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Commentary
‘INVESTMENTS’ STAY HIDDEN FROM BUDGET BOTTOM LINE

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Murky infrastructure deals keep from view the government’s true financial health

The Turnbull government has been making some ambitious infrastructure announcements and, with the budget soon and an election within the next year, there will be more.

Consistent with Malcolm Turnbull’s contention that the commonwealth should not be “an ATM for the states”, the big promises of commonwealth support for rail links to Melbourne’s Tullamarine and the new western Sydney airports have been styled as joint ventures, ideally with some private sector involvement. There is an implicit assumption that the projects should deliver some return to the commonwealth.

Funding for Turnbull’s pet Snowy Hydro storage project, which is likely to be provided in the budget, will take the same form. Last year’s big budget commitments to the inland rail route from Melbourne to Brisbane, and the western Sydney airport were also styled as equity investments to deliver an eventual return.

The structure developed by the Rudd government for the National Broadband Network provides the template. Whereas grant funding — for example, the $1 billion commitment made two weeks ago by the Turnbull government to the M1 motorway in southeast Queensland — comes off the budget bottom line, investment funding does not. The idea is that the investment is building an asset of at least equivalent value.

The project nevertheless adds to public debt and the interest cost of that hits the budget bottom line. Estimates by the Parliamentary Budget Office show the interest cost on the debt used to finance the NBN will reach about $730 million next year and eventually will rise to an annual cost of more than $2bn within a decade.

Auditors allow this “off budget” treatment of infrastructure investments because it is assumed they will deliver a positive commercial return. If the government were putting money into an activity that was never expected to deliver a return, it would have to be counted as a budget cost.

Urban Infrastructure Minister Paul Fletcher argues that the budget treatment is not the motivation for the Turnbull government pursuing investments in preference to grants. Rather, he says it is about making the best use of the commonwealth’s money to shape cities, develop property and deliver overall economic benefits. As an equity partner, the commonwealth has clear legal rights. It is bringing out the investment banker in the Prime Minister.

The commonwealth does not have a fixed view of the structure to be used in the Tullamarine and western Sydney airport ventures. Turnbull’s letter to Victorian Premier Daniel Andrews, sent simultaneously with the leak of the commonwealth’s plans to Melbourne’s Herald Sun, says the commonwealth is committing up to $5bn “in equity or otherwise as agreed on the same basis as Victoria’s investment for a 50 per cent share of the project”. The commonwealth appears to be contemplating a stand-alone corporate venture with potential private partners to operate the line, distinct from Melbourne’s Metro Trains.

In the case of the western Sydney rail route, the commonwealth is discussing a “market sounding process” to test private sector interest in station developments.

Suburban rail is an improbable money-spinning venture. It is highly capital intensive and has always required large public subsidies. In NSW and Victoria, ticket sales cover less than 30 per cent of operating costs and make no contribution to capital costs. Most suburban rail networks around the world recover less than half their costs from fares. Turnbull has spoken of his admiration for the Hong Kong Metro, which covers its costs with ticket sales and adds a fat profit by selling off the property around stations for high-rise developments.

Hong Kong, of course, has unique advantages, with a large population in a small area. It houses almost 7000 people in every square kilometre compared with just 400 in Sydney. Air rights above underground stations are worth vastly more.

Still, new public transport investments generally will lift property values along the route, and there is scope for governments to recoup some of their investment.

The Turnbull government sees opportunities to develop a tract of defence land it owns in Bill Shorten's inner electorate of Maribyrnong and wants the Tullamarine rail line to run past it. Motivated more by regional development than inner-urban property sales, the Andrews government wants the route to go instead through the outer suburb of Sunshine as a hub to connect Tullamarine with regional rail lines.

There is abundant scope for arguments to run for years. Some contend it would be cheaper for the Victorian government to borrow the entirety of the cost than enter a joint venture requiring a return on investment to the commonwealth.

The biggest issue with the commonwealth's approach to infrastructure development is that it is taking on a series of commercial risks. The public sector's track record on profit-making ventures is mixed at best. The commonwealth will wind up with a portfolio of corporate infrastructure assets, presumably to be held by the Department of Finance and privatised to the extent possible.

The notion that these are profit-making investments remaining off-budget is preserved until they are sold. At that point, a profit or loss is crystallised on the public sector balance sheet, but still not incorporated in the annual budget surplus or deficit. There is no transparency in the budget statements about how these ventures are faring.

The test of a government's fiscal sustainability is its level of net debt. When the net debt cannot be rolled over or serviced, a country is in crisis. The annual budget surplus or deficit has value as an indicator of what is happening to a country's net debt.

As the government makes increased use of alternative financing mechanisms that do not appear in the annual cash balance, the budget is devalued as a guide to the government's financial health.

As an aside, the government last week jettisoned safeguards in the $5bn Northern Australia Infrastructure Facility that were designed by Treasury officials to ensure that it did not become a boondoggle for Nationals politicians, Northern Australia fantasists and sundry carpetbaggers.

The independent board remains intact, but provisions that its loans had to be matched by private lenders and that it could lend only to projects that would not otherwise get funding have gone. There are suggestions it may be allowed to advance equity.Taxpayers should worry about how their infrastructure dollars are being spent.

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