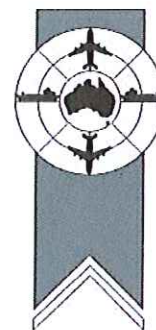


Australian Institute of Export

Productivity Commission Inquiry into Australia's Export Credit Arrangements – Export Finance & Insurance Corporation

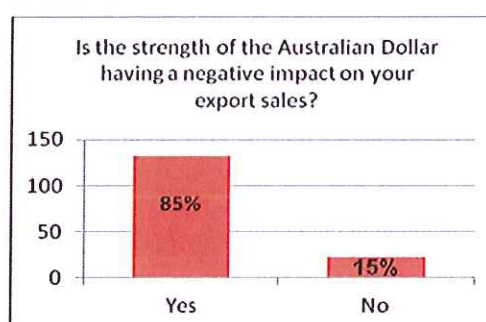


1. Where does export activity among SME's stand in Australia today

The combined effects of the Global Financial Crisis (GFC), the continuing strength of the Australian Dollar and high interest rates relative to competition, continues to have a negative impact on the export sector, particularly among SME's. Research conducted by the Australian Institute of Export clearly highlights the difficulties exporters were experiencing when the dollar moved beyond parity.



October 2010 - Respondents: 273



July 2011 - Respondents 155

The study clearly indicated that an increasing number of companies are concerned about the strength of the Australian Dollar and its effect on sales now and into the future. In October 2010 when the dollar was less than parity, 61% said its strength was having a negative impact. By July 2011 this figure had grown to 85%.

In both studies approximately 50% of respondents said that the sales impact was between 10 % and 30% with most commenting that while the sales decline is an issue, the primary concern is the reduction in margins which would impact employment.

The categories that have shown the greatest concern are education, manufacturing, viticulture and services, particularly where work is undertaken in Australia (e.g. film production) where no real mechanism exists to manage the foreign exchange risk.

The July 2011 study revealed that moving production off shore is becoming a real consideration.

Evidence of the slowing of export activity in Australia can be drawn from the level of participation in the Export Market Development Grants Scheme (EMDG) which is aimed at the SME sector. The Australian Institute of Export (AIE) represents over 100 export grants consultants who collectively lodge 60% of all EMDG claims. Estimates for the year ended 30th June 2011 (to be lodged by 30/11/11) indicate that claim numbers will be down for the 2010/2011 fiscal year by in excess of 30% with the corresponding reduction in actual dollars claimed. As the scheme provides dollar for dollar assistance for export marketing activity any reduction in marketing expenditure in any given year is likely to be reflected in a sales decline the following year. Consultants too have reported a decline in the number of new EMDG applicants which is another clear indicator of reduced export activity.

2. Is financing of international trade transactions deemed a problem amongst SME exporters?

There are three pieces of evidence that would support the argument that SME exporters have difficulty raising finance for export activity.

a) Review of Export Policies and Programs (September 2008)

While not deemed a major issue for large advanced exporters, raising trade finance remains a concern for SME exporters. This issue was identified as a major impediment to export activity well before the GFC in the Review of Export Policies and Programs led by Mr. David Mortimer AO. (see pages 124 – 138” Winning in World Markets...Meeting the competitive challenge of the new global economy” (see appendix 1)

b) Australian Institute of Export Research and Market Intelligence

As the leading provider of education & training on the export process the Australian Institute of Export has a close interface with SME exporters. Although anecdotal, feedback from students at courses clearly supports the argument that raising finance for export transactions has historically been a major issue for SME exporters.

Research conducted in December 2008 during the GFC clearly highlights the difficulty experienced by exporters at that time. When asked - has obtaining finance for your exports changed over the last three months? Just under 50% claimed it was extremely or more difficult. This simply highlights that a difficult situation got worse during the GFC.

c) Trade 20/20 Finance Strategic Dialogue (October 2009)

The Australian Government Trade 20/20 Outcomes Report dated October 2009 highlighted a number of shortcomings in the Australian market relative to Financing Trade. Exporters at this forum pointed to significant difficulties in accessing trade finance, believing Australian banks to be very risk averse (see appendix 2).

3. Has EFIC provided an effective means of minimising market failure?

From the Institutes long experience in working with SME companies, it is very aware that both the Australian and International banks operating in Australia are conservative when providing financial support and in particular working capital. Given the distances, time and risk in undertaking International sales transactions the level of conservatism is often even greater when it comes to export.

Two key EFIC products (Headway and the Working Capital Guarantee facility) which provide an additional level of guarantee to the lending bank have assisted many SME exporters to overcome the conservative nature of banks. This in our opinion has reduced the potential for market failure, contributed to export growth, sustainability and arguably resulted in job creation. By example:

“Viocorp International has direct experience of the support facilitated by an EFIC government backed facility. In Viocorp's case, the company had won its largest export contract (\$5.5M) for the provision of Internet broadcasting technologies to a major client in Malaysia. The contract duration was for 5 years however a significant amount of the work had to take place in the initial year resulting in a cash flow challenge for Viocorp. EFIC were able to assess the position and quickly determine an appropriate structure of support. In conjunction with the company's bank, EFIC was able to provide the additional security necessary to secure an appropriate overdraft facility to allow Viocorp to undertake the project successfully. We found EFIC both pro-active and commercially focused with a great attitude throughout the exercise.”

Ron McCulloch- CEO Viocorp International

"As with any business cash flow is important and when you are growing and expanding your business this becomes an even more important issue. The EFIC Headway product gave Frosty Boy Australia finance assistance in achieving our goals. EFIC Headway also helped us to keep our pricing competitive in some very tough export markets and today we export to more than 30 countries. This product is well adapted to cater for the need of exporters with a simple process and a great support network".

Dirk Pretorius – CEO Frosty Boy Australia

Viocorp International and Frosty Boy Australia are but two cases where EFIC has made a tangible difference; there are many other examples of EFIC working with the banks to underwrite export financing where the tenor and/or location are outside the standard operational credit guidelines for the banks.

An important financial support service provided by EFIC is the bonding lines.

Exporters can be asked, especially when bidding for overseas government jobs, to put in place bonds (performance, bid bonds etc) to guarantee that the project will be completed. These bonds in some instances can run to 100% or more of the contract value, and to have their bank provide this service, the bond facility needs to be secured to the bond dollar value.

