It boondoggles the mind

Does the Northern Australia Infrastructure Facility (NAIF) give subsidies?

Minister Canavan is wrong to say NAIF gives loans not subsidies. A $900 million concessional NAIF loan to support Adani's coal mine would be taxpayer subsidy, according to the government's budget, the WTO, other coal companies and the Productivity Commission. NAIF can also give non-loan financing.

Briefing paper

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Summary

The Northern Australia Infrastructure Facility (NAIF) is a $5 billion government fund for concessional financing to build infrastructure in northern Qld, NT and WA. The default financing mechanism is a loan. Adani has applied for a concessional loan of nearly $1 billion from the NAIF for a rail line so that it can export coal from its proposed Carmichael coal mine.

Minister for Resources and Northern Australia Matthew Canavan and Deputy Prime Minister Barnaby Joyce have strongly supported the Adani loan proposal, while at the same time insisting the NAIF is independent. Minister Canavan has said

> "I want to make it absolutely and abundantly clear; any proposal, any investment from the Northern Australia Infrastructure Facility to any project is a loan, not a subsidy or a grant,"[1]

This is contradicted by

- The government's budget, which treats it as costing $1.6bn over estimate;
- The World Trade Organisation's rules, which show it is a subsidy;
- Other coal companies, who have have called it a subsidy.
- The Productivity Commission, which views such loans as unjustified.

Subsidies to coal mines make little economic or environmental sense. Loans to this project prevent loans to other projects, and breach of Australian government commitments to the G20 to phase out fossil fuel subsidies.

Subsidies to coal companies are extremely unpopular. New polling shows 64% of Australians oppose a subsidised loan to Adani, including most Queenslanders and most LNP voters. Australians would prefer NAIF to spend money on almost anything else.

Minister Canavan is also not correct to say that any NAIF financing must be a loan. NAIF can also provide non-loan financing, through a vague "alternative financing mechanism", on discretion of NAIF and government. It is unclear how such a mechanism would work. While equity is ruled out, the explanatory memoranda suggest guarantees or contingent repayment. Cash payments are not ruled out.

[1] http://mobile.abc.net.au/news/2017-05-04/adani-told-arrium-deal-will-not-sway-decision-on-government-loan/8497342?pfmredir=sm

NAIF gives concessional loans

NAIF is set up to give concessional financing to projects that would not otherwise go ahead and cannot attract sufficient commercial financing.

The NAIF's Investment Mandate sets out conditions for NAIF criteria for a loan.

> s7(1) "The Facility must not provide a Financing Mechanism unless the Board is satisfied the Project would not otherwise have received sufficient financing from other financiers.
>
> …
>
> Mandatory Criteria 3
>
> The proposed Project is unlikely to proceed, or will only proceed at a much later date, or with a limited scope, without financial assistance.[2]

The NAIF Investment mandate deals at length with the need for the NAIF board to carefully consider the size of the 'concessional loan' being offered.

> **s(9) Determining Concessions**
>
> (1) In determining any concession to be granted in an Investment Decision, the Board must have regard to:
>
> (a) the extent and mix of all concessions necessary for the Investment Proposal to proceed; and
>
> (b) the extent of the project's public benefit.
>
> (2) The Board must limit the concessions offered to the minimum required for the Investment Proposal to proceed.
>
> (3) The Board may propose contract terms to ensure that the Facility is not providing greater concessions than necessary. This may include, but is not limited to:
>
> (a) removing, relaxing or minimising concessions provided; or
>
> (b) having the ability to seek early exit from an investment.[3]

[2] *Northern Australia Infrastructure Facility Investment Mandate Direction 2016* https://www.legislation.gov.au/Details/F2016L00654

The NAIF Mandate also suggests forms that the 'concessions' can take.

> s(10) Loan conditions
>
> (1) Loans will be the default Financing Mechanism considered for all Investment Proposals.
>
> (2) The Facility may propose, but is not limited to, the following loan concessions:
>
> > (a) longer loan tenor than offered by Commercial Financiers, not exceeding the longest term of Commonwealth borrowings;
> >
> > (b) lower interest rates than offered by Commercial Financiers, which must not be lower than the rate at which the Commonwealth borrows at;
> >
> > (c) extended periods of capitalisation of interest beyond construction completion;
> >
> > (d) deferral of loan repayments or other types of tailored loan repayment schedules;
> >
> > (e) lower or different fee structures than those offered by Commercial Financiers;
> >
> > (f) ranking lower than Commercial Financiers for cash flow purposes.[4]

The plain meaning of a concession is to confer a discount or preferential treatment on an activity or group (eg pensioner concession). All of the above conditions provide for preferential treatment to infrastructure developers.

