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The Commonwealth Government's Role in Infrastructure Provision

This paper examines the rationale for Commonwealth government involvement in infrastructure provision, how it influences the provision of infrastructure, and trends in that influence. In particular, it seeks to delineate the role that the Commonwealth plays as distinct from that of State governments.

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Executive Summary

Investment in economic infrastructure (such as telecommunications and transport networks) and social infrastructure (for example, schools, hospitals and public housing) has a major bearing on the community's wellbeing. Commonwealth governments have an important influence on the provision of such infrastructure. This paper examines the rationale for Commonwealth involvement in infrastructure provision, how the Commonwealth affects the provision of infrastructure, and trends in that involvement. In particular, it seeks to delineate the role that the Commonwealth plays since there seems to be a tendency to identify the Commonwealth with infrastructure provision and hence to overstate its relative importance when, in fact, much of the responsibility for infrastructure provision lies with State and Territory governments, local government, and the private sector.

Governments seek to influence infrastructure investment for a number of reasons. First, governments want to ensure that infrastructure is adequate to meet demand and improve services. Private markets may not supply some goods such as street lighting so government provision may be necessary. Some services may provide benefits to society over and above those that accrue to the individual. These 'external benefits' or 'positive externalities' are often cited to justify spending on public education. Finally, the existence of 'natural monopoly'—that is, when the minimum efficient size of plant is so large relative to market size that the market can support only one supplier—may also warrant intervention.

Some of the influence that the Commonwealth exercises over infrastructure provision derives from its constitutional responsibility, for example, for telecommunications and postal services. However, the Commonwealth's influence extends beyond these functions because the Commonwealth has the financial capacity and power under section 96 of the Constitution to provide financial assistance to the States and Territories in areas traditionally their responsibility such as roads, health, and education. In practice, the following pattern of funding responsibilities has evolved.

Level of government	Economic infrastructure	Social infrastructure
Commonwealth	Aviation services (air navigation etc) Telecommunications Postal services National roads (shared) Local roads (shared) Railways (shared)	Tertiary education Public housing (shared) Health facilities (shared)
State	Roads (urban, rural, local) (shared) Railways (shared) Ports and sea navigation Aviation (some regional airports) Electricity supply	Educational institutions (primary, secondary and technical) (shared) Childcare facilities Community health services (base hospitals, small district hospitals,

Level of government	Economic infrastructure	Social infrastructure
	Dams, water and sewerage systems Public transport (train, bus)	and nursing homes) (shared) Public housing (shared) Sport, recreation and cultural facilities Libraries Public order and safety (courts, police stations, traffic signals etc)
Local	Roads (local) (shared) Sewerage treatment, water and drainage supply Aviation (local airports) Electricity supply Public transport (bus)	Childcare centres Libraries Community centres and nursing homes Recreation facilities, parks and open spaces

The Commonwealth influences the provision of infrastructure in three main ways:

- investment by government business enterprises (GBEs) and agencies
- by providing funds to the States and Territories in the form of specific purpose payments, and
- through the formulation of 'framework policies' such as taxation provisions and National Competition Policy.

In the early 1990s, the Commonwealth accounted for about one quarter of public infrastructure. This was provided mainly directly by GBEs. However, with privatisation, a trend since late in the 1980s has been for the relative importance of GBE investment to fall. This trend has slowed as the pace of privatisation has slowed. Of the remaining GBEs, Telstra and Australia Post account for the bulk of the flows and stock of investment.

The Commonwealth is a major source of infrastructure funds for the States and Territories. These funds are paid as specific purpose payments for capital purposes. In 2002–03, for example, these payments amounted to more than $2.5 billion. The largest items funded were road programs ($977 million), public housing ($824 million) and government schools ($265 million).