This puts great pressure on working capital availability.

Through EFIC's bonding facility, the amount of security required is reduced, and it has allowed many contracts to proceed over the years, that otherwise may have been too costly for the Australian tenderer.

"Gold Peg International have had a long and successful relationship with EFIC. Without the help of EFIC, through Advance Payment and Performance Bonds, we would not have been able to tender for and subsequently win a large number of contracts around the world without tying up our working capital. As a company that makes a significant proportion of its revenue from exports it is fantastic to have such a positive, responsive and helpful organisation available to assist, allowing us to concentrate on expanding further our export growth. In these difficult times for exporters the ongoing support by EFIC will be very important in our ongoing export strategy."

Simon Donnelly - Managing Director Gold Peg International

As highlighted above the Global Financial Crisis (GFC) presented a range of issues which arguably made a difficult trade finance situation even more difficult. At a time when exporters required additional security of a "confirmed" Letter of Credit, there were periods during the GFC when banks operating in Australia "pulled in" their lines to correspondent banks offshore. Here EFIC (albeit hamstrung to an extent by the EFIC act which requires EFIC to only operate in the defined "market gap" area) was able to assess the risk and provide selective credit enhancement (and peace of mind) to Australian exporters.

While not deemed direct action, EFIC also assists SME exporters through:

- a) The quality of its credit assessment team. The low level of losses, given the tenors and locations of some of the support provided, speaks to the experience and knowledge of this team. Given the size of our market it is not viable for any of our commercial banks to replicate this knowledge.
- b) The creation of the Navigator website. This site provides an easy introduction to the various finance related steps in an export transaction, and has direct links to the websites of providers at government (State & Federal) and industry providers (banks, insurance companies etc). Given the limited level of knowledge concerning trade finance among exporters this site fulfills a very valuable role.

4. Could EFIC provide additional support to better address the needs of the contemporary exporter?

- a. Australian exporters tend to fall into two categories, those that are very large (dominated by the resources sector and agriculture) and those who are small. The number of mid-sized exporters is relatively small. Collectively, small exporters represent a significant volume of exports and make a disproportionately high contribution to employment. As EFIC products are skewed to the mid and large exporter, a significant number of exporters/businesses with potential fall outside the act under which EFIC currently operates.

The Australian Institute of Export would support the expansion of the EFIC act to provide greater support to the small exporters who have strong potential for growth.

- b. In terms of direct lending the current EFIC act is limited to exporters of capital goods. This too limits EFIC to providing direct lending to predominantly large exporters of manufactured equipment.

The Australian Institute of Export supports broadening the EFIC act to include a wider range of goods and services to be more in keeping with the changing nature of Australian exports.

- c. There have been a wide range of influences on forging the current behavior of Australia's exporters. The high Australian dollar, the lingering GFC, increased competition all resulting in lower margins for many Australian exporters. The world has clearly become more global and as the research above indicated, many Australian manufacturers have decided or are strongly considering establishing an offshore production facility, warehouse or distribution centre.

In 2009 as a result of the last EFIC Review (2006) it was deemed appropriate to introduce legislation which would expand the role of EFIC in order to allow it to provide financial support to a wider range of transactions for Australian SME's exporting or investing overseas, including those establishing global supply and distribution chains.

Although receiving bipartisan support the legislation, due to a range of circumstances, was not put to Parliament.

The Australian Institute of Export strongly supported the Governments plan in 2009 and due to the changing nature of International Trade supports this change in the EFIC act even more strongly.

5. Conclusion

The Australian Institute of Export has a membership base of just under 1,000 and reaches over 15,000 exporters and international trade service providers including banks, insurance companies, freight forwarders, freight and logistics companies and consultants. Its constituent base is predominantly SME companies. In conclusion AIEEx firmly believes:

- a. SME exporters are experiencing the most difficult business environment in over thirty years, driven by the high dollar, GFC, increased competition and high interest rates relative to other countries. Collectively they represent a significant volume of exports and make a large contribution to employment.
- b. The nature of Australian exporting activity is changing with the growth in Services and changes in the dynamics of Agriculture and Manufacturing.
- c. Raising capital and financing export activity remains a major challenge for SME exporters.

- d. The services provided by EFIC are an important part of the mix that contribute to Australia's international competitiveness. The service however is limited by the EFIC act particularly in relationship to the SME sector.
- e. There is an increasing interest by SME exporters in moving production or establishing global supply and distribution chains as a means of reestablishing margins.
- f. That by incorporating 2009 changes to the EFIC act, expanding its direct lending limitations and better servicing smaller exporters, Australian export capability will be enhanced and market failure minimized.

8 Access to finance for international growth

MAIN POINTS

Lack of access to finance is a consistently reported impediment to Australian businesses seeking to expand their export and international investment activities.

Well-designed, well-targeted financial assistance programs that are consistent with Australia's international obligations can contribute to improving export performance and increasing international competitiveness. Australia's main trade competitors offer a range of export financing assistance measures.

Financial assistance that is not directed efficiently at clearly demonstrated market failures and does not result in additional exports should be abolished or phased out.

The Review concluded that the Export Market Development Grants scheme is effective and that measures should be adopted immediately to resolve current funding uncertainty. Options include tightening the provisions of the scheme.

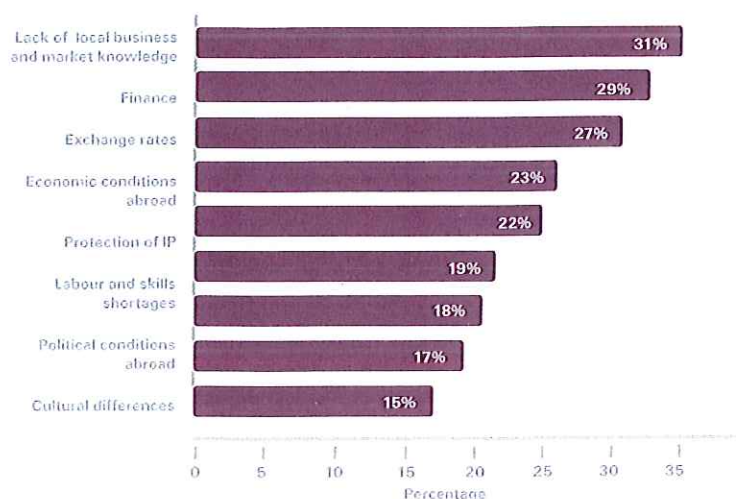
The Review recommends a limited expansion of the Export Finance and Insurance Corporation's powers to support Australian companies seeking to invest offshore.

