An open letter to Mr Barry O'Farrell, Premier of New South Wales.

Great transport infrastructure soon for less than $20 a year

by Ian Spring.

This is an outline of a Federal borrow and build program which, while keeping our debt to GDP ratio at its current very low level of 10%, would yield an ongoing $9 billion a year, enough for a 20 year fast track solution to our awful transport infrastructure problems.

The surprise is that the program would cost Australians only an average of $20 per year each in the first year, and an extra $20 for each subsequent year.

This contrasts sharply with current infrastructure funding proposals in New South Wales which involve job losses, ongoing heavy tolls, and the sell-off of state assets, but would generate only a fraction of the funds necessary to do the job effectively.

The NSW government should join with the other states to ask the Federal government to implement a federal borrow and build program along the lines outlined below.

Table 1: Borrowing and spending under the program ($billions).

Nominal dollars					Constant dollars	
Year ending June	GDP	Borrowing & Spending	Net debt	Net debt as % of GDP	Annual spending 2012 dollars	Sub-totals spending 2012 dollars
2012	1500	-	150	10	-	
2013	1590	9	159	10	9	
2014	1685	10	169	10	9	
2015	1786	10	179	10	9	
2016	1894	10	189	10	9	
2017	2007	10	200	10	9	45
2018	2127	12	212	10	10	
2019	2255	13	225	10	10	
2020	2391	14	234	10	11	
2021	2542	15	254	10	11	
2022	2686	15	269	10	11	99
2023	2847	15	284	10	11	
2024	3018	17	302	10	12	
2025	3199	18	320	10	12	
2026	3394	20	340	10	13	
2027	3595	21	360	10	13	160
2028	3810	21	381	10	13	
2029	4039	23	404	10	13	
2030	4281	24	428	10	14	
2031	4538	26	454	10	15	
2032	4811	27	481	10	15	230

HOW THE FEDERAL BORROW AND BUILD PROGRAM WOULD WORK

A risk free and virtually cost free solution for infrastructure? To understand how this would work we have to look at the numbers.

In slightly rounded figures, GDP to end June was $1500 billion, and grows in money terms at around 6% per annum, part real growth part inflation. Net federal government debt was $150 billion, 10% of GDP, a totally safe level.

My proposal is that rather than letting debt as a percentage of GDP run down as the economy grows, the Federal government should borrow enough each year to keep the debt/GDP ratio at 10%. Doing this would generate an ongoing $9 billion a year, which could be made available for spending on transport infrastructure - urban and non-urban, road and rail. See Table 1.

Alternatively, borrowing could be set at .6% of GDP each year, which would have much the same effect.

Interest on this new borrowing, at a maximum of say 5% p.a., would be $450 million for the first year. Spread across the population of 22 1/2 million people this amounts to just on $20 a head, and the program would cost $40 a head in the second year, with further similar annual increases thereafter.

These are gross costs. The net cost, after allowing for tax feedbacks from the boost to the economy that the new investments would bring, will be even less than this. In fact, in the longer term these tax feedbacks will come to more than cover interest costs.

While the interest payable under the program should be treated in the Federal budget as an expense, borrowing and spending activities should be hypothecated and kept off-budget. This would preserve a clear separation between recurrent revenue and expenditure, and borrowing based long-term capital investment.

A big proportion of the funds should be used for direct subsidies of 50% or more to PPPs, aimed at having tolls on new work at half commercial rates. The subsidy would give a good combination of cheap public funds and private project management skills.

This particular borrow and build program has been recommended because I judge transport infrastructure to be our worst national problem. Also, by keeping net debt below 10% of GDP this model will solve the infrastructure problem in a way that should be readily acceptable to the electorate.

The main shape of the proposal is that while GDP and debt go up each year, the debt/GDP ratio stays the same. (Less serious readers might call this the Magic Pudding theory of finance.)

BENEFITS ACROSS THE ECONOMY

Major new money available for infrastructure would mean quick pain-free progress towards fixing the perennial backlog in urgently needed national road and rail transport links.

Commuters would see improvements quickly, and get life changing relief within a decade. New urban road and rail would offer commuters good choices between these modes at reasonable prices, and would yield strong social and productivity benefits.

Table 2: Extra funds available to individual states ($ 2012 billions).

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	TOTAL
% of population	32	25	20	10	7	2	2	1	
First year 2012-13	3	2	2	1	1	0.2	0.2	0.1	9
Five years to 2017	14	11	9	4.5	3	1	1	0.5	45
Ten years to 2022	32	25	20	10	7	2	2	1	100
Fifteen years to 2027	51	40	32	16	11	3	3	2	160
Twenty years to 2032	74	58	46	23	16	5	5	2	230

Allowing for both direct and indirect jobs, and the leveraging of PPPs, the total boost to the economy could be up to $15 billion per annum - about 1% of GDP.

This would create many thousands of good quality long-term jobs, a big proportion of them in major centres of population.

Lifting the economy in this way will be very welcome at a time when we seem to be facing real prospects of a downturn.