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[3] *Northern Australia Infrastructure Facility Investment Mandate Direction 2016* https://www.legislation.gov.au/Details/F2016L00654

[4] *Northern Australia Infrastructure Facility Investment Mandate Direction 2016* https://www.legislation.gov.au/Details/F2016L00654

A subsidy according to the government's own budget

The federal budget shows the cost of the NAIF. The total cost is $1.6 billion over estimates. This is shown in Figure 1.[5]

Table 2.1.2: Program components of Outcome 1 (continued)

Program 2: Growing Business Investment and Improving Business Capability

	2016-17 Estimated actual $'000	2017-18 Budget $'000	2018-19 Forward estimate $'000	2019-20 Forward estimate $'000	2020-21 Forward estimate $'000
Sub-program 2.5: Energy (c)					
Annual administered expenses:					
Energy Efficiency Programs	30	-	-	-	-
GEMS National Legislative Framework	110	-	-	-	-
Total annual administered expenses	**140**	-	-	-	-
Total sub-program 2.5 expenses	**140**	-	-	-	-
Sub-program 2.6: Northern Australia Development					
Expenses not requiring appropriation in the Budget year:					
Northern Australia Infrastructure Facility (d)	-	213,495	461,025	510,531	460,251
Total expenses not requiring appropriation in the Budget year	-	**213,495**	**461,025**	**510,531**	**460,251**
Total sub-program 2.6 expenses	-	**213,495**	**461,025**	**510,531**	**460,251**
Total program 2 expenses	**588,205**	**692,836**	**813,851**	**785,743**	**683,290**

(a) This is a component of the Growth Fund.
(b) Expenses not requiring appropriation relate to depreciation and amortisation expenses for the National Offshore Petroleum Titles Administrator.
(c) The estimates reflect the impact of energy functions that transferred to the Department of the Environment and Energy as a result of the 19 July and 1 September 2016 Administrative Arrangements Orders.
(d) The figures represent the expenses associated with the concessional loans proposed under the Northern Australia Infrastructure Facility.

Source: Department of Industry, Innovation and Science Budget Statement p33

These costs represent "expenses associated with the concessional loans". They are the total concession over the life of the loans, allocated to the year the loans are made.

It is unclear how the Department or the NAIF has calculated this concession, given it cannot know in advance what loans will be made or what the concession will be. Nor is it clear what the 'market' loan has been assumed to be. However, some assumptions have been made for the purposes of calculating the concession.

[5] DIIS Budget Statement 2017-18 https://industry.gov.au/AboutUs/Budget/Documents/PBS-2017-18.pdf

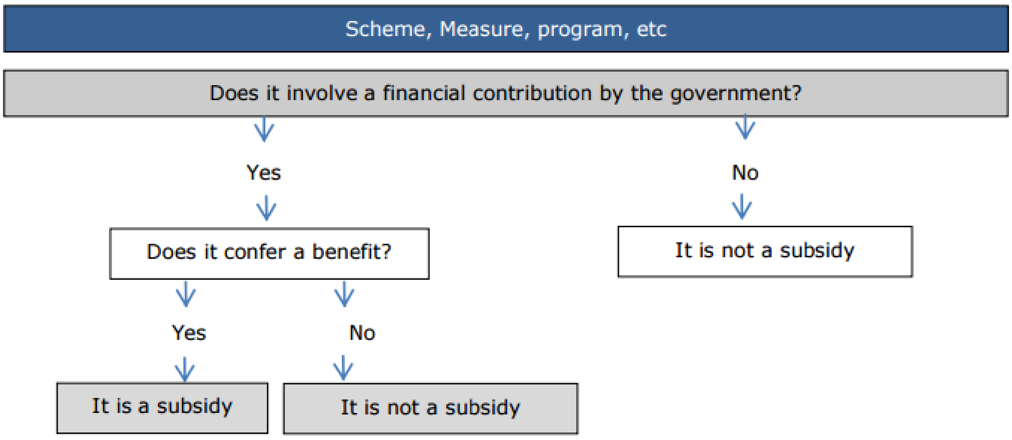
A subsidy according to the WTO

The World Trade Organisation defines subsidy as

> (i) a financial contribution (ii) by a government or any public body within the territory of a Member (iii) which confers a benefit.[6]

The WTO also offers a flow chart to help determine if a scheme is a subsidy:

Figure 1: What is a subsidy?



Source: WTO (2017) *Detailed Presentation of Subsidies and Countervailing Measures in the WTO*

NAIF loans are financial contributions by a government that confer a benefit. They are therefore a subsidy, according to the WTO.

