



Australian Government

Department of Foreign Affairs and Trade

Australia's Export Credit Arrangements

Submission to the Productivity Commision

19 December 2011

PRODUCTIVITY COMMISSION REVIEW OF AUSTRALIA'S EXPORT CREDIT ARRANGEMENTS: DFAT SUBMISSION

Introduction

This submission is provided in response to the Productivity Commission's request for submissions as part of its inquiry into Australia's export credit arrangements.

The Export Finance and Insurance Commission (EFIC) is Australia's export credit agency (ECA). EFIC's role is to assist Australian businesses in their overseas activities by providing insurance and financial services, particularly for viable projects and transactions where the commercial market does not have the capacity or willingness to cover specific countries, companies and contracts. It does this by providing a range of products and services, including export payments insurance, loan guarantees, bonds, reinsurance, overseas investment insurance (political risk insurance), loans and information services in the 'market gap'. The range products and services that EFIC is able to offer is governed by the *Export Finance and Insurance Corporations Act 1991* (the EFIC Act).

The EFIC Act provides for two means of supporting Australian exports through financial and insurance products and services:

- Commercial Account, where the risks underwritten are carried by EFIC, with premium and other fees retained by EFIC and any losses borne from EFIC's capital and reserves; and
- National Interest Account (NIA), where transactions approved by the Minister are funded and administered by EFIC. The Australian Government bears all the risk related to transactions undertaken by EFIC in the national interest.

ECAs exist in most of Australia's trading partners and take a variety of forms and provide a variety of products. EFIC is reasonably conservative in terms of its risk appetite. As a public financial corporation, it sits in the middle of the spectrum of private to fully public ECA institutional arrangements. EFIC follows OECD benchmarks governing the operations of ECAs.

DFAT believes EFIC plays an important role in providing export credit and financial services that complement, but do not compete with, the private sector to ensure that Australian exporters and investors are not put at a competitive disadvantage compared to exporters and investors from other countries solely on the basis of financing cost. EFIC should not be providing support to Australian exporters that would put them in a more advantageous position than exporters in other countries. Australian exporters are expected to compete on the basis of quality and price of goods and services.

Fostering a strong export culture enables us to pay for our imports as our economy grows and an open, outward-looking economy, exposed to competition and technological advances in foreign markets, creates an incentive for the domestic economy to operate at its potential.

While the market gap is difficult to quantify and test, the guidelines and controls governing EFIC's operations provide a degree of assurance that EFIC is not competing with the private sector. DFAT is not aware of any complaints from private sector financiers, as was the case in the lead up to the divestiture of EFIC's short term credit insurance business, to suggest that EFIC is operating beyond the market gap.

DFAT would generally support amendments to the EFIC Act to reduce its complexity, but recognises that any significant expansion of EFIC's mandate is likely to be controversial and would need to be accompanied by appropriate eligibility criteria.

As an independent statutory corporation wholly-owned by the Commonwealth, EFIC operates at arm's-length from Government, making its own decisions on the management of its commercial account, but at the same time remaining accountable to the Government and the Parliament. Achieving a balance between autonomy and Government accountability is an important and challenging role for EFIC.

International context

ECAs play a significant role in the facilitation of international trade and investment. Although there has been a trend, among OECD ECAs, towards the privatisation of their short-term credit business, ECAs remain a dominant supplier of medium to long-term export credit and political and sovereign risk facilities.

All of Australia's key trading partners and competitors have ECAs. Many are explicit and active tools of industry or trade promotion policies, particularly in times of tight liquidity such as the Global Financial Crisis (GFC). For example, the Export Development Corporation of Canada is considered an instrument of Canadian public policy whose activities support and are aligned with the government's international commerce agenda. Its mandate was extended temporarily in 2009 in response to the GFC to enable it to engage in trade-related domestic activity.

Particularly noteworthy is the expanding activity of regional ECAs, including China's Exim Bank, Korea Exim and the Japanese Bank for International Cooperation. These institutions are increasingly represented among the consortium of financiers required to support large resource and infrastructure projects.

The structures used for ECAs can be loosely grouped into three categories: government departments; government corporations; and private companies that manage government accounts. The most common organisational structure for official ECAs is statutory public corporations (which is the governance framework that EFIC operates under).

The scope of operations of ECAs also varies across countries. Some have a limited range of products that can be offered to exporters and do not provide direct loans. EFIC is able to offer a wider range of products than some other ECAs. For example, in addition to insurance and guarantees, EFIC is able to provide direct loans in limited circumstances.

The OECD Arrangement on Officially Supported Export Credits (the Arrangement), to which EFIC and all OECD country ECAs adhere, provides a framework for the orderly use of officially supported export credits. The Arrangement seeks to foster a level playing field for official support, however, not all of the services offered by official ECAs are covered (investment insurance, short-term working capital facilities and bonding facilities are not covered). EFIC is responsible for ensuring that its export finance and medium-term insurance facilities are consistent with the OECD Arrangement.

The Arrangement provides a safe haven for ECAs under the WTO Subsidies and Countervailing Measures Agreement (the SCM Agreement), to the extent that their activities are covered by the Arrangement. An export credit practice which is in

conformity with the interest rate provisions of the Arrangement is not considered a prohibited export subsidy under the SCM Agreement.

In the Asian region there is an increasing number of ECAs that are expanding their activities globally. Many of the new and active regional ECAs are not OECD members and are not obliged to operate in a manner consistent with the disciplines established by the OECD Arrangement. However, most would still be subject to the SCM Agreement, which places certain disciplines on the granting of export credits.

See **Attachment A** for further details on international trends in the provision of official export credits and the OECD Arrangement.

EFIC's role

Although the proportion of Australian exporters and investors using export credit and finance services is relatively small, EFIC's services continue to be important in managing risk and helping Australian exporters to compete fairly.

