



Australian Government

The Treasury

Senate Economics References Committee

Privatisation of state and territory assets and new
infrastructure

CONTENTS

PART 1: HISTORICAL AND POLICY CONTEXT.....	1
Introduction	1
The Level of Infrastructure Spending in the Economy	1
The Roles of the Private and Public Sectors in the Funding and Financing of Infrastructure	3
Policy Context for the Initiative	5
Rationale for Divesting Assets	11
PART 2: MECHANICS OF THE INITIATIVE AND ANNOUNCEMENTS FROM STATES	13
How the Initiative Operates	13
Asset Divestments.....	15
Additional Infrastructure Projects	16
Announcements from States.....	17
ATTACHMENT: TERMS OF REFERENCE FOR THE INQUIRY	19

PART 1: HISTORICAL AND POLICY CONTEXT

Introduction

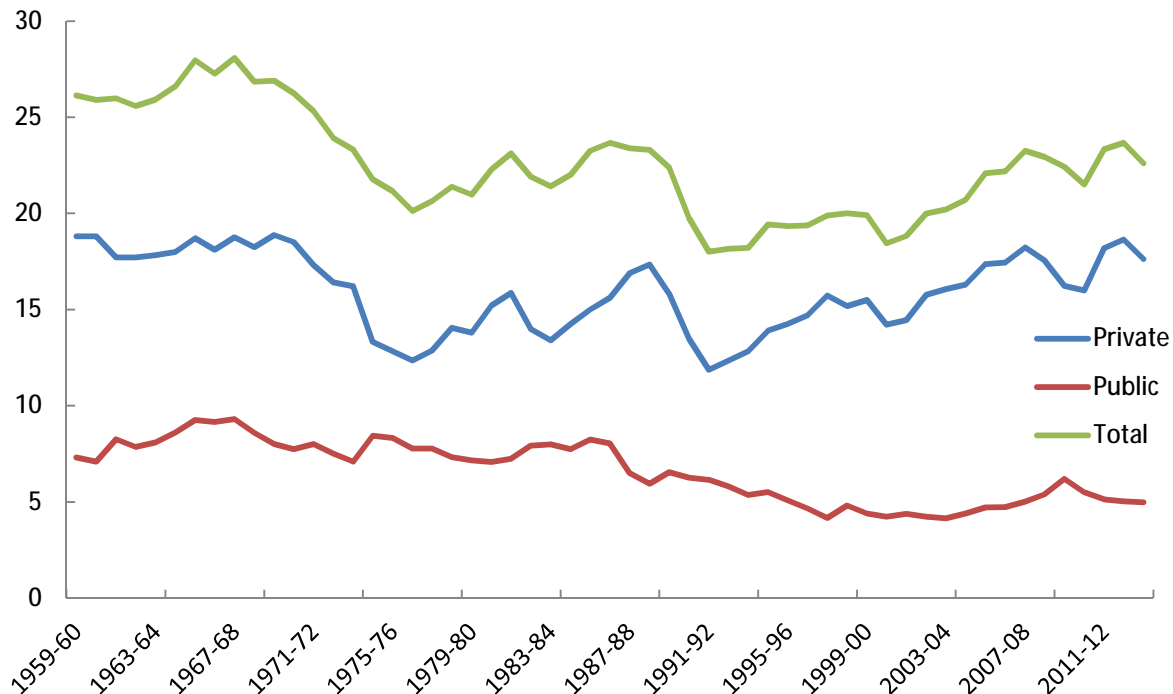
1. This submission is provided to assist the Committee in its Inquiry into the privatisation of state and territory assets and new infrastructure (Terms of Reference attached).
2. The Government has committed record levels of funding to transport infrastructure. In the 2014-15 Budget, the Government announced an \$11.6 billion Infrastructure Growth Package, which took the total Commonwealth expenditure on infrastructure to \$50 billion to 2020.
3. The Asset Recycling Initiative (the Initiative) is a key part of this Package. It provides states and territories with financial incentives if they sell assets and recycle the capital into additional infrastructure. In doing so, it will generate close to \$40 billion in additional infrastructure, with construction of projects to commence on or before 30 June 2019.
4. This is an important element of the Government's efforts to bolster economic growth in the short to medium term as the investment phase of Australia's resources boom comes to an end, and to lay the foundations for sustained improvements in prosperity and wellbeing over the longer term.
5. The submission is divided into two parts. The first part outlines the historical and policy context for the Initiative. The second part looks at the mechanics of the Initiative and the announcements from states and territories to date.
6. This submission has been prepared in consultation with the Department of Infrastructure and Regional Development.

The Level of Infrastructure Spending in the Economy

7. Before considering the specifics of the Initiative, it is useful to have some historical context for the overall level of infrastructure spending in the economy.
8. Infrastructure can be thought of as long-lived, physical assets that facilitate the flow of goods, information and factors of production (economic infrastructure), or underpin the delivery of essential services such as health and education (social infrastructure).
9. Analysing long-term trends in aggregate spending on infrastructure is a challenging task. Definitions of what constitutes 'infrastructure' vary and there is no single long-term data series that provides a clear picture of what might be designated as infrastructure spending. International comparisons are even more difficult.
10. Nor is it easy to form a definitive view regarding the optimal level of infrastructure spending. Certainly, caution is needed in ascribing any particular significance to long-term average levels of expenditure as a guide to desirable levels of spending in any given period. Among other factors, the age and efficient utilisation of the existing stock of infrastructure are clearly relevant to any such judgement.
11. Bearing such caveats in mind, Chart 1 shows historical capital investment in Australia as a proportion of GDP, excluding dwellings. Capital includes spending on both economic and social infrastructure, but also other forms of capital such as

machinery and equipment, and weapons systems, which would not normally be considered 'infrastructure'.