Another trend is that the Commonwealth is increasingly influencing infrastructure provision through 'framework policies'. They are the regulations, legislation and other policies that set the parameters within which other governments and the private sector make investment decisions. Examples are the 'infrastructure provisions' of the *Income Tax Assessment Act 1936*, National Competition Policy, and involvement in setting strategic directions for industries such as water and energy. The Commonwealth's actions and statements of intent affect the direction and strategies that other levels of government and the private sector take with respect to their provision of infrastructure even though no Commonwealth funding may be involved.

Introduction

The level of investment in infrastructure, its productivity and the purposes for which infrastructure is used have a major influence on the community's wellbeing. As used in this paper, infrastructure refers to *economic* infrastructure (physical facilities such as telecommunications and transport networks) and *social* infrastructure (schools, hospitals, public housing, museums etc).[1] Commonwealth governments have an important influence on the provision of infrastructure. This is evident in the National Commission of Audit's finding that, in the early 1990s, the Commonwealth accounted for about one quarter of the stock of public infrastructure, and that Commonwealth investment flows accounted for around 1.6 to 1.4 per cent of gross domestic product in the 1960s to the first half of the 1990s.[2]

This paper examines the rationale for Commonwealth involvement in infrastructure provision, how the Commonwealth affects the provision of infrastructure, and trends in that involvement. In particular, it seeks to delineate the role that the Commonwealth plays since there seems to be a tendency to identify the Commonwealth with infrastructure provision and hence to overstate its relative importance when, in fact, much of the responsibility for infrastructure provision lies with State and Territory governments, local government, and the private sector.

Investment Concepts

Before examining these matters, it is important to clarify exactly what the term 'investment' means.

Investment in physical infrastructure is often called 'real' investment as distinct from 'financial' investment (see below). *Real* investment is the process of adding to productive, tangible assets. When used in this sense, investment is a *flow*, that is, investment over a period of time. Investment flows are measured in gross and net terms. *Gross* fixed investment is spending on new capital equipment, while *net* investment is gross fixed investment less an allowance for wear and tear on assets. The *stock* of investment, on the other hand, refers to holdings of assets at a point in time. In the Budget papers, the stock of real investment is shown under the heading of 'non-financial assets'. Note that not all investment in non-financial assets is in infrastructure. For example, additions to stocks of goods, for example, by their nature are not considered infrastructure investment. Similarly, the purchase of land *per se* is not included in net capital investment since this merely entails a transfer of ownership. Land improvements, on the other hand, would generally be considered to be infrastructure investment.

The second broad concept of investment—and one that more closely accords with everyday usage—is *financial* investment. This is investment in financial assets such as cash, deposits, loans, investments in share and bonds, and financial derivatives. The Commonwealth's equity in Telstra is an example.[3]

Rationale for Government Involvement

There are several reasons governments seek to influence investment in infrastructure.

First, infrastructure investment directly affects the level of economic activity, and governments have, under the influence of Keynesian ideas, increased infrastructure spending to stimulate the economy. Second, governments seek to ensure that the stock of infrastructure is adequate to deal with the demands of users, and that investment is in activities that improve living standards and services.

There are other reasons governments become involved in infrastructure provision. The main *economic* justification for government involvement is 'market failure'. This is the unwillingness or inability of private markets to supply some goods and services or supply them at socially desirable levels, that is, where private markets 'undersupply' the good. Market failure can take several forms. Markets do not supply 'public goods' such as defence or street lighting. A characteristic of public goods is that their provision for one person cannot exclude others from consuming it. Markets do not provide such goods because private suppliers cannot charge consumers for their use of the good.

Government provision of goods may be justified on the grounds that they yield 'external benefits' or 'positive externalities'. They are benefits to society over and above those that accrue to the individual.[4] For example, external benefits are often cited as justification for spending on public education, the argument being that people may ignore the broader return to society of such investment in 'human capital' and therefore 'underconsume' education. Conversely, 'negative' externalities such as air and noise pollution may provide grounds for government intervention to reduce their incidence.

