



EXPORT FINANCE INSURANCE CORPORATION - AN IMPORTANT EXPORT PARTNER

The Export Finance Insurance Corporation has been an important player in supporting Australian business' export performances for nearly half a century. While the market gap in which it operates has changed substantially over this time, and is likely to continue to change in the foreseeable future, a strong and effective EFIC has a valuable role to play in building and sustaining presence in more challenging export markets.

The Export Finance Insurance Corporation (EFIC) is a key Australian Government agency involved in facilitating Australia's export performance and engagement with the global economy.

It plays a significant role in addressing the 'market gap' that exists in the supply of export finance and insurance by the private sector, in particular with higher risk markets and/or those countries where political risk is problematic and private sector insurance coverage is not available per se or at affordable prices.

The absence of EFIC, or a facility providing similar services, would result in business and export opportunities being lost in more difficult markets and thus the capacity of Australian business to build market presence and shares in emerging foreign markets.

EFIC'S ROLE

The primary role of EFIC, an Australian Government statutory corporation, is to provide finance and insurance, including risk assessment advice, to Australian exporters.

Under its governing statute, the *Export Finance Insurance Corporation Act 1991*, the organisation is required to perform four core functions:

- first, to provide insurance and financial assistance to exporters of Australian goods and services;
- second, to encourage financial institutions, such as banks, to provide financial assistance to exporters;
- third, to manage the Australian Government's aid-related mixed credit program (an activity which is currently winding down); and

- fourth, providing information and advice on insurance and financial arrangements to assist Australian exports.

EFIC is expected to operate on commercial principles and be self-funding, both of which it has achieved in recent times, returning a dividend to the Australian Government of almost \$A72 million over the past five years.

EVOLUTION

EFIC has changed substantially since the last review of the organisation in 2000, most notably through the sale in 2003 of EFIC's short-term business to a private sector operator.

The sale reflected the presence of an efficient private sector service provider and the desirability of avoiding duplication in the market and diversion of EFIC from its core role of addressing gaps in the market for export finance and insurance services.

Indeed, there has been an expansion in private sector provision of export finance and insurance services since the last review in 2000, pointing to a contraction and a change in the nature of the market gap in which EFIC looks to operate.

To its credit, EFIC has shown a remarkable ability, for a public sector organisation, to adapt to changing market conditions, not least of which has been the noticeable growth in the private sector provision of medium to longer-term finance and insurance products and services.

This expansion of private sector activity has caused a substantial change in the market gap in which EFIC operates and has propelled the organisation to identify new opportunity sectors which it has been doing with

some success and with good prospects for the foreseeable future.

Of particular interest in the turnover of the major markets for which EFIC has provided support to exporters under its so-called Commercial Account, is the decline in political risk insurance for mining ventures in Papua New Guinea, Indonesia and Argentina and the rise of Spain, The Philippines and the United States (the latter for re-insurance).

EFIC can reasonably expect to see increased demand for its products and services from Australian exporters targeting more difficult – and in credit risk terms, marginal – markets in non-traditional areas like Africa, where political risk tends to be higher than other Australian export markets.

The emergence of greater private sector provision of export finance and insurance services is also likely to add pressure on EFIC to take on riskier transactions, for which exporters cannot gain coverage in the commercial market.

This will require EFIC to give more intensive focus to risk assessment issues in its lending and insurance provision decision making processes.

Although the international economy, and world trading system, are fairly benign at the moment for commercial and political credit risk, changes in economic conditions or policies, or political developments, in even a single market can have rapid flow-on effect to other markets – as the Asian financial turmoil of the late 1990s demonstrates.

At the same time, any increase in international economic or political risk could well lead to a retraction of private sector supply of export finance and insurance facilities for impacted and related export markets, a contingency for which EFIC should always be prepared.

THE NATIONAL INTEREST ACCOUNT

While the so-called Commercial Account – the provision of financial and insurance services to the private sector on a commercial basis – is the backbone of EFIC's activities and its *raison d'être*, it also has an important national interest function which it implements through a separate National Interest Account (NIA).

Under this arrangement, the responsible Minister – currently the Trade Minister, Mark Vaile MP – can direct or approve EFIC entering into a financial or insurance facility he/she considers to be in the 'national interest' - usually driven by foreign, trade, overseas aid or other

strategic objectives.

Prominent examples would include financial and insurance assistance for Australian engagement in international aid/rescue operations in foreign countries which may have experienced natural disasters, such as earthquakes or a tsunami.

Other circumstances where the NIA may be exercised include where the financial commitments and/or risks involved in a particular, otherwise worthwhile, transaction may be too large for EFIC's balance sheet, or where EFIC already has a significant exposure to an individual market or trading entity.

Importantly, and in contrast with EFIC's operations on its Commercial Account, if the agency suffers a loss on the National Interest Account, the Australian Government will reimburse EFIC for the loss.

To its credit, EFIC has been able to turn a respectable profit on the NIA over the past five years.

RULES OF ORIGIN

To date, EFIC has demonstrated a commendable capacity to be flexible and responsive to changes in the market segments in which it operates.

However, its ability to do so in the future appears to be constrained by several factors that will limit its room to manoeuvre.

Of particular concern is the restrictive approach imposed upon EFIC by complex rules of origin (ROO) requirements under which it operates – that is, the degree of Australian content in a manufacture before it is deemed to be sufficiently 'Australian' to access EFIC's services.