The Review considered alternative measures targeted to specific areas of market failure not currently addressed. While not costed or developed fully, these options may be considered as alternatives to increasing investment in existing programs.

A common framework is required for the design, monitoring and promotion of financial assistance programs for export and international business growth, together with a commitment to regular comparative assessment of the efficiency and effectiveness of such programs.

The Review urges all levels of government to work together to rationalise and coordinate the existing range of financial assistance programs to best target the collective funding currently allocated.

Figure 8.1 Major barriers to international expansion of Australian companies



Source: EFIC (2008).

8.1 ACCESS TO FINANCE: A BARRIER TO INTERNATIONAL BUSINESS GROWTH

The Review recognises that financing is a constraint in all businesses. Indeed, scarcity of resources in relation to the demand for them is the underlying axiom of economics. There is, however, a case for some modest public assistance for businesses beginning their engagement in the international economy.

Financing needs are becoming more complicated. More Australian businesses are expanding their presence offshore in order to achieve growth. At the same time, the size of businesses pursuing these modes of operation is changing: many small and medium-sized enterprises are now engaging in complex forms of global business development.

Australian and international research

The OECD's *Draft Report on the Top Barriers and Drivers to SME Internationalisation* (April 2008) notes that 'shortage of access to working capital to finance exports' is one of the most significant barriers to internationalisation for small and medium-sized enterprises. The Global Readiness

Index (EFIC 2008) found that inadequate knowledge of overseas markets and lack of finance are the two biggest obstacles Australian companies face when seeking to expand overseas (see Figure 8.1).

Varying financing needs

The amount and nature of non-financial assistance needed by exporting businesses are mainly determined by a company's experience and stage of internationalisation, rather than the size or value of the business. When it comes to access to finance, though, businesses with turnover of less than \$10 million are most likely to report that their export growth is constrained by lack of access to capital. Sixty per cent of Export Market Development Grants scheme participants have turnovers of less than \$2 million and 80 per cent have turnovers of less than \$5 million.

New exporters typically need help to navigate the various forms of financial assistance available, as well as to gain access to transactional finance to support their first international sales. Limited working capital dictates that up-front funding is most valued by these businesses. Smaller, less-experienced companies need simple forms of finance with inexpensive

application processes and the shortest possible delays between incurring the expenditure and grant allocation.

Exporters seeking to grow their export businesses by entering new markets or expanding their presence in existing markets usually find access to transactional finance less of a problem. Their greater experience and higher export sales make these businesses a more attractive proposition for primary financial institutions, and debtor and inventory financing is increasingly available. Typically, though, these companies use retained earnings to fund export expansion and can struggle to obtain alternative finance to fund expansion in their developing export markets.

... it is vital that Australian SMEs can venture beyond the traditional 'export of product paradigm' and participate in global supply chains. If Australian SMEs are to do this, successfully, they must have access to adequate funding. Traditionally SMEs have found it difficult to source sufficient funding in the long term from the market to finance their international growth.

—*Australian Chamber of Commerce and Industry submission to the Review*

The difficulties facing companies looking to invest in establishing a physical presence overseas are most often associated with obtaining medium-term growth capital and with the availability of security to support investments in overseas facilities. Companies seeking to exploit intellectual property in international markets can also face difficulties with the lack of business infrastructure to use as collateral and with less-developed cash flow.

A common issue facing many SME exporters is raising capital for expansion of their export business especially in the early stages of export development. In particular problems arise when they need to fund expansion which involves investment in a foreign country. This is often the most critical (and most expensive) stage in consolidating/expanding their overseas markets.

—*Australian Institute of Export submission to the Review*

Private financial market capacity for export finance

It is reasonable to expect that the commercial availability of finance and the diversity of financial service products would expand as more businesses enter international markets; however, the pace of finance sector development appears to lag behind the increasing interest in offshore business by small and medium-sized enterprises.

The Review's consultations with some Australian financial institutions suggest that some exporting businesses can fall into a grey area between Australian banks and banks in other markets. Assets acquired offshore are often not accepted as security by domestic financial institutions. Overseas financial institutions might be reluctant to provide attractive finance when the majority of a company's other banking transactions and cash flow are in markets other than the market in which expansion is occurring.

Inadequate financial and managerial skills

Austrade notes that new exporters and businesses investing overseas are often unable to obtain finance because of lack of financial skills and poor understanding of financial products.

Common failings in this regard are a poor understanding of where to obtain finance (particularly in relation to equity) and under-prepared businesses not clearly explaining their business and their needs when approaching financiers.

The preference of businesses in Australia for access to particular types of finance can also be a factor. By far the most favoured source of funding for export growth is retained earnings. Debt is a secondary source, while seed capital, venture capital, mezzanine finance and private equity are not favoured. The reluctance to use equity is in part a result of perceptions of high transaction costs and sacrificing a disproportionate share of future profits, or a desire on the part of founders or owners to retain management control.

This market gap can be exacerbated by a lack of understanding of international business among the local branch staff of some financial institutions. Potential problems include incorrectly diagnosing the needs of exporting businesses and inaccurately weighting the risks and benefits of exporting businesses.

The Review considers that the need to improve managerial skills is greatest for these companies. When financial support is provided in the absence of advice and information there is the potential for suboptimal outcomes. The Review identified the need for an independent source of advice and information on export financing, including referrals to commercial service providers as well to other sources of government financial assistance. An important outcome of this service would be to build management and financial skills within businesses. Establishing firmer financial foundations among firms new to export and international business will have a positive effect on long-term success.

Recommendation 8.1

Equip Austrade to advise new exporters and offshore investors on appropriate sources of financial advice.

8.2 THE CURRENT PUBLIC SECTOR RESPONSE

A number of programs offered by the Commonwealth and state and territory governments provide financial assistance to firms to develop international business.

