Australian Government
Department of Foreign Affairs and Trade

Inquiry into the Export Finance and Insurance Corporation Amendment (Support for Infrastructure Financing) Bill 2019

DFAT Submission to the Senate Foreign Affairs, Defence and Trade Legislation Committee

6 March 2019

INTRODUCTION

The Department of Foreign Affairs and Trade (DFAT) supports the Export Finance and Insurance Corporation Amendment (Support for Infrastructure Financing) Bill 2019 (Bill).

The Australian Government's 2017 Foreign Policy White Paper highlights how our economic and security interests are converging. To meet the challenges of an uncertain future in an increasingly contested and competitive region, it sets out an active agenda for Australia to work with partners to support our shared interests in the Indo-Pacific.

The amendments will give Australia's export credit agency, the Export Finance and Insurance Corporation (Efic), a new overseas infrastructure financing power and an extra $1 billion in callable capital. These changes will ensure Efic more actively supports Australia's step-up in the Pacific and our agenda for an open, inclusive and prosperous Indo-Pacific by enhancing its role in overseas infrastructure projects. The amendments will also enable Efic to conduct operations under the name Export Finance Australia, providing greater brand recognition for Efic and the Australian Government.

In particular, the proposed changes will:

- Enhance Australia's standing as a preferred partner for the Pacific and our region by better positioning us to assist with their infrastructure development needs through more commercially meaningful financial contributions than is possible under Efic's current limited capital base.

- Allow Efic to contribute more strongly to our Pacific step-up, particularly in Papua New Guinea, where commercial demand is close to outstripping Efic's ability to offer support under its current country lending limits.

- Assist the Australian Infrastructure Financing Facility for the Pacific (AIFFP) to become operational by 1 July 2019 – while the AIFFP will be established within DFAT, the proposed changes will allow Efic to manage AIFFP loans for infrastructure projects that meet the AIFFP's development objectives in the Pacific and Timor Leste.

- Allow us to work more closely with countries who share our commitment to drawing more private sector capital to principles-based, sustainable infrastructure development in the region, including the United States and Japan under our Trilateral Partnership for Infrastructure Investment in the Indo-Pacific.

- Support Australian businesses—including our more than 45,000 small to medium sized enterprises—to access opportunities from the significant demand for infrastructure development in our region, including by being part of projects that would not previously have met the Australian content threshold for Efic support.

Efic would still apply its robust due diligence procedures for individual transactions as it does now. This involves considering the commercial merits of individual transactions, as well as the social and environmental impacts, and a country's debt sustainability.

The amendments would also complement our existing and substantial support for infrastructure policy reform in the region through our aid program.

INFRASTRUCTURE NEEDS IN THE PACIFIC AND OUR REGION

Australia is stepping up support for regional infrastructure development because we know that well-planned, well-built and well-maintained infrastructure can boost sustainable economic growth, enhance economic integration and deliver broader development outcomes. Done right, infrastructure development in our region will play a key role in furthering Australia's foreign policy, trade and development goals.

This is why we support all investment in infrastructure that conforms to the principles outlined in the 2017 Foreign Policy White Paper, including: transparency and non-discrimination, promoting fair and open competition, upholding robust standards, meeting genuine needs and avoiding unsustainable debt burdens.

We want to ensure countries in our region have access to a range of sources of financing to support their infrastructure development in a sustainable way, and that they are well equipped to make informed investment choices that benefit their communities.

This is especially the case in the Pacific, where we have the most at stake and can bring the most influence to bear.

The stability and economic progress of Pacific island countries is of fundamental importance to Australia. Yet small domestic markets, limited resource bases, and greater distances to major markets are challenges for economic and human development throughout the region.

More investment is needed for infrastructure in sectors such as telecommunications, energy, transport, and water to support the region's development and facilitate the movement of goods, people and services.

The Asian Development Bank (ADB) estimates the Pacific's infrastructure needs at USD3.1 billion per year, a total of USD46 billion between 2016 and 2030. Such significant sums cannot be provided by any one country or organisation alone.[1]

[1] ADB, 2017, *Meeting Asia's infrastructure needs*, page 43

The multilateral development banks are increasing their lending in the Pacific, with the ADB's portfolio currently at USD2.7 billion (with around 90 per cent in infrastructure). As of 27 Feb 2019, the World Bank's active portfolio in Papua New Guinea and the Pacific amounts to USD1.55 billion, of which 60 per cent is in economic infrastructure (communications, energy, transport, and water and sanitation). But more financing options are needed to meet the region's varied needs.[2]

The ADB has estimated Asia requires a massive USD26.2 trillion in infrastructure investment between 2016 and 2030 to help sustain economic growth and reduce poverty.[3]

These amendments will enable the Australian Government to offer the Pacific and our broader region an expanded range of financing options. Financing options that will bridge the gap between finance from the private sector and development partners.