The borrowing program will bring near immediate benefits to the federal budget from the income tax revenue coming from the incomes of those building the new works. This could amount to 10 - 20% of project costs. Once projects were operational, their boost to the economy would generate a permanent stream of 'tax dividends' - indexed for inflation.

The construction industry, currently facing savage reductions in public spending on infrastructure, would be an early beneficiary.

Within a few short years improved infrastructure would start to reduce transport costs, to lower retail prices, and to protect industry's international competitiveness.

Early on, while plans and acquisitions for the new wave of capital works were getting underway, strong funding could be directed to city, suburban and rural roads, to rail improvements, and to other shorter lead time projects.

Rating agencies would see implementation of the program as a plus for both state and Federal governments.

BIG IMPACT ON NSW

On a population basis NSW's share of the new funds would see $3 billion a year directed through the State government for transport infrastructure. See Table 2.

This would be enough to enable the most urgently needed road and rail links for Sydney to be completed within the next 10 years. Funds would certainly be available for the completion of WestConnex and the North West Rail Link within the first 5 to 10 years. Progress will be limited only by design and construction time.

The next stage, including the construction of a cross Sydney harbour rail link, should be completed very early in the second decade of the program. This new crossing would enable high quality passenger friendly to-and-through-central-Sydney urban rail across the system.

There would be ongoing funding available during this second decade to continue to strengthen the State's transport infrastructure. This may include high-speed Newcastle Sydney Wollongong rail, and maybe a start on high-speed interstate rail works. We would wish to extend the program well beyond 2032. We might make the Singapore standard our new benchmark?

FEDERAL FUNDING WOULD BE MUCH BETTER THAN CURRENT NSW IDEAS

The virtually cost free and worry free nature of the federal borrow and build program has been set out above.

By contrast, the current NSW funding proposals are a real Pandora's box, and would involve heavy costs, economic and social.

- The heavy cutting of public service jobs at the expense of education and health to set aside funds for infrastructure will no longer be necessary. The Federal program will solve the infrastructure problem.
- Tolls on new roads, and the reintroduction of tolls on existing roads where tolls have already been discontinued, would place an added burden on commuters and business. Tolls are additive, and toll fatigue is already a serious problem.
- So-called 'value capture' along the routes of new transport links is bad economics and bad politics. It would stifle development just where it is needed, and would be a nightmare to implement. It is a Mickey Mouse idea.
- Fully privately funded PPPs. As currently proposed by the state government would place a heavy burden on commuters and business. Private PPPs are likely to be under scaled, and would soon need expensive disruptive re-engineering.
- After so many recent failures the wholly private model is surely not a reliable option. Slicing and dicing tolls won't save the hip pocket.
- Suggestions for the possible sale of major utilities, water, electricity, lotteries et cetera involve regulatory difficulties and huge community backlash. Any higher prices to customers after sell-off would constitute a tax on consumers and industry.

Overall, current NSW proposals are unconvincing, and have met a sceptical public and media reaction.

A STEADY FEDERAL PROGRAM WOULD TAKE THE AD HOC OUT OF PLANNING

Guaranteed ongoing Federal funding would provide a much more secure basis for long-term planning and priority setting than the current, essentially fly by the seat of the pants, ideas being suggested in NSW.

The federal funding proposal where PPPs are subject to public tender and supported by at least 50% free subsidy from Federal funds, allocated through the states, would see reasonable tolls on well engineered full-sized new roads.

Cheaper road tolls and a big infusion of federal funds into urban rail would achieve the keenly sought planning objective of good balance between road and rail. Sydney's infrastructure would be brought up to an internationally competitive level within 20 years.

All states would enjoy similar benefits from the federal borrow and build program.

IF FEDERAL FUNDING IS SO EASY WHY HAVEN'T WE DONE IT BEFORE?

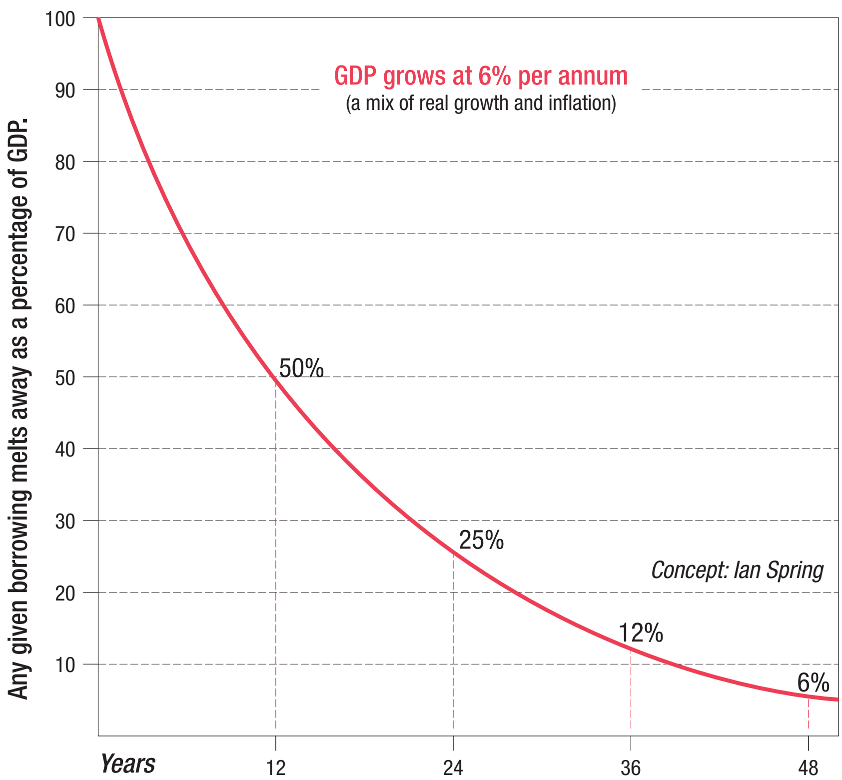
<u>The real maths of borrowing and spending are not well understood.</u>