The existence of 'natural monopoly' is another possible justification for government involvement. A natural monopoly exists when the minimum efficient size of plant is so large relative to market size that the market can support only one supplier. A profit-maximising natural monopolist would 'undersupply' the good and charge prices higher than in competitive markets. There are two main approaches to dealing with the potential problems of natural monopoly. The first, government ownership, has been used to supply telecommunications, postal services, airports, electricity generation and transmission etc.[5] An alternative to government ownership is private sector ownership with regulation of prices and anti-competitive practices. The United States, for example, uses this model for some telecommunications services.

Sources of Authority for Commonwealth Involvement

The Constitution does not, in general, allocate specific powers between the Commonwealth and the States. Instead, it specifies areas in which the Commonwealth may legislate. With few exceptions, the Commonwealth's powers are concurrent with those of the States, that is, the States have as much right to legislate in those areas as the Commonwealth. But by virtue of section 109, the Commonwealth has 'paramountcy', that is, where Commonwealth and State laws conflict or are inconsistent, a valid Commonwealth law prevails to the extent of the inconsistency.

The major areas in which the Commonwealth can legislate are set out in sections 51, 52 and 96 of the Constitution. Section 51 sets out the legislative powers of the Commonwealth Parliament while section 52 deals with the exclusive powers of the Parliament. The most important areas include interstate and international trade and commerce, taxation, defence, social security, foreign affairs, immigration, banking and finance, corporations, telecommunications, marriage, and the power to make financial grants to the States. The areas in which the Commonwealth has exclusive or largely exclusive powers are the imposition of duties of customs and excise, the payment of bounties (subsidies), defence, currency and the making of laws with respect to the seat of government and Commonwealth places such as Commonwealth airports.

The Commonwealth has no constitutional power to legislate in a number of important areas. For example, apart from the provision of medical and sickness benefits and its quarantine powers, the Commonwealth has few direct powers to make laws in respect of health, although many heads of power support laws relating to health matters, for example, trade and commerce, and tariffs on imports. Similarly, the Commonwealth has very little direct power to legislate for education.

The Constitution does not explicitly recognise local governments, which are established under State legislation. The Commonwealth generally treats local government as an extension of the States.

Actual Exercise of Commonwealth Powers

In practice, however, the Commonwealth plays a major role in areas that have traditionally been State responsibilities. The actual power that the Commonwealth exercises thus extends beyond the functions for which it is constitutionally responsible such as telecommunications and postal services. The two main reasons for this are its financial capacity, and its constitutional power to provide financial assistance to the States.[6]

A feature of the current federal system is the large imbalance between the financial resources available to the two tiers of government and their respective expenditure responsibilities, that is, 'vertical fiscal imbalance'.[7] To offset the imbalance between State spending responsibilities and revenue-raising ability, the Commonwealth provides financial assistance in the forms of general revenue assistance—mainly revenue from the goods and services tax—and specific purpose payments. Section 96 of the Constitution allows the Commonwealth to provide financial assistance to the States on whatever terms and conditions the Federal Parliament may specify, and specific purpose payments are generally made under this section. The Commonwealth uses its financial might and section 96 to fund functions that would otherwise be considered State responsibilities such as hospitals, schools, roads, public housing, and local government. In practice, therefore, a *de facto* pattern of responsibility for funding infrastructure provision has evolved as shown in Table 1.

Table 1: Division of responsibility for infrastructure funding among the tiers of government

Level of government	Economic infrastructure	Social infrastructure
Commonwealth	Aviation services (air navigation etc) Telecommunications Postal services National roads (shared) Local roads (shared) Railways (shared)	Tertiary education Public housing (shared) Health facilities (shared)
State	Roads (urban, rural, local) (shared) Railways (shared) Ports and sea navigation Aviation (some regional airports) Electricity supply Dams, water and sewerage systems Public transport (train, bus)	Educational institutions (primary, secondary and technical) (shared) Childcare facilities Community health services (base hospitals, small district hospitals, and nursing homes) (shared) Public housing (shared) Sport, recreation and cultural facilities Libraries Public order and safety (courts, police stations, traffic signals etc)
Local	Roads (local) (shared) Sewerage treatment, water and drainage supply Aviation (local airports) Electricity supply Public transport (bus)	Childcare centres Libraries Community centres and nursing homes Recreation facilities, parks and open spaces

Source: Adapted and updated from: Industry Commission, *Impediments to Regional Industry Adjustment*, Report No. 35, December 1993, pp. 227–8.