The EFIC Act gives EFIC the following mandate:

- . to encourage and facilitate Australian export trade;
- . to encourage banks and other financial institutions in Australia to finance exports;
- . to manage the Commonwealth's aid-supported loans as well as the debt management program; and
- . to provide information and advice regarding insurance and financial products available to support Australian exports.

EFIC is to operate in the 'market gap'. Although the EFIC Act does not explicitly refer to the 'market gap mandate', the second reading speech for the *EFIC Act 1991* stated that EFIC '*will continue to fill a market gap by providing services which are not normally available from the private sector,*' and that '*EFIC will continue to work with the private sector and not in competition with it...*'.

Statement of Expectations letters from successive ministers for trade have consistently asserted that EFIC should only perform its functions in the market gap (or, in the most recent letter, more specifically, 'where the credit and insurance sectors are not able or willing to provide credit and insurance') and that it continue to monitor the capacity of commercial markets and consider this when assessing potential transactions.

All decisions about potential commercial account transactions are made by EFIC on the basis of commercial viability and market gap and without reference to prevailing government sentiment towards, or activities in, a particular sector or market. There is no expectation on the part of government that EFIC will do otherwise. In the case of the NIA, decisions are taken by the Minister for Trade, usually through Cabinet, and may involve the consideration of non-commercial objectives such as foreign policy.

EFIC's exposures in South Pacific, Asian and African economies potentially facilitate a range of development outcomes that align with Australia's broader foreign and security policy objectives. For example, in May 2011, EFIC signed an agreement with the Asian Development Bank that enables it to guarantee letters of credit issued by financial institutions in Bangladesh, Pakistan and Sri Lanka on behalf of local

companies importing goods and services from Australia, including essential foodstuffs and manufactures necessary for day-to-day living and longer-term economic development.

The requirement to operate within the ‘market gap’ of the export credit and finance industry reflects not only a perceived gap in the provision of export credit services offered by the private sector but also a perception of the wider benefits from EFIC’s activities. In particular, given that most other countries maintain a government-supported export credit agency, Australian exporters may be put at a competitive disadvantage to exporters in other countries if EFIC were not able to step into the market gap. In that sense, EFIC may help to level the playing field for Australian exporters so that availability and pricing of financing and insurance are not key determinants of their capacity to compete globally.

As articulated in its Trade Policy Statement, the Gillard Government believes international trade makes a positive contribution to the pursuit of its vision of “a prosperous, sustainable Australia providing opportunity for all”. It does this “by increasing national prosperity and creating high-skill, high-wage jobs”.

According to the Mortimer Review, an internationally focused Australian business sector with a strong export culture and access to global markets:

- . enables us to pay for our imports as our economy grows;
- . fosters innovation and stimulates business formation and entrepreneurial dynamism, which has flow-on productivity growth benefits, especially when firms become active in larger markets;
- . lifts the competitive performance of Australian firms through exposure to international trends in technology, product design, and marketing; and
- . provides an opportunity for exporters to diversify away from a single domestic market and to benefit from economies of scale.

The concept of market gap is closely related to market failure. It implies that mutually advantageous transactions are not taking place for a number of reasons. For example, evidence suggests that for particular export transactions, at a given time, the private sector finds the risks too difficult (or prohibitively expensive) to assess.

The use of the information by one firm does not reduce the total amount of information available to others. Left to private markets, the search costs that would need to be borne by a single firm, particularly in an emerging or frontier market, can be prohibitively high. Just as a government can correct for market failure in mineral exploration by conducting early geological survey work and disseminating the information obtained to all private exploration firms, there is a legitimate role for government in generating information in emerging or frontier markets and disseminating this freely to interested firms. The work EFIC does in this area complements that of Austrade whose assistance is more in the form of practical, on-the-ground advice about the peculiarities of particular overseas markets and commercial practices.

However, it is not always possible to obtain sufficient information for optimal decision-making, so market failure cannot always be corrected simply through the dissemination of information. The most obvious information deficiencies are in emerging, frontier and transitional economies; where governments play a significant role in the economy; where language and business culture can provide a barrier;

where there may be less openness of regulatory frameworks and transparency of business processes; and where there are greater difficulties accessing distribution channels and commercial connections. EFIC's involvement in transactions can provide an important signalling mechanism to the private sector, which may ultimately lead to a 'crowding-in' effect.

A lack of information (or the expense associated with undertaking a risk assessment) can often pose particular challenges for SME exporters seeking to finance export opportunities. In particular, modest revenue streams, limited capital to secure finance against, and limited experience can often limit a SME's ability to secure working capital. While these challenges are common to all SMEs, the risks associated with exporting to some overseas markets makes securing finance particularly difficult for SME exporters.

The costs (borne by banks) in undertaking a risk assessment for an SME export transaction can often be quite high when compared against the return from providing finance. Consequently, SME exporters are often unable to secure from banks, on any terms, the finance needed to support an export transaction. In this context, EFIC has been working to increase awareness of its services to the SME sector. In 2010-11, EFIC signed 90 SME facilities worth AUD 136.7 million across a wide range of sectors.

It is important to differentiate between market failure due to insufficient information and situations where there is sufficient information, but this information feeds into higher pricing of finance and insurance products. In the latter situation, the case for EFIC stepping into the market is less compelling as the market may actually be functioning effectively and high prices are a result of the particular circumstances.

The market gap fluctuates with the level of liquidity and credit risk in finance markets, and changes over time as banks and financiers develop more sophisticated financing or insurance techniques, or gain greater comfort with particular classes and durations of transactions. Additionally, private market appetite varies according to the particular characteristics and underlying commercial viability of a transaction under consideration. Thus, EFIC's operations will fluctuate with changes in the market gap, both due to shorter-term changes in market conditions and longer-term structural issues in credit provision for exports.

