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5 October 2009

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Dear Mike

Infrastructure: Facts and Issues, Towards the First National Infrastructure Plan

Business New Zealand is pleased to have the opportunity to provide a submission to the National Infrastructure Unit on its document entitled 'Infrastructure: Facts and Issues, Towards the First National Infrastructure Plan' dated September 2009. [1]

Summary

Robust infrastructure is vital to the standard of living of all New Zealanders. This submission explains Business New Zealand's proposals for improving New Zealand's infrastructure planning framework. To this end, much of Business New Zealand's comments are less targeted at making suggestions or raising concerns with the 'Facts and Issues' document (though this is often implied), and more about setting out the expectations of Business New Zealand and its members of the Infrastructure Plan itself. In summary, these are for the Infrastructure Plan to:

1. focus on the economic characteristics of the types of infrastructure (i.e. are the outputs 'public' or 'private'). This will reveal the nature of the regulatory problems that are present;

2. understand the role of government in addressing the infrastructure-related regulatory problems. These will determine the set of 'tools' (regulation, procurement, ownership) available to influence or direct the level, quality (process, timeframe, physical characteristics) and cost of infrastructure development and the sectors they can be applied in;

[1] Background information on Business New Zealand is attached in Appendix One.

3. be clear about the Infrastructure Plan's goal(s) and what the future might look like. Use this to inform the resilience of the plan and to balance competing priorities. Having a view of the future implies the need to measure the contribution that the infrastructure spend is making towards it (e.g. is the electricity or transport infrastructure becoming more or less reliable as a result?); and

4. in setting actions, allow for product and capital market competition to flourish where possible. Markets generally provide an efficient means of harnessing widely dispersed information on consumers' preferences, and production costs.

Introduction

Business New Zealand welcomes the progress made on infrastructural planning issues. To date, the laissez-faire planning and implementation of infrastructural projects has let New Zealand's energy, transport and other infrastructure fall behind the demands being made upon it by our economic expansion and positioned us poorly, relative to our trade-competitors, to weather adverse economic conditions such as those we now face.

However, this does not mean that New Zealand should now lurch towards the development of an infrastructure central plan. In Business New Zealand's view, this has as many (if not more) pitfalls than no planning at all. Finding the right balance is the challenge for the Government and Treasury. Business New Zealand's submission seeks to assist in this regard.

Some Contextual Comments

Before moving into the substance of Business New Zealand's submission, it's useful, by way of scene-setting, to provide some contextual comments.[2]

For some time now, New Zealand has been out of step with other international jurisdictions who have seen the economic benefits that co-ordinated infrastructure planning can deliver. New Zealand's infrastructural development processes have been largely decentralised with minimal central co-ordination, direction or oversight, except through the annual budget process. This has inevitably resulted in disjointed infrastructural development and unsurprisingly, false-starts and wheel-spinning.[3]

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[2] Business New Zealand's responses to the specific questions posed in the 'Facts and Issues' document are attached to this letter as Appendix Two.

[3] One of the most tangible examples of a 'false-start' was the Department of Corrections failed attempt in the early 1990's to run a Design, Construct, Manage and Finance (a 'DCMF') tender process for the then new Mt Eden Remand Facility. This tender process was eventually terminated. While notable for a number of failings (prescriptive delivery detail, absence of a clear cost counterfactual, non-complying bids), the absence of a co-ordinated and well understood strategic cross-government approach to the involvement of the private sector in the development of infrastructure was one of its more notable.

Often a lack of clearly defined property rights for some resources has not helped in this regard. For example, resource consent delays and uncertainty of property rights in respect of water for large hydro-electricity generators.

A recent report by the World Economic Forum entitled 'The Global Enabling Trade Report, 2009' noted of New Zealand that

> "Upgrading the quality of infrastructure, especially roads and railroads, would be beneficial to further facilitate a smooth flow of goods both across borders and to destinations inside the country."

While New Zealand ranks 22nd out of 121 countries surveyed, its quality of roads ranks a more modest 45th.

However, it is important that this not be seen as the starting point for the Infrastructure Plan. There has, over the past year, been much to celebrate with respect to advances in infrastructure planning and implementation. Good progress has been made in removing unnecessary barriers to infrastructural development, not least of which is the increased political recognition of the strategic importance of quality economic and social infrastructure. These and other examples of good progress are:

1. the Broadband Investment Initiative and the Telecommunications Development Levy;
2. removal of the thermal electricity generation ban;
3. changes to the Government Policy Statement on electricity governance with a focus on transmission, and clear signals of further changes to come;
4. introduction of the Infrastructure Bill and its referral to Select Committee;
5. the first phase of changes to the Resource Management Act and commencement of phase two changes; and
6. improvements to Part 4 of the Commerce Act.

