Australian Services Roundtable

ASR's Response to the Australia's Export Credit Arrangements Productivity Commission Issues Paper, October 2011

The Australian Services Roundtable is the peak business body for the services industries in Australia. Sectors represented include financial services (banking, insurance, securities, fund management), professional services (accounting, legal, engineering, architecture), health services, education services, environmental services, energy services, logistics, tourism, information technology, telecommunications, transport, distribution, standards and conformance, audio-visual, media, entertainment, cultural and other business services.

Introduction

Australia's location, its distance from markets, reduces its trade intensity and therefore its wealth and productivity. Access to finance is frequently listed by potential exporters as a key limiting factor in their expansion via export markets. Information asymmetries are a feature of finance markets and both Australia's location and relatively small export business community make this issue particularly significant in the provision of export finance and insurance. There are therefore significant potential welfare gains in addressing market failure in relation to knowledge of export credit risk.

How do the products and services offered by EFIC complement or overlap those provided by the Australian, State and Territory governments?

EFIC provides specialised financial and insurance services and products for Australian exporters and offshore investors to grow their international business.

Other government agencies do not provide such services. Austrade in its submission notes that it exchanges information with EFIC, as no doubt do many other Government departments and agencies.

Are there products or services under these programs, or that are not currently available, that should be provided by EFIC?

No

Are there products and services, including the provision of publicly available information and analysis, that are currently provided by EFIC but could be better provided by other agencies?

No

Would any changes to the products and services offered by EFIC materially affect the value to exporters and taxpayers of other government programs?

Yes, other programs to assist exporters would be of less value if exporters could not find reasonably priced export finance and insurance.

Are the activities of EFIC the most cost effective way of achieving the desired trade enhancement outcomes?

Yes

How visible are the services offered by EFIC to exporters? How does this compare with awareness of services offered in the private sector? Is the public promotion of EFIC sufficient?

EFIC services are well known to ASR members. EFIC engages well with ASR and has provided information for the ASR newsletter and ASR events. EFIC services are also brought to the attention of potential clients by their banks and other financial institutions.

Should government products and services, including those provided by EFIC, specifically target firms seeking to export overseas? What is the evidence of a market failure for firms seeking to export? Do these market failures exist for firms seeking to expand in the Australian domestic market?

The issues paper states that 'International trade increases the welfare of a nation by allowing it to specialise along the lines of comparative advantage, thereby redirecting resources to their highest valued uses and expanding the consumption choices available to its consumers and producers. International trade can also generate gains in productivity and allow benefits from economies of scale. Competing in international markets may also confer dynamic (long-run) benefits that arise from the development or transfer of more efficient management skills and technologies, and the training of higher-quality labour.'

This is the fundamental argument in favour of international trade. The same arguments also apply to international investment and the PC's final report should recognise this. The majority of international services business takes place through the activities of foreign affiliates (ie mode 3 services trade). Part of the benefits from the economies of scale referred to in the above argument is a massively enhanced capacity to invest in innovation – the global market being some 100 times larger than the domestic market. Any constraints on Australian businesses' access to foreign markets therefore can be expected to have a very substantial effect on investment in innovation.

It is well established that Australia's location has the effect of lowering its engagement in international trade and thus Australia's welfare. The location effect is as much about distance from information sources as it a purely physical effect, and this is certainly true for services businesses.

Australia's exports are dominated by commodities which for the most part are well understood and served by Australian and international financial markets. Mostly these involve large transactions undertaken by large firms.

Over the last decade there has been a rapid growth the international business activities of Australia's services businesses, including small and medium sized firms.[1] The parts of the banks and other financial businesses that serve these firms typically are purely domestic in focus and would require an injection of new skills and capabilities to make any judgements about foreign business ventures. The result is that it is very rare for services business to raise capital for business expansion where consideration of a foreign cash flow is given in securing the funding, unless it is via support from EFIC.

The EFIC headstart program is a particularly effective intervention as it combines the international business risk assessment capabilities of EFIC with the knowledge of a particular company held by its bank. All the transaction details are transparent to the bank so it is in a position of full knowledge to make a judgement about whether it is worth investing in international business risk assessment capabilities. It is highly likely that over time a number of banks will do this, particularly as the growth in international services business shows no sign of abating.

What evidence is there of market failures that are faced by SME exporters in particular? What is the case for finance and insurance assistance that applies specifically to SME exporters (as opposed to SMEs generally or all exporters irrespective of size)?

There is evidence that the parts of the banks that serve SMEs do not have the capability to assess international business risk. They do have the capacity to assess domestic business risk.

What are the arguments for anchoring credit and insurance support to changes in global supply and demand for export finance and insurance products? Are those arguments unique to the export sector?

[1] Much of this growth has not been captured in ABS statistics; partly because of the significance of mode 3 (investment) services trade and partly because ABS frames for sampling services businesses are out of date.

