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## **Submission to the Senate inquiry into the management of Inland Rail**

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## Introduction

Inland Rail is a project with significant cost risks, and the financial arrangements for the project are such that the public may never know whether these risks eventuate.

This submission is about the financial arrangements of the project. It is made to the Senate Rural and Regional Affairs and Transport References Committee for its Inquiry into the management of the Inland Rail project by the Australian Rail Track Corporation and the Commonwealth Government.

The first section explains how Inland Rail is being funded. The second section explains the cost risks, and the third explains how this method of funding lacks transparency.

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## 1 How Inland Rail is being funded

The Commonwealth Government made an equity investment of \$600 million to the Australian Rail Track Corporation for Inland Rail in 2016-17.<sup>1</sup> It committed a further \$8.4 billion to the project in the 2017-18 Budget.<sup>2</sup>

This \$9 billion equity investment is not the usual form of transport infrastructure funding. Normally, the Commonwealth provides state governments with funding contributions towards particular projects in the form of tied grants.<sup>3</sup> State governments contribute as well, and the Commonwealth contribution is paid to the state as it attains specified milestones.

Equity investments and grant funding are treated differently in the Commonwealth budget. Grant funds to the states reduce the budget bottom line – the underlying cash balance – in the year that they are paid. But equity injections into Public Non-Financial Corporations (PNFCs) are treated as ‘off budget’. This means that the spending does not affect the government’s bottom line when the project is built, but

down the track through interest payments on debt, net of any dividends.

The Charter of Budget Honesty states that a new investment can only be treated as an off-budget equity injection if the government has a ‘reasonable expectation’ of recovery of the investment.<sup>4</sup> In other words, the entity must be expected to make a positive rate of return over time.

But the standards required by the Charter of Budget Honesty give governments lots of leeway. A positive rate of return is not the same as a commercial one. It’s no secret that the \$9 billion for Inland Rail will never be paid back, even when the revenues start to flow.<sup>5</sup> The project is feasible only with this substantial public funding contribution.

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<sup>1</sup> Treasury (2016). *Budget 2016-17: Budget Paper 2*, p171.

<sup>2</sup> Treasury (2017). *Budget 2017-18: Budget Paper 2*, p189.

<sup>3</sup> The Commonwealth has also contributed a tied grant to Inland Rail, of \$300 million (Treasury (2016). *Budget 2016-17: Budget Paper 2*, p171).

<sup>4</sup> *Charter of Budget Honesty Act 1998*.

<sup>5</sup> See, for example, Hansard (2018) House of Representatives Public Accounts and Audit Committee, February 16, p4.

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## 2 The cost risks of Inland Rail

The net benefits of Inland Rail, as assessed by Infrastructure Australia, are very marginal, with a benefit-cost ratio of 1.1:1.<sup>6</sup> In other words, the project proponent – the Australian Rail Track Corporation – expects that every dollar of public money spent will yield just \$1.10 of benefits, if all goes according to plan.

There are several reasons to doubt that all will go according to plan.

First, there is significant risk of a cost overrun. Cost overruns are more likely and larger on average for large and complex projects; every 10 per cent increase in a project's size is associated with a 6 per cent higher chance of an overrun.<sup>7</sup> Any overrun that occurs is likely to be 3 per cent larger, on average, for each 10 per cent increase in project size.<sup>8</sup>

Second, there appears to be insufficient provision for 'worst case' cost outcomes. The experience of the past 15 years has shown that the difference between the median, or 'P50' cost, and the 'worst case', or 'P90' cost, is 26 per cent, but

Inland Rail has provision for only 8 per cent above the median for 'worst case' costs.<sup>9</sup>

The 2017-18 Budget papers have a section on the risks of Inland Rail, pointing out that 'this project is sensitive to increases in project cost and lower revenues from users, which could decrease the returns on the government's investment in the project'.<sup>10</sup> The 2018-19 and 2019-20 Budget papers note these risks too.

The Auditor-General has criticised the Australian Rail Track Corporation for shortcomings in providing value for money in procurement activities.<sup>11</sup> Infrastructure Australia's endorsement of the project came with caveats and concerns about costs going up, benefits going down, and political risks.<sup>12</sup>

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<sup>6</sup> Infrastructure Australia (2016). *Project business case evaluation: Inland Rail*.

<sup>7</sup> Terrill, M. and Danks, L. (2016). *Cost overruns in transport infrastructure*, Grattan Institute, pp30-31.

<sup>8</sup> Terrill, M. and Danks, L. (2016). *Cost overruns in transport infrastructure*, Grattan Institute, p69.

<sup>9</sup> Terrill, M. and Danks, L. (2016) *Cost overruns in transport infrastructure*, Grattan Institute, p37.

<sup>10</sup> Treasury (2017). *Budget 2017-18: Budget Paper 1*, pp9-11.

<sup>11</sup> Australian National Audit Office (2017). *Management of the pre-construction phase of the Inland Rail programme*.

<sup>12</sup> Infrastructure Australia (2016). *Project business case evaluation: Inland Rail*.

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### 3 Implications of off-budget funding for transparency

If any of the cost risks materialise, the government may find itself in the position of writing down the fair value of Inland Rail.

If it does so, this will appear on the balance sheet as a change to the 'other economic flows', but it will not be separately identified. And the write-down will not show up in the underlying cash balance figure that the media highlights on budget night.

#### Conclusion

Putting the Inland Rail project off budget does not save taxpayers the cost of dubious decisions.

What it does is delay the time of reckoning. Equity injections into PNFCs are financed by government borrowing, with a corresponding interest bill on the stock of debt.

If Inland Rail ends up costing more or worth less than anticipated, future taxpayers will still be liable.