

## **The Australian Model of Asset Recycling: “A Spurious Justification for Privatization”**

*The sixth impossible thing to believe, therefore, is that the “asset recycling” model is in the public interest. Rather, it looks very much like an extension of this Government’s favors to the corporate end of town. [[New Matilda](#)]*

As debate over President Trump’s proposed \$1 trillion infrastructure plan has gained strength in Congress and the media, some are proposing that the U.S. should look to Australia—and specifically to that country’s Asset Recycling program—for a model of how to support a long-term program of badly needed infrastructure investment. The suggestion reportedly emanated from the first in-person meeting between President Trump, Prime Minister Turnbull and Australia’s ambassador to the U.S., Joe Hockey, who as federal Treasurer was the architect of the Asset Recycling plan in Australia.

However, from what Australians themselves have said and written about the program over the past three years, what we have witnessed recently is a *caricature* of the Australian experience with public asset “recycling.” Far from being a model to be followed, it is a model to be learned from for what should *not* be done to promote badly needed infrastructure improvements in the U.S.

Introduced in 2014, the Australian Asset Recycling program ultimately crashed and burned, and was withdrawn by the conservative Tony Abbott government. (“[It was a rather miserable end for Joe Hockey’s centerpiece for 2014](#)”). The Abbott government was unable to get enabling legislation and funding for the program through the Senate, which had held extensive hearings on the Asset Recycling program and raised multiple criticisms of its economics, administrative feasibility, transparency, conceptual soundness, riskiness, fairness, policy impact, and ability to deliver good and necessary public infrastructure.

The Australian Senate amended the bill [to “give the federal parliament capacity to determine what gets privatized and also ensure that new projects will be subject to cost benefit analysis”](#) and block them [“if they are judged not to be in the public interest.”](#) While Abbott pointed to the funding restrictions on the plan as the reason for its failure, it was its poor design as a tool of proper infrastructure development and financing, and the raucous controversies that it produced (see below) that killed the plan.

If Americans wish to avoid a similar experience, they will do well to study the extensive analysis of the problematic issues with the Australian Asset Recycling Plan and apply them here so we can establish a sustainable infrastructure improvement program.

Following are some of the issues raised in Australia about the Asset Recycling Plan both in parliamentary hearings on the plan and as it rolled out after 2014. The 2015 Senate Committee report, [expert witness submissions](#), and recommendations [can be found here](#).

**From an economic standpoint, [the Australia Institute asked some crucial questions about the Asset Recycling Program](#):**

“From an economic perspective this proposal raises a number of questions:

- Is privatization of government assets always desirable and should it be encouraged through Commonwealth payments?
- Is the Asset Recycling Program the best way to assist the financing of new infrastructure investment?
- Is private sector funding of infrastructure always desirable?
- How many assets are available for privatization and where are they?”

Regarding so-called expert financial and infrastructure industry advice supporting the Australian (and Trump) asset recycling program, the institute remarked “It is worth remembering many advocates of privatization have a vested interest in it,” but “**as investor Warren Buffett once said: *If you want independent advice, don't ask a barber whether you need a haircut.***”

A central criticism of the plan was that far from providing new funding or financing for infrastructure, it just redirected current funds to projects favored by the austerity-minded conservative government. The opposition Labor Party “attacked the heavily touted infrastructure package [as a smoke and mirrors trick, with little genuinely new spending, and redirections from public transport investments to major arterial roads.](#)”

The shadow infrastructure minister, Anthony Albanese, said of the Asset Recycling plan, “At the same time as [Joe Hockey is] saying we need to invest more in productive infrastructure, [he's planning to rip billions of dollars out of public transport projects](#) that have been fully funded in previous Labor government budgets.” Unions also opposed the Asset Recycling scheme, [and demanded that essential public services be protected from privatization](#). Such comments are similar to current American concerns about what the Trump infrastructure plan is doing to slash public transport funding.

