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30 January 2015

The Committee Secretary
Senate Economics References Committee
PO Box 6100
Parliament House
Canberra ACT 2600

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Dear Committee Secretary,

INQUIRY INTO PRIVATISATION OF STATE AND TERRITORY ASSETS AND NEW INFRASTRUCTURE

The Association of Superannuation Funds of Australia (ASFA) would like to provide this submission in relation to the Committee's inquiry into privatisation (and recycling) of state and territory assets and new infrastructure.

About ASFA

ASFA is a non-profit, non-politically aligned national organisation. We are the peak policy and research body for the superannuation sector. Our mandate is to develop and advocate policy in the best long-term interest of fund members. Our membership, which includes corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through its service provider membership, represent over 90% of the 12 million Australians with superannuation.

Terms of Reference

We have comments with respect to those terms of reference which relate directly or indirectly to superannuation.

(a) (i)The role of the Commonwealth in working with states and territories to fund nation-building infrastructure, including the appropriateness of the Commonwealth providing funding.

ASFA believes it is entirely appropriate for the Commonwealth to provide such funding given the benefits to the Australian economy that infrastructure investments provide. These investments boost productivity and help drive economic growth.

As a large and significant investor in infrastructure, the superannuation sector is also broadly supportive of measures that bring suitable assets onto the market. APRA data indicates that in the 2014 September quarter, APRA-regulated superannuation funds invested $47.4 billion in infrastructure (around 4 per cent of total assets), mostly unlisted, and 80 per cent of which was invested in Australian assets. MySuper funds have a high relative exposure to infrastructure assets, with $25.7 billion in infrastructure (around 7 per cent of relevant assets). Many funds have a benchmark allocation to infrastructure of 10 per cent or more, with upper bounds often considerably higher.

There's little doubt that the superannuation sector has a strong appetite to lift its level of infrastructure investments. There are a variety of factors that contribute to this.

Firstly, it is projected that superannuation capital will increase from $1.8 trillion to $6 trillion by 2037. The increase in superannuation capital alone suggests that there will be a significant increase in demand for infrastructure investments.

It is also likely that there will be a structural shift in the composition of the superannuation system as the first wave of baby boomers move into retirement. This generation of retirees will require products that deliver income streams in retirement. It is projected that the percentage of assets in retirement products will increase over the next 15 years from a current 30 per cent of all superannuation assets to 35.6 per cent, or around $365 billion to $1,036 billion. This will require funds to adjust their investment strategies and increase their allocation to assets that have low volatility, steady returns and long term investment horizons to match the needs of members. Many infrastructure assets fit this investment profile.

As the pool of superannuation funds continues to grow, we are also likely to see an increase in the number of funds consolidating. This means less but larger funds, who will have greater capacity and scale to invest in infrastructure, as well as better in-house expertise to bid for projects.

While the potential and desire for superannuation funds to invest in infrastructure is strong, an ongoing impediment has been the absence of a long-term, stable and transparent pipeline of investment opportunities.

When funds are unable to locate assets in Australia that suit their investment strategies they will naturally seek investments elsewhere. When it comes to infrastructure, the lack of suitable projects in Australia leads to funds actively pursuing infrastructure investment opportunities overseas. While this boosts the diversification of the fund's investment portfolio, it pulls the economic benefits of infrastructure investment away from the Australian economy.

Superannuation funds are universal owners, that is, they are invested in the whole economy. As such, productivity improvements that directly benefit the whole economy as a result of investment in infrastructure assets will benefit superannuation funds in other parts of their portfolios.

All these factors in aggregate lead to the conclusion that the superannuation industry welcomes moves by the Commonwealth to provide funding to encourage privatisation and recycling of state and territory infrastructure assets.

(a) (ii)The role of the Commonwealth in working with states and territories to fund nation-building infrastructure, including the capacity of the Commonwealth to contribute an additional 15 per cent, or alternative amounts, of reinvested sale proceeds.

The capacity of the Commonwealth to contribute an additional 15 per cent of reinvested sale proceeds depends on the state of the Commonwealth's budget and its existing and future priorities, and the capacity of State governments to deliver new infrastructure.

In this respect, most state budgets do not have the capacity to adequately fund their new infrastructure requirements. In many cases, the only way they will be able to fund nation building infrastructure is by recapitalising their budgets through the sale of existing assets.

Privatising assets can be politically challenging for State governments. Therefore it is entirely appropriate for the Commonwealth to facilitate these transactions by providing incentives for asset sales.

(b) The economics of incentives to privatise assets

At present there is an inherent disincentive for State governments to privatise infrastructure assets due to the revenue structures that exist between State and Federal governments.

National Competition Policy requires state-owned enterprises to pay company tax equivalents to their owner. Amongst other things, this tax equivalence regime was designed to bring about neutrality between government businesses and competitors in the private sector. This policy can have an impact on whether or not States decide to privatise an infrastructure asset.

Following privatisation, the new owners generally will receive dividends and pay company tax to the Commonwealth. This mean, in effect, the privatisation will involve a transfer of taxes from States to the Commonwealth. States have an incentive to privatise only if the sale price is sufficient to compensate for the loss of the income stream comprising of both dividends and tax equivalents.

By offering the States 15 per cent of the sales price for eligible sales the asset recycling initiative provides a form of compensation for the transfer of the tax revenue to the Commonwealth.

(c) what safeguards would be necessary to ensure any privatisations were in the interests of the state or territory, the Commonwealth and the public;

ASFA understands that privatisation can lead to community concern about how assets will be managed in the future.

Certain privatised assets should be subject to appropriate regulation to protect consumers, the environment or the community in general. From the perspective of the superannuation sector the best infrastructure investments are those where there is long term community acceptance of private ownership. This reduces political pressure for regulatory changes to pricing structures which can have significant impacts on the value of an asset.

As long-term investors, superannuation funds are interested in achieving long-term sustainable investment returns. Our interests align with those of the community and governments that are interested in ensuring that assets are managed responsibly and for the long-term benefit of society.

ASFA believes that all stakeholders including investors, constructors, banks and governments have a role to play in communicating the benefits of privatisation of assets to the community.

Conclusion

Australia's superannuation funds have the capital, expertise and commitment to invest in Australian infrastructure and Australia's infrastructure sector has the sophisticated engineering, financial and project skills to deliver the new projects we need.

Superannuation funds stand ready and willing to invest, but historically there has not been a consistent pipeline of suitable projects. Providing incentives to the states to sell mature assets will help establish a steady, long-term pipeline of investment opportunities, while freeing up the capital required to deliver the new infrastructure the Australian community both needs and deserves.

Superannuation fund members also stand to benefit from asset recycling. As more Australians enter retirement, this will drive demand for assets with reliable income streams, low volatility and long-term investment horizons. Many infrastructure assets, such as ports and energy networks, are a natural fit for this profile.

We understand privatisation can lead to community concern about how the assets will be managed in the future. In this regard there is a natural symmetry between the interests of superannuation funds, who want to achieve sustainable, long-term returns, and the interests of the community, who want to ensure these assets are managed responsibly and for the long-term benefit of society.

We believe that providing the States with financial incentives to privatise assets is entirely appropriate, and indeed welcomed by the superannuation sector and the community.

If you have any queries or comments regarding the contents of our submission, please contact ASFA's Policy Adviser, David Graus,
Yours sincerely

Glen McCrea
Chief Policy Officer