EFIC CAN PLAY AN IMPORTANT ROLE IN BRIDGING OVERSEAS INFRASTRUCTURE FINANCE GAPS

To meet the infrastructure needs of the Pacific and our broader region, financing from both the private and public sectors is required. For example, the ADB estimates Asia will need approximately $187 billion of additional private sector investment between 2016 and 2020.[4] Most countries in our region are also keen to attract more private sector investment as a way of reducing their significant infrastructure financing needs.

However, commercial banks are often unwilling or unable to finance overseas infrastructure. The reasons for this include the long-term financing needs of infrastructure projects and the complexities of working in emerging markets. The ADB notes that the actions of governments are critical to attracting more private investment in Asia. It argues infrastructure governance improvements are needed as well as "financing and risk management instruments, including viability gap funds, to support project finance needs."[5]

Export credit agencies, like Efic, have historically played an important role in bridging gaps in financing for infrastructure and supporting companies when other sources of finance are not available. Export credit agencies can also play an important role in 'crowding in' private sector finance by reducing the risk profile of transactions and demonstrating the potential for commercial returns. The Government's 2017 Statement of Expectations for Efic requires it to maintain a demonstration role to private finance providers.

Bridging financing gaps and attracting private sector finance is where Efic can, and should, play a greater role. These amendments will enable Efic to do this. Australia has an interest in supporting greater economic activity in the Pacific, and promoting greater ties between Australian businesses and the region.

[2] ADB, 2018, 2017 *Annual Portfolio Performance Report*, page 2 and ADB, 2018, *Our Work in the Pacific,* page 1

[3] ADB, 2017, *Meeting Asia's infrastructure needs*, page 43

[4] ADB, 2017, *Meeting Asia's infrastructure needs*, page 59 (excludes China)

[5] ADB, 2017, *Meeting Asia's infrastructure needs*, page 66

THE BILL WILL ASSIST EFIC TO FINANCE A WIDER RANGE OF PROJECTS IN OUR REGION

Where infrastructure projects are commercially viable, finance should be on commercial terms. The Government requires Efic to conduct its operations on a commercial basis.[6]

Efic has experience with financing commercial infrastructure projects in the region. For example, Efic finance has supported the provision of drinking water infrastructure in Sri Lanka,[7] water supply and sanitation in the Marshall Islands,[8] and the upgrade of a toll road in the Philippines.[9]

Efic's current ability to finance commercially viable infrastructure projects is constrained, both by its limited capital base, and narrowly drafted eligibility criteria that require Efic to find sufficient levels of Australian content before it can provide certain types of finance.

This limits Efic's ability to finance infrastructure projects that offer longer term commercial and other benefits to Australia.

The proposed amendments will enable Efic to finance a wider range of projects across the region. They will enable Efic to take account, not just of direct Australian content, but also broader benefits for Australia and Australians now and into the future, such as:

- Greater Australian participation in supply chains.
- Access to new markets for Australian businesses.
- More Australian jobs, payments, dividends or other financial proceeds from overseas to Australia.
- Stronger relationships with our regional partners, especially in the Pacific.

Using an Australian benefits test, Efic could more deeply engage in sectors such as telecommunications, transport, water and energy and power generation. Infrastructure in the sectors can be commercially viable. For example, Efic has provided support to an Australian company assisting with the upgrade of water supply and sanitation infrastructure in Ebeye Island in the Marshall Islands and to seawall projects in Kiribati.[10] It supported another Australian company to build a hybrid power station for an integrated coconut processing facility in Micronesia.[11] With an Australian benefits test and more capital, Efic could support more projects like these.

[6] Efic Statement of Expectations, 7 September 2017

[7] Efic Annual Report 2014 – 2015

[8] Efic Annual Report 2017 – 2018

[9] ADB, 2008, *Extended Annual Review Report*, https://www.adb.org/sites/default/files/project-document/68307/33924-phi-xarr.pdf

[10] Efic Annual Report 2017 – 2018.

