



Australian Government
Productivity Commission

PRODUCTIVITY COMMISSION

INQUIRY INTO AUSTRALIA'S EXPORT CREDIT ARRANGEMENTS

MS P. SCOTT, Presiding Commissioner
DR W. MUNDY, Commissioner

TRANSCRIPT OF PROCEEDINGS

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Continued from 26/3/12 in Sydney

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MS SCOTT: Good afternoon and welcome to our hearings here in Canberra. My name is Patricia Scott, I'm the presiding commissioner for this inquiry and my colleague Dr Warren Mundy, who is a commissioner here. We have two organisations appearing this afternoon. We do have some time in between, so I understand that there were good discussions going on outside, so by all means think about taking a break after we have had testimony from Mr McCredie. We will be holding another hearing, as we do want to speak to EFIC again. Participants at this inquiry will receive a copy of the final report.

We would like to conduct all hearings in a reasonably informal manner but I do remind participants that a full transcript is being taken. We won't be taking any comments from the floor, but if for some reason you felt you would like to make a statement at the end of the day I will give you an opportunity for you to do so and I will ask at that stage if anyone is interested. Participants are not required to take an oath but should be truthful in their remarks. Participants are welcome to comment on the issues raised in other submissions. A transcript will be available on our web site in a few days time.

In the event of an emergency we will proceed down the stairs and, in this case, as Warren and I know where the stairs are, you would be following us. I welcome to the table Andrew McCredie, executive director appearing for Australian Services Roundtable. Thank you for coming along, Andrew. Would you like to make an opening statement?

MR McCREDIE (ASR): Yes. Thanks, Patricia and Warren, for inviting me here, and I will make an opening statement. The Australian Services Roundtable is the big business association for the services sector. We cover all parts of the services sector, from financial services to tourism.

MS SCOTT: How many paid-up members do you have?

MR McCREDIE (ASR): We have around 50, Patricia, many of them are peak bodies in their own right, such as the Financial Services Council or the Architects, Engineers Australia, Universities Australia, the Australian Tourism Export Council.

MS SCOTT: Thank you.

MR McCREDIE (ASR): So our members are, in many cases, are more substantial bodies than we are ourselves, but when we come to policy positions we canvass these policy positions with all our members. What you note our membership is, it is a concern that the services economy is not well understood within government and

even within business. As a consequence, a lot of analysis is not accurate in reflecting the nature of modern business and modern services business. I might say that this current report is on a par with other similar reports in failing to understand the services economy.

I guess this is understandable. When I did economics, and perhaps many other people here, services were described as the non-traded part of the economy. It was often believed that the sector was nonproductive or indeed, if it wasn't that, it was at least linked with low productivity growth. However, that is very far from where services are today. Services are the most dynamic part of the economy in all developed countries and in Australia it comprises 80 per cent of the economy, 85 per cent of employment, including most of the high-paid jobs. Employment in services has risen by 2.3 million over the last 20 years, while employment in agriculture and manufacturing has declined. The services sector is also increasingly internationally traded. Indeed, there are now very few parts of the services sector which are not in some way impacted by international competition. This is very much a good thing. Increased trade exposure in services has been shown by numerous economic studies to be associated with increased services productivity.

Relative to goods, the barriers to trade and services are higher and they are far more likely to be cost escalating rather than rent creating as the benefits of improved business practice and technologies introduced by foreign companies rapidly spread throughout the domestic services sector. This is an important point in looking at the trade exposure of the services sector. The fact that mostly we are talking about not rent-creating behaviour but actually cost-escalating behaviour. So this is a point that I make repeatedly when I am talking to international trade bodies on the value of services trade reform. In fact, I will be talking on these issues at a forthcoming global services forum in Doha organised by UNCTAD and at which ASR is a co-sponsor along with a number of other, similar service business organisations.

In talking about services trade, it is important to understand that the internationally accepted definition of services trade - and it is set out on the Manual on Statistics of International Trade in Services - describes four modes of services trade. It is estimated that around two thirds of services trade takes place via mode 3, which is commercial presence, or the investment mode. In some sectors of services trade it is difficult to operate without a commercial presence; financial services being a good example of this. Recently DFAT commissioned ABS to do a survey of mode 3 trade in financial services and they discovered that 96 per cent of Australia's financial services trade takes place via mode 3.

It is easy to understand that there may be legal requirements for financial services trade to take place that way, but equally it applies to other sectors of services. The Australian shopping mall operator Westfield is a good example of this.

It is very difficult to export shopping malls, but Westfield has some 61 per cent of its assets under management overseas, where it has 75 shopping malls out of its total portfolio of 118 shopping malls. They are in places like the United States, the United Kingdom, New Zealand, and Brazil. So it is critically, I think, important to understand the nature of services trade when you are looking at what EFIC actually does, because around half of EFIC's customers are in the services business. EFIC clearly does understand the nature of services trade and it supports services trade in all its modes.

