Foreign Affairs, Defence and Trade Committee Department of the Senate
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Canberra ACT 2600

Submission to the Foreign Affairs, Defence and Trade Legislation Committee on the Export Finance and Insurance Corporation Amendment (Support for Infrastructure Financing) Bill 2019

Background

I am a Senior Lecturer in Politics & International Studies at the University of Wollongong and I teach and research on global development and aid challenges. I have a particular interest in development finance, I have written a book on the World Bank and am in the process of co-authoring a book on the system of Multilateral Development Banks. I have also worked and volunteered in the development sector in Australia over many years.

Executive Summary

Expanding the Export Finance and Insurance Corporation's (EFIC) capital and area of operations are not the best way to assist the Pacific address key development challenges and improve Australia's relations with the region and our security. The proposal appears largely as a reaction to Chinese activity in the Pacific rather than as a coherent, long-term model for expanded Australian support for the Pacific in infrastructure or other areas, and this amendment should be withdrawn or rejected.

It appears that this legislation will give to EFIC the power to administer the new Australian Infrastructure Financing Facility for the Pacific (AIFFP). EFIC simply does not have the expertise to administer a development focused facility, it is an export credit agency. Further, the reality that the callable capital increase gives EFIC the capacity infrastructure loans anywhere in the world, not just in the Pacific, has not been adequately thought through.

Examination of Australia's purpose in expanding debt-based development finance needs to be undertaken in consultation with Australian development agencies, industry and our development partners. Key points from my submission below are:

- Australia's 2017 Foreign Policy White Paper refers repeatedly to the importance of strengthening the rules-based international order including rules for trade and investment. This proposal follows China and other countries in blurring the lines between export credit and development finance, thus Australia would be, in effect, contributing to an **undermining of the rules-based order**.
- The EFIC expansion seems designed to support large infrastructure projects (including coal and other fossil fuels) with inadequate social and environmental oversight and no input from affected communities. In other words, EFIC **lacks transparency** as will the AIFFP if run by EFIC. This will likely lead to backlash from the Pacific in the medium term.
- **Debt** is again increasing across a range of developing nations including the Pacific. Development finance has been expanding rapidly for some time and has not been able to address the scourge of global poverty, rather we see the IMF warning about an emerging debt crisis. Australia needs to stand against the tide and maintain a grant-based aid program that genuinely assists the poor. This would also be the best long-term strategy to improve our relations with Pacific Island nations.
- The changes to EFIC and the proposed AIFFP have occurred without any **consultation with our Pacific neighbours** regarding their needs and the best way to support development.

I also support for submissions made by the Australian Council for International Development (AFCID) and by Jubilee Australia.

Key Issues

Support for the Rules-Based International Order

Australia's 2017 Foreign Policy White Paper refers repeatedly to strengthening the rules-based international order and the importance of rules supporting the flow of trade and investment, yet this amendment and the related creation of the AIFFP would follow China and other countries in blurring the lines between export credit and development finance. This blurring is a global trend and undermines the rules that have been established over the past decades to govern aid and development finance.

- China's blurring of these lines is already creating economic and political costs for it. Poorly planned projects are being bailed out and countries are starting to reject Chinese assistance. The US realised in the 1930s that the political costs of development loans through ECAs were too high and hence began to support the idea of multilateral development finance institutions, starting with a unsuccessful proposal for an Inter-American Bank in 1939 (the Inter-American Development Bank being finally established in 1959) and then the International Bank for Reconstruction and Development or World Bank from 1941 (Oliver, 1971).
- As Mudde (2018) noted these kinds of response to China and creation of new, mixed financing arrangements: "may work short-term at a national interest level, [but] they are exacerbating the problem at an international level – in short, the level playing field for international trade, the ambition that drove the OECD Arrangement, is becoming seriously distorted."
- The Senate Inquiry should consider whether the changes to EFIC are fully in line with Australia's commitments under the OECD's "Arrangement on Officially Supported Export Credits."
- Because the proposals is not fully developed, it is not clear whether AIFFP financing would count as OECD Official Development Assistance (ODA) under the DAC-DAC rules. However, the Government has confirmed that $500 million of the funding will come from the ODA budget, and it will likely thus significantly further reduced Australia's engagement with a number of countries across the Asia-Pacific region.

Expansion of subsidised official finance around the globe are a barrier to relatively fair competition in the global market as Export Credit Agencies (ECA) compete with each other to gain markets at the expense of other nations (Baron 1983). This proposal sees Australia expanding the international rivalry with China, who itself created policy banks and an ECA by copying the West. Each country tends to justify its ECA on the basis of levelling the market with other countries, this is a race to the bottom. As Baron concluded back in 1983 (p.5) "there may be a role for self-sustaining government-supported export insurances and guarantee programs, there is no justification for the loan programs of the Eximbank."

- ECAs involve picking winners and losers among Australia's own industries, by subsiding one firm or organisation to supply goods and services, other firms are not able to compete. Evidence from the US indicates that while many small businesses use ECAs, they use it predominately for insurance while lending and guarantees are dominated by big business (Mandlebaum, 2014). However, for the large firms able to access large loans ECA act to encourages them not to take on risk themselves, rather only where it will be underwritten by the state.
- ECA subsidisation of trade is large and has grown rapidly with Chinese participation. Yet for other developing countries, it acts as a barrier to development as they are not able to offer their industries the same level of subsidy to exports. The focus of EFIC will be Australia's national interest not that of our Pacific neighbours, thus this scheme is likely to inhibit rather than promote their capacity to develop, contrary to the claims in the legislation and supporting documentation.

Transparency

Globally, ECAs are: (a) not transparent, indeed there have been frequent corruption scandals around them; (b) are not designed to promote development in recipient countries; and (c) often produce political challenges for donor governments by their activities, as China has recently experienced.

