

(ENDS)

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About Infrastructure Partnerships Australia

Infrastructure Partnerships Australia is an independent public policy think tank and executive network, focused on excellence in social and economic infrastructure. We bring together Australia’s major public and private infrastructure organisations, harnessing deep industry expertise and our policy expertise to shape government infrastructure policy toward the best possible economic and social outcomes.

The Annual Infrastructure Oration event brings together Australia’s leading stakeholders from the infrastructure sector to hear a keynote address tackling issues of major public policy. The event is attended by over 600 senior executives from the public and private sectors, with keynote addresses delivered by prominent politicians, public servants and business leaders.

The Annual Infrastructure Oration has previously been delivered by: Vince Graham, former CEO of Networks NSW and Railcorp (2016); Scott Charlton, CEO of Transurban (2015); The Hon. Mike Baird, Premier of NSW (2014); Tony Shepherd AO, President of the Business Council of Australia, Chairman of Transfield and Patron of Infrastructure Partnerships Australia (2013); Hamish Tyrwhitt, CEO of Leighton Holdings (2012); and Peter Brecht, Managing Director of Infrastructure at Lendlease (2011).