Structural market gap

The structural market gap is one which exists where the credit and insurance sector is not able to provide credit and insurance services to financially viable Australian export transactions or overseas projects. This inability, or indeed unwillingness, is generally unresolved in the short term (i.e. the market does not clear in response to changes in interest rates or premiums).

Over the longer term, however, experience shows that structural market gaps can close. Key factors that can influence the level of the market gap include:

- . the demonstration and confidence building effects associated with ECA activity in emerging economies;
- . greater access to information; and

- improvements in the capacity, and willingness, of financial markets to manage risks associated with export transactions in emerging economies.

In particular, EFIC can encourage the participation of banks and financial institutions in export projects focused on difficult markets, which can ultimately increase the private sector's capacity, and willingness, to share the risks involved in those markets. Export Finance Guarantees, which provide explicitly for bank risk participation, support this objective. A further example of this is the short-term credit insurance business which, once primarily the domain of ECAs, is now almost exclusively left to the private sector. Furthermore, international developments in export finance indicate ECA involvement in direct loan transactions is declining in favour of off-balance sheet facilities, such as guarantees.

Areas where EFIC has previously addressed a structural market gap in Australia include:

- credit insurance for major commodity exports such as wheat to buyers in riskier countries/markets that are not well understood;
- finance for large capital goods and project exports such as fast ferries where the length (tenor) of the facility is an impediment to private participation;
- political risk insurance and loan facilities for large mining projects such as the Lihir Gold Mine in PNG where the uncertain political or security environment creates a market gap; and
- facilities for Small and Medium-sized Enterprises (SMEs) that face challenges securing finance due to the small size of their annual turnover and of their finance requirements.

EFIC's level of activity in the export and foreign investment markets has grown in the years since the global financial crisis, but it still represents only a small fraction of the market. In its 2010-11 financial statements, EFIC stated that it signed 101 facilities on the Commercial Account and National Interest Account worth a total of AUD593.1 million. This is approximately 0.2 per cent of Australia's total exports in 2010-11 (AUD297.5 billion), a figure which indicates little prospect of EFIC 'crowding out' private sector economic activity.

Moreover, EFIC's exposures profile closely reflects segments of the finance and insurance market where over the years exporters have found it difficult to secure private sector support. For example, although EFICs facilities vary in maturity, typical amortised loans and guarantees are for 10 years compared to under 12 months for private business loans (the average term to maturity at 30 June 2011 was around 3 years). Again, although the distribution of EFIC's exposures by geographical region is reasonably diverse, at 30 June 2011, 70.5 per cent of EFIC's exposures by value were in the emerging, frontier and transitional economies of the Pacific, Middle East, South America, Asia and Africa.

Changes in the level of the structural market gap

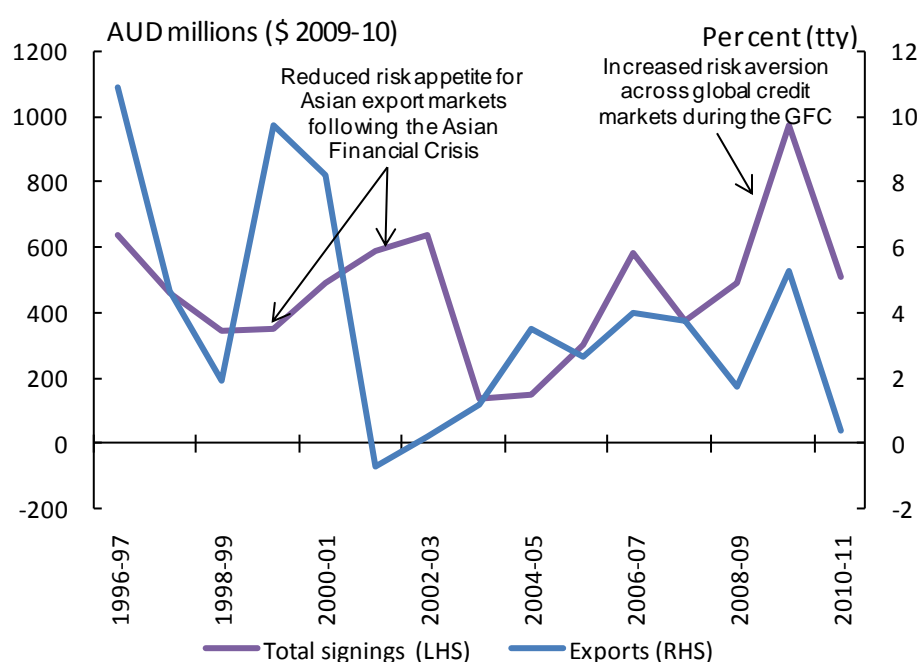
The level of the long-run structural market gap can be influenced by changes in the availability of credit (and the risk appetite of commercial providers of export credit facilities) and global economic conditions, although the relative importance of these factors is difficult to determine. The market gap tends to widen during times of

increased risk aversion in credit markets and contracts during periods of high levels of liquidity and risk appetite in credit markets. Economic conditions in developing economies (the traditional markets for the facilities offered by ECAs) also influence demand for the facilities offered by ECAs.

For example, the value and volume of transactions in which EFIC was involved was relatively high during the early 2000s (see Chart 1). This partly reflected a decline in the appetite of credit markets for risks associated with emerging markets (following the Asian Financial Crisis) combined with relatively strong growth in imports and investment across developing Asia (as the region recovered from contraction in economic output resulting from the Asian Financial Crisis¹). However, as the world economy began to recover in 2003-04, and confidence returned to credit markets, the structural market gap contracted as risk appetite in credit markets increased.

The increased risk aversion in global credit markets at the time of the Global Financial Crisis also resulted in a sharp increase in the level of new business undertaken by EFIC in 2009-10.