**Chart 1: Historical public and private capital investment
Percentage of GDP, 1959-60 to 2013-14**

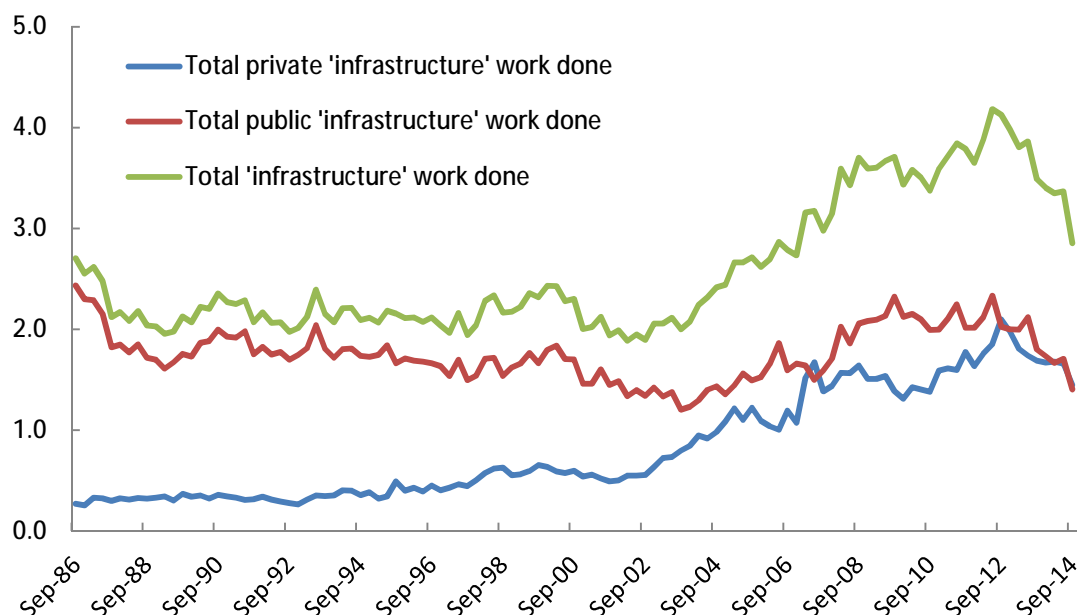


Sources: ABS Cat. no. 5204.0 and 5206.0 – nominal (current prices) gross fixed capital formation, excluding dwellings.

Note: 'Public' includes Commonwealth, state and territory governments.

12. Chart 2 focuses on the value of engineering and construction work, which is a better indication of what might be defined as economic infrastructure spending.

**Chart 2: Value of engineering construction work done (economic infrastructure)
Percentage of GDP, September 1986 to September 2014**



Sources: ABS Cat. no. 5204.0 and 8762.0 – nominal (current prices) value of work done on economic infrastructure (including roads, highways, bridges, railways, harbours, water storage and supply, sewerage and drainage, electricity generation, transmission and distribution, and telecommunication but excluding gas pipelines; recreation; oil, gas coal and other minerals; other heavy industry; and other). The data series has been seasonally adjusted by Treasury.

Note: 'Private' is work done by the private sector for the private sector. 'Public' includes work done by both the private and public sectors for the public sector.

13. Engineering construction work as a percentage of GDP was relatively stable until the mid-2000s. Prior to that, private spending was about 20 per cent of total spending, but this share has risen rapidly to account for about half of total economic infrastructure expenditure.
14. This trend most likely reflects the growth in mining investment, including infrastructure construction by the private sector. Significant private sector investment, first in roads and subsequently in railways and harbours, has accompanied the development of Australia's extensive resource assets over this period. Private spending started to decline in 2012, as mining investment fell.
15. Public spending as a percentage of GDP has also declined since 2009-10, as spending on roads, water and electricity-related infrastructure has either levelled off (in the case of roads) or fallen (in the case of water and electricity) as a percentage of GDP.

The Roles of the Private and Public Sectors in the Funding and Financing of Infrastructure

16. The Initiative seeks to address issues relating to both infrastructure funding and financing, and it is therefore useful to understand the distinction between the two, and the respective potential roles of the public and private sectors.

17. Funding refers to the transfer of resources to pay for the infrastructure, in return for which those providing the funding obtain the stream of services supplied by the infrastructure asset. There is a relatively limited set of funding options for infrastructure. It can only be funded by taxpayers, or by direct beneficiaries of the services it provides, via user charging or some other form of value capture.
18. Financing of infrastructure refers to the need to manage the likely timing mismatch between the need for upfront expenditure on the new asset, and the eventual provision of funding; e.g. the receipt of user charge payments over time. It generally involves some combination of equity and debt on which the financiers look for a financial return sourced from the funding associated with the infrastructure. These financiers (generally private sector) also directly take on the risks associated with the construction and operation of the infrastructure asset.¹
19. The following examples help illustrate this distinction:
 - **Example A:** The government contracts a private company to build a road, and, once constructed, the government operates and maintains it. The government has funded the road without any financing from the private sector.²
 - **Example B:** The government provides no upfront funding, but makes a yearly payment to the company to construct and operate the road. There are no tolls. In this case, the government has funded the road, while the company provided financing.
 - **Example C:** The government provides no funding for the road (either upfront or during its operation), but allows the company to charge a toll each time drivers use the road. In this case, the private sector has both funded and financed the road.
20. In most cases, funding for the provision of goods and services is best provided by the beneficiaries of that investment, under circumstances that allow a price signal to ensure the efficient provision and allocation of resources. In the case of infrastructure, user charging offers this potential.
21. However, it is well understood that infrastructure can have the characteristics of a public good, and has traditionally required significant levels of public sector funding. This will tend to be the case where the infrastructure:³
 - is non-excludable, in that it is difficult to restrict use of the infrastructure to those who pay; or
 - generates benefits to individuals or to society (including meeting equity objectives) beyond the direct users of the infrastructure (that is, it creates positive externalities).

