The Port Phillip Channel Deepening Project (CPD) makes an excellent case study when considering the mysteries of economic evaluation of major projects.

On March 21, 2007, the Port of Melbourne Corporation (PoMC) announced in a media release that it had issued a Supplementary Environmental Effects Statement (SEES), which comprised a detailed report on environmental and economic matters concerning the CPD. The report stated that ‘the economic case for the project is very strong’.

Chapter 16 of the SEES document states:

'A benefit-cost analysis (BCA) shows that the project can be expected to generate benefits of $1936 million over the appraisal period (to 2035) in present value terms. The costs of the project (both to PoMC and others) are estimated to be $590 million. 'With a benefit/cost ratio of 3.3, the project surpasses the normal threshold economic criteria for the assessment of infrastructure projects.’

Chapter 16 also states that of the $1936 million benefits generated, $658 million will be directed to Victorian business interests, and the rest to interstate and overseas interests.

(The figures quoted above were generated for PoMC by the economic consultant, Meyrick and Associates.)

The first thing to note is that the $590 million cost excluded project costs incurred up to the end of 2006 (including the 2005 trial dredging) because, according to PoMC, the economic analysis was ‘.... intended to inform a decision on whether or not to proceed with the project. Money that has already been spent, and cannot be recovered, is not relevant to that decision.’ The actual total cost estimate was stated by PoMC to be $763 million.

The second thing to note is that the PoMC refers to a ‘benefit-cost’ analysis, and a benefit/cost ratio of 3.3 (ie, the benefit is divided by the cost). This is not the same process as a ‘cost-benefit’ analysis which is defined as a study which ‘estimates the sum of costs and benefits of a policy or event for a particular community.’ (Ref.: Victorian Auditor-General’s Report, ‘State Investment in Major Events’, May 2007.) With a benefit-cost study, the benefits may not necessarily be directed to the community paying for it.

The PoMC ‘benefit/cost ratio’ has characteristics which distinguish it from a normal cost-benefit analysis, viz.,

- some of the project costs are omitted,
- while the Victorian community will pay the initial costs of establishing the deepened channel, only about one third of the estimated benefits go to the Victorian interests.
- the benefits are ‘gross’ benefits, not net benefits (as they do not take into account the additional port charges to be applied by PoMC in order recover the project costs).

The benefits and costs of the CDP claimed by PoMC have been dissected by the well known Victorian economist Francis Grey, principal of Economists @Large. His findings were presented to the CDP panel hearing on July 17, as part of the Blue Wedges Coalition’s submissions.

Grey conducted a full cost-benefit analysis and found:

- the benefits of the project had not been calculated to accepted industry standards,
- assumptions had been made that were not appropriately conservative (such as the size of the ships in the future world shipping fleet, which would justify channel deepening),
- significant costs (such as the ‘sunk cost’ of the trial dredging) had been omitted.

He concluded that a conservative estimate of the project costs was not $590 million, but $1000 about million, and that the net project benefit was not $1936 million, but minus $540 million. This, said Grey, was a clear sign that the project should not proceed.
Considerable confusion appears to reign in the media regarding the claimed economic benefit of the channel deepening project. The article ‘Deeply disturbing’ by Jeremy Loftus-Hills (The Age, January 17, 2008), makes the probably correctly-based suggestion that it is ‘the bullying tactics of the shipping companies, not the promise of greater wealth for Victorians, that is really driving the channel deepening’. The author refers to a ‘cost-benefit analysis’ by Meyrick and Associates, but as explained previously, this was not what was carried out.

Meyrick and Associates confirmed their findings in a memorandum to the SEES panel, dated 25 July 2007 ‘... the Channel Deepening Project would produce, over 25 years, economic benefits estimated at $1936 million ($1.936 billion) in present value terms. These will be mainly in the form of savings to ship owners and the users of commercial shipping.’

This statement appears to be at odds with information published in the article ‘D-day for bay as last legal hurdle falls’, published in The Age on January 16, 2008. The article highlighted the following information regarding the channel deepening project:
- Economic benefit to Victoria over the next 22 years - $1.36 billion
- The project would add up to $2.2 billion to the national economy over coming decades

This information was based on a report to the Dept of Treasury and Finance by the consultant, Price Waterhouse Coopers (PwC) dated March 2007, which included the following statement:
‘Over the next 22 years, the CDP will generate $1.7 billion in economic benefits to Australia, 80% of which will accrue to Victoria.’

The Age calculated the $1.36 billion in ‘benefits’ to Victoria thus: 80% of 1.7 = 1.36.

The PwC report does not represent new information. It was included in the SEES document, Chapter 16.8 ‘Economic Impact assessment of the CPD’. Figures 16.7 and 16.8 in this chapter correspond to Figures 5.3 and 5.1 in the PwC report for the Dept of Treasury and Finance.

The PwC report was not a cost-benefit analysis, but comprised an assessment of the economic impact of the project, in terms of increased gross state/national product, produced mainly by the additional employment assumed to be generated. The measure of the economic benefit was the increase in disposable household income. The report found that 80% of the ‘benefit’ accrued to Victoria, because Victoria was the location of the project and this was where most of the employment would be generated.

Very importantly, a major component of the total economic impact figure estimated by PwC comprised the economic effects of the construction phase of the project. This was akin to including the Albert Park circuit construction phase in an economic impact assessment of the Grand Prix. In a normally prosperous economy, a project is not justified by the employment and expenditure that it generates during construction, but by the beneficial effects which follow it.

In summary, neither of the Meyrick or PwC economic studies demonstrate that the channel deepening project is good for the Victorian economy. The Meyrick ‘benefit-cost’ study is wrong on cost (using $590m when $1 billion is nearer the mark), fails to show clearly who will pay it, and is only credible in finding that the benefits will mainly go to (out-of-state) ship owners and users of commercial shipping.

The PwC study is an economic impact assessment (not a cost-benefit analysis). It depends on the assumption that ‘competition results in a pass-through of savings by shippers’, and that this will ‘boost the incomes of Victorian importers and exporters’ and that this will trickle down to the general Victorian economy. The study is flawed and meaningless anyway because it includes the effects of the construction phase of the project.

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