



## CEDA Research Program in 2009



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Review Staff of the Department of Prime Minister and Cabinet. Michael has a PhD from Stanford and taught at Yale (Irving Fisher Professor, 1978–79), Stanford, Monash and ANU. As founding Director of the Centre of Policy Studies, an early publication was *Telecommunications in Australia – Competition or Monopoly?* Michael also formed the Tasman Institute and was leader of Project Victoria, which prepared reform agendas on the reform and privatization of state owned enterprises in Victoria. Michael was Division Director, Infrastructure at Macquarie Bank from 2002–04, and chaired the Asia Pacific Infrastructure Forum in Melbourne in December 2004. One role included preparing an assessment of Asia's infrastructure situation for APEC leaders after the 1997 crisis, a report funded by the Asian Development Bank and delivered to the APEC Finance Ministers meeting in Kuala Lumpur 1999.

## CEDA Research in 2009

In 2009 Australia faces the most serious financial and economic challenges since CEDA was formed almost 50 years ago.

While CEDA forums will continue to traverse the full spectrum of topics, CEDA Research will focus on vital areas of economic and institutional reform where CEDA can make a difference.

With the appointment of Dr Michael Porter to the role of Director, CEDA Research, CEDA has also embarked on a plan to harness its convening power across the community, to advance needed reforms and to enhance its reputation as a credible participant in Australian public policy debate.

Project selection has involved consultation with CEDA members, as well as business, academic and community leaders. Each topic is an area with a need for independent debate and where there can be a major impact on Australia's economic and social wellbeing. The topics are outlined below in greater detail.

In addition CEDA will maintain a watching brief over other challenges in the context of the global financial crisis and its implications for Australia.

### Infrastructure

Transport problems in Sydney and Melbourne, bottlenecks at ports and terminals, plus new environmental demands of the water and energy sector, have combined to create a sense that Australian infrastructure has fallen well behind required standards. Australia has been a leader and even an exporter of innovative public-private partnership (PPP) models of infrastructure finance over the last two decades. For example, in Victoria substantial new investment in infrastructure is associated with a reduction in government debt.

Over the last 12 months this model has been challenged by events globally and domestically. With the emerging and severe domestic and international economic downturn, and high levels of unemployment, Keynesian-style arguments are re-emerging for public sector infrastructure spending as a way of moderating the slump.

Infrastructure will be a priority topic for CEDA Research, given the complexities, risks, and time delays that characterise sound infrastructure investment. The poorly-performing state of NSW exemplifies what happens (ie very little) when the planning, political and other processes become unpredictable. It is not possible to prepare PPPs to the standard required, and there is well-demonstrated scope for poor PPPs to fail, worsening debt situations and leaving the state exposed.

CEDA looks to participate in and facilitate policy and planning dialogues in the years ahead on infrastructure projects across Australia.

### Water: Establishing an institutional and structural framework

At CEDA's 2008 Big Issues Forum, water emerged as the first concern in relation to the current business and policy debate. The rational pricing and trading of water, and the institutional and governance arrangements that underpin such a market, are yet to be thought through by Australian governments at either a state or federal level. While billions of dollars are being spent on desalination plants and pipelines, the policy and regulatory framework is unclear and inconsistent across states.

Many necessary pricing, irrigation and other institutional reforms are lagging and CEDA believes a significant research contribution can be made to mapping the appropriate institutional frameworks for water catchment, conservation and trading, adapted to local needs and potential. There is a need to learn from better principles and practices across Australia and internationally, and to provide outcomes in keeping with water demands at appropriate price structures. In some states water catchments are not the problem – but the distribution and pricing of water leave much to be desired. In other states water grids are in development – aiming to mimic the efficient and effective distribution of electricity and gas.