¹ Financing in this context does not relate to the issue of instruments that might be used to raise capital for infrastructure, but do not share in the risks of the projects. For example, governments may issue securities to raise capital to fund an infrastructure project. This is not infrastructure financing unless the owners of the debt bear some of the risks of the infrastructure project.

² This funding may be from a state government or from the Commonwealth. If the Commonwealth is funding a project, the state government may be financing the works between grant payments.

³ Productivity Commission, *Inquiry into Public Infrastructure*.

22. In these situations, the infrastructure project might be economically viable in the sense that the social benefits of the project outweigh the costs, but the project will not be financially viable because not all of the benefits of the project can be captured by the financier. This means that the project would not be able to raise sufficient funding directly from users or beneficiaries of the infrastructure. In the absence of funding from governments, the market will undersupply goods with these characteristics. In these circumstances, there is a role for governments to fund these projects.
23. Nevertheless, there has been a significant increase in user charging in a number of areas of infrastructure provision over recent years. Road transportation infrastructure is an area that has traditionally lagged behind other infrastructure sectors in adopting cost recovery from users, and where there is clearly scope to enhance the role of private sector funding. For this reason, for example, the Government is working with state, territory and local governments are investigating trials of distance-based road user charging for heavy commercial vehicles on commercially significant road corridors.⁴
24. Increased private sector funding through user charging will encourage greater private sector financing. Private sector financing can inject additional discipline and oversight for projects relative to the situation where the government engages a construction company to build the asset. Private sector financing enables the sharing of risks between governments and the private sector for projects, which can be beneficial when the private sector can more efficiently manage the risks relative to governments.
25. Indeed, in some circumstances, there can be considerable advantages to the private sector providing the financing, even where the government is providing the funding (example B above). This provides the rationale for many of the public-private partnerships in Australia, where the private sector is engaged to construct, operate and finance infrastructure using government funding. The relative merits of private-sector financing for an infrastructure project need to be assessed by governments on a case-by-case basis to ensure it represents value for money.

Policy Context for the Initiative

26. The Initiative seeks to address a number of interrelated policy challenges. These relate to the short- to medium-term need to respond to the declining level of resource sector investment and to the longer-term challenge to sustain and enhance Australia's productivity performance. Also, the Initiative recognises the significant funding constraints confronting all levels of government, and the desirability of continuing to encourage increased levels of private sector funding and financing. In the latter context, it seeks to respond to the recent evidence of private sector risk aversion to certain types of greenfield infrastructure.

Structural change and the drivers of economic growth

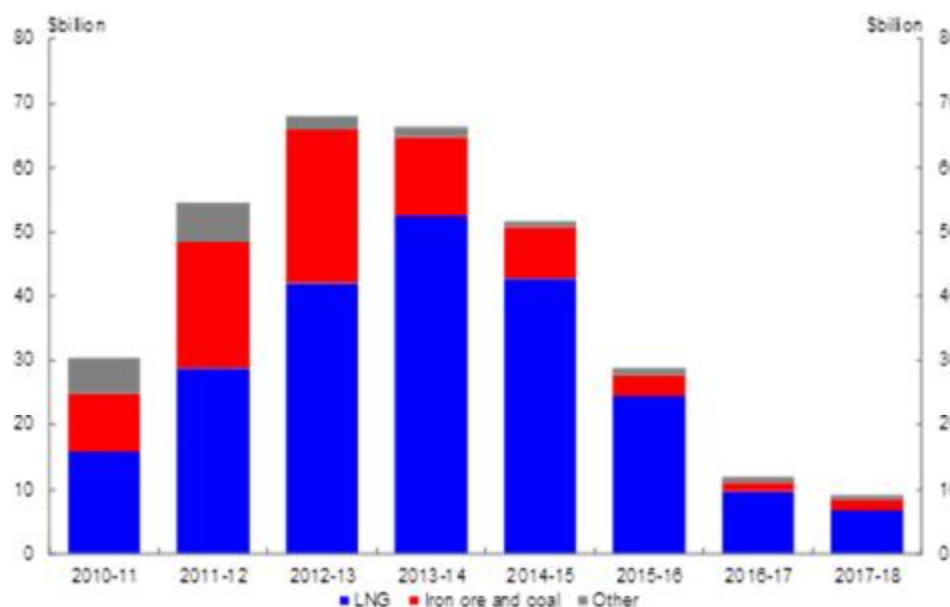
27. Investment in infrastructure can serve to support economic activity in the short- to medium-term by boosting aggregate spending. The resources investment boom that Australia has experienced in recent years is receding. As illustrated in Chart 3, over the next few years, resources investment is expected to continue to fall significantly

⁴ http://www.infrastructure.gov.au/infrastructure/publications/files/Productivity_Commission_Inquiry_Report_into_Public_Infrastructure.pdf.

towards its pre-boom levels; as a share of GDP, it is expected to decline from its peak of around 8 per cent in 2012-13 to around 2 per cent in 2017-18.