These moves signal a clear intention by Government to move in a co-ordinated and decisive manner on infrastructural issues. The 'Facts and Issues' document, and the forthcoming Infrastructure Plan, need to be seen against this increasingly positive backdrop.

Business New Zealand's Approach to Infrastructure Planning

Business New Zealand has the following thoughts with respect to the development of an Infrastructure Plan (and by implication the 'Facts and Issues' document):

1. the primary driver of the plan is about infrastructure as an enabler of economic development and the creation of wealth and prosperity for all New Zealanders. While this statement appears to be self-evident, it is not immediately obvious from the 'Facts and Issues' document. Of 380 paragraphs, a discussion about

infrastructure and growth is relegated to paragraphs 372 to 380. The Minister of Finance, however, appears more certain:

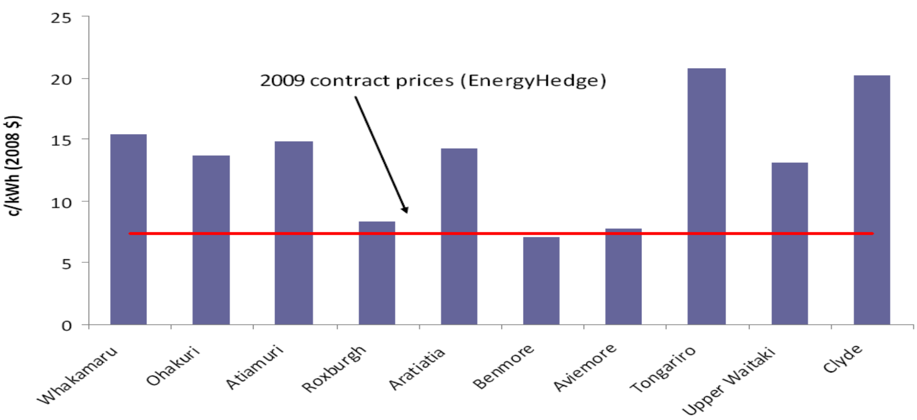
> "The Government was elected with a mandate to fix the infrastructure problems holding New Zealand back and to target projects that will help us build a higher performing economy,….."

and

> "The National Infrastructure Unit within the Treasury will ensure that the Government's infrastructure programme is both strategically sound and helps build a more competitive, more productive economy."[4]

In an infrastructural-sense, the approach taken will depend on whether you want to enable/facilitate higher growth or achieve a certain target (such as 5% growth). One implies the removal of bottlenecks whilst another is the identification of 'lead-projects'. Business New Zealand's view is that, in the first Infrastructure Plan at least, the emphasis should be on removing regulatory and governance bottlenecks and incentivising markets to efficiently allocate scare resources to those projects that are highest value/greatest contribution.

This would not preclude the government from using bureaucratic investment/procurement initiatives to 'lead' growth. But the risks associated with such an approach need to be well understood. This is no better demonstrated than in what was then characterised as the social or public infrastructure of the electricity sector, pre-market reforms. The figure below shows the estimated breakeven price, in current dollars, for a range of power stations constructed between 1950 and 1992. As the figure shows, most stations were so expensive to build that they would be unable to recover their full costs, even at today's much higher prices. The difference has been borne by the investors in those stations (in this case the taxpayer).



Source: Improving Electricity Market Performance, Appendix Two, page 58

[4] Minister of Finance press release entitled "Government invests in KiwiRail, sets up infrastructure unit", dated 2 March 2009.

