Parliamentary
Budget Office

National Reconstruction Fund	
Party:	Australian Labor Party

Summary of proposal:

This proposal would establish a new fund to invest in key Australian industries, which may include manufacturing, advanced manufacturing, mining (excluding coal) and infrastructure. It would have the goal of improving sovereign capability in medical, crucial materials and defence industries.

The fund would be subject to a mandate to ensure returns of at least the 10-year Australian Government bond rate. It would primarily use loans but may also use alternative financing arrangements.

The fund would operate separately but in partnership with other Australian Government funds and would adopt a similar governance structure to the Clean Energy Finance Corporation (CEFC).

The funding made available through the fund would be:

- $10 billion over five years from 2022-23 ($2 billion per year); and
- an additional $5 billion over the next two years from 2027-28 ($2.5 billion per year).

The available funding would be drawn down as investments are made, with any repaid capital being reinvested. Earnings from the fund would be available for the Australian Government to draw on.

Departmental funding would be drawn from the overall amount allocated to the fund.

The fund would commence operation on 1 July 2022 and would be ongoing.

The fund's initial investments would include:

- $3 billion for Powering Australia
- $1.5 billion for a Medical Manufacturing Fund
- $1 billion for a Value Adding in Resources Fund
- $1 billion for a Critical Technologies Fund
- $1 billion for advanced manufacturing
- $500 million for Agriculture, Fisheries, Food and Fibre.

Costing overview

This proposal would be expected to decrease the fiscal balance by around $296 million, increase the underlying cash balance by around $156 million and decrease the headline cash balance by around $4,977 million over the 2022-23 Budget forward estimates period.

The proposal would have an ongoing impact beyond the 2022-23 Budget forward estimates period. A breakdown of the financial implications over the period to 2032-33 is provided at Attachment A.

The financial implications of this proposal are uncertain and highly sensitive to assumptions on the speed at which capital is deployed, the rate of interest earned, the time required for project approval and the average maturity period of investments. In particular, the costing includes no allowance for the impact of the proposal on business profitability or company tax revenue. The magnitude of such effects would be highly uncertain and could comprise different effects, including:

- enterprises switching finance from traditional lenders to concessional loans under this proposal (reducing the profits of banks) and reductions in the returns of competing investment projects (crowding-out effects)
- increases in profits from marginal projects as a result of a reduction in the cost of capital from the proposal, especially when considering the grants on offer (crowding-in effects).

It is unclear which of the crowding-out or crowding-in effects would dominate and this could vary from period to period.

Consistent with *Parliamentary Budget Office (PBO) Guidance 02/2015*, public debt interest expense impacts have been included in this costing because the equity injections and concessional loans provided under this proposal involve financial asset transactions.

The fiscal, underlying cash and headline cash balance impacts differ in the treatment of interest and dividend payments, and the flow of loan principal and equity amounts. In particular, only the fiscal balance reflects the concessional loan discount expense, associated unwinding income, and loan write-downs, and only the headline cash balance includes transactions related to loan principal amounts and equity investments. The impact on net debt will be broadly consistent with movements in the headline cash balance. A note on the accounting treatment of concessional loans is included at Attachment B.

Table 1: Financial implications ($m)[(a)]

	2022-23	2023-24	2024-25	2025-26	**Total to 2025-26**
Fiscal balance	-39.2	-72.8	-98.5	-85.6	**-296.1**
Underlying cash balance	6.8	26.2	49.5	73.4	**155.9**
Headline cash balance	-573.2	-1,131.8	-1,664.5	-1,607.6	**-4,977.1**

(a) A positive number represents an increase in the relevant budget balance; a negative number represents a decrease.

Key assumptions

The Parliamentary Budget Office has made the following assumptions in costing this proposal.

- Committed funding would not impact consolidated revenue until funding is deployed or drawn down for investment or operational purposes.
- Each tranche of funding would be deployed evenly over 3 years after it is made available. This is consistent with the time needed to assess eligibility, the average length of investment projects, and providing staged funding to projects.
- Average investment maturity would be around 7 years, consistent with the CEFC's investment management experience to date.
- Market interest rates would move in line with the 5-year government bond rate projections.

- Debt not expected to be repaid would be 5% of loans issued, as this proposal would involve high-risk early-stage enterprises and innovations.
- Any equity returned to fund would be reinvested in the same financial year.
- Departmental costs would be broadly consistent with the costs of the CEFC relative to the amount of funding administered. There would be additional departmental expenses in 2022-23 to reflect establishment costs.