These include:

- the Export Market Development Grants scheme
- products offered by the Export Finance and Insurance Corporation
- tax concessions provided under sections 23AF and 23AG of the *Income Tax Assessment Act 1936*
- export-specific tariff concessions, including Tradex
- state and territory financial assistance programs for exporters.

The effectiveness and impact of these measures are canvassed in the following sections. It is also useful to briefly look at the export assistance measures offered by Australia's international competitors.

The Export Market Development Grants scheme

The Export Market Development Grants scheme is the Commonwealth Government's primary financial assistance program for aspiring and current exporters. It encourages Australian small and medium-sized enterprises to enter and develop sustainable export markets by reimbursing



Box 8.1

The Export Market Development Grants scheme: a snapshot

- In 2007–08, 3933 grants were made, an increase of 10.9 per cent in grant numbers and 3.6 per cent in payment amounts compared with 2006–07.
- The average grant paid was \$37 896 and the median grant was \$29 973.
- Eighty per cent of recipients were small exporters reporting annual income of \$5 million or less and 74 per cent of recipients reported having fewer than 20 employees.
- Sixty-one per cent of recipients were in service industries (predominantly tourism, education and culture, and information and communications technology), 36 per cent were in manufacturing (predominantly food and beverages) and the remainder were in the primary sector.
- The top two countries targeted by grant recipients were the United States and the United Kingdom; they were followed by China, Singapore, Japan and Germany.

up to 50 per cent of eligible export promotion expenses above a threshold of \$10 000. A scheme participant is limited to eight taxable grants, each grant being between a minimum of \$5000 and a maximum of \$200 000. Eligibility rules are legislated through the *Export Market Development Grants Act 1997*. Funding amounts to about \$150 million a year.

On the basis of the detailed analysis included in the 2008 *Review of the Export Market Development Grants scheme*, the Review concluded that the scheme is effective and efficient. Our conclusion is consistent with the strong positive feedback received from business on the scheme.

The Review considers, however, that a priority is to give applicants certainty about the level of funding they will receive. The current uncertainty, created by demand for funding under the scheme greatly exceeding the available funding levels, substantially negates the objective of encouraging exporters to commit additional resources to export promotion.

While continuing to support a capped scheme, the Review identified two options:

- Allocate significant additional funding to meet current and future estimates of demand.
- Set ongoing expenditure at or near the 2009–10 budgeted level (\$200 million)

and make significant changes to the scheme provisions (such as reducing the number of grants from eight to five and increasing the minimum threshold to \$30 000 or reducing reimbursement rates).

Of these options we prefer the latter.

The Review also notes the immediate pressure on the scheme in 2008–09, with funding set at \$150 million despite projections that claims will exceed 2007–08 levels, and recommends that this be addressed.

We also consider that the capped scheme should be indexed annually to preserve the real value of the funding. This would also go some way to dealing with difficulties in relation to the scheme's cost of administration highlighted in the *Review of the Export Market Development Grants scheme*.

... to optimise [the scheme's] potential: ... rais[e] its funding limit from \$200 to \$300 million per annum in addition to providing for an annual CPI adjustment to preserve the real value of the funding.

—Australian Industry Group submission to the Review

The Review examined options for improving the scheme. Given that the immediate priority is to resolve the funding uncertainty,

these options have not been developed fully; however, to the extent possible, we found potential areas of improvement, including:

- inclusion of the costs of outward investment activities as eligible expenses
- removal of eligibility for approved trading houses
- broadening of eligible approved body provisions to enable the inclusion of sporting and cultural organisations involved in developing exports and international investment opportunities through international business networking promotions.

Recommendation 8.2

Continue the Export Market Development Grants scheme as a capped program, with either the cap adjusted to match demand against current eligibility criteria or eligibility adjusted to meet the current cap. The capped funding scheme should be indexed annually to preserve the real value of the funding.

Recommendation 8.3

Tighten the scheme provisions (by reducing the number of grants from eight to five and increasing the minimum threshold to \$30 000).

Recommendation 8.4

Implement changes to provisions of the EMDG scheme and eligibility criteria to the extent possible to reflect the contemporary needs of Australian businesses growing internationally.

Recommendation 8.5

Review the effectiveness of the EMDG scheme at regular intervals (but not more frequently than every five years).

Export Finance and Insurance Corporation products

The Export Finance and Insurance Corporation is the Commonwealth Government's official export credit agency, providing specialist finance and insurance services for exporters when financial, country or industry risks exceed the capacity available in financial markets. EFIC is a wholly owned statutory authority of the Government. It collaborates with the commercial market to provide financial products and services (such as export finance guarantees, direct loans and political risk insurance) on a self-funded commercial basis.

EFIC's export finance business operates in the 'market gap'; that is, where the private market lacks the capacity or willingness to meet the financing and insurance needs of Australian companies exporting or investing overseas.

Given that the perceived market gap can change depending on prevailing economic conditions, EFIC's mandate has been reviewed on several occasions in the past 10 years. The organisation has also adapted its focus to changing commercial factors—for example, its introduction of the Headway product for small companies in 2006.

ACCI strongly recommends simplifying the EFIC Act and expanding EFIC's powers to provide a broader range of services to SMEs seeking to establish global supply chains.

—Australian Chamber of Commerce and Industry submission to the Review

Table 8.1 EFIC facilities, 2006–07: a summary

	Number of facilities	Value of support	Value of export investment business supported
2006–07 Total	39	\$554.4 million	\$1.4 billion
• Commercial Account	22	\$538.3 million	\$1.3 billion
• Headway	16 ^a	\$6.7 million	
• National Interest Account	12 ^b	\$9.4 million	\$85 million

a. Headway is reported as having indirectly assisted a further 30 exporters by catalysing their banks to provide increased finance without requiring a Headway guarantee.

b. Includes 11 facilities shared over the Commercial Account and the National Interest Account.

Source: EFIC (2007).

The Review concluded that there continues to be a gap in private market capacity in the medium- and long-term export finance business. We support a limited expansion of EFIC's powers to assist Australian companies seeking to invest offshore where these companies are small and new to offshore investment and have a sound business case, and where the private banking sector is unwilling to provide support. Like other EFIC programs, these new services would be expected to be self-funding. They should also be reviewed after two years of operation to determine their appropriateness and effectiveness.