28. There is spare capacity in the economy and subdued wage and price pressures. The decline in resources sector investment will free up a large pool of skilled construction labour that will be available to be deployed elsewhere in the economy. This implies the need for stronger non-resources growth to help return the economy to trend growth.
29. Increased infrastructure investment should assist the Australian economy to transition away from resources-based to broader-based sources of growth. This will be achieved, in part, by offsetting the decline in resources-based investment through higher aggregate spending, and also by facilitating investments in other areas of the economy that benefit from improved infrastructure.
30. The increased Commonwealth investment through the 2014-15 Budget will also help to address rising demand for infrastructure associated with population growth, ageing and greater urbanisation in major Australian cities.

Chart 3: Spending on Major Resource Projects



Note: Treasury's major resources projects profile is the sum of spending on existing and planned resources projects greater than \$2 billion, weighted by their probability of going ahead.

31. The Treasury estimates that once the construction of infrastructure projects supported by the Commonwealth Government \$50 billion infrastructure investment is completed, this will add around 1 percentage point to Australia's GDP. This calculation is based on adding the expected contributions from states and territories and the private sector to the Government's \$50 billion of infrastructure projects. The total \$125 billion of investment is assumed to take place evenly over the next seven years. When completed, the total investment will add around 2-3 per cent to the economy's productive capital stock and raise the level of GDP by 1 percentage point.
32. Provided this infrastructure is economically efficient, in that government infrastructure investment complements the private sector's capital and is associated with higher private sector productivity, it will serve to support economic growth in the long term. Research from the International Monetary Fund has identified that public investment shocks have statistically significant and long-lasting positive impacts on output in the economy. In its 2014 World Economic Outlook, the IMF

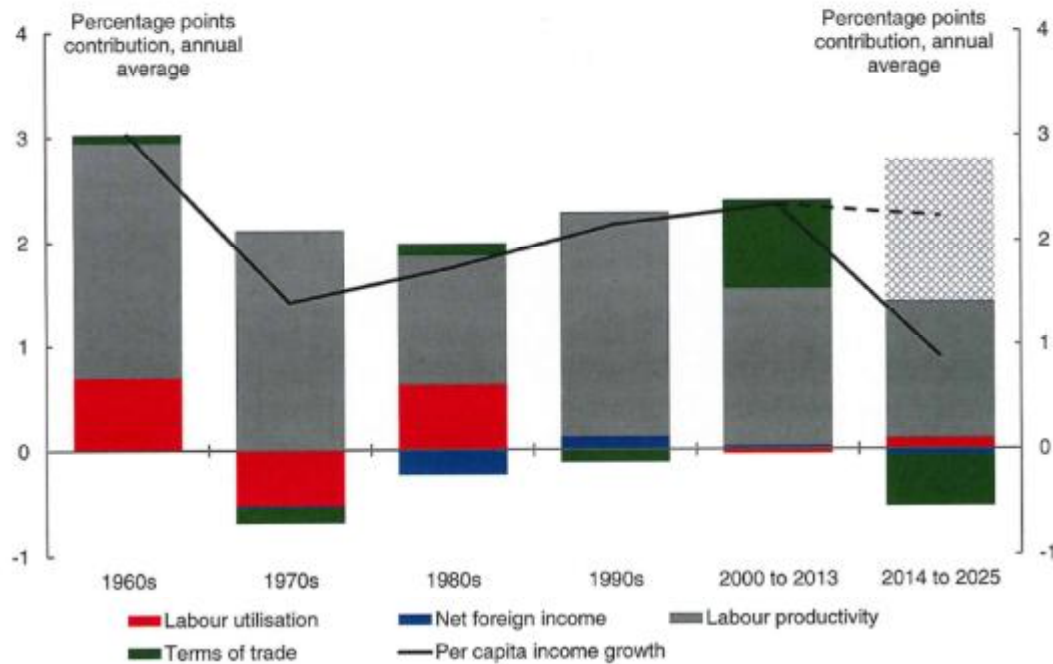
showed that the positive effects on output can also reduce debt-to-GDP levels over time. The IMF notes that this is dependent on a number of pre-conditions being met, including that the economy has some slack and that there are efficient investment processes – that is good processes for project selection and rigorous cost-benefit analysis.⁵

33. In order to optimise the lasting impact of infrastructure investment on the economy, it is important that the right projects are built at the right time.
34. As the Government response to the Productivity Commission stated, effective, long-term planning brings substantial benefits to future infrastructure investment. The Government's reforms outlined in this response are aimed at improving the robustness and transparency of the selection and assessment of major infrastructure, enhance Infrastructure Australia's ability to provide effective, independent advice to the Government, and deliver refocus planning efforts on priorities identified in Infrastructure Australia's 15-year plan.

Australia's productivity challenge

35. Over the long-term, productivity growth is the main source of improvements in average incomes, which are a measure of material living standards. Recent decades have seen significant contributions to incomes from improvements in labour utilisation (or hours worked per head of population), and the terms of trade.
36. Over the last decade, a dramatic rise in the terms of trade has maintained the growth in gross national income as productivity growth has waned. However, over the next decade a decline in the terms of trade is likely to detract from income growth. As shown in Chart 4, growth in average incomes over the medium term is therefore likely to be determined significantly by productivity growth.
37. If labour productivity grows at its long-run average of around 1.5 per cent over the medium term, per capita incomes will grow on average by about 1 per cent per year – Australians have become used to double this rate of income growth over the past three decades. This scenario is represented by the solid bar for labour productivity and the downward slope in the line for national income growth per capita from 2013-2025.
38. If Australia is to counter the impact of the declining terms of trade, annual labour productivity growth will need to increase to around 3 per cent in order to maintain the level of national income growth experienced in the past decade.
39. While this is significantly higher than that achieved in recent decades, it nonetheless suggests that policies that serve to improve productivity over the long-run will serve to support growth in living standards.

⁵ International Monetary Fund, World Economic Outlook, October 2014.