How Does the Commonwealth Influence the Provision of Infrastructure?

Commonwealth governments influence the provision of infrastructure investment in three main ways:

- investment by government business enterprises (GBEs) and by departments and agencies
- by funding infrastructure through specific purpose payments to the States, and
- through the formulation of 'framework' policies.

Commonwealth Investment

Government Business Enterprises

The main avenue for direct Commonwealth provision of economic infrastructure has traditionally been GBEs. They are authorities or companies listed in regulations made under the *Commonwealth Authorities and Companies Act 1997*. Box 1 shows current GBEs.

Box 1: Commonwealth Government Business Enterprises

Australian Government Solicitor
Australian Postal Corporation
Australian Rail Track Corporation Limited
Australian Technology Group Limited
Defence Housing Authority
Health Services Australia Limited
Medibank Private Limited
Telstra Corporation Limited

In addition, two entities—Airservices Australia[8] and the Australian Submarine Corporation—although not prescribed as GBEs, are treated as such.

Telstra and Australia Post account for the bulk of GBE investment. Telstra accounts for the bulk of the flows of investment in infrastructure as well as the stock of infrastructure assets. Australia Post is the second largest GBE as measured by total assets. Other GBEs such as the Defence Housing Authority also have considerable assets. Privatisation has led to a fall in the number of GBEs. At the end of the 1980s, there were 20 major Commonwealth GBEs.[9] Table 2 shows the privatised GBEs that were major infrastructure providers.

Table 2: Major GBEs infrastructure providers that have been privatised

Date	Enterprise	Sale proceeds ($m)
December 1991	Aussat	800.0
September 1992	Australian Airlines	400.0
March 1993	25% of Qantas	665.0
June 1994	Moomba-Sydney Pipeline System	534.0
July 1995	Qantas public share offer	1450.0
May 1997	Phase 1 airports (Melbourne, Brisbane, Perth)	3337.0
November 1997	Telstra 1	14 200.0 plus $3 billion from retained earnings
November 1997	Australian National Railways Commission	95.4
April 1998	Phase 2 airports (Adelaide; Alice Springs; Canberra; Coolangatta; Darwin; Hobart; Launceston; Mt Isa; Parafield; Tennant Creek; and Townsville; Archerfield; Jandakot and Moorabbin)	730.8
December 1998-May 1999	Australian River Co (formerly ANL Limited)	20.7
October 1999	Telstra 2	16 000.0
February 2002	Combined sale of National Rail Corporation Ltd and NSW's Freight Rail Corporation	220.0
June 2002	Kingsford Smith Airport	4233.0

Source: Department of Finance and Administration website. Accessed 20 February 2004.

GBE investment serves multiple purposes. Some investment is for the commercial sale of goods and services. In this case, investment decisions are made primarily on the basis of their expected commercial viability and rate of return. Other investment serves a mix of commercial and policy purposes. For example, Telstra supplies telecommunications services on a commercial basis but also has to undertake community service obligations even though the Commonwealth does not fund these obligations.

Departments and Agencies

General government departments and agencies also invest in infrastructure.[10] Agencies provide non-market public services and are funded mainly by taxes. Agency investment can be for commercial purposes but is often primarily to serve policy objectives. Agencies invest in buildings, plant and equipment and 'other' infrastructure such as information technology networks. The flows of investment are relatively small and have been negative since 1999–2000 as shown in Table 3.[11]

Table 3: Commonwealth general government net capital investment ($ million)

1996–97	1997–98	1998–99	1999–00	2000–01	2001–2	2002–03	2003–04
90	147	1433	-1225	-1168	-369	-235	-417

Source: Budget Paper No. 1 2003–04, p. 13-7. Data for 2002–03 and 2003–04 estimated.

