Business Council of Australia

submission

Submission to the Senate Standing Committee on Economics Inquiry into the Privatisation of State and Territory Assets and New Infrastructure

FEBRUARY 2015

Working to achieve economic, social and environmental goals that will benefit Australians now and into the future

Contents

The Business Council of Australia (BCA) is a forum for the chief executives of Australia's largest companies to promote economic and social progress in the national interest.

About this submission

This is the Business Council's submission to the Senate Standing Committee on Economics Inquiry into Privatisation of State and Territory Assets and New Infrastructure. The Terms of Reference are in Exhibit 1.

Exhibit 1: Terms of reference

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.

Source: Parliament of Australia website

Key points

- Australia needs ongoing investment in productive infrastructure to meet the needs of a growing population and support economic growth.

- Selling mature government infrastructure assets and reinvesting the proceeds into new infrastructure projects will deliver better infrastructure services for the community, improved public finances and a more productive economy.

- The government's Asset Recycling Initiative is the type of innovative infrastructure funding policy that can help governments under fiscal pressure to address Australia's infrastructure gap. The Initiative implements the *National Partnership Agreement on Asset Recycling* agreed by Australia's governments in 2014.

- The Asset Recycling Initiative should be accompanied by appropriate infrastructure regulation, planning and prioritisation policies that promote efficient infrastructure provision.

Key recommendations

- Private ownership of infrastructure assets should be preferred unless there is a demonstrated public benefit from public ownership. Private ownership leads to more efficient operation of infrastructure assets and allows scarce public funds to be better allocated to meet the economic and social objectives of government.

- The Business Council recommends governments should adopt explicit infrastructure ownership policies (see Exhibit 2) whereby they limit ownership of economic infrastructure to:

  – selected greenfield infrastructure projects, where there is sufficient early demand risk

  – for mature assets, where there is a demonstrated net public benefit.

- Otherwise, governments should sell mature infrastructure assets and reinvest the funds to grow the economy and improve the living standards of Australians.

- Adequate infrastructure regulation will need to be in place, depending on the level of competition in the market, to realise the efficiency benefits from privatisation, safeguard the long-term interests of consumers and provide long-term certainty for investors. Getting these regulatory settings right is challenging but important and should be a focus of the committee's inquiry.

- Given the need for significant new public infrastructure, the Business Council supports the reinvestment of funds raised from asset sales into new infrastructure projects under the Asset Recycling Initiative, as well as state funds such as the New South Wales Restart Fund.

- In re-allocating capital, governments should prioritise the funding of new infrastructure projects that have been identified in long-term, strategic infrastructure plans and which have been evaluated according to a rigorous, transparent cost–benefit analysis.

- The payments to the states under the Asset Recycling Initiative should accord with the criteria for new projects set out in the *National Partnership Agreement on Asset Recycling*. Disagreement over project selection by federal and state governments under this scheme would be costly and should be avoided.

Infrastructure policy

Ongoing investment in productive infrastructure is essential for long-term economic growth and for meeting the needs of a growing Australian population.

Over time infrastructure policies have moved towards a market-based approach where infrastructure is provided by publicly or privately owned corporations operating within regulated infrastructure markets, with funding derived predominantly from user charges. Increasingly policy has supported private ownership of infrastructure in many parts of Australia. Private ownership and user charging regimes are widespread in the transport, water, energy and communications sectors.

This shift in policy away from direct government ownership of infrastructure supports the efficient investment and use of infrastructure and is important for lifting productivity. The Business Council supports policies that encourage private investment in infrastructure in order to support innovation, improve efficiency and to take the pressure off stretched government budgets.

Governments, of course, continue to have responsibility for directly funding new public investments where they are not adequately provided by the private sector. For example where there is significant early demand risk, or where adequate market and regulatory frameworks to support private ownership are not yet sufficiently in place, or where there are social benefits that require public funding. See Exhibit 2.

Exhibit 2: BCA principles on infrastructure ownership, regulation and pricing

The following criteria should determine whether an infrastructure asset is owned privately or by governments, and how that asset should be operated:

- Governments should sell infrastructure assets where the private sector already owns other like assets and provides other like services (this effectively demonstrates adequate policies are already in place to protect consumers).
- Private ownership should be preferred where appropriate arrangements can be established for the infrastructure service in any of these three ways:
  - There is a market price set by an effective and contestable market for the infrastructure service.
  - There is a regulated price that allows an adequate return on an efficient investment while also protecting the interests of consumers.
  - There is an implicit contract price that a government agrees with the owner of the infrastructure on behalf of public users (includes community service obligations).
- Government ownership should only be preferred where it can be demonstrated that it is necessary for achieving the community's objectives with respect to infrastructure provision e.g. demand risk on some new greenfield projects.
  - These businesses should be sold once the project has matured.
  - Government owned infrastructure should outsource delivery and operations based on competitive long-term contracts.

Source: BCA, 2012.

