

# Chapter 1

## Introduction and background

1.1 On 30 October 2014, the Senate referred the matter of privatisation of state and territory assets and new infrastructure to the Economics References Committee for inquiry and report by 2 March 2015. On 2 December 2014, the Senate granted an extension to the committee to report by 20 March 2015. In particular, the committee was to examine:

Incentives to privatise state or territory assets and recycle the proceeds into new infrastructure, with particular reference to:

- (a) the role of the Commonwealth in working with states and territories to fund nation-building infrastructure, including
  - (i) the appropriateness of the Commonwealth providing funding, and
  - (ii) the capacity of the Commonwealth to contribute an additional 15 per cent, or alternative amounts, of reinvested sale proceeds;
- (b) the economics of incentives to privatise assets;
- (c) what safeguards would be necessary to ensure any privatisations were in the interests of the state or territory, the Commonwealth and the public;
- (d) the process for evaluating potential projects and for making recommendations about grants payments, including the application of cost-benefit analyses and measurement of productivity and other benefits;
- (e) parliamentary scrutiny;
- (f) alternative mechanisms for funding infrastructure development in states and territories;
- (g) equity impacts between states and territories arising from Commonwealth incentives for future asset sales; and
- (h) any related matter.<sup>1</sup>

### Conduct of inquiry

1.2 The committee advertised its inquiry on its website and in the *Australian*. The committee also wrote directly to the Commonwealth, state and territory governments and other stakeholders, drawing attention to the inquiry and inviting them to make written submissions.

1.3 The committee received 37 submissions, which are listed at Appendix 1. The committee held public hearings in Darwin on 16 February 2015 and in Sydney on

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1 *Journals of the Senate*, No. 63, 30 October 2014, p. 1704; *Journals of the Senate*, No. 72, 2 December 2014, p. 1940.

18 February 2015. The committee thanks all those who assisted with the inquiry, especially those who made written submissions.

### **Background to inquiry**

1.4 The National Commission of Audit report *Towards Responsible Government*, was published in two parts in February and March 2014. The report noted that after privatisation of a number of public assets from 1990 through to 2006, privatisation activity at the federal level has remained largely dormant since this time. In contrast, state and territory privatisation activities have increased since 2006.<sup>2</sup>

1.5 On 28 March 2014, the Treasurer, the Hon Joe Hockey MP, announced an Asset Recycling Initiative (the Initiative), proposing that the Commonwealth would offer substantial financial incentives to states and territories to sell assets and recycle the proceeds of those sales into new infrastructure. The Initiative would cover transactions negotiated between the states and the Commonwealth until 30 June 2016, and offer incentive payments of 15 per cent of the assessed value of the asset being sold (or leased) through to 30 June 2019.<sup>3</sup>

1.6 On 2 May 2014 the Commonwealth, states and territories confirmed their commitment to the National Partnership Agreement on Asset Recycling (NPAAR). The NPAAR is intended to:

- assist in addressing state and territory funding constraints that limit their ability to invest in additional economic infrastructure; and
- contribute to increased investment in productivity-enhancing infrastructure by encouraging the sale of state-owned assets to unlock funds and recycle the capital into additional infrastructure.<sup>4</sup>

1.7 To provide financial assistance to the states and territories, the 2014–15 Federal Budget included an Infrastructure Growth Package and stated an intention to establish an *Asset Recycling Fund* of approximately \$5.9 billion, by combining

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2 National Commission of Audit, *Towards Responsible Government*, Phase One, February 2014, p. xiv, 220–221.

3 The Hon Joe Hockey MP, Treasurer, *Treasurers agree to boost infrastructure*, Media release, 28 March 2014.

4 Council of Australia Governments, *National Partnership Agreement on Asset Recycling*, 2 May 2014, p. 2.

uncommitted funds from the *Building Australia Fund*<sup>5</sup> and the *Education Investment Fund*.<sup>6</sup> These funds were intended to be available from 1 July 2014.<sup>7</sup>

### **The Bill and the operation of the Asset Recycling Initiative**

1.8 On 29 May 2014 the Asset Recycling Fund Bill 2014 (the Bill) and the Asset Recycling Fund (Consequential Amendments) Bill 2014 were introduced into the House of Representatives to establish an Asset Recycling Fund that would:

- enable grants of financial assistance to be made to the states and territories for expenditure incurred under the National Partnership Agreements on Asset Recycling and Land Transport Infrastructure Projects;
- make infrastructure national partnership grants; and
- enable the making of infrastructure payments.<sup>8</sup>