Methodology

Expenditure estimates for the equity commitment were developed using information on the CEFC provided by the Department of Industry, Science, Energy and Resources, including funding commitments, drawdowns, interest payments and dividends.

- Around 90% of committed funds were provided as concessional loans and the remainder as invested equity, consistent with the current commitment and investment schedule of the CEFC.
  - Repaid capital would be reinvested in the fund and deployed to additional projects.
  - Interest payments and dividend earnings on investments would be returned to the consolidated revenue fund.
- Departmental costs were calculated as a share of total loan and equity amounts, consistent with the current operational expenses of the CEFC.

As the initial capital investment for this proposal ceases deployment in 2030-31, all capital deployed from the fund in 2031-32 onwards will be met by the reinvestment of loan principal repayments and the reinvestment of any equity returned to the fund.

The proposed investments listed in the summary of the proposal would be part of the fund's business-as-usual operations.

Financial implications were rounded consistent with the PBO's rounding rules as outlined on the PBO Costings and budget information webpage.[1]

Data sources

Information on the CEFC's funding commitments, equity investments, concessional loans and operational expenses was provided by the Department of Industry, Science, Energy and Resources as at the 2022-23 Budget.

Reserve Bank of Australia (2022), *Indicator lending rates – F5*, accessed 5 April 2022.

[1] https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Budget_Office/Costings_and_budget_information

Attachment A - National Reconstruction Fund – financial implications

Table A1: National Reconstruction Fund – Fiscal balance ($m)[(a)]

	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30	2030-31	2031-32	2032-33	Total to 2025-26	Total to 2032-33
Revenue													
Income from unwinding concessional loan discounts	*6.0*	*17.0*	*35.0*	*53.0*	*71.0*	*90.0*	*111.0*	*125.0*	*132.0*	*130.0*	*129.0*	***111.0***	***899.0***
Loan interest accrued	*19.0*	*55.0*	*110.0*	*166.0*	*221.0*	*287.0*	*365.0*	*427.0*	*466.0*	*479.0*	*494.0*	***350.0***	***3,089.0***
Dividends on equity investments	*1.9*	*5.7*	*10.9*	*17.6*	*22.8*	*28.1*	*33.5*	*37.1*	*38.8*	*38.8*	*38.8*	***36.1***	***274.0***
Total – revenue	**26.9**	**77.7**	**155.9**	**236.6**	**314.8**	**405.1**	**509.5**	**589.1**	**636.8**	**647.8**	**661.8**	**497.1**	**4,262.0**
Expenses													
Administered													
Concessional loan discount expense	*-24.0*	*-52.0*	*-82.0*	*-95.0*	*-108.0*	*-129.0*	*-153.0*	*-149.0*	*-134.0*	*-114.0*	*-118.0*	***-253.0***	***-1,158.0***
Debts not expected to be repaid	*-28.0*	*-61.0*	*-97.0*	*-112.0*	*-128.0*	*-153.0*	*-182.0*	*-178.0*	*-161.0*	*-137.0*	*-143.0*	***-298.0***	***-1,380.0***
Total – administered	***-52.0***	***-113.0***	***-179.0***	***-207.0***	***-236.0***	***-282.0***	***-335.0***	***-327.0***	***-295.0***	***-251.0***	***-261.0***	***-551.0***	***-2,538.0***
Departmental													
Departmental costs	*-8.1*	*-11.5*	*-18.4*	*-21.2*	*-24.2*	*-29.0*	*-34.5*	*-33.7*	*-30.5*	*-26.0*	*-27.0*	***-59.2***	***-264.1***
Total – departmental	***-8.1***	***-11.5***	***-18.4***	***-21.2***	***-24.2***	***-29.0***	***-34.5***	***-33.7***	***-30.5***	***-26.0***	***-27.0***	***-59.2***	***-264.1***
Total – expenses	**-60.1**	**-124.5**	**-197.4**	**-228.2**	**-260.2**	**-311.0**	**-369.5**	**-360.7**	**-325.5**	**-277.0**	**-288.0**	**-610.2**	**-2,802.1**
Total (excluding PDI)	**-33.2**	**-46.8**	**-41.5**	**8.4**	**54.6**	**94.1**	**140.0**	**228.4**	**311.3**	**370.8**	**373.8**	**-113.1**	**1,459.9**
PDI impacts	***-6.0***	***-26.0***	***-57.0***	***-94.0***	***-131.0***	***-171.0***	***-215.0***	***-255.0***	***-277.0***	***-278.0***	***-271.0***	***-183.0***	***-1,781.0***
Total (including PDI)	**-39.2**	**-72.8**	**-98.5**	**-85.6**	**-76.4**	**-76.9**	**-75.0**	**-26.6**	**34.3**	**92.8**	**102.8**	**-296.1**	**-321.1**

(a) A positive number for the fiscal balance indicates an increase in revenue or a decrease in expenses or net capital investment in accrual terms. A negative number for the fiscal balance indicates a decrease in revenue or an increase in expenses or net capital investment in accrual terms.