Agencies fund investment from internal and external sources. Internal sources include cash from operations, asset sales and depreciation provisions. Sources of external funds are capital appropriations[12] including equity injections[13] and loans. Internally-generated funds are the main source of finance for agencies' capital expenditure in the general government sector[14] and the Government has moved to have agencies fund an increased proportion of capital expenditure from internal resources.[15] Under accrual budgeting, agencies are funded for all expenses including asset depreciation.

The reasons agencies invest in infrastructure are varied. For example, the replacement nuclear research reactor at Lucas Heights will provide research facilities and produce isotopes with medical, industrial and environmental applications. In 2002–03, policy decisions included $67 million for the Sydney Harbour Federation Trust for property remediation and other works; $121 million for Centrelink to buy hardware and develop software; and $48 million for a Bureau of Meteorology asset replacement program.[16] Table 4 shows the areas in which agencies have invested in recent years.

Table 4: Commonwealth general government net capital investment by function ($m)

Function	2000–01	2001–02	2002–03	2003–04
General public services	-82	-258	118	171
Defence	325	-41	-555	-455
Public order and safety	26	44	107	56
Education	-3	13	4	2
Health	20	20	23	30
Social security and welfare	50	49	78	23
Housing and community amenities	-119	-274	-190	-68
Recreation and culture	-64	-33	-4	11
Fuel and energy	2	13	1	0
Agriculture, forestry and fishing	-1	2	0	-1
Mining and mineral resources	31	5	10	2
Transport and communications	-1355	14	85	24
Other economic affairs	-10	93	83	23
Other purposes	12	-14	3	-236
Net capital investment	**-1168**	**-369**	**-235**	**-417**

Sources: Final Budget Outcome 2000–01 and 2001–02. Budget Paper No. 1 2003–04, p. 6-66. Data for 2002–03 and 2003–04 estimated. Data not available for earlier years.

Specific Purpose Payments

The second way the Commonwealth influences infrastructure provision is through specific purpose payments (SPPs) made to the States. Capital-purpose grants since 1995–96, classified by function, are shown in Table 5.

Table 5: Specific purpose payments for capital purposes ($'000)

Function	1995–96	1996–97	1997–98	1998–99	1999–00	2000–01	2001–02	2002–03	2003–04
Education	246 375	332 641	314 809	315 279	338 973	315 773	327 572	358 628	346 821
Health	5 158	5 443	7 119	7 933	7 957	16 966	17 887	8 937	0
Social security and welfare	56 814	54 446	50 136	46 376	40 506	43 058	43 716	41 569	44 035
Housing and community amenities	1 005 663	899 757	803 802	871 319	927 592	1 011 901	1 339 210	1 055 510	919 250
Recreation and culture	13 164	39 362	355	7 981	6 336	7 775	14 416	0	0
Fuel and energy	0	0	0	0	0	2 867	14 719	25 556	16 109
Agriculture, forestry and fishing	17 611	21 592	66 605	81 554	92 994	52 027	26 756	13 381	9 803
Transport and communication	833 940	837 174	853 667	915 173	916 473	883 741	1 328 286	1 040 967	1 015 550
Other economic affairs		1 642	4 436	0	0	0	0	0	0
Tourism	2 500	0	0	2 659	0	1 000	0	0	0
Other purposes	163 902	585 490	80 528	46 592	67 821	83 788	37 487	1 509	1 412
Total	**2 641 749**	**2 777 547**	**2 181 457**	**2 294 865**	**2 398 652**	**2 418 896**	**3 150 049**	**2 546 057**	**2 352 980**

Sources: Final Budget Outcome various years. Budget Paper No. 3 2003–04, p. 6-66. Data for 2003–04 estimated

Table 5 shows that the three largest functions are transport and communications, housing and community services, and education (see Box 2).