While the Review found general support for the programs offered by EFIC and noted reports that it supported \$1.4 billion of exports in 2006–07, our attention was drawn to the small number of companies making use of EFIC services (see Table 8.1). Of the 22 facilities on the Commercial Account (excluding Headway), it appears that only 13 companies were supported in their export and international investment

activity in 2006–07. In the same year, around 80 per cent, or \$449.2 million, of the total value of facilities let was directed to two companies in the mining sector.

During consultations, the Review heard about the limited awareness of EFIC products. The Review considered there was scope for enhanced cooperation between Austrade and EFIC to raise awareness of EFIC products in the Australian exporter and international business communities.

Recommendation 8.6

Enact a limited expansion of the Export Finance and Insurance Corporation's powers to support Australian companies seeking to invest offshore where these companies are small and new to offshore investment and have a sound business case, and where the private banking sector is unwilling to provide support.

Recommendation 8.7

Review the appropriateness and effectiveness of EFIC's new services after two years.

Tax exemptions for income earned by Australians working abroad

Section 23AF of the *Income Tax Assessment Act 1936* (introduced in 1980) provides an exemption from Australian income tax for the earnings of Australian individuals working overseas for more than 90 days on projects approved by the Minister for Trade as being in the national interest. The purpose of the exemption is to increase the competitiveness of Australian companies and government organisations seeking to win international tenders.

The exemption applies only to projects in countries where income tax is not levied on employment income or where income tax is not levied on foreign workers' income because the project is funded by international development agencies. At present more than half the approved projects are commercial projects in the tax-free Gulf states of the Middle East; the remainder relate to projects funded by international development agencies such as the World Bank, the Asian Development Bank and the United Nations Development Programme. AusAID-funded projects are not eligible.

Section 23AG of the Act (introduced in 1986) has more general coverage and provides an exemption from Australian income tax for foreign earnings derived by Australian individuals working overseas (in specified circumstances). Such income would otherwise be subject to Australian tax at the individual's marginal rate, with a credit provided for foreign tax paid.

One challenge in assessing the impact of sections 23AF and 23AG is that,

although the Australian Taxation Office's advice is that about 24 000 individuals currently claim an exemption under these sections (amounting to \$1.2 billion in income in 2005–06), this figure cannot be accurately disaggregated. Combined revenue cost estimates for sections 23AF and 23AG were \$450 million in 2005–06, increasing to \$520 million in 2008–09 (Treasury 2008).

Both Australian companies and individuals benefit from the section 23AF exemption. In 2007, 165 project applications from 32 Australian organisations were approved. To date, 41 of these applications have been successful, worth an estimated \$800 million. The number of Australian individuals benefiting is estimated to be about 2000 a year, and the average number of individuals engaged per project is small—in the range of five to 15.

Engineers account for about 85 per cent of the individuals who claim the section 23AF exemption; project managers, teachers, professors, medical professionals, architects and designers account for the remainder. Among individuals claiming under section 23AG, the range of occupations is probably more diverse, including defence and police personnel deployed under specific assistance programs as well as cyclical workers such as oil rig workers and international airline pilots. With more Australian firms and individuals working overseas in a range of circumstances, the Review notes the potential for inconsistent tax outcomes among them.

Although these provisions are likely to contribute to Australian companies securing overseas projects and to the employment of Australian workers on overseas projects, the Review concluded that it is difficult to determine the full extent to which the provisions have contributed to successes or whether there are more effective mechanisms for supporting the export of Australian goods and services.

Export-specific tariff concessions

Duty drawback is an export concession scheme that returns duty paid on imported goods where those goods are exported unchanged or incorporated in other goods and then exported. There is no refund of GST. The scheme is administered by the Australian Customs Service, and around \$100 million is returned to exporters each year.

Tradex is an export-specific concession scheme administered by AusIndustry and designed to provide a more efficient alternative to duty drawback. It reduces the cost of exports through the up-front removal of duty and GST payable on imports where those imports are destined for export or for use as inputs to exports. Tradex provides around \$200 million in combined duty and GST relief each year.

The Australian Customs Service administers a range of other tariff concessions that are designed to provide duty-free entry for components and materials for use in manufacturing and value-adding activities in specific circumstances and that also provide some benefit to exporters of the goods in question.

Comparison with Australia's main trade competitors

Australian exporters must compete effectively against government-supported exporters in other countries. As a member of the OECD, Australia conforms to OECD arrangements on officially supported credits, and companies can gain access to this form of support through the Export Finance and Insurance Corporation. Australia's main trade competitors also support their exporters in a variety of other ways (see Table 8.2).

In considering options for changing the composition and nature of financial assistance provided for Australian businesses seeking to internationalise, the Government will need to ensure that any new measures reflect Australia's international obligations as a member of the World Trade Organization.

Currently, our competitors have infinitely more funds to spend on promotional appearances at trade shows and incentives to importers. The USA and Chile are particularly active in this area and clearly have additional Government funding support for such activities.

—*Australian Horticultural Exporters Association
submission to the Review*

Table 8.2 Financial programs offered in other countries: a snapshot

Country	Tax break	Grants	Loans	Guarantees	Insurance
Canada	●	●	●	●	
China	●	●			
France		●		●	●
Germany		●			
Hong Kong		●	●		
India	●	●	●		
Indonesia		●			
Israel					
Ireland		●			
Japan			●		
Malaysia	●	●			
New Zealand		●			
Saudi Arabia					
Singapore	●	●	●		●
South Korea			●		
Taiwan					
Thailand	●		●		
United Arab Emirates		●			
United Kingdom		●			
United States		●	●		

Note: National-level programs only. Excludes OECD financial products. More detail on the provisions of the schemes identified is contained in the Review of the Export Market Development Grants scheme.