But criticism of the Asset Recycling Program has come not only from the Labor side of the political spectrum, [but also from staunch conservatives](#). For example, Rod Sims, chairman of the **Australian Competition and Consumer Commission**, said of the program, “I’ve been a very

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strong advocate of privatization for probably 30 years. I believe it enhances economic efficiency [but] I'm now almost at the point of opposing privatization because it's been done to boost proceeds, it's been done to boost asset sales, and I think it's severely damaging our economy. If we want support for privatization then we've got to do them in ways that deliver what's expected to be delivered, which is lower prices for consumers, not higher."

As for who stood to benefit from the Australian "asset recycling" program, Australian researcher Warwick Smith [offered a clear answer](#): "It's tempting to call the federal government's "asset recycling initiative" another example of their small government ideology, which is usually just cover for private rent seekers who want to pillage the public purse. When in doubt, follow the money. **So who benefits from the privatization of public assets? The obvious answer is the buyer. Such assets will only be purchased if they stand to make a return. However, the biggest winners when multiple asset sales are considered are the banks.** Privatized assets are almost always bought with borrowed money. So, while individual companies or consortia might benefit from the purchase of a government asset, **it's the banks and other lenders who benefit from a culture of privatization.**"

There were also major issues with how the program was implemented. Although the idea behind the Asset Recycling plan was to fund good new projects that were fully vetted in exchange for a federal top-up of the proceeds of public asset sales (a 15% bonus), the Northern Territory government, in an attempt to access Asset Recycling funds, went ahead in 2015 and privatized two major public assets (including leasing Darwin port to a Chinese company for 99 years) [without having a clue where the money would go](#).

Opposition to the deals was strong, [with one Northern Territory lawmaker saying the process was inappropriate](#): "Public assets like TIO belong to Territorians, not the government. If a government has a case to sell a public asset in the best interests of the community, where there has been a cost-benefit analysis, they should make that case to the voting public and win their mandate to sell. The CLP have failed to consult with the public and they are arrogantly pursuing a behind-closed-doors sell-out of assets that belong to Territorians."

**Many of these shortcomings were laid out in the parliamentary inquiry.**

The Australian Senate committee [reported](#): "2.1 During this inquiry the committee focused its attention on the link between infrastructure funding and privatization under the Asset Recycling Initiative, which provides states and territories with financial incentives if they sell assets and recycle the capital into additional infrastructure.[1]"

2.2 While the committee was aware of some support for the Asset Recycling Initiative,[2] **the majority of submitters and witnesses identified a range of concerns and did not support**

**the Initiative. This chapter discusses the issues that may arise from binding infrastructure funding to privatization under the Asset Recycling Initiative, with a specific focus on the:**

- Potential distortion of state and territory decisions on privatization and infrastructure funding;
- Possibility that privatization decisions will be rushed, leading to poor processes, poor consultation and poor regulatory safeguards; and
- Potential unfairness and inequity between the states and territories.”

The coercive nature of the Asset Recycling program was illustrated in Queensland, whose treasurer said the federal government [was using the program as a whip to drive privatization deals it considered unsound](#). “Sadly the Australian Government **intends on withholding federal infrastructure funding from Queensland, unless we agree to sell state assets.**”

#### Flawed Decision-making and Distorted Incentives:

Australia’s experience invites serious questioning of the methods of project selection being used in any “Asset Recycling” scheme to address the issue of whether a politically or ideologically distorted federal decision-making body (possibly a “captured agency”) will override existing safeguards for sound decision-making and risk analysis, and [become a political football](#) come election time.