Chart 1: New signings² and total Australian exports (tty growth)



Source: EFIC annual reports and ABS National Accounts data

In particular, EFIC has reported unprecedented demand for debt to finance large-scale resource and infrastructure projects. A consortium of financiers is necessary to address the scale of the debt required. Furthermore, EFIC and other ECAs are being asked to participate because traditional sources cannot satisfy the longer-tenor commitment requirements for such projects.

¹ For example, four export finance facilities, totalling around AUD 200 million, were provided to the Philippines in 2001-02. This was equal to around 50 per cent of total export finance signings in 2001-02.

² Note that EFIC's short-term credit insurance business was sold by 30 September 2003.

EFIC is responding to this demand within the constraints of its mandate and exposure capacity limits. Given EFIC's commercial constraints, there is increasing pressure for NIA support.

Part 4 of the EFIC Act sets out the range of products that EFIC is able to offer and the range of circumstances under which EFIC can provide support to exporters and investors. Generally EFICs products are required to be in support of 'export contracts' and 'eligible export transactions'. EFIC has argued that Part 4 is overly complex and should be simplified to provide greater flexibility and to allow EFIC to be more responsive to changing exporter needs. DFAT would generally support changes to the EFIC Act that reduce complexity and expects that this would be reasonably uncontroversial.

EFIC has argued previously for the EFIC Act to be simplified and to incorporate a 'net benefit' test. Such a test would allow EFIC to support a broader group of clients, such as SMEs seeking to establish supply chains offshore. This would recognise the changing nature of global trade and the broader benefits that can flow back to Australia, including increased exports or dividend flows, strategic positioning for revenue growth or market penetration, and access to technology or entry into new markets. However, an expansion of EFIC's role beyond support for exports from Australia could be perceived by some as EFIC assisting the off-shoring of Australian industry. Consideration of such a measure would need to analyse carefully the advantages and disadvantages, as well as what ECAs in other countries are doing. DFAT's view is that EFIC's role should continue to have a strong connection to Australian exports, but DFAT also supports EFIC having some capacity to provide financial services to SMEs to support the expansion of their global supply chains, provided there are appropriate eligibility criteria.

EFIC's market gap assessment process

The Statement of Expectations, issued by the Minister for Trade, states that EFIC should ensure its activities do not compete directly with existing commercial sector providers of insurance, reinsurance and financial services and products which support Australian exports and foreign investment. Each transaction considered by EFIC must be assessed for conformity with the market gap mandate. Information which demonstrates how EFIC has assessed the existence of a market gap must be included in any Board paper seeking approval for a large transaction.

As such, EFIC's pricing should not undercut the private sector when private support is present, nor undercut pricing for comparable risks when private support is absent. By charging a premium for the additional risk or quality of service it is providing, EFIC would also be encouraging the private sector to fill the gap.

For each prospective transaction, EFIC commences a scoping process to determine whether it is able to support the transaction on the basis of its market gap mandate. EFIC does this based on considerations of:

- . **private market capacity:** whether current country or project limits, term constraints or lack of relevant experience affect the extent or quality of coverage provided or the consistency or reliability of private sector support.
- . **risk:** e.g. country or project specific risks. As a KPI for the market gap, EFIC aims for an average risk rating of between 3.5 and 4.5 for their portfolio.

- **size:** whether the project's size affects commercial market participation i.e. too small or too large relative to commercial market limits.
- **term:** a facility with a longer term will be more likely in the market gap than shorter tenors.
- **industry:** e.g. a developing industry or greenfield development, or an industry with an inherent high risk profile e.g. involving concessions or contracts with emerging market host governments.
- **firm size:** whether the firm's size or experience creates a barrier for commercial providers, or the firm's experience heightens their perception of risk in a particular market.

When considering providing support for a transaction, the EFIC Board makes an assessment of the market gap with reference to the relevant indicator or combinations thereof.

Governance

EFIC is an independent statutory corporation wholly-owned by the Commonwealth of Australia. EFIC falls within the Foreign Affairs and Trade portfolio and is responsible to the Minister for Trade ('the Minister'). The main pieces of legislation regulating the governance and activities of EFIC are the *Commonwealth Authorities and Companies Act 1997* ('the CAC Act') and the EFIC Act.

The EFIC Act establishes an EFIC Board to manage EFIC's affairs. Under the EFIC Act, the members of the Board, except for the Managing Director, are appointed by the Minister. The EFIC Act provides for a government member who "holds office during the Minister's pleasure". The government member is currently the Secretary of the Department of Foreign Affairs and Trade (DFAT), Dennis Richardson, and the alternate government member is Bruce Gosper, Deputy Secretary, DFAT.

The Managing Director is appointed by the Board after consultation with the Minister.

Under the CAC Act, the EFIC Board is required to keep the Minister informed about EFIC's operations and provide any information required by the Minister for Trade or the Minister for Finance and Deregulation. EFIC is also required to notify the Minister of certain significant events such as the acquisition or disposal of interests in companies or other ventures.

The EFIC Board meets approximately each six weeks and the government member or (usually) the alternate government member nearly always attends. The inclusion of a government member on the Board is considered critical because of the specialised foreign and trade policy expertise that the member can bring to EFIC's management of transactions on its Commercial Account, as well as complex NIA transactions. Should the government member be unavailable, board papers are still provided and the member can offer written comment.

Complementing the EFIC Act and other relevant guidance such as Statements of Expectations and Statements of Intent between EFIC and trade ministers, a Service Level Agreement (SLA) sets out in some detail the responsibilities of DFAT and EFIC in administering the National Interest Account. The July 2011-July 2014 SLA requires DFAT to provide timely advice about new information or decisions from any

source relevant to EFIC's role and operations. For EFIC's part, the SLA, in addition to requiring EFIC to conduct due diligence and manage its NIA operations efficiently and in compliance with the EFIC Act and ministerial decisions, sets out in detail a comprehensive range of reporting, consultation and information sharing requirements.