I made this preamble because in box 2.1, "The characteristics of Australia's export market," you don't seem to understand the nature of services trading, with respect. In fact you quote an ABS publication, The Characteristics of Australian Exporters 2009-10, which uses a subset of the Balance of Payments Manual 6 for the basis of their data, with the exception that they exclude mode 2 of services trading from that information. They also exclude manufacturing services. They call that a good. Not normally - in the Balance of Payments Manual it is called a service - but in this particular survey that you have used these services exporters are called exporters of goods.

So on top of that there are a few provisos that ABS puts to their survey, which are quite relevant to services exports. They say that individual business providing in a supply chain of services - it is quite common, for example, for multinational firms to undertake work for overseas operations via supply chains in Australia. These are not counted as exports under the balance of payments manual thing. Appropriately not so, but in the context of what EFIC does, I think these supply chain issues are relevant. Secondly, in relation to the modes that are counted in your box, that's modes 1 and 4, the ABS says that smaller and occasional exporters in the services space are unlikely come to ABS's notice and therefore are not included in the estimates.

The number of excluded businesses may be significant, but the value is not thought to be terribly significant. The ABS continues to try to identify these businesses and incorporate them into its estimates. The very poor survey methodology for services businesses that ABS uses has been the subject of our report that we wrote in September 2010 and we are working with ABS on trying to improve the surveys for services exporters. In the legal services space, we've been reasonably successful, as a result of work particularly with the law council and ABS. They have now doubled the number of services exporters in legal services.

We expect that that would apply pretty much across the board. So they then make the point that mode 2 of course is not included in this estimated number of exporters. These were all people involved in tourism or education. So mode 2 and mode 3 are the predominant modes for services export and both of them are excluded

from your box.

DR MUNDY: Sorry, can I just interrupt you there.

MR McCREDIE (ASR): Yes.

DR MUNDY: So how many services exporting firms do you think there are in Australia?

MR McCREDIE (ASR): I would think there was probably 100,000.

MS SCOTT: The number receiving EFIC's assistance?

MR McCREDIE (ASR): It would be a tiny fraction of that because many of them would be very small and, in my definition there of exporters, there would be people who were part of supply chains to exporters. As you know well from doing your survey, EFIC only looks at large - and, in many cases, people who are providing simple advice for a few - I mean, ASR itself is a services exporter in that we've done commissioned research for overseas bodies.

MS SCOTT: You're a small little outfit.

MR McCREDIE (ASR): And we're a fairly small little outfit. There's millions of professionals across Australia and many of them have done overseas work in one shape or form or other.

MS SCOTT: If we were to leave you with EFIC's support - - -

MR McCREDIE (ASR): No, they wouldn't do it with EFIC's support and EFIC wouldn't support them, because it wouldn't be commercially viable for them to assess them.

DR MUNDY: Or they wouldn't need that support.

MR McCREDIE (ASR): But I am making this point in the context of what is the picture of Australian exporters. You've got a picture that says that 95 per cent of exporting businesses in Australia are goods exporters, and that's simply not true, and also that 79 per cent of the exports are goods. It's not true if you take into account mode 3, and mode 3 is a major way in which services exports are generated. So I do think this is important. I make a long statement about this because it's not the first time we've talked about these issues.

I think it is about time that the Productivity Commission put somewhere in its

corporate memory bank the fact that there are four modes of services exports. These are important. They relate to the activities of bodies like EFIC and bodies like Austrade, and rightly so. It's part of the nature of international business that it's conducted this way. So there are ABS data which don't include them, but they are not appropriate to use for this purpose, and that's the point I am making. Did you have a further question, Warren?

DR MUNDY: No. I was going to ask, to the extent that the ABS definition may be deficient, I guess - - -

MR McCREDIE (ASR): It's not deficient. It's for a purpose. It's for the balance of payments services.

DR MUNDY: That's the question I was going to get to, was for the purposes of this inquiry, which is directed not at - - -

MR McCREDIE (ASR): Balance of payments issues - - -

DR MUNDY: At balance of payments issues, not at correcting the national accounts, and I am aware of the debate that's gone around the creation of a national council and creation of services. In fact a whole chapter of my PhD is on this issue.

MR McCREDIE (ASR): Right.

DR MUNDY: Have any of these exporting firms that you suggest that we have neglected - and I, in our defence, say we're not the only organisation that struggles with this inadequacy and clearly the statistician does too.

MR McCREDIE (ASR): I don't know. I think the ABS understands these issues very well. We've had a lot of discussions with them and I - - -

DR MUNDY: My question is, Mr McCredie, to the extent that it's relevant to this inquiry and the firms that EFIC has supported or under its current policy framework is likely to support, how were these missing firms, in your mind, relevant, because I'm trying to go to the question of if this error was corrected, would it lead the commission to revelations of fact that might be germane to the purpose of the reference the assistant treasurer has given us?

MR McCREDIE (ASR): Yes, I think it would.

DR MUNDY: How?