1.9 The Bill was debated and amended by both the House of Representatives and the Senate. On 17 July 2014 the House of Representatives disagreed with approximately half of the Senate's amendments, including amendments 21, 23, 28 and 31 which would require that Infrastructure Australia evaluate large projects and publicly disclose a cost-benefit analysis under some circumstances. On 18 July 2014 the Senate voted to insist on the amendments. At the time of preparation of this report the Bill remains before the House of Representatives.<sup>9</sup>

1.10 Despite the introduction of the Bill, the committee understands that the Commonwealth may not require legislation to make incentive payments to the states and territories, and that this could be offered under existing legislation. Treasury informed the committee that the Asset Recycling Initiative is able to proceed even if the Bill is not passed:

The Commonwealth is currently able to make the incentive payments to the states and territories under the framework established by the *Federal Financial Relations Act 2009*. This is the same framework for making

5 The *Building Australia Fund* was established in 2009 to to finance capital investment in transport infrastructure (such as roads, rail, urban transport and ports), communications infrastructure (such as broadband), energy infrastructure and water infrastructure; <http://www.finance.gov.au/investment-funds/NBF/BAF.html>, (accessed 5 march 2015).

6 The *Education Investment Fund* was established in 2008 to provide funding for projects that create or develop significant infrastructure in higher education, research and vocational education and training institutions; <https://www.education.gov.au/education-investment-fund>, (accessed 5 march 2015).

7 Australian Government, *Budget 2014–15*, Budget Measure, Budget Paper No. 2, 13 May 2014, p. 114

8 House of Representatives, *Votes and Proceedings*, No. 41, 29 May 2014, p. 515; Asset Recycling Fund Bill 2014, *Explanatory Memorandum*, p. 4.

9 Asset Recycling Fund Bill 2014, [http://www.aph.gov.au/Parliamentary\\_Business/Bills\\_Legislation/Bills\\_Search\\_Results/Result?bld=r5255](http://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bld=r5255), (accessed 5 February 2015); Schedule of amendments made by the Senate to which the House of Representatives has disagreed. (accessed 5 February 2015).

payments under other National Partnership Agreements with the states and territories.<sup>10</sup>

### ***Operation of the Asset Recycling Initiative***

1.11 The committee understands that there is demand for new investment in high-quality infrastructure across Australia<sup>11</sup> to support economic growth and create jobs in the short to medium term, and to deliver higher productivity in the longer term.<sup>12</sup>

1.12 The Treasury submission described how the Asset Recycling Initiative would operate. The Commonwealth would make an incentive payment equal to 15 per cent of the proceeds from an asset divestment, only if the state or territory government reinvests these proceeds<sup>13</sup> and the incentive payment into additional infrastructure.<sup>14</sup>

1.13 The Treasury submission also indicated that the terms of each bilateral agreement between the Commonwealth and an individual state or territory is stated in a schedule to the National Partnership Agreement that is made public.<sup>15</sup> Funding to individual states and territories is allocated on a first-come, first-served basis within the following timeframes:<sup>16</sup>

- the asset divestment must be completed by, and the construction of the additional infrastructure must commence by 30 June 2019;<sup>17</sup>
- once a schedule has been agreed, incentive payments would be made in two instalments subject to satisfying specific agreed criteria; and
- before a state or territory is entitled to an incentive payment, it must report against the specific agreed criteria by providing the Commonwealth with a Statement of Assurance.<sup>18</sup>

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10 Treasury, *Submission 28*, p. 14.

11 Infrastructure is the basic physical and organisation structures and facilities needed for the operation of a society or enterprise. It includes roads, bridges, tunnels, water systems, sewers, electricity grids, telecommunication systems, <http://www.oxforddictionaries.com/definition/english/infrastructure>, (accessed 6 March 2015).

12 Department of Infrastructure and Regional Development, *The Asset Recycling Initiative*, [http://investment.infrastructure.gov.au/publications/reports/pdf/factsheets2014/Factsheet\\_The\\_Asset\\_Recycling\\_Initiative.pdf](http://investment.infrastructure.gov.au/publications/reports/pdf/factsheets2014/Factsheet_The_Asset_Recycling_Initiative.pdf), (accessed 5 March 2015).

13 Treasury, *Submission 28*, p. 13; Council of Australia Governments, *National Partnership Agreement on Asset Recycling*, 2 May 2014, Clause 19.

14 Treasury, *Submission 28*, p. 13; Council of Australia Governments, *National Partnership Agreement on Asset Recycling*, 2 May 2014, Clauses 18, 19.