In addition to this, **Prof. John Quiggin** pointed out to the committee that [state and local decision-making on whether to privatize or not is affected by the privatization incentive](#) being offered. In the case of the Asset Recycling Initiative, “**bad privatization decisions are being encouraged by the presence of the subsidy**. The fact that you cannot get it for a privatization that makes such strong economic sense and for which you do not need the subsidy is an indication of exactly how things are being distorted on both sides of the decision. Regarding both the assets originally for sale and secondary investments, this program distorts both of those decisions.” Quiggin called the Asset Recycling Initiative “[a spurious justification for privatization](#),” and said “[the politically toxic idea of privatizing public assets is being repackaged as ‘recycling’](#).”

The Senate committee itself notes that “**the distorting effect of the Asset Recycling Initiative was confirmed by the Treasury submission** which indicates that states and territories are required to show that the decision to divest an asset [must have been significantly influenced by the Initiative in order to qualify for incentive payments](#).”

To this can be added a point made by the [Australian Productivity Commission \(p. 280\)](#), that the incentive structure of all “capital recycling models” (such as Abbott’s Asset Recycling Initiative),

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“where the proceeds of sale are automatically hypothecated to investment in new infrastructure projects, **may create risks for over-investment in new greenfields infrastructure.**” In addition to being more risky in the construction and ramp-up phase, this might discourage needed investment in existing “brownfield” infrastructure.

In fact the Productivity Commission said the central problem with such “capital recycling” schemes is that they merge what should be different aspects of any good public investment decision-making process:

“Capital recycling involves the linking of two separate decisions; the decision to privatize state-owned assets, and the decision to invest in a new infrastructure project or set of projects. **While the linking of the two decisions may be a useful mechanism to alleviate community resistance to privatization, this should not replace the need to undertake these sets of analyses separately.** Ideally, **both sets of decisions would be made within a transparent decision-making environment, where a robust cost–benefit analysis is undertaken, and there is scope for independent review.**”

Regarding the “**potential unfairness and inequity between the states and territories,**” the Australian Senate committee noted that “the Northern Territory government submitted that **...some jurisdictions appear to be at a much more advanced stage of preparation for asset sales** and have a large pipeline of potential privatizations. It is foreseeable that **the existing pipeline of privatizations in the larger jurisdictions may significantly eat into the pool of funds allocated for incentive payments under the asset recycling initiative.**”

The committee also noted that “the [Business Council of Australia](#) suggested that the Asset Recycling Initiative **should be designed to prevent one or two states from capturing all of the available \$5 billion in funding through large-scale privatization projects,**” and that “Emeritus Professor Bob Walker and Dr. Betty Con Walker also suggested that **incentives for privatization from the Commonwealth may encourage states and territories to sell their most profitable businesses, which are currently providing essential services.**”

#### The Public Balance Sheet:

In his testimony to the Senate committee and other writing, Prof. John Quiggin also raised the larger possibility that the asset recycling scheme will do longer term damage to the public sector’s balance sheet by removing income-producing assets and transferring these over to the private sector and creating other distortions.

After reviewing a decade and more of experience in Australia and the United Kingdom, [Quiggin concludes](#), “In reality, **most privatizations have reduced public sector net worth,** either

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because the assets have been underpriced, or because the proceeds have been dissipated in current expenditure **or economically unsound investment projects.**" (p. 7).

Quiggin maintains that if widely scaled-up and bundled into an "asset recycling" scheme, the risks of such a negative impact on public net worth would increase:

*The idea of asset recycling is, in essence, an attempt to systematize and subsidize this procedure. Rather than once-off deals in which asset sales are packaged with expenditure project, a general procedure is suggested to subsidize such packages.*

*The idea of recycling is that a resource, used once to produce some good or service such as a newspaper or container, can be reclaimed and reused. Ideally, the same resource can be reused many times, reducing the need for new supplies. 'Asset recycling' has nothing in common with this process. Income-generating assets are valuable precisely because they generate income. **Selling the assets and spending the proceeds on current or capital items that generate no flow of income, and cannot be justified by ordinary cost-benefit analysis is not, in any meaningful sense, recycling.***