MR McCREDIE (ASR): For a start, table 6.1, EFIC's Support for Large

Companies. I haven't seen the full portfolio of EFIC support. I've only got what you've got in your report, and this is a table that shows a selection of companies that are supported.

DR MUNDY: The table of EFIC support is generally available on the public record, if you care to look at EFIC's web site.

MR McCREDIE (ASR): I haven't done that, but that table shows that eight out of 10 of them are in the services sector. There's one shipbuilding and there's one mining and the rest are all services companies. So I think services are relevant to what EFIC does.

DR MUNDY: I'm glad we haven't missed the big ones.

MR McCREDIE (ASR): What EFIC themselves tell me is that around half their work is for services companies. So I don't hear complaints from my members about EFIC's services companies. My complaint in this inquiry is that the Productivity Commission doesn't seem to understand the nature of the services export trade, the way it is undertaken, the number of companies that are involved in the services export trade, how they conduct it and how they need to be supported.

DR MUNDY: I guess the interesting thing is, on table 6.1 and your concern about our failure to understand exporters are important, we have actually listed here a pile of exporters who are services companies. So I just don't see how we can, on the one hand, have neglected them and, on the other hand, listed them in a table.

MR McCREDIE (ASR): No, because you then go on to say that they shouldn't get any support because they're large.

DR MUNDY: It's not a question of whether they're a services company.

MR McCREDIE (ASR): No, but later on in the report you've got another recommendation that says that, "We see no sign of any kind of market failure for investment and therefore investment shouldn't be covered." That's the mode 3 services trade. It seems to me that that is a recommendation directed at the heart of the services trade.

DR MUNDY: It's an observation about market failure.

MR McCREDIE (ASR): No. It's an observation about the services trade. So why do you think that there is less grounds for market failure in the investment mode?

DR MUNDY: We've set out our reasoning for this. This is here to gather evidence

and - - -

MR McCREDIE (ASR): Well, you know, I'm puzzled by it. I didn't see - in my reading of the report you just said you hadn't received any evidence of market failure on investment.

MS SCOTT: Are you about to present some on that?

MR McCREDIE (ASR): First of all, I'd like to understand - before I say something I'd like to understand why it is that you wrote that in the report.

MS SCOTT: Are you about to present evidence on the issue you raised?

MR McCREDIE (ASR): What I'd like to have, actually - and maybe this is the right time to have it - is a good discussion about what do you actually mean by a market failure in relation to this report, because I don't - - -

MS SCOTT: We have defined market failure in the report pretty clear.

MR McCREDIE (ASR): Right.

MS SCOTT: In fairly standard terms.

MR McCREDIE (ASR): How do you see it as being different from net economic benefit?

MS SCOTT: Well, I guess because this is a hearing and we've asked to hear from you, we're not envisaging it as an opportunity for you to ask us questions, especially when the answers are contained in the report.

MR McCREDIE (ASR): Well, I don't believe there's a clear explanation as to why you think net economic failure is substantially different from a market failure.

MS SCOTT: Okay. What about we park that, and given that you've got 10 minutes left would you like to present the evidence you have on the market failure that is present in the service area that you feel we haven't spent sufficient attention on?

MR McCREDIE (ASR): Well, in your report you do list a number of things which you associate with a market failure. I accept that. Not in your list, but you discuss it elsewhere, is the fact that there may be other factors such as tariffs that some people have argued - but you don't accept those arguments, but you grant that some people have argued that the existence of other distortions may be a ground for a policy that addresses these distortions. Obviously tariffs are one distortion. I would argue not

only the existing tariffs but in fact Australia's rather sad history, long history, of tariffs which is - whereas we have a very domestically focused economy.

MS SCOTT: There wouldn't be any disagreement about that.

DR MUNDY: We'd be in violent agreement with you on that fact.

MR McCREDIE (ASR): Yes. I mean I think this also relates to - you know, it has many implications, including in our economics faculties we don't have enough focus on trade and services issues. I don't think we have enough economic expertise on these issues in the country and we don't have enough expertise with our domestic banks on international trading issues, particularly outside standard commodity areas. That's something that we made - a point we made in our submission about this. I think that hasn't been fully written up in your report, it hasn't been fully discussed. But on top of that, just in the financial area, we have many policies which give - and the PC themselves have talked about these things quite a bit. I think it would have been good for you to have mentioned some of these distortions, domestic distortions that we've got, particularly in housing. We've currently got large guarantees to enable our domestic financial institutions to borrow from overseas with government guarantees. We've got no tax on imputed rent; PC have talked about this. We have very general provisions for negative gearing. Now, all of these are a significant distortion, a far more significant distortion, than anything that EFIC is doing or is likely to do; so there's that factor.