The Asset Recycling Initiative

Under the government's Asset Recycling Initiative the Commonwealth will provide states and territories with payments of 15 per cent of the sale price of privatised assets on condition that the returns are reinvested in new priority infrastructure projects. The program is capped at $5 billion.

This approach can bring many economic and social benefits:

- more efficiency and greater innovation in infrastructure provision from private sector ownership, which will in turn grow productivity and provide better consumer outcomes
- governments can reallocate scarce public funding to pay for new public infrastructure needs or to manage debt
- new infrastructure provides the community with better transport, water, energy and communications services
- superannuation funds can purchase infrastructure assets and diversify their portfolios to the benefit of fundholders.

The *National Partnership Agreement on Asset Recycling*sets out the framework for governments to agree to the assets that qualify under the Initiative and the new investments that should be funded.

Benefits of privatisation

Privatisation has been successfully carried out in a number of states and territories in recent decades. Experience in the electricity sector has shown that the private sector can improve service delivery and deliver quality infrastructure more cost effectively. Examples include:

- The Productivity Commission's report into Electricity Network Regulation found that "state-owned network businesses have conflicting objectives, which reduce their efficiency and undermine the effectiveness of incentive regulation. Their privately-owned counterparts are better at efficiently meeting the long-term interests of their customers. State-owned network business should be privatised".[1]

- Network prices for government-owned businesses have increased at a faster rate than they have for privately-owned businesses — where they have fallen. From 1996-97 to 2012–13 the network prices of government-owned assets of New South Wales and Queensland increased by over 122 per cent and 140 per cent respectively, compared to Victoria where they declined by 18 per cent.[2] (It should be noted that ownership is not the only contributor to this difference geographical size of the states and the age of the assets and therefore the need to invest are also contributing factors).

- The Australian Energy Regulator (AER) benchmarking data found that overall privatised distribution assets, such as Victoria's and South Australia's networks, are more productive than government owned networks, such as those in New South Wales and Queensland.[3]

- Over the past ten years, privately owned networks spent less on their networks than was budgeted to them by the AER, while government owned networks spent over 20 per cent on both operating and capital expenditure than the AER had budgeted to them.[4] These additional costs are recovered by consumers through higher electricity prices.

Opportunity for asset recycling

Infrastructure Australia's National Infrastructure Plan for 2013 identified between $116 and $139 billion of infrastructure assets held by governments that are suitable for transfer to the private sector.

It is acknowledged that sections of the community are not always confident about the sale of assets. Governments should draw upon the body of evidence when explaining to the community the considerable merits of this approach and the costs to the taxpayer from failing to make the best use of public capital tied up in mature assets. By recycling the capital raised from asset sales, governments can provide the community with assurances that funds released from asset sales will go into new and better infrastructure that will lead to improvements in living standards.

1. Productivity Commission, *Electricity Networks Regulatory Frameworks Inquiry*, 2013.
2. Ernst and Young, *Electricity Network Services: Long-term Trends In Prices and Costs*, 2014, p. 6.
3. Australian Energy Regulator, *Electricity Distribution Network Service Providers: Annual Benchmarking Report,* November 2014, p. 6.
4. Ernst and Young, *Electricity network services - Long-term trends in prices and costs*, page 13, 2014

Privatisations under the Asset Recycling Initiative will also give large numbers of Australians the opportunity to invest in infrastructure directly or indirectly via their superannuation accounts. The superannuation system, with funds under management to rise to over $6 trillion by the 2030s, has expressed a desire for more opportunities to invest in infrastructure.

The long-term, steady and indexed returns from infrastructure investments are a good match for the liabilities associated with funding the retirement incomes of millions of Australian fundholders.

The New South Wales Restart Fund offers a positive current example of how the asset recycling approach is currently working. The proceeds from the sale of assets such as the Desalination Plant and the ports of Botany and Kembla are being used to fund tangible and visible improvements in infrastructure including WestConnex and renewal projects in areas like Wollongong.

Complementary policy settings

As the Productivity Commission said, it will be important that the Asset Recycling Initiative policy is complemented by sound decision making around privatisations and new infrastructure investments.

> The aims of the Asset Recycling Initiative are laudable. But the risks are significant. [...] the Initiative does not obviate the need for good governance and transparent and sound analysis of privatisation and procurement decisions.
> Productivity Commission, *Public Infrastructure Inquiry Report*, 2014, p. 264.

For newly privatised assets appropriate regulatory frameworks should be in place to promote efficient operation and pricing and to safeguard consumers in the relevant infrastructure markets. The COAG Competition Principles Agreement should be applied when reforming or privatising public monopolies.

Competitive neutrality must ne rigorously applied by governments to ensure there is a level playing field for both private and public infrastructure and that public infrastructure businesses do not derive a competitive advantage due to public ownership.

How the proceeds from asset sales will be spent on new infrastructure is vitally important. State and territory governments should direct the federal funding contribution and the funds raised by the asset sales towards well-designed projects that have the highest net economic and social benefits to the community.