[11] Efic, https://www.efic.gov.au/resources-news/case-studies/balance-utility-solutions/

WITH MORE CAPITAL, EFIC WILL BE ABLE TO DO MORE

The amendments increase Efic's callable capital by $1 billion on its commercial account, from around $675 million now, to approximately $1.7 billion. This change will apply to all of Efic's operations – it will not be restricted to infrastructure development. The capital increase will enable Efic to support more Australian businesses through its established range of specialist finance solutions as well as more effectively support overseas infrastructure. It is important to note that the overall cap on the Government's contingent liability related to Efic's commercial account of $6.5 billion would not change.

The increase in callable capital is vital because it enables Efic to continue to provide finance in places where it is approaching its country lending limits. Efic is already approaching its lending limit in Papua New Guinea, one of our most important neighbours. This constrains Efic's ability to finance important infrastructure projects and the jobs and opportunities that will flow back to both Australia and Papua New Guinea from this.

The increase in callable capital is also vital for Australia's credibility and flexibility as an infrastructure financier and to enable Efic to gain crucial traction in infrastructure financing syndicates. Other financiers have larger capital bases, and can offer much larger amounts - ranging into the hundreds of millions - for an infrastructure deal than Efic can.

For example, in 2018 the US Congress approved the Better Utilization of Investments Lending to Development (BUILD) Act which created the U.S. Development Finance Corporation and gave it a funding envelope of USD60 billion (AUD84 billion) (see Case Study 3 below).[12] Likewise, the Japanese Government gave its export credit agencies a target of supporting USD200 billion (AUD280 billion) of overseas infrastructure projects between 2015-2020. As at 31 March 2018, JBIC has a total capital stock of JPY1,765.2 billion (AUD22.2 billion).[13] Canada's export credit agency, Export Development Canada, was given an additional CAD350 million (AUD372 million) of capital in 2009 to support future export opportunities.[14] It manages a total portfolio worth CAD110 billion (AUD117 billion).[15] These larger capitalisations allow export credit agencies to have greater counterparty limits and fund larger infrastructure projects.

The increase in capital will enable it to work more effectively with Australian firms, commercial banks, international financing institutions and other export credit agencies, helping to make Australia an infrastructure financing partner of choice for the region. Efic's total capital will still be modest compared to its international peers. It will need to be selective when considering which projects to finance. However, without the capital increase, Efic's ability to provide finance for infrastructure projects will continue to be constrained, and its ability to use its infrastructure power would be limited.

[12] US Congress, https://www.congress.gov/bill/115th-congress/senate-bill/2463

[13] JBIC, https://www.jbic.go.jp/en/about/organization.html

[14] Export Development Canada, https://www.canada.ca/en/news/archive/2009/03/edc-customers-business-volumes-record-levels-2008.html

[15] EDC 2017 Annual Report pg. 53

THIS BILL WILL ASSIST WITH THE TIMELY IMPLEMENTATION OF THE AUSTRALIAN INFRASTRUCTURE FINANCING FACILITY FOR THE PACIFIC

In order to be operational by 1 July 2019, the AIFFP has sought to build on existing experience within government on infrastructure financing. The AIFFP will draw on established processes and use the Government's National Interest Account, administered by Efic, to manage loans. This minimises the need for new or complex bureaucratic architecture while the AIFFP is established.

The introduction of a new overseas infrastructure financing power based on an Australian benefits test will allow Efic to manage AIFFP lending. Without this power, the AIFFP's ability to lend to projects would be constrained by Efic's current lending mandate which requires projects to include Australian content before certain types of finance can be provided.

Efic will contribute its longstanding experience financing projects in emerging markets. It will also contribute its rigorous due diligence process which incorporates a careful assessment of credit risks, country risks and environmental, social and technical risks. This will complement DFAT's experience managing infrastructure projects and grant programs in the Pacific.

Efic-managed AIFFP loans will allow funds to flow to infrastructure projects where the primary rationale is a development one.

The AIFFP will bolster Australia's position as the partner of choice in the Pacific and Timor Leste through an enhanced capacity to fund priority infrastructure.

THESE CHANGES WILL ENABLE US TO WORK MORE CLOSELY WITH OUR PARTNERS

These amendments will enable Australia to work more closely with partners by bringing our infrastructure financing tools into closer alignment with what other countries, particularly Japan and the United States, already offer the region and their own firms.

This will enable Australia to deliver on its commitment to the Trilateral Partnership for Infrastructure Investment in the Indo-Pacific, which we concluded last year with the United States and Japan. On 17 November 2018, Australian, Japanese and US leaders announced the formalisation of the Partnership through a Memorandum of Understanding between the US Overseas Private Investment Corporation, the Japan Bank for International Cooperation, DFAT and Efic.