Chart 4: Sources of growth in national income per capita

Note: The hatched area represents the additional labour productivity growth required to achieve long run average growth in real gross national income per capita.

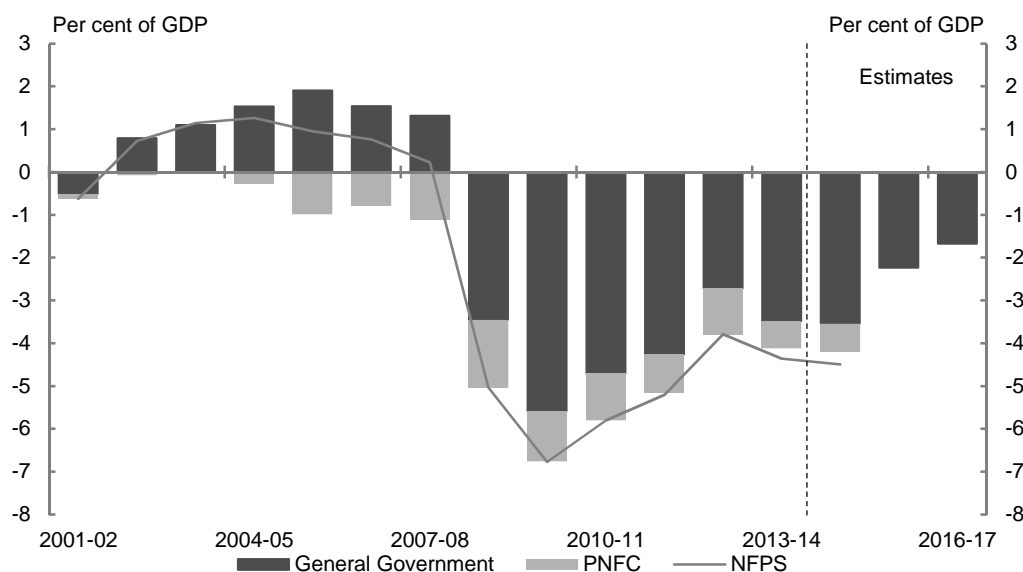
40. Well-designed economic infrastructure is critical. It connects manufacturers to markets, consumers to services and commuters to workplaces. With poor quality or inadequate infrastructure, the economy would be less efficient, competitive and productive. While the link between infrastructure spending and productivity growth is difficult to quantify, studies have found that, in aggregate, efficient infrastructure investment does support productivity growth in the economy.⁶
41. Ultimately, the degree of any productivity gain from infrastructure spending is likely to be influenced by a range of factors, including the stock and quality of the infrastructure already available in the economy, how efficiently it is used, the phase of the business cycle, and the rigour of project selection processes.
42. It is also worth noting that the productivity impact of individual infrastructure projects is not clearly discernible, especially in the short-term. However, there is likely to be a strong relationship over the long term between efficient public infrastructure investment in aggregate and overall productivity growth. As government infrastructure investment exhibits qualities of public goods, it is likely to complement private capital expenditure and improve capital productivity.
43. For example, investments in efficient transport and telecommunications infrastructure may lower the costs of intermediate inputs or factor inputs, such as labour and capital. Effective transport and telecommunications systems can also lead to reduced freight or business travel costs. Both of these may allow greater production with the same inputs, or the same production with fewer inputs.

⁶ Productivity Commission Report on Road and Rail Freight Infrastructure Pricing. See also BITRE Information Sheet on Infrastructure Transport and Productivity.

44. Furthermore, public infrastructure investment may generate spillovers or network effects, of which there are three main types – labour market, agglomeration and competition impacts.
- **Labour market impacts:** improving the proximity of workers to jobs will tend to improve job matching and thus the efficient operation of labour markets.
 - **Agglomeration impacts:** greater proximity of similar firms may generate spillovers of knowledge or technology; agglomeration may also allow businesses to achieve greater economies of scale or scope, or to reallocate resources within networks.
 - **Competition impacts:** greater effective proximity of suppliers, customers and competitors will tend to lead to more competitive and efficient markets.
45. Infrastructure projects funded through the Initiative which support private sector activity, and aid the functioning of markets, will therefore serve to support productivity and living standards in the long term.

Fiscal constraints and private sector investment

46. The pressure to increase infrastructure investment is coming at a time when governments at all levels are facing significant fiscal constraints. The capacity of governments, both at the Commonwealth and state/territory levels, to fund additional infrastructure is inhibited by constrained budgets. This has become a significant impediment to the funding of infrastructure in Australia and makes the ability of governments to attract private sector investment crucial.
47. As illustrated in Chart 5, across all states and territories, the general government sector fiscal balance is expected to remain in deficit across the forward estimates, although the deficit is expected to narrow from 2.4 per cent of GDP in 2014-15 to 0.8 per cent of GDP by 2016-17.

Chart 5: Consolidated Fiscal Balance by Sector^(a)

(a) Data for the PNFC sector (and therefore the NFPS) is not available beyond 2014-15.

PNFC = Public Non-Financial Corporations

NFPS = Non-Financial Public Sector

48. Increased private sector investment in infrastructure is essential in addressing the infrastructure needs of the economy, particularly in light of the fiscal constraints facing governments.
49. There is strong demand from private sector entities to invest in mature, 'brownfield' infrastructure assets. This is because of the stable, low-risk nature of the revenues streams these assets are able to generate. However, private sector investors, particularly following the global financial crisis, have shown significantly lower tolerance for investing in new, 'greenfield' infrastructure assets where there is significant uncertainty around the revenue stream the asset will be able to generate.
50. The Initiative recognises the reduced willingness of the private sector to invest in certain types of greenfield infrastructure by encouraging states and territories to divest mature, 'brownfield' infrastructure assets in order to fund greenfield infrastructure. Private sector demand for brownfield infrastructure assets remains very high, so divestment of these assets is an effective way for government to fund greenfield infrastructure without reliance on other sources of government funding such as taxes or debt.
51. Infrastructure Australia has identified over \$100 billion in government-owned infrastructure assets that could be privatised.⁷ This indicates that there is a significant supply of assets that could potentially be sold or leased. Against this, the outcomes from recent tenders have indicated strong demand from the private sector for mature infrastructure assets with the ability to generate stable returns.

