CityLink and Nam Theun 2: Infrastructure for private profit

by Andrew Nette

The World Bank and the Federal and state governments of Australia are leading proponents of experiments in the privatisation of large public infrastructure projects in Lao PDR and Australia. Andrew Nette questions claims that private sector infrastructure projects benefit society.

The World Bank and other international financial institutions are promoting the involvement of private sector companies in the development of large-scale infrastructure projects in the Mekong Region. In Australia, similar projects are confronted with public controversy and problems – and raise serious questions about the accountability and economic benefits of private sector infrastructure projects for society.

Transfield, one of Australia's largest construction and engineering companies, is at the centre of a number of Australia's radical experiments in privatised public infrastructure, including the CityLink expressway in the State of Victoria's capital, Melbourne. In Lao PDR, Transfield is the leading proponent of the private sector consortium promoting the construction of the controversial US$1.5 billion Nam Theun 2 hydroelectric dam.

Both CityLink and the proposed Nam Theun 2 dam are Build-Own-Operate-Transfer (BOOT) projects – meaning that private sector partners arrange financing for the project and own and operate it as a concession over a number of years, the length of this concession period being defined in a contract between the private sector developers and the government. At the end of the concession period ownership and operation of the projects is transferred to the government.

While BOOT projects may appear to provide 'free' infrastructure, in reality the governments of Victoria and Laos have had to agree to numerous conditions which shift commercial risk from the private concession holders onto the governments and citizens. The private sector participants in the CityLink and Nam Theun 2 projects have also received generous government subsidies, and have avoided responsibility for the huge costs required to mitigate or compensate the substantial social, economic and environmental impacts of their projects.

The Melbourne CityLink Project

CityLink involves linking a number of existing roadways to create a continuous highway system through the centre of Melbourne. Initially estimated to cost approximately US$1.5 billion, CityLink's price is now estimated to be as high as US$2 billion, making it one of the most expensive infrastructure projects in Australian history.

The CityLink and Nam Theun 2 projects have avoided responsibility for the huge costs required to mitigate or compensate the substantial social, economic and environmental impacts of their projects.

The proposal to build CityLink was first announced in May 1992 and received the government's formal approval in mid-1994. The first section was due to open in April 1999, but has been delayed. The contract for its design and construction was awarded to Transurban, a partnership between Australia's Transfield and Japan's Obayashi Corporation.

As CityLink is a BOOT scheme, Transurban was responsible for securing the financing to construct the project, and will own and operate CityLink for a concession period of 34 years. During this time it will recover its investment and, Transurban hopes, make a profit through the imposition of road tolls – payment of a fee by those using the CityLink highways. At the end of the concession period ownership of CityLink will be transferred to the Victorian State government.

In the early 1990s, BOOT was part of a strategy of the Australian Labor government of Prime Minister Paul Keating to promote greater private sector involvement in large-scale infrastructure projects, both in Australia and other countries. In 1996, to encourage private sector involvement in Australian public infrastructure projects, this government established the Development Allowance Authority (DAA) which allows these private companies to avoid paying taxes to the state governments and national government of Australia.

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These “tax breaks” received by CityLink are worth about US$37 million.[1]

Private secrecy, public risk

Central issues for all BOOT projects are those of accountability and risk distribution, and CityLink is no exception. In the case of CityLink tax breaks are only one of the financial benefits and risk avoidance measures received by Transurban and provided by the State of Victoria and the national government of Australia. Yet many of the benefits that CityLink has received have been hidden from public scrutiny, on the basis that the information is ‘commercially sensitive’. Kenneth Davidson of *The Age* newspaper said of the CityLink Act, the laws defining the relationship between the state and Transurban, “The legislation seems to be structured in a way which allows the Minister, if he chooses, to hide from taxpayers the extent of their financial responsibility for the project under the rubric [principle] ‘commercial in confidence’.”[2]

The CityLink Act, and the distribution of risks contained within it, was the focus of intense negotiations between Transurban and the Victorian government in 1995. During the negotiations the commercial banks which were to provide financing for CityLink wanted the Victorian government to guarantee Transurban’s returns on the project including a commitment to compensate the consortium if traffic volumes were less than Transurban’s forecasts. The Victorian government was concerned that if the state provided a guarantee to cover private sector losses, international credit rating agencies would consider the money borrowed by the state government for this risk guarantee to be state government debt and downgrade Victoria’s credit rating.