Through this Partnership, our three countries are working together to mobilise private investment in regional infrastructure to drive economic growth, job-creation and poverty reduction. The Partnership sends an important signal both of our shared commitment to help the region meet its immense infrastructure needs in a sustainable way, and of our common intent to seek an open, inclusive and prosperous Indo-Pacific.

The Trilateral Partnership seeks to be a force-multiplier in the Indo-Pacific. It provides a new vehicle through which regional countries can coordinate to advance their infrastructure priorities and focuses efforts to advance the infrastructure investment principles set out in the Foreign Policy White Paper and mentioned above. This approach will help to meet the region's genuine needs while avoiding unsustainable debt burdens.

How Efic could support Trilateral Partnership projects

With more capital and a broader mandate, Efic would be able to more easily work with the Japan Bank for International Cooperation and the US Overseas Private Investment Corporation and its nominated successor, to finance infrastructure projects in the region. For example, Efic could jointly finance a large scale energy infrastructure project in the region, bringing together the best of Japanese, American and Australian private sector expertise. Efic's increased capital base would enable it to bring a more credible financing offer to our partners, and help to maximise Australian participation.

The United States is also stepping up its tools for infrastructure financing. In October last year, President Trump signed the *Better Utilization of Investments Leading to Development* (BUILD) *Act* into law. The legislation establishes the U.S. International Development Finance Corporation – a consolidated agency that brings together the capabilities of OPIC and USAID's Development Credit Authority, while introducing new and innovative financial products to mobilise more private capital in the developing world.

AUSTRALIA IS, AND WILL REMAIN, A RESPONSIBLE LENDER

Australia, both through Efic and through the AIFFP is, and will remain, a responsible lender.

Australia is a party to a range of international agreements that promote responsible lending, including the G20 Operational Guidelines for Sustainable Financing and the OECD Recommendation on Sustainable Lending Practices and Officially Supported Exports Credits.

We are also a member of the Paris Club of major creditor countries, whose objective is to find solutions to payment problems for debtor nationals and to ensure the long-term debt sustainability of low-income countries.

We recognise debt sustainability is a challenge facing some Pacific island countries. That's why a country's overall debt sustainability will be a key consideration in accessing the AIFFP, and will continue to be a key consideration for Efic lending.

Currently, around 90 per cent of Efic's lending is to commercial borrowers. For commercial infrastructure projects, loan repayments are generally made from the project revenues, not government budgets.

The Government requires Efic to comply with OECD sustainable lending guidelines and Australia's other international commitments.[16] When Efic does lend to governments - or government guaranteed entities - it carefully assesses the country's capacity to repay the loan. This includes a thorough analysis of a country's public debt and external debt positions. Efic does not lend to countries experiencing, or likely to experience, debt distress.

These amendments would enhance Australia's scope to provide responsible lending to many countries in our region thereby helping to provide them with more financing options to pursue infrastructure development in a sustainable way.

[16] Efic Statement of Expectations 7 September 2017

Australia will continue to work with partners, including the IMF and World Bank to improve monitoring of debt vulnerabilities, including enhanced debt data transparency, early warning systems and debt management advice for countries in our region.

MEETING GENUINE NEEDS AND UPHOLDING ROBUST STANDARDS FOR INFRASTRUCTURE

Australia is committed to working with our partners to ensure that the infrastructure we support is in the interests of the country as well as Australia. Australia is committed to principles-based sustainable regional infrastructure initiatives that:

- Are transparent and non-discriminatory, promoting fair and open competition.
- Uphold robust standards, including environmental and social safeguards.
- Meet genuine need.

To ensure an overseas infrastructure project is not bad for the country concerned, Efic will apply its robust social and environmental safeguards before it commits any finance. Efic seeks to identify potential environmental and social risks and impacts early in the financing process. Projects which do not adequately address identified environmental and social risks do not get financed. This helps ensure Efic only supports high quality infrastructure projects.

DFAT and Efic have a zero tolerance approach to bribery and corruption. Efic has a comprehensive framework of anti-corruption policies and procedures, and complies with the OECD Council Recommendation on Bribery and Officially Supported Export Credits.

DFAT also helps countries in our region prepare high-quality, investment-ready projects and improve policy frameworks to attract private capital. With our partners, we also support the development of infrastructure plans and the preparation, financing and implementation of projects that best meet the region's needs.