### Australia's fiscal architecture

In 2009 the extraordinary run of financial failures, and a loss of liquidity and confidence arising from the global financial crisis, have quickly turned a surplus-oriented state and federal system on to a deficit path as the risks of demand plummeting sharply increase the chance of unemployment and associated spending pressures on governments. Whether infrastructure or other spending and tax cuts are best suited to address the situation has become a major issue. Meanwhile the government has set up the Henry Inquiry to conduct a 'root and branch' review of Australia's complex fiscal framework.

CEDA Research will look beyond the current economic and financial turmoil to consider a number of aspects to Australia's tax system, along with analysis of more effective and efficient options on the spending side. It will consider a tax package that is less distorting, enables tax returns to be optional for those with no foreign income, and subject to withholding taxation. Spending levels and service delivery innovations should effectively target need and disability, while

allowing a flatter marginal income tax rate for most people of around 25 to 30 per cent. Low, simplified and less distorting tax systems expand the income base and should not compromise the equity of the system. Ken Henry has made positive statements on these issues.<sup>1</sup> While CEDA will actively facilitate research and policy dialogue in this area, it will not engage actively in activity on tax reforms before the release of the Henry Inquiry.

CEDA Research also plans to explore improved delivery of public sector services, including efficient and fair financing models for service delivery of health, education and welfare. The need is for sound incentives on individuals, governments, agencies and service providers. One option is a HECS-style capital market approach to the provision of essential ability and disability services, where access to capital and the associated interest rates reflect well-administered means tests.

### The information economy

Sound and efficient information flows are at the heart of a functioning modern economy, and the new digital capacities and associated technologies are revolutionising the ease and effectiveness with which people can communicate, learn and function. New products and IT-strengthened business models abound, as do the chances to do most things better. The government is about to make decisions on a proposed government-assisted roll out of an optical fibre-to-the-node system – the FTTN network.

CEDA is advancing broader telecommunications options and strategies that will enable better outcomes from expanded use of fibre-based systems.

CEDA's report, *Growth 60: Australia's Broadband Future: Four doors to greater competition*, was released on 3 December 2008. It notes that information services (data, text, voice, video, or television including internet-based TV [IPTV]) can be delivered on existing technology through each of the 'four digital doors' of telecommunications infrastructure:

- copper telephone wires (ADSL2+ and VDSL)
- wireless (including 3G and 4G mobiles)
- cable (DOCSIS 3)
- fibre.

This can all be done at speeds meeting or (with cable) far exceeding the government's 12 Mbps target.

While fibre, like a Ferrari, may be the fastest option for some, the other technologies offer powerful channels as complements and competitors. All four classes of technology need to be factored in to different local situations (as Joshua Gans argues in chapter 3 of *Australia's Broadband Future*) before mandating a universal fibre rollout.

*Australia's Broadband Future* also questions the \$4.7billion taxpayer subsidy at a time of other fiscal challenges. While major spillover benefits from improved broadband could warrant subsidy – such as in telemedicine and remote education – most of the Australian community already has access to what can become quality broadband. This includes HFC cable and wireless – notably mobile 3G, emerging 4G, Wimax and hybrid systems. Remote communities are increasingly satisfied with 3G mobiles, and satellite systems in really problematic or remote locations. With 4G mobiles and application of DOCSIS 3 on cable, in tandem with other complementary innovations, service will get even better in the near future without the early rollout of fibre. While fibre is a superfast future channel, competition and cooperation across all four doors are the key. For almost all people the benefits of enhanced broadband systems now being implemented accrue throughout the community and generally will not require further subsidy.

CEDA Research noted that, "Policy and regulatory failure have characterised the telecommunications industry world wide over the last few decades – essentially because technology in computers, digital displays and sound have combined with wireless, wire and optical telecommunications technology to create unforeseeable, dramatic and yet beneficial change in media platforms and products."

Regulation must find a balance between competitive tension across and within telecommunications platforms, and incentives to invest in the needed infrastructure.

The alternative models need public debate to ensure the best policy framework is adopted. The CEDA report includes proposals that can assist the panel advising on the FTTN tender to recommend efficient pathways through these options, building on existing and competitive infrastructure and facilitating a more dynamic and innovative information sector in Australia.