Comment on the Terms of Reference

Role of the Commonwealth

The Commonwealth has a role to improve policies that improve the welfare of all Australians. A growing, productive economy is critical to achieving this aim, and is enhanced by the efficient provision and use of infrastructure assets through private ownership and well regulated infrastructure markets.

The Commonwealth also has a role to fund new investments in nationally significant infrastructure where they are not adequately provided by the private sector, due to the importance of these investments for productivity and economic growth.

Within the federation, the Commonwealth Government has arguably a greater capacity to fund new public investment in infrastructure due to its efficient tax base and potentially higher borrowing capacity at lower costs.

State governments are by comparison more limited in their access to efficient tax revenues or new borrowings. Some states do, however, have significant funds tied up in government-owned businesses that could be released through the sale of those assets and re-allocated to meet pressing infrastructure needs.

It is appropriate for the Commonwealth to require the states to draw from other available sources of funding when it is making a contribution to infrastructure projects managed by the states. The states should also be required to source funding from user charges.

The federal budget will benefit from new productive infrastructure investment over the longer term as the economy grows and higher federal tax revenues are collected down the track. This will in effect provide a return to the commonwealth from the 15 per cent contribution.

Economics of incentives to privatise assets

The incentives under the asset recycling fund are designed to facilitate the privatisation of mature state assets and to share the economic dividends with state governments and the communities in those states.

By facilitating asset sales the scheme can bring on the benefits of privatisation more quickly. The incentive payments can help governments to communicate the benefits of privatisation to the community by linking the funding to improved infrastructure outcomes.

Similarly structured incentive schemes have been used by the Commonwealth to achieve national policy objectives in policy areas where responsibility is shared with state and territory governments.

What safeguards should be in place

Prior to the sale of any Commonwealth, state, territory or local government businesses with monopoly characteristics, an assessment consistent with the 1995 National Competition Principles Agreement should be undertaken to promote pro-competitive outcomes where possible. This should include putting in place appropriate pricing and access arrangements, even where this has the effect of reducing the sale price of the asset.

These regulatory arrangements will enable potential investors to have a clear understanding of the terms under which the asset will be permitted to operate, and should allow customers to raise any issues or concerns they may have. It minimises the risk of pressure for post-sale regulation in subsequent years that, in turn, would undermine the confidence of investors and their willingness to invest in growing these businesses.

Infrastructure regulation is at different stages of development by sector in Australia. More enhanced regulatory frameworks to enable the sale of assets in the transport and water sectors should be progressed through COAG.

The Business Council supports the recommendation in the Draft Report of the Competition Policy Review to introduce a new national Pricing and Access Regulator as a way of lifting the quality and consistency of infrastructure regulation.

Process for evaluating potential projects

The Business Council advocates for all governments to prioritise infrastructure investment by choosing projects that are linked to a long-term strategic plan and which have been demonstrated to deliver positive benefits to the community under a rigorous, transparent cost–benefit analysis. Wider economic benefits should be considered, in accordance with the government's recently released *Overview of Project Appraisal for Land Transport (Commonwealth Government).*

The Business Council supports the criteria set out in the *National Partnership Agreement on Asset Recycling* for funding new projects. These are that the projects should "demonstrate a clear net positive benefit, enhance long-term productive capacity of the economy and, where possible, provide for enhanced private sector involvement in both the funding and financing of the infrastructure"

Parliamentary scrutiny

In deciding whether additional parliamentary scrutiny is needed under this policy, a relevant factor is the need for certainty and timeliness in decision making for attracting private investment into new and existing infrastructure and for realising the benefits of new infrastructure provision for the community.

Alternative mechanisms for funding infrastructure development in states and territories

User-pays funding should be prioritised for economic infrastructure. Value-capture initiatives should also be considered where other beneficiaries of a project, such as local landholders and businesses, can make a contribution.

The Commonwealth might consider borrowing to fund good-quality projects so long as a number of safeguards are followed. These are:

- the investment is Infrastructure Australia-approved
- there is a rigorous, published cost–benefit analysis with a positive benefit–cost ratio
- the borrowing is within government's existing credit rating borrowing capacity (e.g. the Commonwealth's AAA rating)
- Treasury bonds are generally preferred to infrastructure bonds (because they are lowest cost)

- before allocation, the borrowed funds are ring-fenced for infrastructure capital spending, not operating spending.

Equity impacts between states and territories arising from Commonwealth incentives for future asset sales

The Asset Recycling Initiative should be designed to ensure that states that have already privatised assets are not unduly disadvantaged.

In allocating funding under a 'first come, first served' basis, the Initiative should also be designed to prevent a single state, or one or two states, from capturing all of the available $5 billion in funding due to a very large-scale privatisation.

BUSINESS COUNCIL OF AUSTRALIA
42/120 Collins Street Melbourne 3000 T 03 8664 2664 F 03 8664 2666 **www.bca.com.au**