The present threshold of sixty (60) per cent Australian content is well above the standard threshold for determining Australian origin, which is currently 50 per cent for the great majority of our trading partners.

This misalignment creates anomalous situations, distorting the conduct of international trade and commerce and causing unwarranted expenses and inconvenience to Australian exporters.

This situation should be rectified, by reducing EFIC's threshold for determining Australian content from the current 60 per cent to the more commonly practiced, and widely accepted, level of 50 per cent.

At the same time, the Australian Government will need to review its broader approach to the application of Australian rules of origin to EFIC financing and insurance assessment criteria, reflecting the adoption of 'Change of Tariff Classification' (CTC) approaches to ROO in a number of our existing and prospective free trade agreements.

By way of example, the Australia – Thailand and Australia – United States of America free trade agreements both specify CTC as the basis for determining national origin, whilst the long-standing Australia New Zealand Closer Economic and Trade Relations Agreement (ANZCERTA) is to be modified in the near future to move from a 'regional value content' to a CTC approach.

In addition, negotiations between the Australian Government on the one hand and the governments of China, Malaysia and the United Arab Emirates (albeit at different stages of progress) on potential bilateral free trade agreements are also likely to involve CTC rules of origin.

Clearly, EFIC's approach to dealing with ROO issues will need to take these matters into account, in particular whether a firm exporting product satisfying a CTC ROO will be eligible to access EFIC's export finance and insurance services.

However, this raises the consequential potential difficulty of EFIC operating a two stream approach in determining Australian origin (regional value content and change of tariff classification) for access to its services, which in turn could cause complications, anomalies and inefficiencies in EFIC's delivery of services especially to client firms and notably SMEs operating in multiple markets.

Recognising the importance attached by exporters, EFIC and the Australian Government to consistency and transparency in EFIC's operations, there may be merit in moving toward a 'national interest/benefit' test for SMEs, in particular, to better access EFIC's services.

Such an approach would provide EFIC with greater capacity to take into account the particular features of a specific transaction (including the special and unique characteristics of many business projects) that may not otherwise neatly fit into a deterministic decision template.

NEW PRODUCTS AND SERVICES

Gaps are likely to remain in the export finance and insurance markets, necessitating a role for EFIC, which has shown itself to be adaptable to changes in the nature of its marketplace and innovative in developing new

niches and products.

In the latter regard is EFIC's "Headway" initiative, to be publicly launched later this year, in the development of which EFIC has consulted closely with the Chamber movement as the premier representative of Australian small to medium sized businesses/exporters.

ACCI welcomes the "Headway" product as a mechanism for delivering additional working capital to SME exporters through their own banks, who are generally familiar with their business ambitions and achievements.

However, EFIC should adopt a rigorous approach and high threshold when considering new market niches to enter.

Although EFIC would likely grow market presence by engaging in what amounts to venture capital lending for new projects – such as major infrastructure in more difficult or higher risk markets – this would constitute a new stream of activity for the agency.

Any decision to move into such areas of activity will require careful consideration of the nature of any market gap – i.e. does the private sector already do this work at all/ sufficiently – and whether such diversification would distract EFIC from its core business of providing structure finance and insurance solutions, risk management services and advice to Australian exporters, especially smaller to medium sized enterprises.

SOCIAL AGENDA

EFIC, in its lending decisions, takes into account a range of considerations beyond conventional balance sheet factors, most importantly supporting broader anti-corruption initiatives and efforts to alleviate the debt burdens of some of the world's most heavily indebted poor countries.

As a member of the OECD's Export Credits Group (ECG), EFIC is a party to its Action Statement on Bribery which sets down a number of measures national export credit agencies, such as EFIC, are expected to undertake to deter and combat bribery in their lending and related activities.

These obligations include informing applicants of the legal consequences of engaging in bribery and requiring those seeking financial and insurance services to provide 'no bribery' commitments in certain circumstances.

Where EFIC finds sufficient evidence of bribery in the award of a contract, or proof of bribery after the grant

of a line of export credit, then it would be expected to take appropriate action.

the Australian trading community.

EFIC also has a constructive role to play in the global Debt Initiative for Heavily Indebted Poor Countries (HIPCs), which is intended to bring down the debt burden of those countries to more economically sustainable levels.

At very least, and as EFIC properly recognises, export financing should not be provided for unproductive activities in HIPCs – i.e. transactions which do not facilitate poverty reduction, nor which assist with economic and/or social development.

In short, export credit agencies should not contribute to making a bad situation worse.

CONCLUSION

EFIC has a valuable role to play in supporting Australian, especially smaller to medium sized, exporters accessing financial and insurance services to support their endeavours to win in more difficult foreign markets.

However, EFIC's future will very much depend on its ability to respond to changes in the international trading environment and the market gap in which it is expected to operate.

Changes to key aspects of its operating requirements, most notably to the rules of origin which frame its activities, are necessary to take into account broader business practice and recent and prospective developments in Australia's international trade agreements.

To this end, ACCI believes that EFIC's threshold for determining Australian content should be reduced from the current 60 per cent to 50 per cent, under existing rules of origin.

There is also an urgent need to consider the impact of the change of tariff classification approach to EFIC's lending arrangements.

Indeed, it may well prove simpler to adopt a national interest/benefit test to determine access to EFIC services, rather than a rigid classification template.

While EFIC can play a constructive role in advancing broader policy agenda through its National Interest Account and its work on corruption and debt sustainability in poor countries, it must remain clearly focused on its primary commercial functions of serving