Box 2: Specific purpose payments for transport, housing and education

Transport and Communications: The main component of specific purpose payments under the transport and communications function is funding for road programs. The Commonwealth funds four programs: the national highway, roads of national importance, the black spots programme, and the roads to recovery programme. The Commonwealth, under the *Local Government (Financial Assistance) Act 1995*, also provides financial assistance to local government for roads. While, in principle, local governments can spend these 'identified road grants' for any purpose, in practice, they spend the grants on roads.

Housing and Community Amenities: The Commonwealth provides funds to the States primarily for the provision of public rental housing for low income households through the Commonwealth-State Housing Agreement.

Education: The Commonwealth provides assistance to State education authorities for the provision, maintenance and upgrading of government school facilities, which can include, amongst other things, land or building purchases, capital works or the provision of equipment. The Commonwealth also provides assistance to non-government schools and systems, as well as hostels for rural students, for the provision, maintenance and upgrading of school facilities, which can include, amongst other things, land or building purchases, capital works or the provision of equipment.

The Commonwealth provides capital payments directly to local governments. In recent years, payments have been mainly for aged care services and children's services. The 2003–04 Budget, for example, provides $4.213 million for aged care services and $388 000 for children's services.[17]

Framework Policies: Facilitating Infrastructure Investment

The third way the Commonwealth influences infrastructure provision is through what might be called 'framework' policies. They are the regulations, legislation and other policies that set the parameters within which other governments and the private sector make investment decisions. The Commonwealth's actions and statements of intent affect the direction and strategies that other levels of government and the private sector take with respect to their provision of infrastructure even though no Commonwealth funding may be involved. Examples of frameworks are the 'infrastructure provisions' of the *Income Tax Assessment Act 1936*, National Competition Policy, and involvement in setting strategic directions for industries such as water, energy, and airports (Box 3). The proposed National Land Transport Plan, AusLink, seeks to provide strategic direction to Commonwealth and other government and private sector investment in land transport infrastructure.

Box 3: Price regulation of airports

When the Government sold the leases of the major airports, it imposed price regulations—including price caps—on aeronautical services. The regulations took account of the need for airports to recover the cost of investment by 'cost pass-through' provisions for 'necessary new investment'. The Australian Competition and Consumer Commission (ACCC) was responsible for approving applications for pass-through price increases. The Government's decision to accept the Productivity Commission's recommendation that pricing regimes at major airports be liberalised has affected investment at these airports.[18] When the price caps were lifted, some airports increased aeronautical charges to finance major investment programs. The ACCC now monitors prices, costs and profits from the supply of aeronautical and aeronautical-related services at major airports.

Framework policies influence investment decisions in different ways. The infrastructure provisions of the *Income Tax Assessment Act 1936* directly influence private sector infrastructure decisions insofar as they contain incentives and disincentives to private sector investment. Unlike some States who have actively promoted public/private partnerships, the Commonwealth's facilitation of private sector investment has generally not taken the form of promotion of public/private partnerships.[19]Proposed taxation incentives to encourage private sector financing are set out in Appendix One.

Many framework policies influence investment indirectly. Such policies often operate through institutions whose function is to interpret and implement legislation. An example is the role of the National Competition Council in assessing the progress that State governments have made in implementing National Competition Policy reforms. These assessments form the basis of the Treasurer's decisions whether to make competition payments to the States (Box 4).

Box 4: National Competition Policy

National Competition Policy (NCP) reforms are designed to encourage competition. The reforms provide for:

- the extension of trade practices laws prohibiting anti-competitive activities (such as the abuse of market power and market-fixing) to all businesses (previously most government and some private businesses were exempt)
- the introduction of 'competitive neutrality' so that privately-owned businesses can compete with those owned by government on an equal footing
- the review and reform of all laws that restrict competition unless the benefits of the restriction to the community as a whole outweigh the costs
- the development of a 'national access regime' to enable businesses to use 'nationally significant' infrastructure (such as airports, electricity cables, gas pipelines and railway lines) which are owned by government and other businesses
- various specific reforms, including increases in competition in specific parts of the economy on which businesses rely such as the gas, electricity, water and road transport industries, and
- the extension of price monitoring to all government businesses that have a market monopoly.