Table 8.3 Financial assistance for exporters: state and territory governments

State/ territory	Program
New South Wales	<p>Outbound Trade Missions Assistance</p> <ul style="list-style-type: none"> • 100% of business matching, shared exhibition space and networking events <p>Independent Market Visits Assistance—Business Matching</p> <ul style="list-style-type: none"> • Up to \$3000 to offset fees paid to approved service providers (for in-market business matching and appointment) <p>Independent Market Visits Assistance—Exhibitions</p> <ul style="list-style-type: none"> • Up to \$5,000 (\$-for-\$) to meet exhibition space cost <p>New Export Opportunities Program (Small Businesses)</p> <ul style="list-style-type: none"> • Up to \$10 000 financial assistance to eligible companies for consultancy assistance with preparation and follow-up marketing planning
Northern Territory	<p>Trade Support Scheme</p> <ul style="list-style-type: none"> • International marketing: Up to 50% reimbursement of costs. Covers existing and emerging exporters not eligible for EMDG • Tourism operators program: Up to 50% of costs to develop/expand international market reach • Export training: Up to 50% of costs to a maximum of \$1000 • Inward buyer missions: Up to 50 per cent of costs to bring prospective international clients or partners to the Territory to further export opportunities <p>Targeted Outbound and Inbound Trade and Investment Missions Assistance</p> <ul style="list-style-type: none"> • Financial support assessed on merits and practical assistance <p>Indigenous Art and Craft Buyer Missions</p> <ul style="list-style-type: none"> • Targeted financial assistance for expenses related to inbound indigenous art and craft buyer missions
Queensland	<p>Queensland Education and Training International Grants—Trade Queensland</p> <ul style="list-style-type: none"> • Matching funding for eligible projects <p>Business and Industry Transformation Incentives</p> <ul style="list-style-type: none"> • Financial incentives for projects that will promote the transformation of priority industries towards an internationally competitive, sustainable and knowledge-intensive future <p>International Marketing Scheme—Pacific Film and Television Commission</p> <ul style="list-style-type: none"> • Funding up to \$20 000 per single recipient per annum to producers and/or screen producers to attend international markets, festivals and meetings where there is evidence of a genuine commitment to seek finance for projects <p>Arts Queensland Sector Project Grants Program</p> <ul style="list-style-type: none"> • Provides creative development grants, project grants and special initiatives to enable artists to create and present work and access international festivals, art fairs, events, touring circuits, professional development opportunities and international co-productions and exchanges <p>Arts Queensland Industry Development Initiative—International Music Market Development Program</p> <ul style="list-style-type: none"> • Contribution to travel/accommodation costs for selected artists and industry representatives to attend, broker business, and showcase at key international music markets. Includes Indigenous Music Market Development. <p>Arts Queensland's Industry Development Initiative—Australian Performing Arts Market</p> <ul style="list-style-type: none"> • Supports and promotes Queensland performing artists at the Australian Performing Arts Market international market showcase. Includes \$40 000 for small to medium arts companies to respond APAM international performance invitations

State/ territory	Program
Australian Capital Territory	<p>TradeConnect</p> <ul style="list-style-type: none"> • Matching funding for services and specific export development activities up to \$5000, capped to a maximum total level of \$20 000 over the course of a three-year period <p>Trade Mission Business Matching Program</p> <ul style="list-style-type: none"> • Funds Austrade business matching program services for companies involved in annual ACT outbound trade mission. Facilitates trade and investment opportunities
South Australia	<p>Market Access Program</p> <ul style="list-style-type: none"> • Reimburses 50% of expenses—up to \$5000 for outgoing missions; up to \$1000 for hosting in-coming buyers; up to \$1000 for developing exports capabilities of a company
Tasmania	<p>Export Marketing Assistance Scheme</p> <ul style="list-style-type: none"> • Matching funding provided up to the value of \$10 000
Victoria	<p>Export Networks</p> <ul style="list-style-type: none"> • Up to \$10 000 per annum to approved bodies to bring companies together to exchange knowledge, experience and ideas <p>Arts Victoria—International Program</p> <ul style="list-style-type: none"> • \$5000–\$25 000 for offshore activities <p>Arts Victoria—Victoria Rocks Music Touring</p> <ul style="list-style-type: none"> • Up to \$15 000 for international touring and up to \$10 000 for professional travel <p>First Step Exporter</p> <ul style="list-style-type: none"> • Reimburses up to 50% of expenses incurred on eligible promotion activity to a maximum of \$10 000 <p>ICT Trade Events and Export Assistance Program</p> <ul style="list-style-type: none"> • 100% reimbursed for some events up to \$2500; 50% reimbursed for \$4000–\$10 000 depending on activity <p>Trade Fairs and Missions Program</p> <ul style="list-style-type: none"> • Trade fairs—up to \$40 000 for groups; inbound missions—up to \$15 000; outbound missions—up to \$30 000; industry capability missions—up to \$200 000; pre-departure training and post-event follow-up—up to \$5000 <p>Grow Your Business</p> <ul style="list-style-type: none"> • Business strategic review—75% reimbursed up to \$4000; business development plan—50% reimbursed up to \$7500; group program—75% reimbursed up to \$15 000; network program—75% reimbursed up to \$15 000 <p>Tuition Exemption for Post Graduate Research Student Dependents</p> <ul style="list-style-type: none"> • Tuition fee exemption available in all Victorian Government primary and secondary schools <p>Regional Inward Buyer Mission Program</p> <ul style="list-style-type: none"> • One-off grants to facilitate inward buyer missions to regional Victoria. No specific funding formula. Applications are assessed on their merits <p>Targeted Trade and Investment Missions—Regional Victoria</p> <ul style="list-style-type: none"> • Complementary to the Trade Fairs and Missions Program. Funding is provided by Regional Development Victoria. Applications are assessed on their merits
Western Australia	<p>Industry Association and Bilateral Business Association</p> <ul style="list-style-type: none"> • Targeted funding assistance to entities to help promote, access or develop international trade opportunities. <p>Market Access and Development Scheme</p> <ul style="list-style-type: none"> • Provides assistance to exporters to offset some of the costs of entering markets, including funding for accommodation and airfares.

Source: Relevant states and territories.