⁷ http://www.infrastructureaustralia.gov.au/publications/files/Australias_Public_Infrastructure-Part_of_the_Answer_to_Removing_the_Infrastructure_deficit.pdf.

52. In this context, the Initiative has been designed to take advantage of these market trends. By encouraging states and territories to divest assets, it will create a pipeline of investment opportunities for private sector investors. This will help to match the demand from private sector investors for mature assets. The proceeds from the divestment of these assets will then be used to fund the infrastructure necessary to both bolster economic activity in the medium term and lay the foundations for improved prosperity and wellbeing over the longer term.

Rationale for Divesting Assets

53. The primary focus of the Initiative is to support new investment in infrastructure by unlocking capital on state and territory balance sheets through asset sales. Nevertheless, there are also other benefits to be gained from the privatisation envisaged under the Initiative.
54. States and territories are responsible for selecting the assets they consider appropriate to be sold in order to participate in the Initiative, as well as ensuring the necessary regulatory arrangements are in place. State and territory governments are accountable to their constituents for these decisions. The Commonwealth respects the role of the states and territories to make these decisions.
55. Nevertheless, the Commonwealth considers it is beneficial for governments to sell or lease assets where this divestment results in greater economic efficiency or where there is no clear public benefit to retaining the assets. Previously, government business enterprises became involved in markets where the private sector was seen as incapable of delivering the required products or services. Private markets have matured in Australia and can provide many products and services currently delivered by public assets, and in many cases can provide them more efficiently. Consistent with this, Infrastructure Australia has noted that “many publicly owned infrastructure assets now serve limited or no public policy objectives.”⁸
56. Australia’s experience over the last 30 years bears witness to the benefits of privatisation programmes. During this time, successive Commonwealth governments have overseen a significant shift from public to private ownership across a wide range of sectors – for example, in telecommunications, banking, energy/utilities, airports and ports – dramatically transforming an economy once dominated by government-owned legislated monopolies and heavily protected private industries.
57. Supported by appropriate regulatory frameworks, private sector owners have increased the efficiency of public assets. They have increased labour productivity; improved governance and management structures, and service quality; and facilitated choice and competition in the market. Taken together, this has reduced service costs and improved consumers’ choices.
58. The Commonwealth has put these principles into action with its recent successful sale of Medibank Private. With a strong level of demand from institutional and retail investors, the sale raised \$5.679 billion. The sale will allow Medibank to better compete in the private health insurance industry, leading to higher service and quality levels for Medibank Private customers. It has also removed the conflict

⁸ Infrastructure Australia, *Australia’s Public Infrastructure: Part of the Answer to Removing the Infrastructure Deficit*, October 2012, p7

where the Government was both the regulator of the private health insurance market and a large market participant. Scoping studies are underway to examine options for the future ownership of Australian Hearing, Defence Housing Australia, the Australian Securities and Investment Commission Registry function and the Royal Australian Mint. These studies will identify the most effective and efficient way of delivering those services to the public.

59. The Productivity Commission inquiry on public infrastructure recently noted that asset recycling can help build community support for privatisation. The Commission recommended that states proceed only where there are sound sale processes, including regulatory frameworks. The Commission stated that the priority for the sale of government-owned assets should not be to secure the highest price per se, but to ensure that:
- economic efficiency is achieved;
 - the risks to consumers and other public interests are managed;
 - the market structure is amenable to the privatisation; and
 - the sale is conducted efficiently, ethically and transparently.
60. With any privatisation decision, governments need to balance the objective of optimising the return to taxpayers with an appropriate focus on maximising economic efficiency. This may require regulation to ensure the market structure is amenable to the privatisation. In most cases, it will be preferable to put the regulatory arrangements in place prior to the asset being divested rather than attempting to impose them after the asset is already under private sector ownership.
61. For example, governments should not sell monopoly, or near monopoly, assets without ensuring that there are appropriate access arrangements and sufficient controls on pricing. Failure to put in place necessary arrangements would allow the private sector operator of the asset to charge excessive prices and potentially to reduce competition in upstream or downstream markets by denying or restricting access.
62. Australian governments have a good track record of putting in place appropriate access and pricing arrangements; see, for example, the controls for electricity network assets under the National Electricity Laws and Rules.