The WTO specifically addresses the issue of whether concessional loans are subsidies:

> In many cases, as in the case of a cash grant, the existence of a benefit and its valuation will be clear. In some cases, however, the issue of benefit will be more complex. For example, when does a loan, an equity infusion or the purchase by a government of a good confer a benefit? Although the SCM (Subsidies and Countervailing Measures) Agreement does not provide complete guidance on these issues, the Appellate Body has ruled (Canada – Aircraft) that the existence

[6] WTO (nd) *Detailed Presentation of Subsidies and Countervailing Measures in the WTO* https://ecampus.wto.org/admin/files/Course_385/Module_1594/ModuleDocuments/SCM-L2-R1-E.pdf p7

> of a benefit is to be determined by comparison with the market-place (i.e., on the basis of what the recipient could have received in the market).[7]

Similarly, when defining the term ‘benefit’, the WTO includes loans :

> The Appellate Body has ruled that the existence of a benefit is to be determined by comparison with the market-place. The question to be answered is therefore whether the financial contribution is "provided on terms which are more advantageous than those that would have been available to the recipient on the market." If the answer is positive, then the financial contribution confers a benefit. So, for example, a government-provided loan confers a benefit where its terms are more favourable to the recipient than those the recipient could have obtained from a commercial lender.[8]

In short, the WTO considers a loan to be a subsidy if it is a financial contribution that offers a benefit that is not available in the market place. This is exactly what the NAIF is designed to provide.

Concessional NAIF loans are subsidies according to the WTO.

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[7] Bold added. WTO (2017) *Subsidies And Countervailing Measures: Overview* https://www.wto.org/english/tratop_e/scm_e/subs_e.htm

[8] WTO (n.d.) *Detailed presentation of subsidies and countervailing measures in the WTO,* https://ecampus.wto.org/admin/files/Course_385/Module_1594/ModuleDocuments/SCM-L2-R1-E.pdf

A subsidy according to other coal companies

Glencore have described the NAIF loan as a subsidy and outlined the harm it will do to others in the coal industry, with Peter Fryberg stating:

> Bringing on additional tonnes with the aid of taxpayers' money would materially increase the risk to existing coal operations.[9]

Major Owners of the Port of Newcastle have also called the proposal a "subsidised loan".[10] They similarly argued that subsidising new coal supply into a market with flat demand will hurt existing coal operations in Australia, including the Port of Newcastle.

[9] Robins and Ker (2015) *Glencore hints at more Hunter Valley coal mine closures,* http://www.smh.com.au/business/mining-and-resources/glencore-continuing-to-consider-coal-closures-20151007-gk334x.html#ixzz3nrFlhIk8

[10] van Rooyen (2017) *Federal bankrolling of Adani will damage other Australian coal regions* http://www.afr.com/opinion/columnists/federal-bankrolling-of-adani-will-damage-other-australian-coal-regions-20170426-gvsrcz

A subsidy according to the Productivity Commission

The Productivity Commission (PC) argues that there is no role for Government in the provision of loans to the resources sector because of the existence, and discipline, of well-functioning private capital markets.

In a review of Efic, the Australian export credit agency, the PC has said:

> While few, if any, markets conform to the competitive ideal, there is no convincing evidence of systemic failures that impede access to finance for large firms or for resource-related projects in Australia.
>
> - EFIC should not continue to provide facilities to large corporate clients or for resource-related projects in Australia, including suppliers to those projects, on the commercial account.[11]

According to the PC, NAIF financing to a resource company at below market rates would be unjustified, because there is no market gap. It is readily inferred that PC would consider this a subsidy.

Ironically, NAIF has outsourced its project assessment operations to Efic, rather than build internal capacity.[12] PC's judgment applies directly to Efic's consideration of the Adani proposal.

Note also that Efic also currently considering the provision of a concessional loan to a South African coal export facility that will also compete with existing Australian coal producers.[13]

[11] Productivity Commission (2012) *Australia's export credit arrangements,* http://www.pc.gov.au/inquiries/completed/export-credit/report/export-credit.pdf

[12] Swann (2017) *Don't be so Naif* http://www.afr.com/news/policy/budget/northern-australia-funds-governance-as-dodgy-as-lehman-brothers-20170327-gv7eo2

[13] Campbell (2016) *Oz tax dollars to fund South African coal: Miners and environmentalists unite [opinion]* https://www.australianmining.com.au/features/oz-tax-dollars-to-fund-south-african-coal-miners-and-environmentalists-unite-opinion/

New coal subsidies make little sense

Given Australia, along with the rest of the world, has committed to move away from fossil fuels, and given the rapidly falling cost of alternatives, it makes little economic or environmental sense to subsidise new coal production.