EFIC liaises regularly with government agencies, both in relation to government processes, general market and trade conditions, and on potential transactions if appropriate (e.g. DIISR (manufacturing, small business), Defence (export controls), DRET (extractive industries)). It also has relationships with industry organisations, financial sector bodies and non-government organisations.

National Interest Account (NIA)

The EFIC Act provides for EFIC to enter into transactions on the NIA. The Minister for Trade takes the decisions regarding NIA business, although the convention has been to seek Cabinet approval. Transactions are usually referred to the Minister for consideration on the NIA where the size or risk exceeds EFIC's commercial parameters, and are subject to the Minister's consideration of whether entry into them would be in the national interest. The 'national interest' is undefined. EFIC manages all NIA transactions as if they were on the Commercial Account.

The Australian Government is responsible for the financial consequences of NIA transactions. EFIC remits to the Australian Government the revenue from the NIA transactions portfolio and the Australian Government reimburses EFIC for the costs of servicing the portfolio and for any losses arising from the portfolio. The costs to be applied against NIA revenue are agreed with the Department of Finance and Deregulation in accordance with Sections 65 and 66 of the EFIC Act.

EFIC consultation with DFAT

DFAT and EFIC officers have regular, often daily contact, to discuss on-going policy and financial matters. Most DFAT officers liaise with the EFIC government liaison officer in the first instance, except in relation to specific tasks, for example, financial matters or work in relation to the OECD or Paris Club. EFIC Senior Management regularly communicates with DFAT Executive and other senior officers. The Minister and his office also have regular exchanges with EFIC management and the Board Chair. The EFIC government liaison officer and senior management visit Canberra on a regular basis to meet with DFAT and other agencies.

The Secretary or the alternate government representative provide a government perspective on matters at hand at EFIC Board meetings and intersessional teleconferences.

EFIC provides an annual briefing/presentation to central agencies on its financial outcomes. This is an opportunity for EFIC and central agencies to exchange views and seek clarification on transaction details. Each year EFIC prepares an NIA Exposure and Risk Management report for Cabinet consideration as well as a half yearly summary for central agency consideration.

Each month, EFIC produces a newsletter, "World Risk Developments", that is published on its website. This document provides economic and financial information on developments in countries and markets around the world. In advance of

publication, EFIC provides a draft copy to DFAT's economic and geographic areas and invites comment from Australia's overseas posts on the content, especially in relation to factual, country-specific points.

EFIC's performance

EFIC is required to operate according to sound commercial principles to ensure that its capital and reserves are sufficient to meet expected liabilities. EFIC is in a similar position to most official ECAs in that it has to fulfil a dual role of breaking even over time (as required by the CAC and the EFIC Acts), and to provide services in an uncommercial segment of the market. In spite of this inherent tension, EFIC has produced moderate profits each year over the period since the 2006 review. Each year, EFIC returns a dividend to government on any profits.

DFAT's experience is that the Board brings a strong commercial perspective to its oversight of EFIC and understands that EFIC is a statutory body, answerable to the Australian Parliament. Its directions are underpinned by an appropriately conservative position on risk. They are also conscious of the international market situation and the broader domestic context.

In a recent meeting with a senior DFAT official, one Europe-based trade finance specialist, whose firm has one of the biggest ECA practices in the world, noted that EFIC is positioned in the mid-spectrum of risk-taking and said they are considered a professional organisation.

Capital adequacy ratio

Under section 56 of the EFIC Act, the Board is required to ensure that the capital and reserves of EFIC at any time are sufficient. Although not an authorised deposit-taking institution, EFIC bases its assessment of capital adequacy upon the prudential standards and calculations used for regulating banks. In this respect, APRA requires banks in Australia to have minimum capital requirements consistent with the Basel II framework. The EFIC Board, which is responsible for setting policy on the capital adequacy ratio (CAR), has adopted Basel II principles and will continue to measure capital adequacy within EFIC on this basis until Basel III guidelines are released by APRA. Generally, the Board aims to maintain a ratio of 16 per cent of risk-weighted assets, including callable capital.

EFIC ended the 2011 financial year with a CAR, excluding callable capital, of 23.4 per cent. Clearly, EFIC's CAR falls well inside both EFIC's self-imposed minimum (16 per cent), indicating that EFIC has enough scope to accept projects as and when they are presented (up to the Board's prudential limit, including country limits).

Information and advice to the Australian government and public

EFIC provides the Government with interim financial statements, information relating to transactions on the National Interest Account (NIA), a semi-annual report on NIA expenditure and risk management, a corporate plan and annual report (which is also available to the public). The EFIC Managing Director and the Board's Chairman meet regularly with the Minister and his Office to provide updates on the financial operations of EFIC. In addition to this, EFIC produces a range of publications aimed

at informing Australian exporters and companies investing overseas, as well as a broader audience, about EFIC.

The EFIC Act requires EFIC Board members and EFIC employees to keep client information confidential. According to Section 87 of the EFIC Act a breach of the secrecy obligation is a criminal offence potentially punishable with a gaol sentence. The Act permits disclosure of information by EFIC to the Minister, the DFAT Secretary and designated DFAT officers or, where the disclosure is for the purposes of the Act, to other persons. The EFIC Act does not prevent EFIC publishing particulars about guarantees, contracts or loans made or proposed to be made under the Act.

Under Section 7 and Part II of Schedule 2 of the FOI Act (as amended in 2010), EFIC is exempt from the operation of the FOI Act in relation to documents concerning anything done by EFIC under Part 4 or 5 of the EFIC Act. The FOI exemptions and the EFIC Act recognise the need to keep confidential the commercial information EFIC obtains from Australian exporters and investors in order to decide whether to enter into insurance, loan or other financial obligations.