Table A2: National Reconstruction Fund – Underlying cash balance ($m)[(a)]

	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30	2030-31	2031-32	2032-33	Total to 2025-26	Total to 2032-33
Receipts													
Dividends on equity investments	*1.9*	*5.7*	*10.9*	*17.6*	*22.8*	*28.1*	*33.5*	*37.1*	*38.8*	*38.8*	*38.8*	***36.1***	***274.0***
Loan interest received	*19.0*	*55.0*	*110.0*	*166.0*	*221.0*	*287.0*	*365.0*	*427.0*	*466.0*	*479.0*	*494.0*	***350.0***	***3,089.0***
Total – receipts	**20.9**	**60.7**	**120.9**	**183.6**	**243.8**	**315.1**	**398.5**	**464.1**	**504.8**	**517.8**	**532.8**	**386.1**	**3,363.0**
Payments													
Departmental													
Departmental costs	*-8.1*	*-11.5*	*-18.4*	*-21.2*	*-24.2*	*-29.0*	*-34.5*	*-33.7*	*-30.5*	*-26.0*	*-27.0*	***-59.2***	***-264.1***
Total – payments	**-8.1**	**-11.5**	**-18.4**	**-21.2**	**-24.2**	**-29.0**	**-34.5**	**-33.7**	**-30.5**	**-26.0**	**-27.0**	**-59.2**	**-264.1**
Total (excluding PDI)	**12.8**	**49.2**	**102.5**	**162.4**	**219.6**	**286.1**	**364.0**	**430.4**	**474.3**	**491.8**	**505.8**	**326.9**	**3,098.9**
PDI impacts	***-6.0***	***-23.0***	***-53.0***	***-89.0***	***-126.0***	***-166.0***	***-210.0***	***-250.0***	***-275.0***	***-278.0***	***-272.0***	***-171.0***	***-1,748.0***
Total (including PDI)	**6.8**	**26.2**	**49.5**	**73.4**	**93.6**	**120.1**	**154.0**	**180.4**	**199.3**	**213.8**	**233.8**	**155.9**	**1,350.9**

(a) A positive number for the underlying cash balance indicates an increase in receipts or a decrease in payments or net capital investment in cash terms. A negative number for the underlying cash balance indicates a decrease in receipts or an increase in payments or net capital investment in cash terms.

Table A3: National Reconstruction Fund – Headline cash balance ($m)[(a)]

	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30	2030-31	2031-32	2032-33	Total to 2025-26	Total to 2032-33
Receipts													
Loan interest accrued	19.0	55.0	110.0	166.0	221.0	287.0	365.0	427.0	466.0	479.0	494.0	350.0	3,089.0
Loan principal repayments	80.0	240.0	510.0	810.0	1,160.0	1,570.0	2,070.0	2,470.0	2,740.0	2,850.0	2,940.0	1,640.0	17,440.0
Dividends on equity investments	1.9	5.7	10.9	17.6	22.8	28.1	33.5	37.1	38.8	38.8	38.8	36.1	274.0
Total – receipts	100.9	300.7	630.9	993.6	1,403.8	1,885.1	2,468.5	2,934.1	3,244.8	3,367.8	3,472.8	2,026.1	20,803.0
Payments													
Loans funded by initial capital	-570.0	-1,140.0	-1,710.0	-1,730.0	-1,750.0	-1,910.0	-2,070.0	-1,490.0	-750.0	-	-	-5,150.0	-13,120.0
Loans funded by loan principal repayments	-	-80.0	-240.0	-510.0	-810.0	-1,160.0	-1,570.0	-2,070.0	-2,470.0	-2,740.0	-2,850.0	-830.0	-14,500.0
Equity investments by initial capital	-90.0	-178.0	-274.0	-251.0	-235.0	-239.0	-242.0	-163.0	-77.0	-	-	-793.0	-1,749.0
Total – administered	-660.0	-1,398.0	-2,224.0	-2,491.0	-2,795.0	-3,309.0	-3,882.0	-3,723.0	-3,297.0	-2,740.0	-2,850.0	-6,773.0	-29,369.0
Departmental													
Departmental costs	-8.1	-11.5	-18.4	-21.2	-24.2	-29.0	-34.5	-33.7	-30.5	-26.0	-27.0	-59.2	-264.1
Total – departmental	-8.1	-11.5	-18.4	-21.2	-24.2	-29.0	-34.5	-33.7	-30.5	-26.0	-27.0	-59.2	-264.1
Total – payments	-668.1	-1,409.5	-2,242.4	-2,512.2	-2,819.2	-3,338.0	-3,916.5	-3,756.7	-3,327.5	-2,766.0	-2,877.0	-6,832.2	-29,633.1
Total (excluding PDI)	-567.2	-1,108.8	-1,611.5	-1,518.6	-1,415.4	-1,452.9	-1,448.0	-822.6	-82.7	601.8	595.8	-4,806.1	-8,830.1
PDI impacts	-6.0	-23.0	-53.0	-89.0	-126.0	-166.0	-210.0	-250.0	-275.0	-278.0	-272.0	-171.0	-1,748.0
Total (including PDI)	-573.2	-1,131.8	-1,664.5	-1,607.6	-1,541.4	-1,618.9	-1,658.0	-1,072.6	-357.7	323.8	323.8	-4,977.1	-10,578.1