2. Business New Zealand considers that the Infrastructure Plan should address the following four key questions:

   a. where do we want to be as an economy in 30 or 40 years time? Put simply, if you don't know where we would like to be as an economy and society, there is little chance of knowing what we need in terms of infrastructure, to get there, or knowing whether what you have done to the infrastructure stock has made a difference. There are two aspects to this:

      - the need for goals: this could be an economy-wide goal (the government has established a broad target of matching Australia's GDP per capita by 2025) and/or sector-specific (such as placing New Zealand in the top *x*% of OECD nations in digital connectivity). Irrespective of the type of goal, its presence implies the need to measure the particular infrastructure spend in terms of its contribution towards it. This, in turn, also implies the creation of a set of performance benchmarks (based, presumably, on the sectoral stocktake);[5] and

      - the need to test the plan's resilience: the process of scenario planning and testing resilience against a range of scenarios (usually three to four) is common business practice. This tool (or something similar) would be helpful in the context of the Infrastructure Plan. It would both provide guidance to the detail of the plan as well as provide a framework for changing the settings of the plan as more information about the range of future outcomes comes to hand;

   b. what do we need to do to the infrastructure stock to get 'there'? This is where the Infrastructure Plan must really bite. Business New Zealand suggests that the Infrastructure Plan could combine the sectoral stocktake with the economic analysis of the various types of infrastructure to develop an overarching policy framework for incentivising the appropriate type of infrastructure, at the right time, for the right cost. Some of this will involve ensuring that the regulatory settings for customer-driven investments, such as in the electricity market, are appropriate (making markets work more effectively). Other parts will involve improvements to bureaucratic, or non-market, governance, planning and/or procurement processes. Obviously, certainty of property rights will facilitate long-term investments;

[5] It is possible, of course, with population and economic growth that an increase in the level of infrastructure spend makes no tangible difference or contribution towards the stated goal (or, indeed, too much difference). Understanding this dynamic will provide policy makers with a powerful set of information on which better informed choices about which policy levers, and to what magnitude they should be adjusted. It is this dynamic that will drive the value contribution the Infrastructure Plan makes to the policy-making landscape.

c. how do we best deliver the required infrastructure? Having established what tools the government has at its disposal for the various sectors, this is a question best answered by ensuring rational investment and procurement decisions can occur. This is predominantly aimed at the delivery of social, or non-market initiated infrastructure. The range of mechanisms available is well known (traditional procurement through to public/private partnerships etc). However, a focus on lifting the performance of public sector procurement practices and long-term asset management is critical to improving the long-term incentives for the efficient delivery of future infrastructure. It would be helpful if the Infrastructure Plan articulated what is expected in this area; and

d. who pays? Ultimately this boils down to users or taxpayers. Where the infrastructure is taxpayer funded (irrespective of procurement method), projects will invariably need to be prioritised. The relationship between the proposal and the Infrastructure Plan's strategic goals becomes important. It will be important to the integrity of the Infrastructure Plan that it is not driven by fiscal constraint – at least in the first instance. Nor should it be seen as a lever to ratchet up spending on social infrastructure. This is because more spending, while possibly helpful, will not necessarily deliver more or better quality infrastructure. A good strategic understanding of what is wanted to be achieved should provide a discipline for this;

3. the Infrastructure Plan will contribute to the development of a more productive economy. A key element to this is the Infrastructure Plan delivering a consistent and coherent infrastructure development policy framework for business. There are two aspects to this:

   a. it should help inform investment decisions. Investors (particularly overseas investors) will look to the Infrastructure Plan to gain confidence that the expected pattern of future infrastructure development is robust relative to other jurisdictions. While judgement will inevitably be required by investors, they will look for the removal of uncertainty that arises from such factors as regulatory opportunism and the absence of policy stability. There is reference to the importance of this in the 'Facts and Issues' document; and

   b. it should allow businesses (from financial institutions to engineering firms and construction companies) to marshal their international and domestic resources more efficiently. Evidence of a 'deal-flow' or pipeline of projects in some sectors would be helpful. If business is expected to assist the government deliver the infrastructure, relatively clear messages signalling investment in capability and capacity development are required;

4. an Infrastructure Plan should be linked into strategies for skills availability and training and literacy. While not an integral part of the Infrastructure Plan *per*

se, a corollary to 3.b. above is that the government's strategic objectives for the education and training sectors and immigration are aligned with its infrastructure development goals;[6] and

5. the Infrastructure Plan has the ability to become a useful accountability tool. To be effective as a document, the Infrastructure Plan should become an important accountability mechanism against which the progress of government and officials relevant to the delivery of the strategic goals it contains, can be transparently measured. With respect to social, non-market infrastructure, the plan should be able to be used by stakeholders to hold government to account for the quality of its infrastructure spending decisions. However, depending on its final form, the risk exists that the Infrastructure Plan could become a tool for stripping away accountability from the relevant public sector agencies. A key element to the effectiveness of the Infrastructure Plan will be its ability to empower not neuter agencies. The latter should be avoided (unless actual performance warrants it). Existing public sector accountability mechanisms can be used to ensure that the relevant agencies are appropriately incentivised to have the right capacity and capability available to deliver high quality, cost effective infrastructure.