In early 2011, EFIC sought legal advice in relation to the amended *Freedom of Information Act 1982* – Information Publication Scheme to determine what it may have to disclose as a result of the amendments to this Act. According to this advice, EFIC is not required to disclose any further information in relation to its existing exemptions on both the Commercial and the National Interest Accounts. EFIC and DFAT will need to work together closely in considering the types of documents and parts of documents that EFIC may be able to disclose, consistent with the ‘proactive disclosure’ sections of the amended FOI Act.

Some members of the public have argued, in particular, that as the risk associated with transactions on the NIA (and ultimately on the Commercial Account through the Government guarantee) is borne by the Government (and therefore, taxpayers) more information about these transactions should be available to the broader public.

There is an inherent tension between EFIC’s mandate to operate in the corporate milieu as an independent, corporate entity and the fact that it is a wholly-owned government body. This tension is manifest in the intermittent divergence of views between EFIC and Government and Parliament on the level and extent of EFIC’s obligation for transparency and disclosure.

DFAT considers that, while the Minister for Trade is responsible for administering EFIC's enabling legislation, all Commonwealth supporting agencies have a role in the sound administration and governance of EFIC and in ensuring that its obligations under the CAC Act are met. The Departments of the Treasury, Finance and Prime Minister & Cabinet should therefore have timely access to EFIC information and documents to fulfil their responsibilities and ensure whole-of-government consistency in the management of Commonwealth authorities.

It is important that the Government receives sufficient information on NIA transactions in particular to ensure it is aware of existing and emerging risks, without imposing an undue administrative burden on EFIC or taking over EFIC’s responsibility for assessing and managing risks. Ultimately, EFIC’s Board and management are expected to exercise high levels of professionalism and standards of corporate governance and risk management.

Environmental and social policy

The Department is aware of concerns raised by NGOs regarding EFIC's public disclosure and due diligence processes on social and environmental aspects of transactions. EFIC undertook a major review of its social and environmental policies in 2010. The new Environmental and Social Review of Transactions policies and procedures are available on the EFIC website. The policy is applied to all transactions undertaken by EFIC and seeks to provide transparency and clarity about transaction decisions. It is based on an OECD agreement, known as the Common Approaches on Environment and Officially Supported Export Credits (the Common Approaches). EFIC's policy also applies other international benchmarks such as the International Finance Corporation (IFC) Performance Standards.

DFAT considers EFIC has made significant efforts to improve the transparency of its Environment Policy. EFIC discloses publically its possible future involvement in any project that carries the potential for significant adverse environmental and/or social impacts outside Australia (Category A disclosures). In addition, EFIC publishes annually key details of all significant transactions, including the name of the client, a brief description and location of the project, the type of facility being provided and its value and the environmental category of the project. It does not publish commercial-in-confidence information.

When reviewing its Environment and Social Policy in 2010, EFIC undertook a public consultation process including a workshop with concerned parties and a call for written submissions. The updated policy is now published on its website. This consultation process led EFIC to establish a biannual forum, in which DFAT participates, to enable NGOs to seek information and voice their concerns. The latest meeting was held on 23 November 2011.

The increase, over recent years, in interest amongst Australian NGOs in the human rights impacts of business transactions reflects an international trend which is being steadily addressed in UN and other fora. In 2005, the UN appointed John Ruggie as the Special Representative on the issue of human rights and transnational corporations and other business enterprises. His final report, *Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework*, was submitted to the Human Rights Council in June 2011 and a working group was established to promote its implementation. The Australian Government co-sponsored a resolution endorsing the UN Guiding Principles on Business and Human Rights at the Human Rights Council session in Geneva in June 2011. The resolution attracted widespread support and was adopted by consensus. In May 2011, the OECD updated its *Guidelines for Multinational Enterprises* to include a new chapter on human rights, which drew heavily on the Ruggie principles.

Alongside DFAT, EFIC has been participating in international meetings addressing human rights and international business and will consider its approach to human rights following the completion of the review by the OECD of the Common Approaches, which is currently underway.

EFIC is currently amending its Customer Service Charter (through which members of the community can provide comments on EFIC's operations) to include a grievance mechanism for stakeholders.

Parliamentary process

In disclosing information, EFIC complies with contractual confidentiality undertakings and statutory obligations of secrecy imposed upon EFIC staff and Board members by section 87 of the EFIC Act.

In recent times, EFIC has been the subject of a number of questions from the Parliament in relation to particular transactions and its policies such as its environment policy. Given that EFIC operates in a commercial environment, often in conjunction with a consortium of other financial providers, it is often difficult for it to provide the information requested and this is particularly the case if EFIC is not the primary owner of the information.

Competitive neutrality

EFIC currently has a partial exemption from the Government's competitive neutrality (CN) policy for its activities other than short-term insurance contracts.

The Government's CN principles are designed to ensure government business activities do not have a net competitive advantage over their private sector competitors and potential competitors simply as a result of their public ownership. They aim to ensure that resources available for public expenditure are used in the most efficient manner possible, and to improve transparency and accountability in public sector business.

Generally, the CN provisions apply to all significant government businesses, but only to the extent that the benefits outweigh the costs. EFIC was given a partial exemption from CN policy for all products other than its short-term insurance contracts, which it no longer provides. While it can be argued that EFIC's CN exemption provides a benefit in terms of EFIC's ability to operate in the market gap, it may also be argued that this exemption that EFIC enjoys could discourage the private sector from filling the gap.

DFAT is not aware of any complaints against EFIC to the CN Complaints Office. However, given that the market EFIC operates in for its medium and long term business is constantly evolving and changing, it may be timely to revisit the question of CN and the costs and benefits of EFIC implementing the CN provisions.