I think on the trade front you quote, I think, Fitzgerald and Monson in 1989, their report, and that seems to me - and I may be wrong here but from reading your report it seems largely your arguments about trade and the impact of trade on an economy seems to stem from Fitzgerald and Monson. Now, in 1993, the World Bank created a report called the East Asian Miracle. In that report they showed that the East Asian economies' focus on trade expansion was a significant factor in their dynamic growth. All of those East Asian countries - I mean they had a variety of different policies from Singapore, Hong Kong, Korea, Japan, but all of them had very generous assistance to exporters through credit arrangements, and often accompanied by a tightening - a hardening of loan portfolios for domestic activities such as housing.

Since, of course, that report in 1993, we've had the experience of China copying, essentially, that framework, and China has been quite successful in copying that framework. So I think to draw on the 1989 report of Fitzgerald and Monson, prior to all of this analysis, seems to me to be possibly not as helpful as it might be. On top of that, as I mentioned in my opening statement, there's a lot of literature showing the impact on productivity of increased services trade exposure, they're very significant. Our region is absolutely blighted with services trade restrictions. So this

brings us onto, I guess, the discussion on some of the national interest activities. I mean we are working with all these economies both through DFAT but also business associations to try and get them to understand the benefits of services trade liberalisation. We're making some progress on this thing, and as I said, I'll be talking in Doha with a whole bunch of developing countries about these sorts of activities, but it's still a hard slog.

Now, in your report I think you talk about beggar thy neighbour type activity here. Well, this is not beggar thy neighbour activity when a country brings in modern shopping malls or modern banking systems or whatever. This is not begging them. This is actually improving enormously their domestic productivity and efficiency. It's the fastest way for these countries to improve their wealth. So I think some of the arguments are trade arguments which might apply in a goods space are a little bit different in the services space. I think there is very strong national interest grounds for us to try and increase services trade in our region. That means working on a commercial basis. Well, I don't think it should be other than a commercial basis to do that - I think it is of benefit.

I don't think this is drawing down. You talking about drawing down our political and diplomatic capital. These activities very much enhance diplomatic and political capital for us to be seen as part of the reform process in these countries. To be contributing to their improved domestic economic performance is very much in our national interest and diplomatic interest. These things touch on your public goods and externalities. The very existence of the Australian Services Roundtable and what we do suggests that companies can't do these things by themselves. Yes, they can band together and respond, and they obviously do support organisations like us, but there are - you know, there are clear public goods and externalities associated with this slightly missionary task of improving services trade in our region.

As I said before, most people still don't really understand the nature of services trade, and Australia is one of the most advanced services economies in the region, and very strong exporter of services. So if we don't fully understand it here, the difficulties of Indonesia and Malaysia, Thailand and so forth understanding services trade are far greater, and there are often significant political barriers to this. So progressing services trade in our region I think is clearly beneficial on an economic basis and on the political and diplomatic basis.

MS SCOTT: All right. Well, I think we've got that. Warren, do you have any questions for Andrew?

DR MUNDY: No, I'm fine, thanks.

MS SCOTT: Well Andrew, thank you for coming along today and thank you for

your submission. I think we will now adjourn for approximately half an hour and we'll resume promptly at 4.30. We're expecting ACCI to be along then.

MS SCOTT: Okay. Thanks for coming along, Bryan. Good afternoon, we're resuming our hearing now. I'm pleased to have at the table ACCI. For the purposes of the transcript, could you please state your name and identify your role and the organisation. If you would like to make a short opening statement.

MR CLARK (ACCI): Bryan Clark. I am the director of trade and international affairs with the Australian Chamber of Commerce and Industry. I guess in terms of an opening statement, as much as anything I would like to ask you a few questions about your report and some of the aspects that you have included in it. But I guess we are a bit disturbed with what appears to be a quite theoretical approach to economics, which is of itself fine, but given the scale and activity of EFIC within the Australian economy it does appear to be a bit of a sledgehammer approach to a nut. I don't glean from the report that the Productivity Commission has fully understood the role of EFIC in assisting exports; in that, certainly from our perspective anyway, EFIC's role is at the margin, beyond, if you like, business as usual for the commercial sector. I don't get the sense that the report has captured this aspect of where we believe, anyway, EFIC's operational range should be.

MS SCOTT: You said you don't think we have captured accurately the scale of EFIC. We have given figures on the number of transactions, the value of transactions, the type of transactions, we have also indicated information about the number of exporters and so on. What particular scale aspect would you like us to consider including next time?

MR CLARK (ACCI): I think the points that stand out to us a little bit are around the not appreciating that EFIC is operating at the margins, so going beyond - - -

MS SCOTT: No, just on the scale aspect.

MR CLARK (ACCI): No, I appreciate that. Yes.

MS SCOTT: So on the scale aspect, what particular statistic or whatever would you like us to include that we haven't got at the moment?

DR MUNDY: In terms of scale, do you think we have overestimated its scale, we have underestimated its scale?

MR CLARK (ACCI): No, I think you concentrated too much on EFIC rather than considering its role against the scale of export trade.

DR MUNDY: Well, EFIC itself indicates it is a couple of percentage - and I think we do note that in the referral.