Thus, while the Victorian government refused to provide a blanket guarantee to Transurban, the concession agreement for the project contains clauses which entitle the developers to seek compensation if the state or national government takes any actions that have an adverse impact on the project’s revenue flow.

Paul Robinson of *The Age* reports that “‘secret government documents’ indicate that compensation may be paid to Transurban:

a) if industrial action disrupts the project,

b) if government action results in a cut of more than 20 per cent of Transurban’s future revenue,

c) if a Commonwealth environmental impact statement prevented the project from proceeding,

d) if polluted sites not previously known about were discovered,

e) if agreed traffic management measures for the tollway and feeder roads were removed,

f) if alterations in transport policy ‘specifically discriminates against tollways’,

g) if increased costs to Transurban resulted from successful claims regarding Aboriginal sacred sites, native title, or historic buildings.”[3]

“The concession agreement ties the government’s hands behind its back in a whole range of ways,” said Paul Mees, President of the Public Transport Users Association and a long-time opponent of CityLink, “For example, if the government totally recovers its sanity and wants to introduce cheaper public transport, it cannot do this until the year 2035, when the concession contract expires – because public transport could be seen to compete with CityLink.”

The national and state government also provided a range of direct subsidies to CityLink. In addition to tax concessions under the Keating government’s DAA, the Victorian government canceled at least US$1.5 million in taxes that should have been paid by Transurban’s corporate partners. And they closed down or narrowed existing roads that compete with CityLink.

Source: *The Age*

The completed, but as yet unopen, CityLink makes headline news in* The Age *newspaper on 26 June 1999 as ongoing CityLink construction disrupts traffic in Melbourne.

The result is that Victorian taxpayers have already heavily subsidised Transurban and will be forced to do so further, should the company invoke any of the many existing compensation clauses. The cumulative impact of this moves the burden of risk away from CityLink’s corporate investors to the government, taxpayers and society.

Kenneth Davidson of *The Age* said of CityLink “Make no mistake. At the broadest this is an environmental and planning disaster in the making. At its narrowest, it’s a silly, high-risk investment which no private consortium will touch unless the risks are fully shifted to the taxpayer.”[4]

Moving into the Mekong

In the Mekong Region, the policies of Prime Minister

Keating's government were translated into the selection of high-profile infrastructure projects to publicise the abilities of Australia's corporate sector, which became eligible for tax concessions, subsidies and loans funded by Australia's foreign aid budget.

A well-known example of the implementation of this strategy was the US$24 million 'Friendship Bridge' over the Mekong River between Laos and Thailand. Overseeing the Bridge's opening in April 1994, PM Keating stressed its 'aid-value' as a part of a road network that would eventually link Singapore to Beijing. In a more frank assessment that he shared with journalists, he said the Bridge represented "a pipe opener for even greater things in commerce" for Australian companies in Laos.

Through its embassy in Vientiane, the Australian Government supported the World Bank's push for BOOT hydroelectric dam schemes in Laos, citing the success of BOOT projects in Australia. It promoted BOOT projects as a way the Government of Lao PDR (GoL) could effectively get something for nothing – with the private sector assuming all the financial burdens and risks of a project and the state receiving all the benefits. From this perspective, BOOT appeared particularly well-suited for Laos, which lacked even a fraction of the funds needed for huge export-oriented 'infrastructure' projects, including hydroelectric dams, promoted by foreign companies and international financial institutions like the World Bank and Asian Development Bank as essential for economic growth in the country.