Eligible exports

EFIC management has proposed changes to its transaction eligibility guidelines to allow it to provide support to SMEs wishing to become 'global companies' by extending their supply and distribution chains overseas. Included in the supporting argumentation is the adoption among OECD member ECAs of a more generous approach to eligible exports in both amount and nature.

While it is recognised that the ways of exporting are changing, an expansion of EFIC's role beyond support for direct exports from Australia would be subject to a range of views. It would be useful to monitor and consider developments amongst other ECAs.

INTERNATIONAL TRENDS IN THE PROVISION OF OFFICIAL EXPORT CREDITS

Official export credit agencies (ECAs) continue to play an important role in the facilitation of international trade and foreign investment. In particular, ECAs remain the dominant supplier of insurance and guarantees for exports of capital goods (which typically have repayment terms in excess of two years) to emerging economies. Private companies continue to be the dominant provider of short-term export credit facilities. Newly created ECAs in emerging economies are playing an increasingly important role in the provision of both long and short-term export credit facilities.

Objectives of official ECAs

The common objective of official ECAs is to promote exports and investment, often by filling gaps in private export credit markets (i.e. information asymmetries and constraints on the size or tenor of transactions). ECAs achieve these goals by providing export finance directly or, in many cases, providing insurance and guarantees.

For example, the US Export-Import Bank has a specific mandate to provide export financing products that fill gaps in trade financing by assuming credit and country risks that the private sector is unwilling or unable to provide (comparable to the mandate of EFIC). By comparison, the Export Development Corporation (EDC) of Canada has a broad mandate to promote exports and foreign investment, with limited reference to addressing market gaps.

The OECD Arrangement on Officially Supported Export Credits

There are around 100 ECAs globally, which all share common features in their application processes, eligibility requirements, risk classification terms and pricing. These similarities partly reflect the success of the *OECD Arrangement on Officially Supported Export Credits* (OECD Arrangement) in harmonising the terms that official export credits are provided on, although non-OECD countries have no obligation to adhere to the OECD Arrangement.

The Arrangement seeks to ‘promote competition among exporters based on quality and price of goods and services exported rather than on the most favourable officially supported financial terms and conditions’. Put differently, the Arrangement seeks to neutralise any distortions to trade flows created by the provision of official export finance (the Arrangement does not apply to exports of military equipment or agricultural commodities).

The OECD Arrangement sets a range of terms and conditions (including minimum fixed interest rates and premiums and maximum repayment terms) for export credit facilities provided by government-supported agencies or government-supported medium- to long-term export credit programs (those with credit terms of two years or more). It does not cover investment insurance, short-term working capital facilities and bonding facilities. EFIC’s export finance and medium-term insurance facilities are consistent with the OECD Arrangement.

The OECD Arrangement also provides guidelines for determining risk premiums across a range of different risk categories (i.e. country and commercial risks). These pricing disciplines are designed to ensure that export credit facilities provided by official ECAs do not preclude the private sector from providing medium and long-

term export credits to exporters, and that distortions in trade flows resulting from official export credits are minimised.

The Arrangement provides a safe haven for ECAs under the WTO Subsidies and Countervailing Measures Agreement (the SCM Agreement). An export credit practice which is in accordance with the interest rate provisions of the Arrangement is not considered a prohibited export subsidy under the SCM Agreement.

EFIC, along with other OECD-ECAs, participates in OECD negotiations to maintain international benchmarks for ECA operations. DFAT attends many of these meetings, alongside EFIC.

WTO Doha negotiations

Divergent views remain on proposals in the WTO Doha negotiations to amend the provisions in the SCM Agreement relating to export credits and guarantees. WTO Members have considered proposals to amend items (j) and (k) of the Illustrative List of the SCM. The proposals seek to amend the basis for identifying prohibited export subsidies in the form of export credits and guarantees from the existing cost-to-government standard to a benefit-to-recipient standard. The proposals also seek to amend references in the SCM to require any changes made to international undertakings on official export credits and successor undertakings (a reference to the OECD Arrangement on Officially Supported Export Credits) be adopted by consensus of WTO Members.

Structure and operations of official ECAs

While the purpose of ECAs, and their functions, is broadly the same across countries, the organisational structure (along with the level of government support) of ECAs varies considerably. As a result, the types of export credit facilities offered by ECAs are not the same.

For example, some ECAs offer insurance, guarantees and loans, while others provide insurance and guarantees only. In addition, some countries have separated the insurance and lending functions of their export credit programs (the Export-Import Bank of China provides direct loans and guarantees and China Export Credit Insurance Corporation provides credit insurance only).

The type and volume of products offered by an official ECA may also reflect a country's economic structure and pattern of exports. For example, ECAs are more likely to play a more important role in countries with a comparative advantage in the export of capital goods that require medium and long-term export credit facilities (Egger, 2007).

Institutional arrangements

The means utilised for provision of official export credit support can be loosely grouped into three categories: government departments; government corporations; and private companies that manage government accounts (see table 1). However, this only identifies legal status and their degree of independence from government. For example, many companies that manage government accounts have access to

government support³ for some of their activities (activities in the ‘market gap’), without which they could not operate. The most common organisational structure for official ECAs is statutory public corporations.

The different organisational structures of ECAs, as well as the level of government support, results in substantial variations in their financial profiles (i.e. their risk-bearing capacity, the volume of transactions undertaken and their profitability). Over recent years the financial framework for most ECAs has been enhanced by: improved risk management (including an adjustment of premium schedules to better reflect risks); enhancements in operational transparency; and the alignment of accounting standards with the private sector. This has resulted in the majority of OECD ECAs earning, on average, a positive return on equity (Wang 2005).