- ECA's have a long history of problems with bribery and corruption and anti-corruption policies remain too weak or laxly enforced in the face of consistent challenges (Bracking, 2007). There have been repeated calls for greater transparency and action on the OECD's Action Statement on Bribery and Officially Supported Export Credits. In Australia's case, Transparency International's *Progress Report 2011: Enforcement of the OECD Anti-bribery Convention* found that 21 of the 38 state parties, including Australia, show little to no enforcement of this Convention.
    - The rapid increase proposed for EFIC will pressure it to lend quickly, which is likely to increase the risk of poor practices and corruption. This is because first, ECA often turn to their existing networks for projects. Second, as a range of commenters in the media have pointed out, in countries with weak regulatory environments, it is too often the case that projects proposed by firms with the best lobbyists get supported by the state, rather than the best or most needed projects. Further, ECAs have been "good at playing the national economic interest card in order to avoid social regulation" (Bracking, 2009: 80).

- ECA investment decisions and its due diligence are based on commercial not developmental criteria. Given the lack of transparency regarding decision-making and terms, adequacy of social and environmental safeguards are unclear. Project affected people have virtually not capacity for redress as ECFIC's complaint mechanism is underdeveloped to say the least.
    - The November 2011 recommendations from the Productivity Commission to reform EFIC and improve its transparency and accountability have not been implemented.
    - Jubilee Australia has been specifically called for: EFIC's exemption from the Freedom of Information Act to be revoked; for greater parliamentary scrutiny of funding provided through its National Interest Account; and publication of risk assessments and due diligence for all EFIC Category A projects.

- ECAs have regularly been in the news over many decades for poorly thought out investments in the arms trade, notorious large dams displacing many people, investments in non-renewable energy and polluting mining programs and so on.
    - ECA should not be continuing to subsidise the fossil fuel industry and Australia should refrain from trying to stop OECD agreements to this end (Cox and Kenny, 2015)
    - One recent example impact the Pacific is the LNP pipeline in PNG, and I would draw your attention to Jubilee Australia (2018) report on this. Poor investments could badly damage Australia's reputation in the Pacific.

Growing Debt versus Poverty Reduction and Sustainability

World Bank rules say they will not give concessional loans to countries in high levels of debt distress. If EFIC and the AIFFP were to follow the World Bank rules almost half the countries in Pacific would not be eligible for loans and that number is increasing. This is not, of course, a problem just for the Pacific. The IMF has been warning about debt distress for a year now. Further, there is strong evidence that ECAs and development banks have motives and systems that means the best outcomes are not always achieved for recipient nations.

- ECAs and development banks, like commercial banks, are driven by a logic of continual debt expansion. This is needed to fund their running costs, profits and to ensure an income stream into the future. At some point, if countries no longer wish to borrow from EFIC and the AIFFP there will be net negative flows to the region. How will the Australian government respond to this?
- Development banks and ECAs will only fund projects that other banks and investors will not fund. This is written into their rules and has been argued to be a key reason that they have historically had problems with poor quality loans (George, 1994; Engel, 2010). To this day, the largest development bank, the World Bank, faces challenges with the quality of its project portfolio (Bretton Woods Observer 2015). Large infrastructure projects are particularly difficult to manage. The capacity of a new, small program to address these challenges is doubtful and this increased the likelihood that EFIC and the AIFFP will fund white elephants and that the citizens of Pacific Islands nations will end up paying for them.
- Given the national interest test, EFIC and the AIFFP would effectively be tied aid and Australia officially united its aid program in 2006. Tied aid increases the costs of aid by more than 20 per cent (see Riddell 2007 for a summary). This unnecessarily increases debt levels and the burden of repayment.

Supporting the Pacific Islands

As noted above, there has been no consultation with Pacific Island nations about this proposal or its governance unlike the Pacific Resilience Partnership, which has had 18 months of consultation and a much higher level of ownership. The focus on infrastructure was not agreed with the Pacific.

- The ABD figure of a $46 billion infrastructure gap in the Pacific is very problematic. The basis of the calculations are unclear and seem to be based on a model that extrapolates Pacific needs from modelling of larger Asian nations. The absorptive capacity of states needs to be considered as does capacity to repay – as noted above, debt distress is already a concern in the Pacific. Further, most Pacific Island nations have limited avenues for generating hard currency, EFIC must ensure that nations are not pushed into projects that excessively deplete natural resources (especially in the fisheries and minerals sectors) in order to generate hard currency for debt repayment.
- Infrastructure projects in the Pacific should be identified in national plans (not by Australian firms); they should improve local well-being, be on an appropriate scale and climate-change resilient. Adequate time for preparation must be allowed to ensure sustainability, minimal displacement of people and local ownership. Consideration needs to be given about whether there are local funds for maintenance over the long-term. Many projects in the Pacific are small in contrast to standard development finance project, which increases their costs and hence makes the loan based financing model even more problematic than for standard projects. EFIC does not have the skills to ensure projects are developmental and is not the appropriate avenue for such support.

Conclusion

In summary not enough time has gone into the implications of the EFIC expansion or whether the AIFFP would benefit development in the Pacific. EFIC does not have the capacity and transparency to contribute to sustainable development in the region or more widely. Its expansion undermines the rules-based international order. More in-depth consideration is needed over Australia's goals in the region and whether the debt financing is the best mechanism for supporting them.

The Senate inquiry should also ask: 1. has Australia discussed this change with other donors in line with our commitments under the Aid Effectiveness Agenda to ensure better donor coordination and reduced aid fragmentation? 2. How will the focus on infrastructure impact Australia's contribution to meeting other Sustainable Development Goals (SDGs) in the Pacific and elsewhere?

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