### Climate change

An issue CEDA Research will continue to address in 2009 is the interplay of energy and greenhouse policies, including how they affect energy security. On the greenhouse policy front CEDA will publish *Growth 61: Climate Change – Towards Copenhagen* in May 2009, and is planning work around the issue of carbon capture and storage.

## Summary: 2009 – a new era

2009 is the start of a new era, as the global financial crisis has swept away many of the rosy expectations associated with the successful shift of economic systems in China, India and Eastern Europe. These expanding economies still lag behind western standards. As a result of these and other forces, the long-term future continues to be one in which the demand for Australian resources and expertise will be strong. What remains is the aftermath of poor financial regulation and management in the US, over-leveraged investment models, and a financial system where regulation has been well behind in comprehending many of the malpractices and excesses of the last two boom decades.

As noted in *The Economic Collapse We Did Not Have To Have*, an address to CEDA's Board of Governors<sup>2</sup>:

We are witnessing a financial collapse that started with a not so unusual downturn in housing in the US. The excess lending for sub-prime housing had followed a permissive post "dot com bust" expansion in housing finance underpinned by the Federal Reserve. Again, this was not so unusual and an outcome of political pushing of loans in the US as an egalitarian device. This activism was spurred on by the unusual economic boom since 1990 and associated confidence in an ongoing boom in part due to the end of collectivism and the surge of China and India and productivity increases due to the revolutions in IT.

What was and is unusual was the explosion – then implosion – of transactions deriving from the packaging of such loans, and in particular credit default swaps, CDS's. CDS are a form of insurance that allows for the transfer of credit risk without the transfer of an underlying asset. Because the word "swap" was used such transactions were free of regulation – something that was endorsed by Alan Greenspan, Chairman of the Federal Reserve – and adopted elsewhere.

The Bank for International Settlements reported the notional amount on outstanding credit default swaps to be \$42.6 trillion in June 2007, up from \$28.9 trillion in December 2006 (\$13.9 trillion in December 2005). By the end of 2007 there was an estimated \$45 trillion to \$62.2 trillion worth of credit default swap contracts outstanding worldwide.

The resulting collapse in these derivatives of housing finance involved counterparties including most key financial institutions across the globe. Sadly, financial derivatives and most of the swaps wizardry of the sector are not areas of expertise of most economics-trained central bankers, economic advisers to governments and well trained experts from the traditions of political economy, modern economics and central banking – back to Smith, Hume, Bagehot and even Keynes. Soros and Buffet were strong critics of such instruments – although evidently not strong enough to completely exclude such instruments from their own portfolios – or for them to successfully press for regulation.

Governments respond to well-informed and argued community debate. CEDA, through its extensive membership base and consistent with its founding principles, will take a lead on the major issues in that debate.

CEDA Research prepares well-informed, research-based publications that tap into the world's best thinkers and are focused on deliverable change.

CEDA events and publications reach tens of thousands of Australians each year. This 'reach' is unique among organisations involved in the public policy debate. CEDA's independence also provides it with the capacity to speak directly to government at a federal and state level, unhindered by vested interests.

### Endnotes

- 1 Australian Treasury, "Australia's Future Tax System, 10 December 2008, available at [http://taxreview.treasury.gov.au/content/ConsultationPaper.aspx?doc=html/Publications/Papers/Consultation\\_Paper\\_Summary/index.htm](http://taxreview.treasury.gov.au/content/ConsultationPaper.aspx?doc=html/Publications/Papers/Consultation_Paper_Summary/index.htm)
- 2 Dr Michael Porter, *The Economic Collapse We Did Not Have To Have*, Address to CEDA's Board of Governors, 27 October 2008. Available at: [http://ceda.com.au/public/research/financial\\_crisis/porter.html](http://ceda.com.au/public/research/financial_crisis/porter.html)

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