- There seems to be little or no public recognition that it is the proportion of debt to GDP, rather than the level of debt, that is the measure of fiscal strength. Despite all the publicity about debt, this message is yet to be understood by the public: or for that matter by many economists and politicians.
- Also, there is essentially no understanding that GDP in money terms grows in normal years at around 6% per annum. This means that any given debt melts to half as a proportion of GDP in 12 years, and to a quarter in 24 years. (See Figure 1). Debt melting puts paid to the old furphy that debt is somehow permanent and must inevitably burden the next-generation.
- If the Federal government ever chose to discontinue the borrowing program, the debt would drop from 10% to 5% of GDP in 12 years. So much for any talk of being stuck with debt.
- Few seem to realise that it doesn't pay to repay government debt. Individuals have to repay debt because of their life cycle. Businesses and governments would rarely be well advised to pay down moderate levels of debt. At 10% of GDP our net government debt is not even moderate, it is miniscule.
- Any efforts to repay government debt would save only the difference between debt servicing costs and inflation. This difference would be around 2-3% per annum, a terrible return on taxpayers funds.
- The states do not have the right tax base to support major long-term capital expenditure. The primary mistake was made in 1942 when the Curtin Federal government took over income taxing powers, but left the states with primary responsibility for infrastructure. Since then there has been no direct income tax feedback available to states from the boost to the economy from major new infrastructure. This vertical fiscal imbalance has led to 70 years of underinvestment.
- Accounting practices have played a role in discouraging borrowing and building. Expenditure on long-term efficiency promoting infrastructure is treated in the federal budget in the same way as recurrent expenditures such as pensions and unemployment benefits - another disincentive to investment.
- Extra infrastructure spending of $10-$15 billion a year will have a negligible effect on interest rates when compared with the hundreds of billions of dollars of mining capital expenditure in the pipeline.

<u>Deeply ingrained community attitudes have discouraged borrowing.</u>

- For more than a generation Australians have had an exaggerated fear of Federal government debt.

Figure 1: How any given borrowing melts away as a percentage of GDP.



Recent world financial turbulence has strengthened these fears.

• Perhaps too, we haven't yet become accustomed to billions, which are the new millions: as they say.

• Government debt has suffered so much overexcited and irrational media and political comment that the possibilities inherent in new borrowing have received no attention.

• Also, there have been simplistic parallels suggested between the Australian economy and those of Europe. This is despite the fact that our circumstances, on budget sustainability, level of debt, and population growth are completely different from those of Europe. Where Europeans have to focus on cutbacks and stringency, our need is to strengthen the national economy.

FEDERAL ACTION IS THE ONLY WAY

States' borrowings have reached their limits, state and federal budgets are stretched, forward estimates for federal transport infrastructure spending are grim, and prospects for fully private PPPs. seem more and more doubtful.

Since much of our infrastructure problem is caused by Federal government policy sanctioning a huge growth in Australia's population, it is only reasonable that the Federal government should help the states cope with this influx. Without such Federal support the nation faces traffic gridlock in major cities, heavy burdens on commuters and industry, and further reductions in productivity.

In fact, I believe that Federal borrowing will be inevitable as soon as the benefits of such borrowing are widely understood. There are already signs of some movement in this direction.

Three top bank economists recently expressed strong views in favour of federal borrowing. An article in 'The Australian' of 11 October outlining their comments was, interestingly, headed "debt phobia 'hobbling chance to borrow and build'". Each of these economists had previously been sent copies of my earlier paper, "Federal funding will fix infrastructure". I believe it is no coincidence that the heading of the article echoes the name of my website.

The first political party to advance the idea of federal funding will face challenges, and will have to accept the responsibility of explaining the new policy to the electorate. Notwithstanding this, the first to put the Federal borrowing idea forward will get a big electoral boost.

By spreading the cost across the whole national community, rather than burdening the few, Federal borrowing is an effective, pain free way to solve our transport infrastructure problems. It is too good an opportunity to miss.

***Ian Spring**, BEc (Hons) Sydney, is a retired economist/business manager who has set out to encourage action to solve our infrastructure problems.*

E: ispring@bigpond.net.au

P: 02 97125339

W: borrowandbuild.com.au

THE NEXT STEP

New South Wales should seek the support of the other states in encouraging the Federal government to establish a twenty-year federal borrow and build program to fix our national transport infrastructure.