State and territory financial assistance

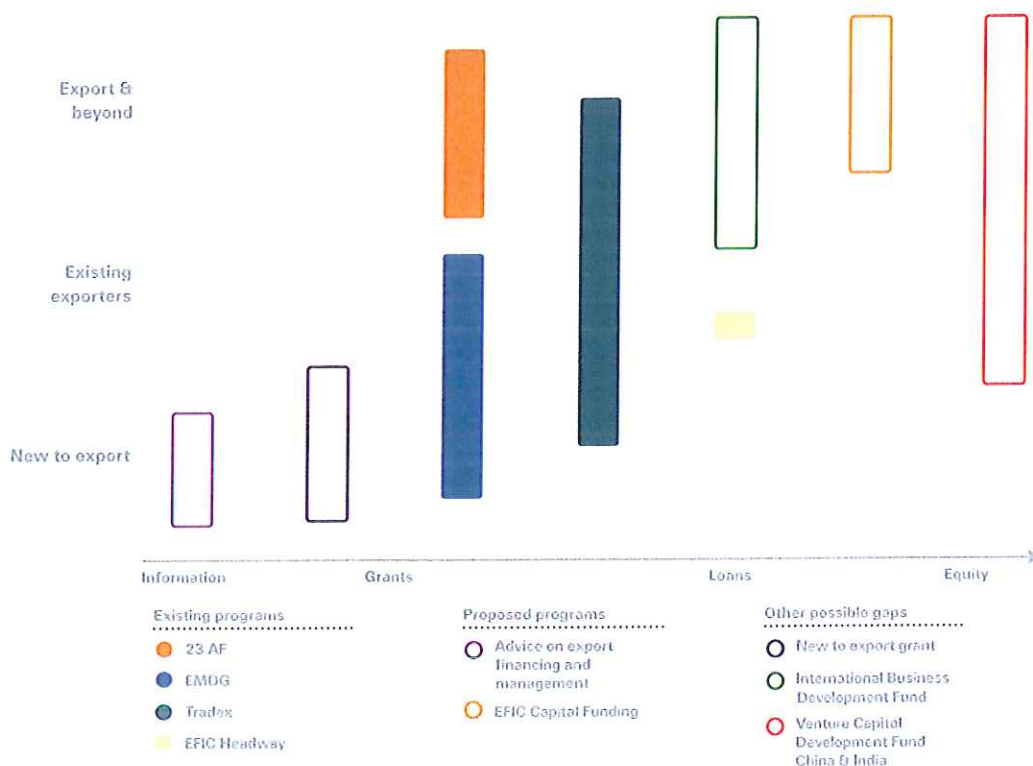
State and territory governments also provide financial assistance to exporters. Table 8.3 reports on financial assistance programs that firms can access directly if they meet certain eligibility criteria. The parameters of the programs vary, but across jurisdictions a primary focus is the provision of small grants that sit below the Export Market Development Grants scheme's eligibility thresholds. The Review noted that the small scale of budget for these programs limits their focus to very specific activities, such as visiting overseas markets and participating in trade fairs or for industry purposes.

8.3 FUTURE FINANCIAL SUPPORT PROGRAMS

The Review was presented with a number of suggestions for additional taxpayer-funded programs to support exports and direct outward investment. With a few exceptions, we have not been convinced that the cost of these proposals to the community will be substantially outweighed by the presumed benefit to the recipient of the support.

However, cognisant that the financing needs of small and medium-sized enterprises are becoming more complicated as models of international business evolve, we considered some of the options that more specifically target identified points of market failure and may encourage faster rates of

Figure 8.2 Financial support programs: a model



internationalisation. We were also mindful of the range of measures employed by Australia's competitors and conscious that the current suite of Commonwealth programs were all initially implemented in the 1970s and 1980s with little change since.

The current coverage of existing programs and potential gaps—from information and capacity building through to different types of finance (grants, loans and equity funding)—are identified in Figure 8.2.

Options for addressing these potential gaps are included at Appendix I. While these options have not been costed or developed fully, the Government may wish to consider these as alternatives to increasing investment in existing programs.

Criteria for financial assistance

The Review concluded that public assistance for exporters and offshore investors should be contemplated only where it is directed efficiently at clearly demonstrated market failures and where it results in markedly greater exports than would be achieved without the program.

Our examination indicates the following criteria for successful financial programs:

- well targeted to specific points of market failure and identified unmet needs
- limited to circumstances where the private market does not operate
- limited in both value and duration to avoid a culture of reliance
- have potential spillover benefits to other Australian companies and organisations
- encourage appropriate risk sharing between recipient and provider,

including repayment arrangements where appropriate

- supported by clear objectives, measurable performance criteria and appropriate risk-management practices
- consistent with Australia's international obligations.

Recommendation 8.8

Ensure that financial assistance programs are well-designed and well-targeted against a consistent set of criteria and objectives. Phase out assistance that is not directed at demonstrated market failures and does not result in exports that are markedly greater than would be achieved without that assistance.

A coordinated national approach to delivering through partnerships

Throughout the Review, the lack of comparable performance information for financial assistance programs offered across the Commonwealth and by states and territories restricted our ability to assess the relative merits.

We consider that a common framework for the design, monitoring and promotion of financial assistance programs for export and international business growth is desirable. A commitment to regular, comparative assessment of such programs would allow for more rigorous consideration of the programs' continued effectiveness and contributions to international competitiveness.

Finance for the initial stages of growth for the right products is reasonably available. However finance for the next stage of growth into exports is harder. The EMDG scheme is essential for the marketing needs of exporters however the finance to fund the other aspects of growth usually in production or manufacturing innovation

to satisfy the new export demand is less available. EFIC has gone some way to assist these companies but most still struggle with cash flow issues. Many companies are also unaware of the existence of EFIC and how it can help.

—Science Industry Australia submission to the Review

We are also of the view that promoting the full range of financial products provided by levels of government as an integrated suite would ensure greater recognition of the existing level of tangible assistance and support available for exporters. From the perspective of Australian businesses accessing these programs, this would provide a clearer view of the choices available.

This is not to suggest that delivery of programs should be centralised: there are opportunities for all levels of government as well as the private sector to contribute to the design and delivery of these programs. The role of government is strongest at the information provision and direct grant stages of the continuum. Private sector expertise is crucial at the loan and equity end of the financing continuum.

Recommendation 8.9

Promote awareness of financial assistance programs through cooperative approaches between Austrade, state and territory governments and the Export Finance and Insurance Corporation and with commercial financial service providers.

Recommendation 8.10

Establish a consistent set of measures to assess the relative effectiveness and efficiency of all financial assistance mechanisms.



Finance Strategic Dialogue Sydney, 26 October 2009

Discussion summary

The Trade 2020 Strategic Dialogue on trade finance, held in Sydney on 26 October, took stock of the adequacy and contribution of trade finance to Australia's emerging business and economic recovery from the global financial crisis. It also looked beyond this to likely developments during the decade to 2020.