If the NAIF spends 20% of its funds on this project, it will take away from other projects.

The Australian government has repeatedly signed up to G20 statements about phasing out fossil fuel subsidies. Giving a large new subsidy to a sub-commercial thermal coal project is in clear breach of this commitment.

Polling research by The Australia Institute has repeatedly shown that the public does not want governments to provide subsidies to coal companies.

A poll conducted in November 2016 showed

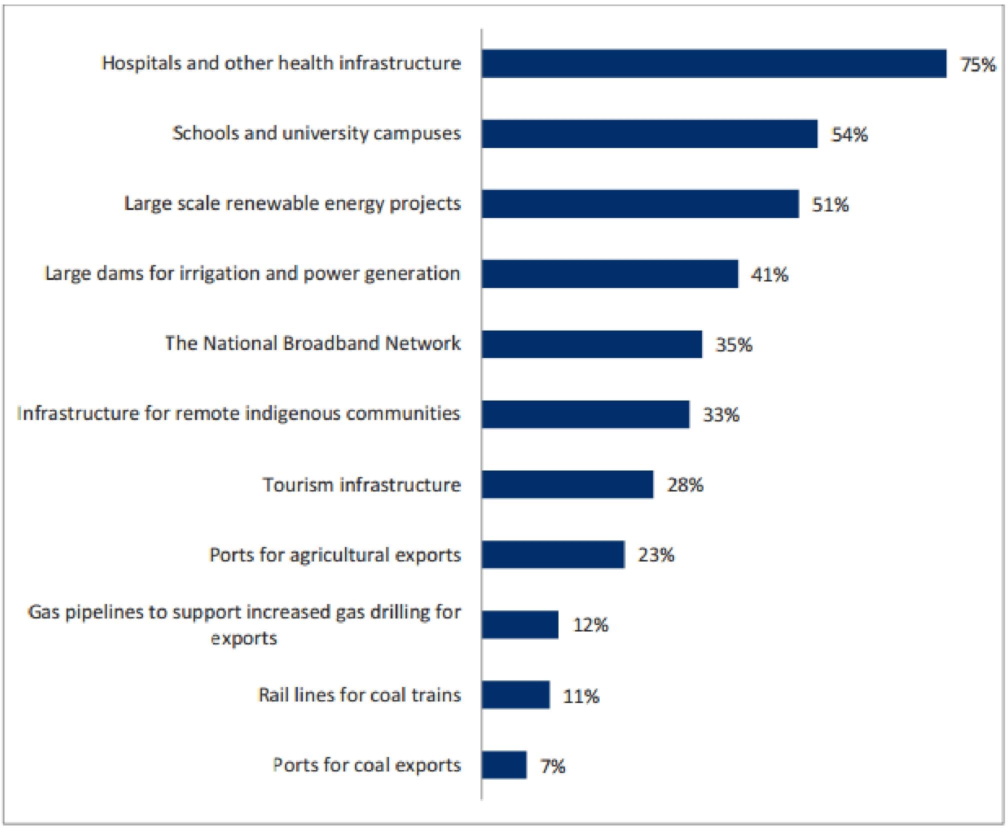
- Nearly all Australians would prefer the NAIF prioritise other projects over coal projects, as shown in Figure 2 (page over).
- 75% would prefer the NAIF to be spent on renewable energy projects over infrastructure for coal companies.
- 62% thought more jobs would be created from spending the NAIF on hospitals and schools than coal infrastructure.[14]

A poll conducted in April 2017 found that 64% of voters opposed a subsidised loan to Adani. There was majority opposition from all voting groups, including LNP voters, and in all states, including in Queensland.

[14] Swann (2016) *NAIF Polling* http://www.tai.org.au/sites/defualt/files/Polling%20Brief%20-%20Priorities%20for%20the%20NAIF.pdf

The Commonwealth Government is proposing to provide $5 billion in taxpayer-funded loans over five years to infrastructure projects in Northern Australia (northern parts of QLD, WA and NT). The loans will be given to commercially unviable projects that would not be built otherwise because private funders will not get good enough returns.

Which, if any, of the following projects should get these loans as a matter of priority? (Select no more than five)



NAIF can offer non-loan financing

While Minister Canavan is incorrect to say that NAIF loans are not subsidies, he is also incorrect to say any financing from the NAIF is a loan.

