Published on February 14, 2019

EFIC reform: a bad idea

By Stephen Howes

Prime Minister Morrison's November 2018 Townsville speech made two announcements about infrastructure for the Pacific. But only one has received any attention: the $2 billion Australian Infrastructure Financing Facility for the Pacific or AIFFP. Such a facility had already been suggested by Labor, and, whether or not one agrees with it, its announcement was not unexpected.

The other announcement was more of a surprise, but has subsequently received little attention: an extra $1 billion for Efic, Australia's export credit agency, to support infrastructure in the region.

It's a dramatic change. That $1 billion will come in the form of callable capital, that is capital the government promises to provide Efic only if it is needed in an emergency. Efic's callable capital today is only $200 million, so that's a six-fold increase! And Efic is not short of capital. Its capital adequacy ratios are already well above the minimum levels the organisation sets for itself. So why the massive increase? As the PM's speech intimated, and as the EFIC Amendment (Support for Infrastructure Financing) Bill 2019 – introduced yesterday into Parliament –

makes clear, Efic's mandate is to be expanded to cover overseas infrastructure projects. Any overseas infrastructure project that can be shown to be of direct or indirect benefit to Australia will be eligible for funding. The indirect benefits can include "stronger relationships" so Efic will effectively be allowed to fund *any* overseas infrastructure project.

It all sounds good. The Pacific needs infrastructure. Australia wants to do more in the Pacific. Asking Efic to do more costs virtually nothing (it's highly unlikely that the capital will ever be called on). So what's the problem?

There are in fact four fundamental problems with the government's Efic plans. The first is the risk that they will give a green light to Australian businesses in neighbouring countries to push projects, including by recruiting local political champions to their cause. The risks are obvious. They are that the better connected rather than the better infrastructure projects will be approved, that good governance will be undermined, and competitive tendering sidelined.

This is not just a theoretical concern. This is exactly how much of China's development financing works (as documented [here](#)). As PNG's Deputy Prime Minster Charles Abel has gone on record [saying](#), China's finance is welcome, but the country's way of doing business (that is, as described above) is weakening institutions. We should not be imitating China and further undermining governance in the Pacific by encouraging a supply-side, project-proponent-led, non-competitive approach to infrastructure.

The Minister's [second reading speech](#) makes it clear that Efic "will be required to maximise Australian participation in overseas infrastructure projects." Isn't that something we (and the Pacific) criticise China for? At fora such as G20 and APEC, we will continue to promote the virtues of open markets and competition. But in practice, we will be arm-twisting potential recipients to maximise Australian content in return for Australian financing.

A second problem with Efic being responsible for overseas infrastructure financing decisions is that what really matters for infrastructure success is not financing availability but the domestic policy framework. If that policy framework is sound, financing will follow. If it's not, no amount of official financing will lead to sustained development. But Efic has no capacity to assess the infrastructure policy framework in PNG or any other country. And it has no mandate to push for policy reform.

Again this is not a theoretical concern. Take the undersea cable connecting Australia, PNG and the Solomon Islands. The utility of that cable depends on access arrangements to it once it has come onshore. Even with DFAT being in charge of the funding, and with DFAT's mandate to support development and engage in policy dialogue, it is far from clear that the policy framework is in place in PNG to enable the new cable to be optimally utilised. If Efic was in charge of lending for the cable – as it would be under the reforms – there would be even less engagement on policy, and even less likelihood of good outcomes being obtained. The only boxes Efic has to tick are a commercial return for itself and benefits for Australia. These can be ticked with or without policy reform, even though it is policy reform that will make the difference between successful and unsuccessful development.

Again, we would become like China: pushing loans to build business and goodwill, regardless of development outcomes.

(And let's not just pick on China. During my years in the World Bank working on infrastructure, I saw many European projects trying to get a look in on the basis of tied finance.)

The third reason that Efic should not be charged with the job of regional infrastructure development is that its mandate has always been and remains to promote Australian exports and business. At least, whatever its national interest imperatives, DFAT's development assistance program is required to promote the welfare of developing countries. That, under the proposed legislation, Efic would be required to show that the infrastructure it planned to support was of benefit to Australia but would not be required to show that it was of benefit to the recipient country is in equal parts bizarre and appallingly nationalistic. (And Efic's commercial viability test doesn't cut it either: it is all too easy for an infrastructure project, backed by government guarantees or loans or monopolies, to be commercially viable but bad for the country concerned.)

Fourth and finally, how will AIFFP and Efic relate in the infrastructure space? The minister's speech says that Efic will take the lead "where there are stronger commercial prospects", but the explanatory memorandum refers to sovereign borrowers, implying that Efic, like AIFFP, will be lending to governments. The minister's speech also talks about Efic "administering" AIFFP loans, but not, presumably, its grants. We run the risk of moving from too little support for Pacific infrastructure to an overly complex architecture.

The government needs to go back to the drawing board. A more considered, less rushed, more principled approach is required, one that puts the needs of the region first. There are various ways forward. Establish and resource AIFFP properly (and equally costlessly) and there would be no need to expand Efic's mandate. And/or, as some have suggested, establish an Australian development finance institution, like the very successful UK Commonwealth Investment Corporation, to support the region's private sector in infrastructure and other sectors. But leave Efic with the job of promoting Australian businesses and exports; it's the last entity we should be asking to develop the region's infrastructure.

For more, see the report by Stephen Howes and Matthew Dornan "Moving beyond grants: questions about Australian infrastructure financing for the Pacific".

About the author/s

Stephen Howes

Stephen Howes is the Director of the Development Policy Centre and a Professor

of Economics at the Crawford School.