MR CLARK (ACCI): Okay, but I don't get the sense that your report is appreciating that. The way I have read your report, anyway, it would look as though there was a very significant industry-wide influence that EFIC is having. They are not; they are on the margin.

MS SCOTT: Let's find a reference or two that will help you in that.

MR CLARK (ACCI): Sure.

MS SCOTT: Because then we can establish what confusion there could be. I'm pretty certain that we have a statement in here - yes, I think - - -

MR CLARK (ACCI): Which page are you on?

MS SCOTT: I'm going to be on page - I'm sorry, it's roman numerals - XVI and XVII. So this is a scale question. EFIC's business operations, so this is in box 1.

MR CLARK (ACCI): Yes.

MS SCOTT: "In 2009-10 EFIC provided on the commercial account 54 facilities to 41 exporting firms. In the same financial year, there were about 45,000 exporting firms in Australia, almost all of which (95 per cent) exported goods in that year." Now, a previous testimony we received from Mr McCredie would challenge the reference to exported goods in that year, but I think we have tried to give a scale of EFIC there.

MR CLARK (ACCI): I'm not suggesting there is not reference to it, but if you read the report, the context of the report when I read was that EFIC's influence on the Australian economy and export industry seemed to be vastly more than is truly where they are. The context, I think, is - - -

MS SCOTT: So you would like us to make it even clearer.

MR CLARK (ACCI): Absolutely.

MS SCOTT: That EFIC is a minor player in the export business.

MR CLARK (ACCI): Yes.

MS SCOTT: Okay, I think I've got that point. Now, your next point?

MR CLARK (ACCI): Without going to the scope of clients for EFIC and the

nature of their product offering, which I think both of which may be able to be discussed and rejigged - - -

DR MUNDY: In what way? We're just recounting the evidence that is publicly available and, to a lesser extent, privately provided to us by EFIC. What more would you - how would you have us rejig it?

MR CLARK (ACCI): No, I'm happy, I was just trying to set aside the client range and product offering.

DR MUNDY: So you're happy with that. Okay.

MR CLARK (ACCI): When you go through your set of recommendations then, there are areas where it would appear to be in some ways a little odd and, certainly in the final recommendations, somewhat constraining. While we do agree that maybe it would be good if EFIC had a broader client base than the one they have ended up with, but I think that is probably circumstance rather than intent. Certainly as you know through our own previous submission, we were happy to see an expanded role for small and medium enterprises into it. But our view of that would not be that such a thing would then be to the detriment of any other product offering; we were trying to suggest that a broader range of product offering would be better, rather than that being the only focus of them.

MS SCOTT: So this is a product offering or the scale of their operation?

MR CLARK (ACCI): Both.

MS SCOTT: Okay. So you would like to see a larger EFIC and you would like to see a wider product offering.

MR CLARK (ACCI): I think the specific product offering needs to be left to the market place, but I do agree with some of what you have picked up through your report, about where they have been operating and that has perhaps been too narrow.

MS SCOTT: How much larger would you like EFIC to be, in terms of the scale of its operations?

MR CLARK (ACCI): I don't know that we want an overall expansion of what they are doing. But where they have offered the product range and to whom, expanded. So not necessarily their full scale of operations but their range of clients.

DR MUNDY: So you're not suggesting in any way that we make a recommendation that the government should appropriate further capital and put it

into EFIC so it can expand its activities?

MR CLARK (ACCI): Well, we wouldn't suggest that but nor would we suggest a reduction.

DR MUNDY: You're not suggesting that any further capital be provided to EFIC?

MR CLARK (ACCI): No.

DR MUNDY: Okay.

MR CLARK (ACCI): So we like their relative operating model. But could it service more clients? Yes, we would like to see it done.

DR MUNDY: Given that you want it to service more clients and you don't want it to expand its capital base - and I presume ACCI would expect that it would be, rather prudently, in accordance with good business practice - then at some point EFIC would have to ration its services, won't it. Because if it has got a finite capital base and it is to be prudently managed, then if it expands its range of products and clients, then at some point someone is going to have to miss out, aren't they?

MR CLARK (ACCI): Or modify how it operates.

DR MUNDY: Yes, so at some point it will be constrained, because it will grown as you suggest it should. More customers, more clients, and at some point someone will have to miss out.

MR CLARK (ACCI): Yes.

DR MUNDY: How should that rationing occur? Who should be missing out or how should that be missing out be thought about? How would you pursue who gets taken out?

MR CLARK (ACCI): Right now we would agree with you that it looks like the client base is too skewed to the top end and the larger companies. While we do accept what EFIC has indicated about coat-tailing, you know, around that, as you support big end contracts, major contracts, and then others flow in behind that - and I guess that is a valid argument - is more specifically supporting the smaller business and wider range of clients and allowing that to be out there. We also accept your thoughts around how often a particular client can access the particular offerings which are there. The three which you suggest certainly curtails current business practice, but it would be consistent also with something like the export market development grants.