Transfield was a key beneficiary of this strategy. It built the Australian-funded border control facilities on the Lao side of the 'Friendship Bridge'. Using this as a 'stepping stone' to pursue other commercial opportunities in Laos, Transfield then entered into an agreement with the GoL to implement the country's first BOOT project, the US$4.9 million Tha Ngon toll bridge over the Nam Ngum River near Vientiane.

The Bridge opened in July 1994, replacing a ferry system. However, the high toll charges to cross the bridge proved so unpopular with local residents that the government bought the bridge 15 years ahead of schedule, paying a price determined by Transfield's forecasted earnings over the complete concession period. Transfield was able to make its profit early while the Lao Government paid much more than the amount of money it would have cost to finance and build the bridge by itself.

Risks and Nam Theun 2

Transfield's biggest opportunity in Laos came in 1993 when the GoL awarded the company the exclusive right to develop the proposed 860 megawatt Nam Theun 2 Hydroelectric Project as a BOOT scheme. The proposed dam would be located on the Theun River, the Mekong's fourth largest tributary, in central Laos.

Transfield established the Nam Theun 2 Electricity Consortium (NTEC), including Transfield, Electricite de France, the world's largest state-owned power utility, three Thai companies, and the GoL with 25 per cent equity in the project. Structured in a similar way to the CityLink BOOT scheme, the dam's construction would be funded by NTEC and operated by the consortium for a 25-year period, after which the project would become the property of the GoL.

In a remarkably similar pattern of risk distribution to the CityLink, the Nam Theun 2 allocates a disproportionate share of risks to the GoL and practically guarantees profits to the private sector companies of NTEC. However, in the case of Nam Theun 2, the private sector participants and potential commercial bank lenders have gone a step further and insisted that the World Bank intervene on their behalf to monitor and control the GoL. The private investors in the project claim this is necessary due to the so-called 'political' risks of doing business in Laos.

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World Bank gurarantees control

The 'political' or 'sovereign' risk guarantee to be pioneered in the Nam Theun 2 project is similar in concept to the contractual assurances given to Transurban whereby future Victorian government decisions that could negatively impact on the project were limited. Under the guarantee arrangement for Nam Theun 2 the World Bank would provide risk guarantees to the lenders, while requiring the GoL to provide 'counter-guarantees' to the World Bank.

In other words, if the guarantee were implemented the World Bank would pay the private investors and then the GoL would be required to reimburse the World Bank and pay a substantial fine.

According to the World Bank-funded Louis Berger Economic Impact Study (EIS) the private investors could call the guarantee in the event that "a failure on the part of the GoL" caused NTEC to have a "debt service shortfall" (unable to repay the lenders according to schedule).[5] Exactly what constitutes "a failure on the part of the GoL" is not clearly specified in the EIS.

However, the guarantee is intended to prevent the GoL from undertaking actions or seeking to mitigate the project's impacts that would in any way reduce NTEC's profits. For example, downstream of the proposed Nam Theun 2 project is the Theun Hinboun hydroelectric dam in which the GoL has an equity share of 60 per cent. The World Bank has not clarified whether the guarantee could be implemented if the GoL were to insist that water be released from the Nam Theun 2 to flow to the reservoir and through the turbines at Theun Hinboun – a strategy that would increase overall financial returns to the GoL, but reduce the amount of water available for electricity generation by Nam Theun 2.

In fact, the use of the guarantee as a mechanism to make the Government of Laos ‘compensate’ the private investors for loss of profits represents a substantial risk for the government. In the probable event that Nam Theun 2 is an economic failure, the private investors will be looking at all possible means to recover their investment. Despite the risks and the World Bank’s stated commitment to a transparent process, the Bank has stated that the agreement between GoL and the Bank outlining the conditions under which the guarantee would be implemented will not be released to the public and the citizens of Laos.

Uncertain returns for Laos

In a structure that is very similar to CityLink, the Nam Theun 2 project includes many contractual arrangements intended to benefit the project’s private sector investors.