In addition, the distortions are compounded by misplaced financial incentives that would impact project selection and, as noted above, political factors (pp. 8-9):

*The idea of asset recycling, in which specific balance sheet transactions are identified as a funding source for favored projects runs the risk of violating the core principles of public infrastructure investment. **Projects are selected on the basis of eligibility to attract financing from the proceeds of asset sales, rather than being evaluated on a standard benefit-cost basis.** Moreover, given the political unpopularity of privatization, there is considerable pressure to fund politically attractive projects, rather than those with the greatest long-term benefits. (...)*

*Asset recycling is commonly seen as a way of financing projects that would otherwise not proceed, implying that they do not pass the relevant benefit-cost test. Under these circumstances, **the value flow of services from the project is less than would have been obtained by repaying debt or making a cost-justified investment. It follows that public sector net worth will decline.***

There is also the question of accurate valuation. There is a risk if revenue-producing assets are privatized, and if they are the public must be sure the benefits outweigh the lost revenue. Australian conservatives have been [touchy or evasive on this issue](#), even to the point of allegedly [fixing a bank advisory report's conclusions about the negative revenue effects of privatization](#).

But if the sums are done correctly and the public balance sheet issues taken into account, Quiggin suggests that “[a sustainable system of asset-recycling](#)” can be developed “which would result in a sustainable balance between the private and public sectors, rather than the liquidation of public assets. Such a policy would involve the allocation of risk to the agents best able to bear it.” At the earlier stages of a project where demand and regulatory risks are high, Quiggin suggests, the government can take a risk-bearing role, and when “demand risk settles down and regulatory issues are resolved,” then the project “is sold and the proceeds are used to build a new port, or some other piece of income-generating infrastructure.” (p. 10-11).

Note here that this would not apply to many infrastructure needs, such as an essential project that is not income-generating—e.g., a non-tolled or non-subsidized road. A decision could certainly be made to use the proceeds of an asset sale for such a purpose, but the negative balance sheet and revenue effects would be compounded, and would hardly support a sustainable “recycling” chain. This is why tolling and/or subsidies are normally hard-wired into “public-private partnership” projects, and are central features of the both the Australian and Trump “asset-recycling” plans.

#### Potential unfairness and inequity between the states and territories:

The actual choice of infrastructure investment priorities has also been affected by Abbott’s scheme, [with Victoria’s elected leaders saying they were refused Asset Recycling funding because they chose to use the money to remove level crossings](#), and accusing the federal government of reneging on its agreements under the program. So another lesson from the Australian experience is “will the promised federal dollars ever materialize?” or will a “recycling” program just set off a race to the bottom of competitive underpricing of public assets so they can attract private investment?

Recently the Turnbull government has been accused of [playing politics with the remaining funds in the asset recycling scheme](#) by “punishing Victoria for voting Labor by withholding asset recycling funds from Melbourne Metro, which Infrastructure Australia identified as a project with national significance” to instead help fund a toll road it favored.

An asset recycling program also runs the risk that it will favor asset-rich states. In announcing his program in 2014, Joe Hockey himself conceded that, as the *Sydney Morning Herald* put it, [“some states would get more money from the \[incentive\] pool than others because some states had more public assets to sell.”](#)

### Transaction Costs:

When rolling out the Trump administration’s proposed budget, Gary Cohn, Trump’s economic advisor, [said officials were closely looking into the Australian model](#), and proposed that “instead of people in cities and states and municipalities coming to us and saying, 'please give us money to build a project', and not knowing if it will get maintained, and not knowing if it will get built, we say, 'hey, take a project you have right now, sell it off, privatize it, *we know it will get maintained*, and we'll reward you for privatizing it.” [Emphasis added].