DR MUNDY: Which I think is set.

MR CLARK (ACCI): Yes, it has a limit.

DR MUNDY: But the notion that there is a limit.

MR CLARK (ACCI): Yes, and I think you certainly - you do want people to be transitioning out of it. It is meant to be market failure support out of it. So by definition, once people have moved through whatever the barrier happened to be, then they shouldn't be continually seeking the same type of support. So I agree with the sentiment that you put in behind that. We also note occasionally in your report and through some of the recommendations as well that you appear to have ignored some of the support that EFIC has got from industry and the financial factor and in fact then use the theoretical approach that some people may well have been supportive of EFIC because they have been receiving funds or other things from it, which I guess is an interesting take.

DR MUNDY: I will respond to that. I think you'll find, if you go and have a look at our web site, the vast bulk of material that we've received from EFIC's customers and the financial system has actually been received after the report was issued. So it's difficult for us to have reflected - - -

MR CLARK (ACCI): A timing basis.

DR MUNDY: It is. Material has been submitted to us in response to the draft report. We did issue an issues paper and we received very little feedback. Indeed yourselves, I think, sent us a page and a half.

MR CLARK (ACCI): Yes.

DR MUNDY: So we can deal with the evidence that we have when we get it.

MS SCOTT: We do also discuss in the report why it might be the case that the financial sector finds it beneficial to have EFIC. We've covered it at considerable length. So maybe you want to comment on that section of the report.

MR CLARK (ACCI): What did strike me as slightly odd is that, even without evidence, you did then apply a theoretical economic approach, that it could be some other things, but more disturbing is you end up with a recommendation around that, which we would find odd. Again, our view of EFIC is it should naturally be supported by the financial sector, as well as the trade sector in general, and its product offering will be similar to those being offered, because it is operating at an

extension beyond, in our view, where their business as usual will stop.

MS SCOTT: The bit beyond the business as usual, what would you normally call that?

MR CLARK (ACCI): I don't know what you're looking for, sorry.

MS SCOTT: No. Some people think that EFIC should be assisting commercial activity beyond business as usual and other people consider it should be assisting non-commercial activity. So, without putting words in your mouth, I'm very keen to find out what the word you would use is. Beyond "business as usual", I'm just trying to get a sense of what that is and why "business as usual" doesn't cover it. What do you think is happening in the market that means we get this segment that is not looked after by - - -

MR CLARK (ACCI): We would agree that it is one or the other, or could even be both, of market failure and/or gap and that EFIC's operating band certainly should not be where commerce would normally operate, in our view.

DR MUNDY: What about where commerce has decided not to operate?

MR CLARK (ACCI): That's where I think the gap one is. I was going to ask you a question around it. I note that you recognise that as possibly a valid place for them to operate, but then yet make no recommendations associated with it.

DR MUNDY: I think we do actually say that their activities should be restricted to areas of market failure and we think the market gap is a wider definition and a somewhat less tractable one. But coming onto this issue about business as usual, a company who was unable to secure a bank guarantee from its bank because it had recently experienced financial difficulty, should that sort of firm be supported by EFIC?

MR CLARK (ACCI): No.

DR MUNDY: Because what we're trying to tease out of this is that it is efficient for the banking system to not do certain things.

MR CLARK (ACCI): Yes.

DR MUNDY: What we're trying to do and what we would be interested in - and if you wanted to make another submission to us, that would be helpful - how is it that we determine where legitimate banking decisions or financial decisions or equity refuses to provide more stops and where this area of market failure starts? It's a

practical question which we need to give advice to ministers on about how they actually operationalise it.

MR CLARK (ACCI): I think market failure is a problematic thing to consider in this, because there's not really a good test of it. You learn about it when it's happened, rather than have foresight. Whereas gap is vastly easier to deal with, because you could see a contribution from the financial sector that says, "What are your internal or external restrictions on in what markets you operate, to what level of exposure to any individual company." All of that sort of information could be gleaned from a process of discovery, one way or the other, from the financial sector, because they may or may not operate in particular areas or have guidelines around the level of exposure they want to have in those places.

DR MUNDY: They may refuse to enter into certain transactions for very good and efficient reasons.

MR CLARK (ACCI): Absolutely.

DR MUNDY: So how do we pick the two part, because it's an identification problem. The outcomes are the same, "My bank won't give me this." Your bank mightn't be giving you that. We've heard a lot of evidence about persistent banking behaviour of refusing to hear it. But we have heard of other examples and we know of other examples where banks have been entirely reasonable, they have their limit full or whatever.

MR CLARK (ACCI): EFIC's role is beyond that, which would then, by the activity of EFIC - and, again, not wanting to get into their specific product offering, because I think all these things should be reactive in the marketplace - is once normal commercial financial arrangements have said, "We are no longer servicing this market," then there is a case for EFIC to act for other people who see a particular opportunity, yet they cannot seek finance in the normal way, into those places. Again, this is where we also would like to make the point around your understanding or your study of EFIC and its implications in the marketplace. It's the question, I think, of how much does EFIC add to the economic activity within the economy, which has not yet been discovered through your report either.

