

# Discussion

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## 1. John Quiggin

I thank the organisers of this conference for inviting me to speak. Before addressing Clifford Winston's stimulating paper, I'd like to comment on the main graphic used for this conference, which shows the Sydney Harbour Bridge. The Bridge is a publicly owned project, constructed under a fixed-price contract and funded by a toll.

More interesting is the tunnel under the bridge, constructed as one of Australia's first build, own, operate and transfer projects. Although the tunnel is notionally private, the revenue flows from the tunnel are guaranteed by the NSW Government, which is therefore the residual income recipient and, in economic terms, the owner. The reason for this arrangement was to evade restrictions on public borrowing imposed at the time by the Loan Council.

The spurious idea that transferring infrastructure to the private sector gives government a 'magic pudding', from which to finance new investment, has been refuted many times, notably by several other speakers at this conference. Unfortunately, it has been repeated even more often, also notably by a number of speakers at this conference, including most of those actually involved in the policy process. The latest variant on this idea, outside the scope of my comments today, is the idea of 'capital recycling'.

Coming to Clifford Winston's paper, it may be divided into two parts: diagnosis and prescription.

The diagnostic element is a critique of US infrastructure policy and the debate surrounding it. Winston begins by disputing the standard view that investment in infrastructure is inadequate. Given the inefficiency with which public investment funds are allocated, and with which public infrastructure is used, Winston argues that it is impossible to determine whether too much or too little is being spent in aggregate.

As regards investment misallocation, Winston focuses on aspects of the US political process that lead to projects being allocated on spurious principles of equity, with the idea that each locality should get a share in every program, regardless of marginal benefit. In addition, there is the problem of influential politicians securing funds for vanity projects, such as the famous Alaskan 'bridge to nowhere'. These particular problems are less evident in the Australian system where political parties play a bigger role than influential individual politicians. However, we have our own problems, such as the largesse lavished on marginal seats.

Next, Winston considers problems with pricing. Infrastructure services are commonly underpriced or given away 'free', with the implied requirement for rationing. Where prices are charged, they are neither cost-reflective nor based on the kind of Ramsey pricing principles that would be recommended by economists.

Although Australia has probably made more progress in this respect than the United States, neither country has addressed the policy that would probably yield more benefits than any other

– that of congestion pricing for roads. It is striking that this issue is regarded as utterly untouchable by Australian politicians, even politicians who have been willing to commit political suicide in the pursuit of privatisation. For example, the Bligh Government in Queensland ruled out any consideration of congestion pricing when the topic was raised in the Henry Tax Review in 2010. Yet the same government went to a crushing defeat in 2012 on the issue of privatisation – a defeat predicted by years of devastating opinion polls.

It is true that congestion pricing is a controversial policy, and that the immediate reaction of the public is generally hostile. But this negative initial reaction does not, based on long experience, compare with the longstanding and remorseless public opposition to privatisation. In Australia, polls regularly record majorities of more than 70 per cent opposed to privatisation. It does not appear that the question has been asked in Australia, but polls taken in the United Kingdom show majority support for renationalisation of the water and railway industries, which have been privatised for decades.

The somewhat skewed views of political leaders may be explained by the company they keep. The small minority of the population who regularly drive into the CBD is heavily over-represented in the social circles surrounding politicians, as is the even smaller minority who benefit directly from privatisation as advisers, lobbyists, financiers and so on. So, perhaps it is unsurprising that political leaders delude themselves into thinking that privatisation is politically saleable and congestion pricing is not.

Winston's final concern relates to technology, and the failure of US transport authorities to embrace advances, some of which are already in use in Australia and elsewhere. Winston diagnoses ingrained risk aversion on the part of public sector employees, but this seems to be a cultural problem specific to the US Government.

Although it's possible to quibble about some of the details of Winston's diagnosis, few economists would disagree with its general tenor. Rational investment planning, cost-reflective pricing and openness to technological innovation all command fairly widespread support.

A decade or two ago, the same might have been said of the prescriptive component of the paper: privatisation. Even among sceptics, privatisation seemed to be the inevitable wave of the future.

Extensive, and largely disappointing, experience has changed the picture, to the point that Winston himself is ambivalent. As noted in the paper, '[p]olicymakers have privatised infrastructure in many parts of the world but the preliminary evidence on privatisation's economic effects is mixed' (p 168).

Whereas privatisation in one form or another seemed to be an inevitable trend in the 1990s, significant countercurrents have emerged in recent years. These include:

- renationalisation in instances of failed privatisation (Railtrack in the United Kingdom, NZ railways)
- new public enterprises undertaking responsibilities previously divested through privatisation (the National Broadband Network in Australia)
- reforms to public-private partnership (PPP) systems that reduce risk transfer to the private sector, and have coincided with a decline in the volume of PPP projects (Australia and United Kingdom).

What explains the disappointing outcomes of infrastructure privatisation, at least relative to the high hopes of the late 20th century? Winston's discussion of the problems of the existing system gives us a clue. There is a striking mismatch between the problems of the infrastructure sector and the strengths of private provision, as may be illustrated by Table 1.

**Table 1: Infrastructure Policy Needs Versus Private Sector Strengths**

<b>Policy needs</b>	<b>Private sector strengths</b>
Cost-reflective pricing	Profit-maximising prices
Efficient allocation of capital	Efficient management of labour
Process innovation	Product innovation

Table 1 may be explicated row by row. As already noted, existing infrastructure systems suffer from the absence of proper pricing, and from pricing that bears little relationship to the cost of provision.