PART 2: MECHANICS OF THE INITIATIVE AND ANNOUNCEMENTS FROM STATES

How the Initiative Operates

63. The operation of the Initiative is governed by a National Partnership Agreement.⁹ All states and territories, along with the Commonwealth, signed this Agreement at the Council of Australian Governments meeting on 2 May 2014.
64. Under the Initiative, the Commonwealth will make an incentive payment equal to 15 per cent of the proceeds from an asset divestment, if the state or territory government reinvests the proceeds from the asset divestment into additional infrastructure.¹⁰ The state or territory government must also agree to invest the incentive payment into additional infrastructure.¹¹
65. States will only receive the incentive payment to the extent that the proceeds from the asset divestment are invested into infrastructure. For example, if only 50 per cent of the proceeds are invested into infrastructure (such as where the other 50 per cent is used to pay down debt), the amount of the incentive payment will be reduced by 50 per cent.¹²
66. The 15 per cent incentive rate was a negotiated outcome following discussions with states and territories that sought to balance the need to avoid excess cost to the Commonwealth with the desire to provide states and territories with sufficient incentive to recycle capital from asset divestments into additional infrastructure investment.
67. The \$5 billion that the Government has allocated to the Initiative is expected to generate close to \$40 billion in additional infrastructure.¹³
68. In order to qualify for incentive payments, the state or territory must agree with the Commonwealth (the Commonwealth Treasurer) to the assets that will be divested and the additional infrastructure that will be funded using the proceeds. This agreement must be made by 30 June 2016.¹⁴
69. The terms of each bilateral agreement between the Commonwealth and an individual state or territory is embodied in a schedule to the National Partnership Agreement that is made public (subject to confidentiality restrictions).¹⁵ Funding to individual states and territories will be allocated on a first-come, first-served basis.¹⁶
70. The asset divestment must be completed by 30 June 2019 and the construction of the additional infrastructure must commence by 30 June 2019.¹⁷

⁹ A copy of the National Partnership Agreement on Asset Recycling (NP) is available at:
[https://www.coag.gov.au/sites/default/files/Signed%20National%20Partnership%20\(without%20Att%20A\).pdf](https://www.coag.gov.au/sites/default/files/Signed%20National%20Partnership%20(without%20Att%20A).pdf)

¹⁰ NP Clause 19.

¹¹ NP Clause 18.

¹² NP Clause 19(a).

¹³ This is calculated as (\$5 billion/0.15) + \$5 billion.

¹⁴ NP Clause 15.

¹⁵ NP Clause 22.

¹⁶ NP Clause 15.

¹⁷ NP Clause 15.

71. Once a schedule has been agreed, incentive payments will be made in two instalments subject to milestones being satisfied. These details are outlined in the table below.

	Payment 1 ¹⁸	Payment 2 ¹⁹
Amount	15% x 50% x (estimated proceeds from divestment ²⁰)	(15% x actual proceeds from divestment) – payment 1
Milestone – asset divestment	Commencement of divestment process (tender or expression of interest)	Completion of divestment
Milestone – project	Commencement of planning and approvals for project	Commencement of construction

72. Before a state or territory is entitled to an incentive payment, it must report against the milestones, by providing the Commonwealth with a Statement of Assurance.²¹
73. 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 payments under other National Partnership Agreements with the states and territories.
74. The Government has also put forward legislation to establish an Asset Recycling Fund. This will provide an additional level of transparency around infrastructure funding under the Initiative. Under this legislation, once the Treasurer determines that the milestones have been satisfied, he will write to the Finance Minister recommending that a payment be made from the Fund.²²
75. In order to maximise the incentive for states and territories to submit funding proposals under the Initiative, the incentive payments made under the Initiative are fully exempt from the GST redistribution treatment undertaken by the Commonwealth Grants Commission.
76. If the incentive payments were not fully exempt, an incentive payment to a state or territory would have also resulted in a decreased GST allocation for that jurisdiction over time. The net effect of this would have been to reallocate any incentive payment made across all states and territories according to their respective population shares, irrespective of their commitment to recycle capital into additional infrastructure. This would have greatly diminished the incentive effect of the payments.

¹⁸ NP Clause 20(a).

¹⁹ NP Clause 20(b)

²⁰ This will normally be the book value of net assets divested unless an alternative estimate is agreed by the Commonwealth (NP Clause 21).

²¹ NP Clause 32.

²² Asset Recycling Fund Bill 2014 section 19(1).

77. If, for any reason, the 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 with the Commonwealth, the National Partnership Agreement provides for the state or territory to be required to repay incentive payments it has received in relation to the asset divestment or additional infrastructure. (It also allows for the possibility that the Commonwealth and relevant jurisdiction may agree that there are exceptional circumstances which would warrant waving repayment requirements in full or in part.) In such circumstances, the funds may be reallocated to other projects under the National Partnership Agreement.²³

Asset Divestments

78. As noted earlier, states and territories have responsibility for determining which assets are divested and the method of divesting the assets.
79. This includes consideration of any necessary access and pricing arrangements. This could involve establishing or applying a tailored access and pricing framework such as that adopted for electricity transmission/distribution assets through the National Electricity Laws and Rules or applying the generic framework as set out in Part IIIA of the *Competition and Consumer Act 2010*.
80. States and territories have until 30 June 2016 to identify assets that they want to put forward under the Initiative. States have until June 2019 to divest the assets, which allows a further three years to address any regulatory issues.
81. State and territory governments will ultimately be accountable to their constituents for the assets that they decide to divest and the method of divestment. Consistent with this, some jurisdictions have sought, or are seeking, a mandate at their elections for their asset divestment programmes. It is the state's decision whether to sell assets, and the Commonwealth does not have a role in deciding which assets should be privatised.
82. Completion of the divestment will be considered to have occurred when there has been a significant shift in the ownership or control of the asset. This outcome would normally be achieved through a sale or lease of the relevant asset; however, the Government is open to considering alternative means of achieving this outcome if a proposal is put forward by states.²⁴
83. States and territories are required to show that the decision to divest the assets must have been significantly influenced by the Initiative in order to qualify for incentive payments.
84. Asset divestments under the Initiative will be subject to regulatory approval and legislative restrictions where appropriate. These include:
- ***Acquisitions that would result in a substantial lessening of competition:*** The divestment of an asset, or acquisition of rights under a lease, must not infringe section 50 of the *Competition and Consumer Act 2010*, which prohibits acquisitions that would have the effect, or be likely to have the effect, of substantially lessening competition in a market. The Australian Competition and Consumer Commission has an informal clearance process that may provide clarity that a

²³ NP Clause 23.