The scope of National Competition Policy has been very wide-ranging. Further details are available on the National Competition Council's website.

Conclusions

Two major trends have emerged with respect to the Commonwealth's role in influencing infrastructure provision.

The first is the decline in the relative importance of direct provision of infrastructure through GBEs. Whereas in the past, the Commonwealth owned a range of GBEs, privatisation has reduced their number. This trend began late in the 1980s and gained momentum throughout the 1990s with the sale of major assets such as the leases on major airports and part of Telstra. This trend has slowed as the pace of privatisation has slowed. Still, Commonwealth governments have been generally reluctant to sell off infrastructure completely. For example, while the Howard Government wants to sell the remainder of Telstra, it retains ownership of part of the interstate rail network through the Australian Rail Track Corporation Limited and the capital city airports which are leased to private operators.

Even after privatisation, the Commonwealth plays an important role in the direct provision of infrastructure, notably through Telstra and Australia Post. In addition to providing commercial infrastructure, these GBEs are required to meet community service obligations. This requirement directly affects infrastructure investment in that some of the investment undertaken to meet these obligations would not be justified commercially and constitutes a subsidy to users.

The second trend is that the Commonwealth is increasingly influencing infrastructure provision through framework policies. In part this is a 'mathematical' consequence of its withdrawal from the direct provision of infrastructure through GBEs. But it also reflects decisions to become involved in setting frameworks for particular industries even though that may not involve Commonwealth funding. It should be noted that the trend for framework policies to become relatively more important is qualitatively different from the past when the Commonwealth became involved in influencing industry development through means such as tariff protection.

The transport sector reflects both trends (Box 5).

Box 5: Transport trends

Direct provision of infrastructure: The Commonwealth has generally moved away from the direct provision of infrastructure through ownership of transport GBEs. In the aviation industry, for example, the Commonwealth sold Qantas and the airports owned by the Federal Airports Corporation, and divested regional airports under the Aerodrome Local Ownership Plan. In the case of rail, the Government privatised Australian National, which operated interstate passenger services and some intrastate freight services, and National Rail which operated freight services. However, the Commonwealth owns part of the interstate rail network through the Australian Rail Track Corporation.

Framework policies: Before 1990, the Commonwealth regulated domestic aviation under the 'two airlines' policy. On 31 October 1990, the Commonwealth ceased economic regulation of the industry that took the forms of demand sharing, price regulation of fares and other means. In the case of rail, since the privatisation of Australian National and National Rail, the Commonwealth has been involved in the development of uniform operational requirements for the interstate rail network, a major issue for operators who face a range of inconsistent State regulations. The Commonwealth and the States, under the *Inter-Governmental Agreement for Rail Operational Uniformity* agreed to establish the Australian Rail Operations Unit to develop a National Code to standardise operations and other aspects on the 'interstate track'.

The Commonwealth will continue to be a source of infrastructure funding through specific purpose payments to the States both because the Commonwealth has the constitutional and financial power to do so and because successive Commonwealth governments have shown a willingness to intervene in areas that traditionally have been the preserve of the States.

Endnotes

1. A third category of 'infrastructure' is human capital, which refers to investment in people in the forms of education and general health programs.
2. National Commission of Audit, Report to the Commonwealth Government, June 1996, pp. 183–4.
3. The Budget treatment of the sale of financial assets is a matter of some interest. To simplify, the sale of a financial asset such as equity in Telstra initially affects only the general government balance sheet and the composition of financial assets. This is because the sale of equity entails the conversion of one form of financial asset, namely, equity investment into another, namely, cash. If the proceeds of the sale are used to reduce liabilities, there is no effect on net worth since the reduction in liabilities is matched by a reduction in cash holdings.
4. Goods possessing such characteristics are called merit goods.