International trade finance is particularly vulnerable to cyclic factors, as the GFC demonstrates. The loss of finance can be destructive to innovative exporters in an expansion mode. EFIC is required to make a profit on its business, so it does seem appropriate that it has the capability to expand its business when in its judgement there are more profitable opportunities.

What is the current private sector capacity to provide export finance and insurance products offered by EFIC? How has this capacity developed in the past five years?

As stated earlier there is a well established private sector export finance and insurance capability for large commodity trading firms in Australia. ASR has been informed that the understanding of international finance issues by the banks has increased as a result of their engagement with EFIC.

What would be the extent and nature of underprovision by the private sector if EFIC withdrew from the market? What would be the costs of this for exporters?

Exporters would be reliant on their own financial resources and the value of their tangible domestic assets to raise capital for expansion into export markets. This would have the effect of reducing the potential returns to scale from exporting and as noted earlier would dampen investment in innovation.

Does the presence of EFIC crowd out potential private sector operators?

EFIC does not crowd out the private sector, in fact EFIC's operations make it easier for the private sector to assess the returns available from investing in international business risk assessment capability.

What are the information problems affecting private providers of finance and insurance and how significant are they? What advantages does EFIC have over the private sector in resolving those information problems?

As explained earlier, domestic financial and insurance institutions would need to make a significant new investment in international business risk assessment capability in order to improve their support for Australian firms in overseas markets. EFIC has three advantages over the private sector in resolving these information problems:

- It specialises on international business risk assessment

- It is not a competitor of the domestic financial institutions – making them more willing to partner with EFIC than with a commercial competitor not bound by EFIC's mandate

- It has access to government information networks, not all of which could be made available to the private sector.

What market failures in the private financial and insurance sectors do EFIC's risk sharing and risk transfer activities seek to address? Is this approach the best way of addressing those market failures and why?

The partnering arrangement efficiently bring together EFIC's international business risk assessment capabilities with the knowledge and relationship expertise that domestic financial institutions have of their business clients.

Is the Australian content requirement appropriate for all Australian exporters?

Do exporters that move away from the 'produce and ship' model of exporting (for example, by expanding supply and distribution chains overseas), make themselves ineligible for EFIC's assistance? If the requirement is to be relaxed, how would that be achieved while still meeting the objectives of the EFIC Act? What would be the implications for the domestic industry?

ASR supports the recommendation in the Mortimer Review to broaden EFIC's mandate and the media release by the former Minister for Trade, the Hon Simon Crean MP stating that this would happen.[2]

It is not appropriate to confine EFIC activities to those that involve some specific level of Australian content. The rationale for EFIC engagement should be based on a broad assessment of the economic benefit to Australia of international business activity. As noted in earlier comments about the benefits of exports, the economies of scale achieved by accessing a bigger market generates benefits in terms of profits, R&D and other headquarter functions. In many of Australia's important regional markets there are very substantial restrictions on the quantity of expatriate employment in Australian-owned affiliates operating in these markets, and in any case there may be business advantages in using local staff. While in many cases the number of Australian personnel involved in delivering the services via the foreign affiliates may be minor, significant economic benefit to Australia may still be realised.

ASR agrees with the statement in the EFIC submission that: "Simplification of the EFIC Act would generate significant process efficiencies both for EFIC and its clients. The introduction of a national benefits test would enable EFIC to provide greater support for small and medium-sized enterprises (SMEs) planning to internationalise their distribution and supply chains."

[2] Media release 15 September 2009, Extra support for small exporters. "*The broader test has been designed to provide effective assistance to exporters seeking to establish global supply and distribution chains and harness the opportunities from the globalising economy*."
http://www.trademinister.gov.au/releases/2009/sc_090915.html

What are the benefits for EFIC of reciprocal risk participation agreements? Are there risks for EFIC associated with these agreements in the role as either a lead or follower ECA?

There are benefits for Australia in networking with ECAs.

First as the issues paper notes, many ECAs do not operate with the same commercial framework as EFIC. It is important for Australia to continue to actively oppose the use of subsidies in trade including as disguised through the non-commercial operations of ECAs and in services trade which remains undisciplined under WTO rules. EFIC stands an example among ECAs that it is possible for a very useful and valuable service to be provided on purely commercial grounds.

Second, in the case of large complex projects, partnering may provide a way to share risks, information and enforcement without which the project might not be supportable by any single ECA. Partnering arrangements themselves add an element of complexity and therefore risk, but within the capability and mandate of EFIC management to handle.

Do reciprocal risk participation agreements have any implications for EFIC's mandate to operate in the market gap, or its ability to price its products and services in line with commercial principles?

They should not.

Is it important that the Australian Government have a mechanism to invest in projects (for example, using the NIA) with other countries through their ECAs?

Yes

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