THESE CHANGES DO NOT IGNORE THE NEED FOR INFRASTRUCTURE POLICY REFORM AND PROJECT SUPPORT IN OUR REGION

Australian support for overseas infrastructure development through Efic and the AIFFP will complement our existing and substantial support for infrastructure policy reform in the region through our aid program. As portfolio agencies, Efic and DFAT will continue to work closely together to ensure support for overseas infrastructure is complementary and coordinated.

In 2018-19, DFAT expects to invest $493 million to help address economic infrastructure development challenges globally, with a particular focus on our region, the Indo-Pacific. This includes support for technical assistance, capacity building and governance and regulatory reforms, to improve infrastructure investment policy frameworks in the region.

Australian Official Development Assistance expenditure on infrastructure is guided by the *Strategy for Australia's Aid Investments in Economic Infrastructure,* which seeks to:

- Mobilise the private sector to finance and deliver infrastructure to meet region's needs.
- Improve access to infrastructure services to facilitate private sector and human development and promote women's participation and empowerment.
- Promote infrastructure to enhance trade and connectivity throughout the region.

In line with these priorities, Australia:

- Provides technical assistance related to policy and regulatory reform, project preparation, finance and delivery to support quality infrastructure development in the region.
- Helps borrowing countries in the region make efficient and effective use of finance available from multilateral development banks for infrastructure development.
- Improves project readiness, helps borrowing countries comply with safeguards requirements and procurement standards, and expedites and strengthens project implementation.
- Supports a number of project preparation facilities that seek to increase the supply of "bankable" infrastructure public-private-partnerships in the Indo-Pacific region.

Australia also supports a range of multi-donor facilities through leading international institutions. For example:

- Australia is a lead donor of the Pacific Region Infrastructure Facility. By bringing together many of the key donors to the region the Facility helps to coordinate member's infrastructure development in the Pacific. The Facility also helps Pacific Island Countries develop and maintain National Infrastructure Investment Plans, and produces research and analysis that is helping to build standards of infrastructure development and financing.
- Australia is an active member of the multi-donor Private Infrastructure Development Group, which mobilises private sector investment in infrastructure in frontier markets, including in South and Southeast Asia.
- Australia supports the Global Infrastructure Facility (World Bank) and the Asia Pacific Project Preparation Facility (Asian Development Bank), which both aim to address the shortage of infrastructure projects ready for investment.
- Australia provides funding to the World Bank's Public Private Infrastructure Advisory Facility, which works to enhance the capacity of developing countries to support public-private partnerships in infrastructure.
- Australia supports the World Bank Australia Safeguards Partnership that focuses on strengthening the implementation of environmental and social safeguards in the Indo–Pacific region.

Southeast Asia Economic Governance and Infrastructure initiative

On 14 November 2018, Prime Minister Scott Morrison announced a $121 million Southeast Asia Economic Governance and Infrastructure initiative.

The initiative will support Southeast Asian countries with the difficult policy and regulatory reforms needed to unlock their economic growth potential, support the preparation of quality infrastructure projects and leverage finance for their infrastructure needs.

To do this, Australia will invest more bilaterally on economic governance and infrastructure issues as well as establish a new multi-country facility to offer Australian expertise to the region.

South Asia Regional Infrastructure Connectivity initiative

On 9 January 2019, Foreign Minister Marise Payne announced a four-year $25 million initiative to raise the quality of investment in energy and transport infrastructure in South East Asia.

Under the initiative, Australia will fund the preparation of regional energy and transport investment plans. The South Asia Regional Infrastructure Connectivity initiative will also help governments develop high-quality infrastructure projects to attract private sector or multilateral development bank finance.

The program will make Australian infrastructure expertise available to the region in engineering, construction, finance, public policy and law.

THE BILL WILL ENABLE EFIC TO OPERATE AS EXPORT FINANCE AUSTRALIA

A new simpler name that references Australia will provide greater recognition for Efic and the Australian Government, both with Australian small and medium sized enterprises and other exporters, and in important overseas markets. It is also consistent with the practice of other official export credit agencies, which often reference their country of origin, such as UK Export Finance, Export Development Canada or the Export-Import Bank of Korea.

CONCLUSION

The 2017 Foreign Policy White Paper recognises that the region's infrastructure needs are massive and wide-ranging. It also recognises that we have an interest in ensuring this infrastructure is developed in a way that conforms with our principles.

Providing Efic with a new overseas infrastructure financing power and an extra $1 billion in callable capital will expand the range of tools available to Australia to support regional infrastructure development. The amendments will ensure that Efic can contribute more strongly to our Pacific step-up and support Australia's agenda for an open, inclusive and prosperous Indo-Pacific.