DR MUNDY: If it contributes to 1 per cent of exports, you can just unpack it.

MR CLARK (ACCI): You might be able to do that, yes.

DR MUNDY: But if it's 1 per cent of exports, it's going to be less than 1 per cent of GDP. You raise the point about the markets not providing, so you may, for example, find that it's difficult to get buyer credit in, say, Sri Lanka. We've heard a number of

examples of this. So I think that's one identical case where you can say the market is not providing here.

MR CLARK (ACCI): Yes.

DR MUNDY: EFIC operates on an individual transaction basis quite often. I guess what I'm trying to work out is if a company has fully utilised its banking, surely you wouldn't think that the banks should just keep on lending and presumably you don't think that the government should then step in once banks prudentially have decided to cease to provide capital, or do you think the government should just then keep tossing in more capital after the banks have said no?

MR CLARK (ACCI): No, certainly government shouldn't do that. As we've all agreed, EFIC's range is small in comparison to what is going on out there. There will be these circumstances where somebody has identified an opportunity and, in the absence of EFIC, it will go missing from the Australian economy. I think that's where there's a great area of concern.

DR MUNDY: So you wouldn't support suggestions that EFIC needs to gear up and start supporting multi billion dollar gas projects in Darwin or whatever else. You actually think that's not the place they should be.

MR CLARK (ACCI): No, but - and hence our support again for small business - there are many circumstances where, at the small business end, it's not the banks prudential lending arrangements which are limiting access to them. It's that they are a small exporter, they have no experience, they're not meeting the criteria of the bank in order to get that in the first place. So we think there's probably a role for doing that. Part of the difficulty in the small business end through, which you can understand why EFIC hasn't operated there terribly well in the past, is the transaction cost, which is also perhaps why the banks don't want to deal with it is what the small business needs is in fact too small for them to be worried about - - -

DR MUNDY: Or the bank has just decided it doesn't want to be in that place.

MR CLARK (ACCI): Yes, and that of itself will then create some challenges for EFIC as well about how it operates on a commercial basis.

DR MUNDY: You can see how that presents a challenge for policy makers and government in specifying the zone in which it wants EFIC to operate and how it assures that?

MR CLARK (ACCI): Mm.

DR MUNDY: Okay.

MR CLARK (ACCI): There would be ways in order to do that, but it may also require a relaxation. I think EFIC at the moment do apply a very stringent process for consideration of their clients, and again, dealing with small business will be challenging at that same level, and maybe there would need to then be some relaxation about the consideration or level of risk being covered.

DR MUNDY: Yes, okay, thanks for that.

MS SCOTT: Bryan, are there any other points that you'd like to make?

MR CLARK (ACCI): Yes. Page 204 I'm going to look at. I've written it down in my notes. So your draft recommendation 10.2 is:

Until it is next reviewed, EFIC's role on the commercial account should be limited to demonstrating to the private sector that providing export finance to newly exporting SMEs can be commercially viable.

We're interested in what your view about demonstration is in this context. After I've read it a few times through the different report I had a particular view, but then it struck me that you had a different meaning in mind. So I would be just interested in you perhaps explaining a little more about what you see in this.

MS SCOTT: Normally I don't take the opportunity to answer questions in hearings because I like to think that it's about us hearing from you. But I think as you said earlier to Warren - maybe I can use some of your expressions to assist you here. I think you indicated to Warren that you didn't think that it would be appropriate for EFIC to support a firm indefinitely in its activities. I think you were referring to seven times - support might need to be capped in some ways, the number of facilities that would be arranged. We're talking here about for exporters who faced basically an information problem with their financial intermediary that provided they were commercially viable and passed all the appropriate tests that EFIC could support them on the commercial account, but not indefinitely, and that if a firm was then successful that would illustrate - prove to their financial intermediary that they can be supported in the future and therefore would not be reliant on EFIC. So that's that idea that assistance would not need to be ongoing.

MR CLARK (ACCI): All right, good. Can I suggest that you rewrite some of this then - - -

MS SCOTT: Okay, go ahead, all ears.

MR CLARK (ACCI): - - - to perhaps draw out this meaning more, because I had interpreted this in two different ways as I saw it through the report, the first one being that EFIC itself needed to demonstrate that it was providing a commercial service, in which case it wouldn't be operating in the market failure space, I would have thought, which was an odd spot. My second interpretation of this is that they demonstrated to the private sector that operating in this particular area was viable and therefore should move out of it, and so you've given me a different definition.

MS SCOTT: I just wanted to clarify in your statement there - still a little confused about where you see EFIC appropriately operating. Do you want them in the commercial space or not? I'm just a little unclear. Commercial or not?

MR CLARK (ACCI): Not.