Section 10.1 of the NAIF Mandate says that the default Financing Mechanism is a loan. However, Section 11 allows the NAIF to recommend an “alternative Financing Mechanism”, other than a loan. Section 11 does not say what these alternatives may be, although Section 11.5 rules out equity.

Section 11 outlines the process for proposing and approving such an alternative Financing Mechanism. The Board must write to the Minister to explain

> “(a) why the alternative Financing Mechanism is preferable;
>
> (b) the estimated commercial value of any concession proposed with the alternative Financing Mechanism; and
>
> (c) the impact the alternative Financing Mechanism will have on the Risk Appetite Statement (see section 12 of this Direction) and on the Facility’s appropriation.”

In addition: “The responsible Minister will seek the agreement of the Minister for Finance prior to determining if the alternative Financing Mechanism will be provided, and will consult with the relevant jurisdiction.”

It is unclear if the requirement to ‘seek agreement’ means that the Minister for Finance can approve or veto a proposal. Note that Section 11.4 contains the only mention of the Minister for Finance in the Mandate or the NAIF Act.

Crucially, Section 11.2 says “(2) All sections and schedules to this Direction apply to any alternative Financing Mechanisms, other than section 10 and Criteria 5 and 6 of Schedule 1.”

- Section 10 says loans are the default Mechanism and lists possible concessions.
- Criterion 5 requires that the “Facility’s loan monies are not the majority source of debt funding.”
- Criterion 6 requires that “The loan will be able to be repaid, or refinanced.”

While it is clear that these sections cannot apply to loans, it is unclear how the exemption of these sections would work. The NAIF does not appear to have a policy in place on this matter.[15]

The text included in both Criteria includes the caveat "A relevant substitute for this criterion should be used for assessing Projects which request alternative Financing Mechanisms, as determined by the Board." However a 'relevant substitute' is not defined. Moreover, this caveat is included in the Criteria, which Section 11.2 exempts from applying to alternative Financing Mechanisms.

While the Mandate rules out equity, it does not rule on other forms of financing.

Both the Explanatory Memoranda (ExMem) for the NAIF Act and the Mandate note the NAIF could offer guarantees.[16] The ExMem for the Mandate also notes that "alternative Financing Mechanisms" can "subject the Commonwealth to risks associated with the operation and performance of a Project". This suggests the possibility of financing with contingent repayment.

While the ExMem for both the Act and the Investment Decision note that the NAIF must expect to be repaid, neither explain how this applies for alternative mechanisms, given they are exempt, and replaced with a "relevant substitute".

The NAIF mandate does not explicitly rule out cash grants. The function of the NAIF is to provide grants of assistance to the States and Territories. The ExMem for the NAIF Act notes that the use of this term

> "in the Bill is not ordinarily intended to include the conventional government accounting definition of grants where the recipient State is entitled to retain the money if it is expended for the purposes of the grant."[17]

However, this does not appear to imply a restriction on the NAIF's powers under this provision.

[15] Swann (2017*) Freedom of Information requests on Adani and the Northern Australia Infrastructure Facility (NAIF)* http://www.tai.org.au/sites/defualt/files/Swann%202016%20Briefing%20Note%20-%20NAIF%20FoI_1.pdf

[16] https://www.legislation.gov.au/Details/F2016L00654/Explanatory%20Statement/Text, http://www.austlii.edu.au/au/legis/cth/bill_em/naifb2016484/memo_0.html

[17] http://www.austlii.edu.au/au/legis/cth/bill_em/naifb2016484/memo_0.html

Conclusion

Minister Canavan is incorrect to say that the NAIF only makes loans, not subsidies.

The mandate of the NAIF requires that 'concessional' loans can only be made to projects that cannot attract commercial finance. The NAIF can make loans at lower rates, with slower repayments, and with less security than commercial loans.

A concessional loan to Adani would be a subsidy from the taxpayer:

- The government's own budget treats it as costing the budget $1.6 million over estimates.
- It is clearly a subsidy under the World Trade Organisation's rules.
- Coal companies in competition with Adani have called it a subsidy.
- The Productivity Commission views it as probably unjustified even as a targeted subsidy.

Polling research has found repeatedly that subsidies to the mining industry, and the coal industry in particular, are very unpopular. Australians would rather the NAIF fund

In addition, Minister Canavan is wrong to say the NAIF must offer loans. NAIF is able to make non-loan financing, on the discretion of the NAIF and the government. It is unclear how these 'alternative mechanisms' would work. While the government appears to have had in mind the use of these provisions for guarantees or contingent repayment, it is not clear what the relevant substitute in these cases would be for the expectation that the NAIF will be repaid. Moreover, cash grants are not ruled out by the Mandate under these provisions.