While a successful Infrastructure Plan will be one that addresses the questions posed above, Business New Zealand considers that there are a number of more generic 'touchstones' that are also relevant to the development of an Infrastructure Plan. These are (in no particular order):

a. *be clear about why a plan is being developed*: a plan to deliver on the Government's spending priorities is different to a plan that seeks to enunciate the framework within which a set of strategic goals can be achieved or a set of priorities and funding can be analysed. Business New Zealand seeks greater transparency regarding why it is important to "present a high-level view of the state of New Zealand's public infrastructure and to describe the principles and direction for future investment"?[7] In Business New Zealand's view, the purpose of an Infrastructure Plan is to:

    - be useful to investors (both infrastructure developers and users);

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[6] For example, previous experience among the business community suggests that one arm of government creates skill demands in the private sector (e.g. through increased spending on roading and other infrastructure) that are not adequately supported by the other arm through allocations to industry training (or the wider education and training system). This is further complicated as government determines (among a number of other things) the number of students funded through a particular tertiary education organisation (e.g. a university, polytechnic, private training establishment, or industry training organisation). Therefore, the ability of the Tertiary Education Commission (i.e. government) to link funding decisions to industry need in recent years has been hampered by inadequate funding mechanisms and a lack of clear results focused accountability. The quality of education and training provision has been, and continues to be, an ongoing concern for business. Care must be taken to ensure that skills provision is focused on quality (e.g. education and training that produces value for business and employees).

[7] Treasury document entitled 'Infrastructure: Facts and Issues, Towards the First National Infrastructure Plan, dated September 2009, page 1, paragraph 1.

- build consensus around policy pathways; and
- be used as a tool to prioritise across objectives (e.g. more investment or less debt);

b. *make the plan politically durable*: this is related to (a) above. A plan focused on delivering the priorities of the government of the day will overtly politicise the plan and reduce its usefulness.[8] By its very nature, this will require the plan to be high-level and policy-framework focused. Critically, it is important that the Infrastructure Plan not be a political document, but one that transcends politics and ideology;

c. *focus on why some markets deliver a socially optimal level of infrastructure while others might not*: what is it specifically about the economic characteristics of the infrastructural services delivered that make some infrastructure markets work, and others fail? This conversation would set the analytical frame for considering the appropriate form of government involvement by ownership, procurement or regulation of some infrastructural markets and not others;

d. *good governance matters*: good governance (both the specific nature of the arrangement and the commercial disciplines they provide) should not be separated from consideration of the efficient delivery of infrastructure. Governance arrangements affect the incentives of businesses to produce the outputs valued by customers and drive the pursuit of business scale and scope. In turn, the nature of the outputs can also influence preferred governance arrangements. A plan without consideration of governance is only half a plan. Figure 7 of the NZCID document (written in conjunction with KensingtonSwan) entitled 'Infrastructure development in comparative nations, insights for New Zealand' provides a great example of how local and regional governance over infrastructure of national significance should not arranged;

e. *sectoral analysis can only take you so far*: sectoral analysis is important to understand where we stand now (for example, in understanding situations of over or under-investment in various types of infrastructure) and therefore in setting performance benchmarks. More importantly, sectoral analysis should be used to inform the strategic goals and delivery tactics for the particular types of infrastructure (in other words, sectoral analysis should be used to inform whether what is being delivered is consistent with the overall desired direction or to inform the

[8] This is particularly important when considering practical implementation aspects of smarter procurement such as PPP's as the anticipated level of interest. Potential private sector participants will make assessments as to the level of sovereign risk (as reflected in policy changes) to factor into decisions on whether to participate at all, what risk premium to include in the price or how to structure their revenue stream.

nature of the changes to policy settings in aid of more efficient outcomes);

f. *'set and forget'*: a good plan should be robust in respect of economic circumstances. While it is not expected that the Infrastructure Plan once developed will then be set aside, the framework contained in the plan should be enduring. However, the expectation is that the Infrastructure Plan's time horizon should be regularly extended, the robustness of the policy framework tested, and required actions updated; and

g. *lists of projects should not dominate the plan*: if the framework, incentives and accountability settings contained in the Infrastructure Plan are correct, projects consistent with these settings (and any fiscal constraints) should naturally become evident. A step-change in the delivery of appropriate infrastructure implementation should then ensue. A failure of this occurrence would imply that the policy settings are incorrect. Lists of market-planned infrastructure investments should be left to market participants though lists of the social infrastructure projects that would be consistent with the planning framework would be informative.[9]