MS SCOTT: You want EFIC to be operating in the non-commercial space?

MR CLARK (ACCI): Yes.

MS SCOTT: Okay, EFIC operating in non-commercial. So that means that you're anticipating that they will make losses on their transactions?

MR CLARK (ACCI): Yes, potentially, yes.

MS SCOTT: You're comfortable with that?

MR CLARK (ACCI): Yes.

MS SCOTT: Over time that may well dissipate their capital.

MR CLARK (ACCI): Sure, yes.

MS SCOTT: You're okay on that too?

MR CLARK (ACCI): Yes.

MS SCOTT: Okay.

MR CLARK (ACCI): Sometimes through your report it is a little confusing on trying to ascertain where you think it ought to be. There are comments through it which refer to EFIC needing to operate commercially but in our thought process that would obviously mean that they were then in a competitive space with the commercial market, which would be odd, in our view. So it is agreed it needs to be - the market failure and the gaps is the space where EFIC ought to operate.

DR MUNDY: Is it your view then that as this capital is dissipated, which you suggest it may be and that would be all right, then at some point the Commonwealth will need to appropriate more money and give it EFIC so it then can go through another round of capital - - -

MR CLARK (ACCI): Or it need not even have that model. It may well come out of straight Treasury appropriation.

MS SCOTT: So this is the idea that other forms of assistance are available out there to small and medium sized enterprises that for one firm assistance from the resources envoy or - heard the terms today, so I want to make sure I get it right.

DR MUNDY: There's about eight of them.

MS SCOTT: So we now have a resource sector supply envoy, that assistance could be provided through their good work or assistance could be provided through Enterprise Connect business advisers or assistance could be provided through the Industry Capability Network. What you're saying, I think, to us is that EFIC could be just one of a number of suites of measures that could assist the firm, the small or medium sized enterprise, that's looking for opportunities to coat-tail on all sorts of developments?

MR CLARK (ACCI): Well, that was going to be a point we'd make through this presentation.

MS SCOTT: Well, I've got that right?

MR CLARK (ACCI): Yes, it's that it needs to be regarded within the suite of activity which is going on.

MS SCOTT: Sure.

MR CLARK (ACCI): That would be our view too. Maybe in the past and perhaps not so evidently now - you know, we have these various programs and agencies who are already acting in a particular space. It's not necessarily a question how everybody is governed but to ensure that they're working in concert out of doing that, be it Austrade - you know, at particular levels we have the export market development grants, we have EFIC operating the - the one you've just mentioned isn't one I'm familiar with but the Enterprise Connect group and the Industry Capability Network are all adding components of value to something. I guess, as is our general call on things - is to streamline these activities so that they are each adding value to each other.

MS SCOTT: Yes.

MR CLARK (ACCI): The other thing that we wouldn't necessarily object to either is a consideration around support aligned to - but not excluding other things but aligned to the advancement of free trade agreements, so that as these are negotiated and a new opportunity exists - often enough that doesn't come in a perfect market form, industry doesn't know of things, there's some difficulty getting in, there's a learning component to it. The activity of EFIC may well, as does the other agencies, trail that along too. Maybe there's a value proposition in that type of operating model as well.

MS SCOTT: Okay, I've got that. That's good, thank you. Now, Bryan, I don't want to race you but we are drawing towards the time when we would anticipate that you're going to wrap up. So is there any other points you particularly were keen to make, because I don't want to find that we've missed out on something.

MR CLARK (ACCI): Well, just to note particularly is - comments around crowding out. We accept the notion of crowding out, that potentially exists, but I don't think it exists in the case of EFIC, particularly given that there doesn't appear to be anybody from the financial sector who is saying this. We would recommend that there be less emphasis on that. I think it's good that the report notes the point, and I'm fairly certain EFIC is conscious of the points around crowding out, but as we said our view is EFIC's activities should be in the point beyond business as usual from the commercial sector rather than back where they ought to be, and I accept that that's perhaps a blurry line at the margins.

MS SCOTT: Well, now that you've identified that you want them in the non-commercial space I think that's clearer identification of where you want them to operate. Any questions?

DR MUNDY: No, I'm done. That was very helpful.

MS SCOTT: All right. Well, Bryan, thank you very much for coming along today and thank you for your earlier submission.

DR MUNDY: Bryan, if you have any suggestions about - particularly how you would think we might redraft them if you could just send us a one-page sub we'd be more than grateful.

MR CLARK (ACCI): Yes, we're still a bit - probably we'll write to you again on more specific points.

MS SCOTT: Okay. We've got a set deadline from the government. Well, thank you, again.

MR CLARK (ACCI): Good.

MS SCOTT: So I now call our hearing to a close for today. We will be identifying a future hearing date, we're just seeking to settle that, but it should be in the very near future. So thank you for your interest today and for coming along. Thank you to the transcribers and the team. Good afternoon.

AT 5.00 PM THE INQUIRY WAS ADJOURNED ACCORDINGLY