Table 1: ECA business models

Governance structure	ECA	Products
Privately Owned (with a state account)	Coface (France)	Insurance and guarantees
	Euler Hermes (Germany)	Insurance and loans
	Atradius NV (Netherlands)	Insurance and loans
Government Department	UK Export Finance	Insurance and guarantees
Government Owned	EFIC	Insurance/guarantees and loans
	Export Development Canada	Loans and guarantees/insurance
	China EXIM Bank	Loans
	Sinosure	Insurance
	Nippon Export and Investment Insurance	Insurance
	Japan Bank for International Cooperation	Guarantees and loans
	US Ex-Im Bank	Insurance, guarantees and loans

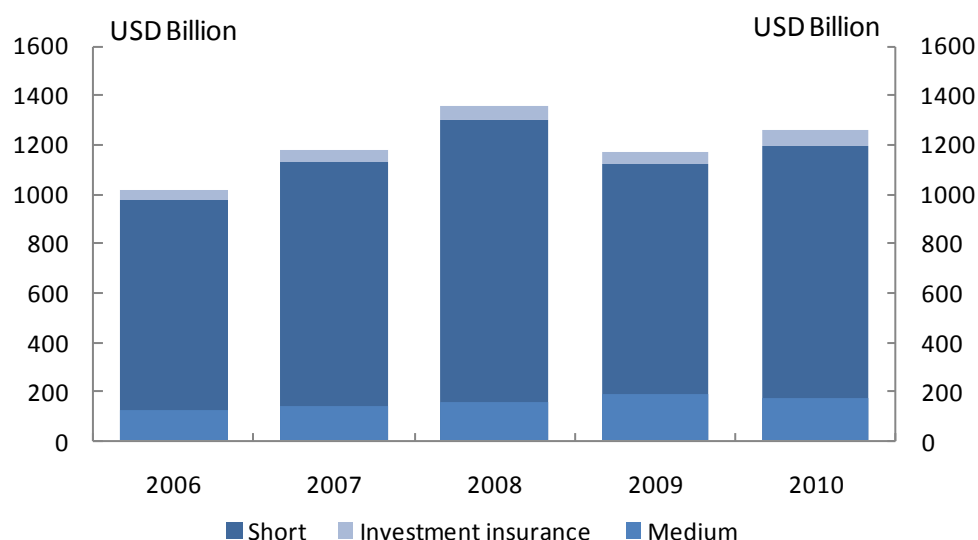
Trends in official ECA activity

Around USD 1.2 trillion in new export credit business (insurance and lending) was provided by Berne Union⁴ members in 2010, with medium-term export credits accounting for around 12 per cent of this new business. The majority of short-term trade finance (which according to the WTO supports around 80-90 per cent of world trade in some manner) is provided by the private sector for short-term transactions.

³ Government support for ECAs typically includes: guarantees to enhance asset quality and reduce the level of portfolio credit risk; enhancement of funding through guarantees of liabilities and short-term access to funding from central banks; and equity injections and deferrals of dividend payments.

⁴ The Berne Union is the peak international organisation of public and private sector providers of export credit and investment insurance. With more than 70 member companies it provides a forum for professional exchange amongst members and promotes sound principles in the provision of export credits and foreign investment.

Chart 1: New export credits issued by Berne Union members



Source: Berne Union

Over the past decade there has been a clear trend towards privatisation of short-term business⁵, reflecting the capacity of the private sector to deliver these services. In particular, specialised insurers have developed an appetite for short-term credit risks. The private sector is now the major provider of short-term export credits. However, in some countries, particularly Canada and the US, ECAs continue to provide short-term insurance. EDC remains the dominant provider of short-term insurance in the Canadian domestic market. ECAs continue to dominate medium and long-term business⁶, particularly for political and sovereign risk insurance and tenors in excess of 10 years (Kotowski, 2007).

Private companies are beginning to offer medium-term and long-term insurance in response to the increased capacity of financial markets to manage and diversify risk (although this trend has moderated somewhat in response to ongoing tightness in global credit markets). However, many private companies continue to be apprehensive about providing insurance for transactions in excess of three years, which partly reflects a lack of reinsurance for long-term contracts (Kotowski, 2007).

New official export credit facilities for capital goods exports increased in 2009-10, reflecting both a decline in capital exports and strong growth in new official export credits (see Table 2). The level of exports supported by these new commitments is likely to be significantly larger than what is suggested by the new credit commitments only. For example, in 2010 new EFIC signings of AUD 970 million supported around AUD 6 billion in exports and overseas investments.

Notwithstanding the recent increase in official export credit commitments, over the past two decades medium and long-term export credit facilities provided by OECD

⁵Short-term export credit facilities are typically provided for exports of commodities (either agricultural or mineral).

⁶ In contrast to the exports covered by short-term export credit facilities, medium and long-term facilities are provided for the export of capital products such as ships and mining equipment. These types of exports typically have payment schedules that extend over several years.

ECAs have declined as a share of exports, with the most significant falls occurring in France, the UK and the US (Wang, 2005).

The long-run decline in OECD export credit facilities primarily reflects: a reduction in the capacity of ECAs to achieve a competitive advantage in the provision of medium- and long-term export finance as a result of the OECD Arrangement for Officially Supported Export Credits; the requirement by some governments for ECAs to, at a minimum, break-even; increased competition from the private sector in medium and longer-term business; and capital market developments in emerging markets (Mulligan, 2007).

By comparison to OECD ECAs, the level of export credits provided by major non-OECD economies (Brazil, India and China) has increased as a share of capital goods exports over the past decade (Mulligan, 2007).

Table 2: New medium-term export credit (per cent of capital goods exports)

	2006	2007	2008	2009	2010
G7	1.7%	1.4%	1.7%	3.4%	3.0%
Australia	2.7%	4.9%	2.9%	6.2%	8.8%
Brazil	22%	19%	18%	40%	54%
China	5%	6%	8%	9%	6%
India	42%	52%	35%	27%	30%

Source: 2010 Export-Import Bank of the US report to Congress on export credit competition and WTO trade database