(a) A positive number for the headline cash balance indicates an increase in receipts or a decrease in payments or net capital investment in headline cash terms. A negative number for the headline cash balance indicates a decrease in receipts or an increase in payments or net capital investment in headline cash terms.

\- Indicates nil.

Attachment B - Accounting treatment of concessional loans

A concessional loan is a loan provided on more favourable terms than the borrower could obtain in the financial market. The most common concession is a below-market interest rate, but concessions can also include favourable repayment conditions. The income contingent loans available through the Higher Education Loan Program are an example of concessional loans offered by the Australian Government.

Budget impact[2]

The accounting treatment of concessional loans differs across each budget aggregate. The underlying cash balance only captures actual flows of interest related to the loans. The headline cash balance captures actual flows of principal as well as interest. The fiscal balance captures accrued interest, the value of the concession and any write-offs related to the loans. The interest cost of financing these loans is captured in all budget aggregates, and is separately identified by the PBO.[3] (Table B1 provides information about the detail provided in a costing.) The provision of concessional loans decreases the Australian Government's net worth if the liabilities issued (the value of Australian Government Securities (AGS) issued to finance the loans) are greater than the assets created (measured at their 'fair value' or price at which the loans could be sold).

Treatment of debt not expected to be repaid

All budget aggregates take into account estimates of the share of loans not expected to be repaid when calculating interest flows and estimating the value of the concession that is being provided. None of the measures capture the direct impact on net worth of the loans not expected to be repaid. If a portion of loans are not expected to be repaid, estimates of the 'fair value' of the loans outstanding will be reduced. Such reductions, both when loans are issued and if loans are subsequently re-valued, are recorded in the budget under 'Other economic flows' which are reflected in net worth but not in the budget aggregates.

Table B1: Components of concessional loan financial impacts in costing proposals

Budget item	Appears in	Comments
Interest accrued or received	All budget aggregates	Captures the interest accrued or expected to be received on the fair value of the debt. (The budget cannot include interest income on a debt that is not expected to be repaid.)
Concessional loan discount expense and unwinding revenue	Fiscal balance	The net present value of the concession (based on the difference between the market and concessional interest rates) is captured as an expense in the fiscal balance. As loans are repaid, the remaining value of the concession reduces, so this expense is 'unwound' with a positive impact on the fiscal balance. The concessional discount and its unwinding are not recognised in cash balances as there is no cash inflow or outflow.
Write-offs	Fiscal balance	Debt forgiveness, also known as mutually agreed write-downs (for example in the case of the death of the borrower of a HELP loan) are expensed when they occur, reducing the fiscal balance. These transactions do not affect the cash balances as no cash flows occur.
Initial loan; principal repayments	Headline cash balance	Higher estimates of loans not expected to be repaid lowers principal repayments. These transactions are not included in the fiscal balance or underlying cash balance as they involve the exchange of one financial asset (loan) for another (cash).

[2] The PBO's treatment of these loans is consistent with the Department of Finance costing guidelines.

[3] This is in accordance with *PBO Guidance 02/2015* and the Charter of Budget Honesty Policy Costing Guidelines which specify that costings of proposals that 'involve transactions of financial assets' need to take into account the impact on PDI payments.

Budget item	Appears in	Comments
Public debt interest (PDI)	All budget aggregates	The PDI impact is the cost of the change in the government's borrowing requirements to fund the loans. The net headline cash balance impact excluding PDI is used to estimate the proposal's impact on PDI payments.