However, the Australian experience—where [public electricity asset privatization has been a hotly controversial topic with a significant electoral impact](#)—indicates that [the question of automatic maintenance comes with economic incentives to the private sector](#) that may not be visible through the fog of “it will cost the taxpayer nothing” boosterism:

*As anyone who has ever sold a house knows, there are transaction costs in selling assets. Stockbrokers, valuers, bankers and lawyers all stand to do well out of privatization, without providing a cent of public value. Once these companies are privatized, managerial salaries rise sharply. **In order to get a high price for the sale, the government may grant special privileges to the new owners, such as a permissive pricing regime.** Most notably, prices of the services provided by these utilities will rise because **the private owners will seek a higher return on investment than the previous public owners — a significant impost in these capital-intensive industries.**”*

### Senate Committee Recommendations and Comments:

Having closely examined the issue of asset-recycling, The Australian Senate committee [summarized its concerns and recommendations as follows](#):

*The committee is concerned about the possibility that **incentives under the Asset Recycling Initiative may encourage privatization without effective public consultation and communication strategies, and without appropriate consideration or analysis of future costs.** The committee strongly encourages governments to conduct proper, **rigorous analysis of the all current and future costs associated with privatization projects.** In addition, **thorough and appropriate public consultation should be always be undertaken, including consultation around transactions costs and the cost of creating an appropriate regulatory environment and compliance with those arrangements.***

So its [three principal recommendations](#) are:

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Recommendation 1: “The committee recommends that proper and rigorous analysis of total costs associated with privatization projects be conducted when privatization is proposed by governments at any level. In addition, appropriate public consultation should be undertaken, including consultation around transactions costs and the cost of creating an appropriate regulatory environment and compliance with those arrangements.

Committee Comment on Recommendation 1: “The committee considers that appropriate safeguards and regulatory arrangements should be put in place for all asset privatization, **well in advance of the sale process commencing**. The committee is concerned about the **evidence it has received that the Asset Recycling Initiative may encourage states and territories to take shortcuts on safeguards and regulatory arrangements in order to meet the timeframes established by the Asset Recycling Initiative.**”

Recommendation 2: “The committee recommends that prior to privatization of assets, governments at all levels introduce appropriate regulatory arrangements and safeguards, including safeguards against anti-competitive behavior to ensure that future costs are known and established.”

Committee Comment on Recommendation 2, **and specifically on the Australian Asset Recycling Initiative**: “The committee notes that in its inquiry into Public Infrastructure, the Productivity Commission **considered the Asset Recycling Initiative and concluded that on balance: the aims of the Asset Recycling Initiative are laudable, but the risks are significant; decisions to privatize a state owned asset and procure new infrastructure should be separate; there is a distinct risk that states and territories will take shortcuts to avoid thorough and transparent analysis; and governments should avoid creating expectations in the community that privatization is only acceptable when the proceeds are used for procuring new infrastructure**, constraining future governments from optimizing their balance sheets in the public interest.”

The committee was also concerned that **the Asset Recycling Initiative would lead to problems** including:

- Potentially distorting decisions by states and territories on infrastructure investment, leading to projects being pursued that would not stand on their own merits;
- Potentially distorting decisions leading to privatization that would not go ahead if they were considered on a case-by-case basis;
- The possibility that privatization and infrastructure projects will be rushed without:

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- Appropriate public consultation and debate leading to poor outcomes; and
- Appropriate safeguards, corporate structures and regulatory arrangements in place; and
- The potential to create inequitable outcomes between states and territories as the Initiative may unfairly benefit those jurisdictions which currently have assets for sale or prepared for sale, rather than those jurisdictions where the infrastructure is most needed.

**Recommendation 3:** “The committee **recommends that the link between privatization of assets and infrastructure funding under the Asset Recycling Initiative should be removed.** This would provide an environment where:

- States and territories are encouraged to consider the merits of privatization on a case by case basis;
- Decisions to fund infrastructure projects are based on the community and economic need; and
- The Commonwealth contributes funding based on the merits of proposed infrastructure projects while considering the equitable distribution of funds across states and territories.