For example, the GoL would surrender its rights to Royalty Payments and Resource Rents in the event that the project fails to “achieve a hurdle rate of return”, or profit, from the dam. According to the Louis Berger EIS this would occur,

“i) due to lack of rainfall in order to meet O&M (operations and maintenance) and debt service payments;

ii) due to change in Lao law;

iii) due to ‘other actions by any authority which increases the cost of the project or reduces the return to NTEC or any contractor’; and finally,

iv) ‘due to Scope change as defined in the agreements.’[6]

The EIS concludes that this “creates additional coverage for both debt providers and equity shareholders for risks that they should be prepared to assume in the normal course of the Project’s financing structure”.[7]

Mitigating circumstances

According to the EIS, “the potential social and environmental costs, without mitigation, for which we have estimates are in the range of [US]$80-160 million in present value terms, with a round mean of $95 million.” The Report continues, “A mitigation budget of $60-75 million for resettlement, biodiversity, construction, health, and downstream impacts (not counting the channel construction) should be nearly adequate, in financial terms to address the costs of the impacts, either through mitigation, offsets, or compensation.”[8] However, the NTEC proposed budget for mitigation of these impacts is only US$32 million, which includes over $9 million for construction of a re-regulating dam and channel downstream of the Nam Theun 2’s turbines. Thus the GoL would be responsible for a minimum of Nam Theun 2 mitigation and compensation costs amounting to between US$35-50 million.

Making the State pay

The proponents of BOOT projects argue that by attracting private investment into expensive infrastructure projects the BOOT model helps to reduce pressure on scarce public funds, thus making these funds available for other purposes. Yet neither Nam Theun 2 nor CityLink achieve this end – in both cases the many risks and costs involved have been transferred from the private investors to government.

BOOT also provides a convenient way for project proponents to avoid public accountability and transparency. Project financial statements do not include the many costs and risks transferred to the State through the guarantees, tax breaks, concession contracts and special bylaws that facilitate BOOT projects. This partial accounting enables project proponents to report expected returns to government far in excess of what will be achieved when the entire package of subsidies and guarantees is considered.

For BOOT proponents like the World Bank, private sector involvement in huge infrastructure projects is an opportunity to deliver the mega-projects it calls “development” with minimal cost to itself and with maximum return in terms of control over the host government. This has the potential to have a substantial impact on the Government of Lao PDR’s sovereignty as the proposed guarantee structure for Nam Theun 2 would surrender a wide range of the GoL’s decision-making authority to the World Bank acting on behalf of the private sector. Similarly, in Victoria, the government’s hands are tied in regards to any future government decisions that could negatively impact on Transurban’s profits.

Commenting on the rationale for BOOT in his report on the Transfield Sydney Harbour Tunnel project (another Australian BOOT experiment), Tony Harris, Auditor General of the State of New South Wales, states that “Assessing market risk is an attribute that the private sector claims as a comparative advantage. Indeed, the principle advantage of private sector equity in or ownership of a project is that the private sector has taken a market risk. Where that risk is evidently not assumed by the private sector....it should not be the equity participant.”[9]

The Auditor General’s comment underlines the key fallacy of the BOOT proponents’ argument. These kind of large-scale projects are not inherently beneficial for society and the private sector is not in the business of providing ‘free’ development. The bottom line is that the private sector is not going to get involved unless the market risks are borne by another party.

Endnotes:

[1] *The Age* (Melbourne) 8.4.96.
[2] *The Age* (Melbourne) 24.12.94.
[3] *The Age* (Melbourne) 29.10.95.
[4] *The Age* (Melbourne) 24.12.94.
[5] Louis Berger Economic Impact Study of Nam Theun 2 Dam Project. July 1997. Annex 5: Risk Allocation Matrix p. 11.
[6] Ibid Annex 5. p. 3.
[7] Ibid Annex 5 p. 3.
[8] Ibid Appendix 1. p. 6.
[9] Report by NSW Auditor General Office on the Sydney Harbour Tunnel project – RTA-Audit of Infrastructure Projects 1994.