²⁴ NP Clause 4.

particular acquisition would not, in its view, substantially lessen competition, and a formal clearance process, that confers legal protections, is also available. Further, regardless of whether an acquisition would result in a substantial lessening of competition, it may be authorised by the Australian Competition Tribunal if it is likely to result in public benefits.²⁵

- **Foreign investment approval:** Under Australia's foreign investment review framework (which comprises the *Foreign Acquisitions and Takeovers Act 1975*, its associated Regulations, and Australia's Foreign Investment Policy), the Treasurer has the power to block foreign investment proposals or apply conditions to the way proposals are implemented to ensure that they are not contrary to the national interest. In this context, the acquisition of a state-owned asset by a foreign government investor will require approval under Australia's foreign investment review framework.

85. These restrictions are designed to ensure that asset divestments do not have adverse impacts on competition or the national interest. The Commonwealth will not make the second incentive payment to a state or territory government in relation to an asset divestment until approval processes (where initiated) have been completed.

Additional Infrastructure Projects

86. States and territories are responsible for selecting projects that will be funded using the proceeds from asset divestments and the incentive payments from the Initiative. The Commonwealth's involvement is limited to assessing whether the project satisfies the criteria in the National Partnership Agreement.
87. The projects supported by the Initiative are not Commonwealth Government-funded projects unless the Commonwealth Government also elects to provide direct funding for the project. Such funding would be provided under separate agreements with the states and territories, including the National Partnership Agreement on Land Transport Infrastructure Projects.
88. In order to be considered, the state or territory must establish that the infrastructure project is 'additional' to what would have occurred in the absence of the Initiative. This is determined by reference to whether the project could proceed within the specified timeframes without using the proceeds from the proposed asset divestments.
89. Once a project has been established to the 'additional', the project must satisfy the criteria specified in the National Partnership Agreement to be eligible:²⁶
- **Demonstrate a clear net positive benefit:** This assessment will take into account the quantified costs and benefits of the project. Wider economic benefits and factors that may be non-quantifiable that have influenced the decision of the state or territory government to proceed with the project will also be considered.

²⁵ For example, the Australian Competition Tribunal authorised the proposed acquisition of Macquarie Generation by AGL Energy Limited in Application for Authorisation of Acquisition of Macquarie Generation by AGL Energy Limited [2014].

²⁶ NP Clause 16.

- **Enhance long-term productive capacity of the economy:** This involves an assessment of the impact of the project on the economy's ability to deliver outputs. This will most commonly be the case for economic infrastructure such as roads and rail.
 - **Provide, where possible, for enhanced private sector involvement in both the funding and financing of the infrastructure:** This involves determining whether the state or territory government has assessed the feasibility for private sector funding (for example, user charging) or financing (for example, a public private partnership) with the project. It recognises that private sector involvement will not be possible in all projects, but states should, at a minimum, have thoroughly tested the potential for increased private sector involvement.
90. The Commonwealth will also consider projects that meet long-term economic infrastructure priorities in regional economies.²⁷
91. The Commonwealth Treasurer will make a final decision on the eligibility of the infrastructure projects put forward under the Initiative. As part of this process, the Treasurer will consult with other relevant Commonwealth Ministers, for example the Minister for Infrastructure and Regional Development, on additional infrastructure activity. In addition, consistent with Government policy, Infrastructure Australia will be consulted for any project in which a state or territory advises that it will invest \$100 million or more in incentive payments.

Announcements from States

92. There has been strong support for the Initiative from states and territories, with all jurisdictions signing the National Partnership Agreement. Most jurisdictions have announced asset recycling programmes.
- **New South Wales:** NSW has announced its intention to lease a 49 per cent interest in its electricity network assets and recycle the proceeds into a \$20 billion infrastructure package. This is subject to NSW receiving an electoral mandate to divest these assets.²⁸
 - **Queensland:** The previous QLD Government was intending to lease \$37 billion in assets and use part of the proceeds to fund an \$8.6 billion infrastructure package.²⁹ At the time of writing, a new Government has not yet been formed following the 31 January 2015 election.
 - **Victoria:** The new Government has not yet advised the Commonwealth whether it will participate in the Asset Recycling Initiative.
 - **Northern Territory:** The Northern Territory has announced the sale of the Territory Insurance Office and is investigating the lease of Darwin Port with the intention of recycling the proceeds into additional infrastructure.³⁰
 - **Australian Capital Territory:** The Australian Capital Territory has sold ACTTAB and announced it is considering the sale of a range of public housing,

²⁷ NP Clause 17.

²⁸ <http://www.nsw.gov.au/news/rebuilding-nsw>.

²⁹ <http://statements.qld.gov.au/Statement/2014/10/7/asset-leasing-plan-will-reduce-debt-and-create-jobs>.

³⁰ <http://newsroom.nt.gov.au/#mediaRelease/10012>.

government buildings, car parks and street lights to recycle the proceeds into an infrastructure investment programme.³¹

- 93. All asset divestments and additional infrastructure projects will be subject to assessment from the Commonwealth Government to determine whether they satisfy the criteria in the National Partnership Agreement.**
- 94. The application of the Initiative is in addition to the Commonwealth funding that states and territories have been allocated under the Infrastructure Investment Programme.**

³¹ http://apps.treasury.act.gov.au/data/assets/pdf_file/0011/601031/Budget-Paper-3-Budget-Outlook.pdf.

ATTACHMENT: TERMS OF REFERENCE FOR THE INQUIRY

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.**