Some Specific Comments

In this section, Business New Zealand outlines some comments aimed at specific aspects of the 'Facts and Issues' document:

1. *the principles*: consistent with the views expressed above, these principles are, in Business New Zealand's view, the crux of the Infrastructure Plan, particularly principle 1 and we support them. Principle 1, if applied correctly, clarifies the role of markets versus government in the delivery of infrastructure.[10] All of the remaining principles (labelled 2a, 2b, 3, 4 and 5, though probably more accurately numbered 2a through 2e) essentially go on to specify in further detail, the criteria to be applied around the 'make or buy' decision should a market failure exist warranting government involvement to secure a socially optimal level of infrastructure. In Business New Zealand's view, the use of these criteria will lead to a more appropriate representation of the delivery of infrastructure than the table in paragraph 7 on page 3. For example, regulatory and governance barriers appear to dictate who owns and delivers water infrastructure, rather than its inherent economic characteristics (to this extent, the listing of 'metered water' under 'quasi-market' appears to be

[9] While not a primary driver of an Infrastructure Plan, the extent to which the Infrastructure Plan serves a 'prospectus'-type role, in terms of selling New Zealand investment opportunities should not be forgotten.

[10] Except to the extent of principle 1 b that implies that there is a role for Government to play in the ownership of monopoly services. This is only true to the extent that there is an associated market failure and even then, application of the competition policy regulatory framework may be preferable to ownership.

more an artefact of the status quo, than a reflection of the optimal framework for its delivery);

2. *the intermediate priorities*: more information is needed to understand how, tactically, the four immediate priorities listed fit within the broader strategic context. There is little doubt in the mind of Business New Zealand that they do, but it would be helpful to see that articulated in the plan. More specifically, the comment that they may help to "make markets" is informative, but not particularly useful as a defining feature. What would be more helpful is a clearer description of how these particular projects fit with the principles set out in 'Facts and Issues' document; and

3. *intermodal competition*: this is an important cross-sectoral issue that warrants more explicit consideration. Supply chain considerations are raised in the 'Facts and Issues' document in the context of ports, but Business New Zealand considers that issues of intermodal competition should be at the forefront of the Treasury's mind, particularly when considering investment in (or subsidies for) state-owned infrastructure companies such as KiwiRail. It is possible that maximising the efficiency of any specific part of the supply chain can reduce overall performance and the application of strong commercial disciplines need to underpin the future use of taxpayers' funds in Crown-owned businesses.

Summary

Business New Zealand welcomes the 'Facts and Issues' document as a useful contribution to the conversation about infrastructure planning. It acts as a helpful collection point, summarising the 'state-of-play' of sectoral infrastructure, and starts to reach into the development of an infrastructure policy framework.

The challenge now is to extend the understanding gained from the development of this document into an Infrastructure Plan. Such a plan must be focused on providing a strategic focus to the allocation of scarce infrastructure resources to their highest value use and the practical actions that can assist in delivering this. Business New Zealand has used this submission to provide an indication of its expectations in this regard.

A good Infrastructure Plan - one that is aligned with the rest of government's thinking about how to transform the economy and the role of infrastructure in the development of a more buoyant and resilient economy, and provides a clearly articulated sense of strategic direction and a resultant policy framework - can be expected to deliver long-term, sustainable benefits.

In Business New Zealand's view, the key to a good Infrastructure Plan is as much about the framework within which the solution to the physical and regulatory bottlenecks can be found as it is about assessing the state of existing infrastructure. The framework, and the measurement of its delivery, can be expected to aid with the richer conversation about the role of government and how to use the policy levers at its disposal in a more effective and strategic manner. Such an approach will enable a clear path to be steered away from the pitfalls of central planning while delivering a stable of tools to improve the quality, quantity and cost of infrastructure projects and enable strengthened project accountability.

Business New Zealand looks forward to working with the Treasury to help deliver this positive outcome.