5. Conversely, where governments supply infrastructure services in competitive or contestable markets, the case for public ownership is weakened.
6. The Commonwealth has other financial powers, namely, the appropriation powers under sections 81 and 83.
7. For a brief discussion, see 'HPublic Finance and Vertical Fiscal Imbalance'H, *Research Note*, no. 13, Parliamentary Library, 2002–03.
8. The Government has undertaken not to privatise Airservices Australia but proposes to convert it into a company registered under the Corporations law.
9. Bureau of Transport and Communications Economics, *Financial Performance of Government Business Enterprises in the Transport and Communications Portfolio 1977–78 to 1988–89*, Information Paper 35, 1990, p.69.
10. The general government sector comprises government departments and agencies that provide non-market public services and are funded through taxes. A list of general government agencies can be found in the notes to the annual Consolidated Financial Statements.
11. Negative investment indicates that depreciation exceeds the flow of new investment so that the stock of investment assets declines.
12. Not all capital appropriations are invested in non-financial assets. Such appropriations can also be used to reduce liabilities and fund one-off expenses such as agency restructuring.
13. Equity injections are a direct injection of cash into the agency. Loans are repayable with interest.
14. Budget Paper No. 1 1999–2000, p. 7–3.
15. ibid.
16. Budget Paper No. 1 2003–04, p. 6–65.
17. Budget Paper No. 3 2003–04, p. 73.
18. John Kain and Richard Webb, 'HTurbulent Times: Australian Airline Industry Issues 2003H', *Research Paper*, no. 10, Parliamentary Library, Canberra, 2003–04, pp. 29–30.
19. Richard Webb and Bernard Pulle, 'HPublic Private Partnerships: An IntroductionH', *Research Paper*, no. 1, Parliamentary Library, Canberra, 2002–03.

Appendix One

Taxation: Sections 51AD and Division 16D of the *Income Tax Assessment Act 1936*

The private sector sees taxation provisions—especially the so-called leasing sections—51AD and Division 16D—of the *Income Tax Assessment Act 1936* as barriers to greater private sector investment in infrastructure. In certain situations, these provisions deny to the private owner of an asset certain tax deductions related to the asset. The effect is to reduce the potential value of income from a project. In 1999, the Ralph Review of Business Taxation recommended that section 51AD be abolished and that Division 16D be replaced.

The Government has acknowledged these concerns. On 14 May 2002, the Minister for Revenue and Assistant Treasurer, Senator the Hon. Helen Coonan, announced that the Government would introduce legislation to replace these sections in the autumn 2003 Parliamentary sittings. The revised legislation is to be based on a risk test rather than the existing control test. However, the Government considers that the need remains to retain provisions similar to Division 16D on the grounds that public private partnerships and lease arrangements are tax-advantaged. The Minister for Revenue and Assistant Treasurer, Senator the Hon. Helen Coonan, in a speech on 21 March 2003, said that the Government would introduce changes to the tax exempt leasing arrangements that will encourage continued financing of essential infrastructure by the private sector.

New Business Tax System (Tax Preferred Entities—Asset Financing) Bill 2003

On 26 June 2003, the Minister announced the release, for comment, of the exposure draft of the Government's proposals. The draft Bill is titled the New Business Tax System (Tax Preferred Entities–Asset Financing) Bill 2003. The Government claims that the proposed amendments (Division 250) will:

- ensure that only taxpayers who have a sufficient level of risk in respect of assets under an arrangement with a tax-preferred entity will be entitled to capital allowances deductions
- ensure that capital allowance deductions are only available where a sufficient level of risk is allocated to, or is assumed by, the private sector
- restrict access to tax benefits to non-resident end users
- improve the notional loan tax treatment of arrangements between taxpayers and non-taxable entities, so that taxpayers will have greater certainty and neutrality as to the tax treatment of such arrangements, and
- provide sufficient protection for the revenue and more certainty and ease of compliance for taxpayers.