The dialogue included representatives from five major banks, credit insurers, leading accounting firms, a range of industries and industry bodies, the Reserve Bank of Australia and Government.

Availability of credit

The starting point for discussion was the availability of credit. Participants recognised that while Australia's global economic status has been enhanced by our comparatively strong economic performance, there are some weaknesses in the domestic economy and continued difficulties for business in accessing credit. In particular:

- Concern was expressed that foreign banks are reducing their exposure in Australia as they consolidate their balance sheets. This is affecting the availability of working capital and export finance.
- It was felt that a strong finance industry will be essential to supporting the expected increase in demand for credit and private investment as the recovery in Australia becomes sustained.

Access to trade finance

The second topic of the dialogue was access to trade finance. Some participants felt that the support of trade finance providers for business was patchy.

While Australian and foreign banks and other lending institutions are interested in working with exporters, some business representatives pointed to significant difficulties in accessing trade finance, believing Australian banks to be very risk averse. They argued that banks concentrate on bricks and mortar security rather than the value of trade that businesses are undertaking, and on domestic not international lines of business.

Bank representatives acknowledged the concerns but pointed to the challenges they face, including:

- the need to maximise shareholder value in choosing which lines of business to pursue
- regulatory disincentives to trade finance lending (through the Basel II guidelines)
- difficulties in obtaining adequate information from business clients about their offshore ventures and partners to enable proper risk assessments. Bank representatives argued that they often did not know enough about the requirements of individual customers and their overseas partners, while businesses (SMEs in particular) are often not well geared to mounting effective business cases for finance.

In the regulatory area, representatives from the banks explained that the revised capital risk weightings under Basel II discourage banks from trade finance lending by applying a one year maturity floor for all lending facilities, including trade finance. In fact, trade finance has a much shorter maturity (generally no longer than 180 days). The capital costs of trade finance under Basel II are therefore artificially inflated. National regulators do have scope to adopt a more flexible approach to trade finance, as has been done in the UK. Australian industry, through the International Chamber of Commerce, is seeking a similarly flexible approach from Australia's regulator, APRA. Dialogue participants considered that support from government for industry's approach could be beneficial.

Participants identified the need for better education of business, particularly SMEs, to enhance their governance, understanding of the role of trade finance in international business and capacity to respond to the prudential requirements of lender institutions. Research by the Australian Institute of Export, which suggests that only one in ten exporting SMEs has a foreign exchange policy, gives an indication of the challenge. There is a range of exporter education programs at various levels of government, in academia and in the private sector which would benefit from enhancement and better co-ordination.

Bank and business representatives were keen to co-operate in addressing some of these issues. There was general agreement, for example, that among SMEs the focus of attention should be on medium-sized enterprises. These businesses comprise a significant proportion of the Australian economy and have critical capital needs, but are generally not well informed about how to access trade finance. One participant commented that these firms are also the least equipped to succeed in overseas trade.

There was also discussion about the value of a strengthened programme of research in trade-related areas, including the trade finance needs of SMEs. Although exports account for 22% of GDP, participants felt there was no strong national understanding of Australia's export industry, particularly the reasons why only 4 - 5% of companies export and the factors that influence export behaviour.

Access to credit insurance

The third topic for discussion at the dialogue was access to credit insurance.

Participants discussed the long-term outlook for the credit insurance market, noting the reduction in global capacity and escalation in prices following the financial crisis. The Australian Institute of Export noted that lack of access to, and higher prices for, export credit insurance continued to be the top concern of Australian exporters. Representatives of credit insurers indicated that they expected the level of capacity to stabilise following sharp declines in response to growing losses in 2008 and 2009. They added, however, that some credit insurance arrangements which were in place prior to the crisis, such as those for wool, had been uncommercial and that permanent decreases in tenors and increases in prices in those sectors were likely.

Some participants noted the high degree of market concentration in credit insurance, with the top three firms accounting for around 80% of global business. This reflected the relatively high barriers to entry in this market due to the very large, expensive databases containing financial and other information on possible buyers that insurers need in order to be able to price their risks. This market concentration also extends to Australia. It means that when prices rise (and supply declines) as is happening now, other providers fail to enter the market. The market is therefore failing in some ways, creating the need for some kind of policy response. The participants discussed that one option would be for the Australian Government to re-enter the market and provide credit insurance itself, as it did until 2003. However, they felt that other policy options, including how to break down the barriers to entry, should also be considered.

Participants noted the link between the shortage of credit insurance and exporters' ability to obtain working capital from banks who rely on cover when setting limits. Credit insurers remarked that APRA's refusal to accept credit insurance as a mitigant when applying Basel II capital standards had exacerbated this problem. There may be a case to review this approach as part of a general review of the application of capital standards, some participants argued.

Representatives of credit insurers also raised the need for improved quality and availability of financial information, which can hamper their ability to provide cover. It was noted that steps to improve information could contribute to alleviating the high costs of market entry, further improving market capacity in the long run. Insurers cited the UK's Companies House as a good example of how to improve access to company information. Insurers also noted that strong links between credit insurers and the financial sector in Europe had assisted insurers to gain access to relevant information in the pricing and provision of cover.

Funding offshore expansion

The fourth topic for discussion was funding support for businesses' offshore activity.

The participants noted that as Australian companies internationalise, it will be important that Australian banks follow company supply chains by establishing a presence in overseas markets and partnerships with foreign banks. Both developments are occurring and bank representatives believe there will be an increase in offshore bank activity in the future. This will be a helpful development in better linking trade finance to business supply chains and is worth supporting.

Participants also noted the Australian Government's recent decision to amend EFIC's governing legislation so that it can provide greater financial support to SMEs in this area.

Role of venture capital

The role of venture capital in supporting Australian innovation and small business was also considered. Generally, participants' perceptions were not positive, with a sense that the venture capital market in Australia remains shallow and characterised by risk aversion. One participant noted that there was more discussion about the role of venture capital six years ago in Australia than there is today. It was felt that there is a need to attract more international investment in Australian innovation, drawing on Australian sector strengths. However, participants recognised the challenge for a small market like Australia, which lacks critical mass, in competing with the US.