Yours sincerely

John A Carnegie
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Business New Zealand

APPENDIX ONE: ABOUT BUSINESS NEW ZEALAND

Encompassing four regional business organisations (Employers' & Manufacturers' Association (Northern), Employers' & Manufacturers' Association (Central), Canterbury Employers' Chamber of Commerce, and the Otago-Southland Employers' Association), Business New Zealand is New Zealand's largest business advocacy body. Together with its 70-member Affiliated Industries Group (AIG), which comprises most of New Zealand's national industry associations, Business New Zealand is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.

In addition to advocacy on behalf of enterprise, Business New Zealand contributes to Governmental and tripartite working parties and international bodies including the ILO, the International Organisation of Employers and the Business and Industry Advisory Council to the OECD.

Business New Zealand's key goal is the implementation of policies that would see New Zealand retain a first world national income and regain a place in the top ten of the OECD (a high comparative OECD growth ranking is the most robust indicator of a country's ability to deliver quality health, education, superannuation and other social services). It is widely acknowledged that consistent, sustainable growth well in excess of 4% per capita per year would be required to achieve this goal in the medium term.

APPENDIX TWO: CONSULTATION QUESTIONS AND RESPONSES

Consultation Question	Business New Zealand Response
1. **Base information**: Is the sectoral analysis contained here an accurate and informative description of the sector? If not, what changes are required to make it so?	Yes, but the real question is how this information is going to be used in a solution orientated Infrastructure Plan.
2. **Missing issues**: Are there important infrastructure issues not mentioned in this document?	The consideration of the implications of governance on the delivery of efficient infrastructure. See page 8 of the attached letter for Business New Zealand's views on this matter.
3. **Decision-making**: This document suggests that for projects to contribute to community/national welfare and economic growth, they must have expected benefits (measured comprehensively) that are greater than their estimated costs (also measured comprehensively) – see the decision-making principles in the 'Policy Context' chapter. As well as considering distributional or equity considerations, are there other considerations that should be taken into account and if so, what is the case for that?	In choosing between different options it is necessary to have criteria for making the choice. Generally efficiency is chosen as the primary criterion for deciding on the best options. A concern with efficiency is a concern with enabling individuals to attain, at the least possible cost, any number of ends that they value. An efficiency criterion can therefore accommodate the value to individuals of leisure, culture, environmental amenities, health and safety, quality and the like. Efficiency is not advocated as the sole criterion for guiding government policy. People are legitimately concerned about distributional/equity objectives. However, the tax and welfare system generally provides for a more effective and direct means of addressing equity issues than the use of industry policy.
4. **Cross-sectoral issues**: What cross-sectoral issues are faced by operators/users of infrastructure in each sector? This document identifies a number of cross sectoral issues. Are there other cross-sectoral issues that should be included in a National Infrastructure Plan?	See page 10 of the attached letter for some comments on the issue of intermodal competition.
5. **Regulatory reform**: Are there important regulatory constraints on the development of infrastructure that are not being addressed by the government's current regulatory reform programme?	Limited and/or uncertain property rights, particularly with respect to water.

Consultation Question	Business New Zealand Response
6. **Aspiration**: For each infrastructure sector, is it possible or desirable to define the service level New Zealand should aspire to? If so, what should it be and why?	Some sort of sectoral-based service levels are inevitable in order for the Infrastructure Plan to be a meaningful contribution to the public policy landscape. Without the definition of service levels, it will be extremely hard to establish the contribution of the investment direction set out in the Infrastructure Plan. In Business New Zealand's view, the need for service levels falls out of a combination of the meta-goals of the Infrastructure Plan and the assessment of the current state of the infrastructure (the latter forming the performance benchmark). In other words, to be able to measure the contribution of the proposals aimed at achieving some goal (such as matching Australia's GDP) in value-for-money, or net-public benefit terms, sector-specific targets of lower granularity will be necessary. Without such service-level targets, it will be extremely difficult to determine whether the proposals are making any tangible difference towards the meta-goal(s). Examples of services could be reliability and capacity measures in the electricity sector, and travel times in the transport sector. This measurement against service-levels will provide vital feedback that will inform the efficacy of the policy settings across the range of infrastructure.
7. **Link to economic growth**: What additional investment would help New Zealand to increase its rate of economic growth? How can we be confident that this additional investment is a prudent use of scarce funds?	While undoubtedly additional specific investments will help New Zealand to increase its rate of economic growth, Business New Zealand considers that (as set out on page 9 of the attached letter), the first order of priority must be to get the right investment policy settings in place. This, combined with a facts-based assessment of the contribution being made by the new investment settings should incentivise the efficient allocation of scarce resources to their highest value infrastructural use.