15 Treasury, *Submission 28*, p. 13; Council of Australia Governments, *National Partnership Agreement on Asset Recycling*, 2 May 2014, Clause 22.

16 Treasury, *Submission 28*, p. 13; Council of Australia Governments, *National Partnership Agreement on Asset Recycling*, 2 May 2014, Clause 15.

17 Treasury, *Submission 28*, p. 13; Council of Australia Governments, *National Partnership Agreement on Asset Recycling*, 2 May 2014, Clause 15.

1.14 If a state or territory does not proceed with the divestment of an asset or the construction of additional infrastructure in accordance with the terms of the bilateral agreement, the state or territory would be required to repay incentive payments it has received. In such circumstances, the funds may be reallocated to other projects under the National Partnership Agreement.<sup>19</sup>

### **Productivity Commission inquiry into Public Infrastructure**

1.15 The Productivity Commission inquiry into Public Infrastructure was initiated on 13 November 2013 and was tasked with:

- investigating costs, competitiveness and productivity in the provision of nationally significant economic infrastructure;
- examining ways to address any barriers to private sector financing, including assessing the role and efficacy of alternative infrastructure funding and financing mechanisms; and
- recommending mechanisms and operating principles to overcome such barriers and reduce infrastructure construction costs.<sup>20</sup>

1.16 The Public Infrastructure inquiry ran for six months, receiving over 200 submissions, and taking evidence from over 40 witnesses and making more than 30 findings and recommendations. The final report of the inquiry was completed on 27 May 2014 and published on 14 July 2014.

1.17 In November 2014 the government responded to the report's recommendations, noting that the findings covered five themes:

- reforms to **institutional and governance arrangements**, including greater transparency of the economic assessment of public infrastructure proposals and tying Commonwealth funding to the implementation of good governance principles;
- **improvements to** project planning and prioritisation;
- governments to consider various **public and private financing models**, including broader application of 'user charging' for infrastructure services and new models of road infrastructure project selection and funding;
- **improvements to** project delivery in order to reduce costs; and
- achieving more productive **labour and construction markets** through reforms, including reforms similar to those underway by the Commonwealth

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18 Treasury, *Submission 28*, p. 14; Council of Australia Governments, *National Partnership Agreement on Asset Recycling*, 2 May 2014, Clause 32.

19 Treasury, *Submission 28*, p. 14; Council of Australia Governments, *National Partnership Agreement on Asset Recycling*, 2 May 2014, Clause 23.

20 Productivity Commission, *Public Infrastructure*, Inquiry report, No. 71, 27 May 2014, p. v.

to review the industrial relations and occupational health and safety accreditation schemes.<sup>21</sup>

1.18 The Productivity Commission indicated that it was important to reform governance and institutional arrangements for public infrastructure to promote better decision making in project selection, funding, financing and the delivery of services from new and existing infrastructure.<sup>22</sup>

1.19 The Productivity Commission also noted that private sector involvement in infrastructure development and/or financing would only deliver efficiency gains with careful planning and implementation – it is not a ‘magic pudding’. Government guarantees and tax concessions would still involve both risks and costs, and ultimately, it is the users and/or taxpayers who will absorb these.<sup>23</sup>

1.20 The Productivity Commission inquiry into Public Infrastructure recommended that privatisation should be subject to appropriate procedural scrutiny to ensure that the public interest is protected through structural separation, regulation, sale conditions and ‘community service obligations’.<sup>24</sup> The inquiry also recommended that Commonwealth financial assistance to states and territories should only be provided where there is clear evidence of a net public benefit from the project that would otherwise not be obtainable without Australian Government support.<sup>25</sup>

1.21 The committee considers that the Productivity Commission report identifies very important issues that should guide any future assistance to states and territories seeking to divest public assets.

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21 Productivity Commission Inquiry report into *Public Infrastructure, Government Response*, November 2014,

22 Productivity Commission, *Public Infrastructure*, Inquiry report, No. 71, 27 May 2014, p. 2.

23 Productivity Commission, *Public Infrastructure*, Inquiry report, No. 71, 27 May 2014, p. 2.

24 Community service obligations are common and exist for a number of utilities, including current and former government business enterprises. For example, Australia Post has statutory community service obligations as part of its customer service charter, which require it to provide an accessible letter service at a single uniform rate within Australia for standard letters, <http://auspost.com.au/about-us/customer-service-charter.html>, (accessed 16 March 2015).

25 Productivity Commission, *Public Infrastructure*, Inquiry report, No. 71, 27 May 2014, p. 40.