It is certainly reasonable to anticipate that privatisation will lead to an increase in prices. However, the success of private infrastructure investment depends on the ability to find profit-maximising pricing structures, and these will rarely be cost-reflective. For example, Macquarie Bank, the leading player in this field, has succeeded largely by virtue of its success in overcoming resistance to unanticipated price increases, such as the large increase in monopoly parking charges imposed at Sydney Airport.

As regards operating efficiency, it is commonly argued that public sector infrastructure enterprises are overstaffed and suffer from restrictive work practices. Private sector operations typically display more managerial flexibility in these respects. However, labour costs usually make up a relatively small proportion of the total costs of infrastructure projects. The primary costs are associated with capital and here the case for privatisation is much less favourable. Not only is equity capital expensive but the long record of investment bubbles and busts, recently exemplified by the US dotcom bubble and the global financial crisis, suggest that private sector allocation of capital is far from optimal.

Finally, as regards innovation, the private sector is clearly superior in identifying and addressing unmet consumer demands, even demands of which consumers are themselves unaware until new products and services are offered to them. On the other hand, there is little empirical evidence to suggest that the private sector does a better job in process innovations like those needed to improve infrastructure services.

Not only is most fundamental research undertaken within the public sector (broadly defined to include universities and publicly funded research institutes) but the same is true of critical technologies. Radar, satellites, GPS, the internet and the World Wide Web, critical to the innovations discussed by Winston, were all developed in, and first deployed by, the public sector.

To sum up, while the infrastructure sector has plenty of problems, there is no reason to think that privatisation is likely to provide a solution. Indeed, the observation of Kay and Thompson (1986),

nearly 30 years ago, that privatisation is 'a policy in search of a rationale' remains just as true today. I close with their observation that:

the reality behind the apparent multiplicity of objectives is not that the policy [privatisation] has a rather sophisticated rationale, but rather that it is lacking any clear analysis of purpose or effects; and hence any objective which seems achievable is seized as justification. (p 19)

## Reference

**Kay JA and DJ Thompson (1986)**, 'Privatisation: A Policy in Search of a Rationale', *The Economic Journal*, 96(381), pp 18–32.

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## 2. General Discussion

In response to a question, the discussion began with Clifford Winston commenting on possibly useful lessons from the US experience of privatisation. Dr Winston described concerns in the lead-up to the deregulation of US railroads (which are typically monopolies or duopolies) about potentially large increases in the price of rail services. However, surprisingly, prices of rail services fell after deregulation. Dr Winston argued that the reason for this was the development of a contract equilibrium, under which logistics firms would band together and negotiate freight charges with the railroad, thereby reducing the railroad operator's relative bargaining power. Dr Winston went on to suggest that contract negotiations could be useful in ensuring efficient pricing outcomes from future privatisation. For example, in the case of roads, third parties representing different subsets of road users (such as car drivers, truck drivers, etc) could negotiate prices with the road provider. Dr Winston claimed that a system of this kind would achieve welfare gains, as pricing would respond to the heterogeneous preferences of users. Dr Winston also commented on shortcomings in the allocation of government funds for infrastructure investment, arguing that the destination of these funds is often determined by lobbying rather than the efficient allocation of resources to projects that will have the greatest benefit. He suggested that privatisation could assist in efficient resource allocation, but went on to stress his belief that the most constructive way of improving infrastructure provision, specifically for transport, is by allowing and encouraging innovation by the modes.

Still on the topic of privatisation, one participant asked for Dr Winston's view on 'capital recycling', which has recently become more popular in Australia. The participant noted that, as well as providing efficiency benefits, privatisation also provides benefits to the public sector's balance sheet by effectively selling a fully operational piece of infrastructure and using the associated capital to finance further infrastructure investment. Dr Winston agreed that governments would be attracted to this idea. Another participant suggested that once demand risk has been resolved (which typically occurs relatively early on in a project's life), an infrastructure asset behaves like a government bond, in that it provides a long-term stream of relatively fixed income. The participant argued that if the shadow cost of government debt is high, it may make sense to sell this income stream and use the proceeds to pay off the government's debt obligations.

One participant commented on Dr Winston's observation that prices for the use of infrastructure in the United States have tended to be much lower than is economically efficient. The participant

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queried the extent to which economically efficient pricing structures could contribute to a closing of the perceived infrastructure investment gap. Dr Winston opined that an important purpose of infrastructure pricing is to provide guidance for efficient investment that is based on cost-benefit analysis. He also suggested that, although the improvement of pricing would do a lot to address inefficiency problems, a major improvement in pricing structures is unlikely to occur. Another participant questioned whether the use of high-occupancy-toll (HOT) lanes in the United States was an efficient way of dealing with the inability to adopt congestion pricing, or whether it was just another inefficient pricing mechanism. In response, Dr Winston stressed that one of the key lessons from the US experience of HOT lanes was that it revealed significant preference heterogeneity among road users – something that government regulation and current operation of infrastructure does not reveal. However, he was sceptical that efficiency gains will be realised using this type of pricing. Instead, he argued that improvements in infrastructure will be realised by modal innovations, specifically through automation (such as driverless cars). Dr Winston also posited that autonomous vehicles will be invaluable in dealing with ageing population problems, as the elderly will want to continue driving but may pose a danger to themselves and other road users.