

SUBMISSION

JOINT STANDING COMMITTEE ON TRADE AND INVESTMENT GROWTH

INQUIRY INTO THE PRUDENTIAL REGULATION
OF INVESTMENT IN AUSTRALIA'S EXPORT
INDUSTRIES

28 April 2021



We're all in, all the time.

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Introduction

Over the past 15 years, CMAX Advisory has worked with Australian exporters across industries including defence and national security, resources, and healthcare. Our work with these businesses has highlighted the critical importance of export opportunities for Australia to build sustainable and resilient industries, and the challenges that individual exporters can face. We welcome the Joint Standing Committee's focus on one such challenge – investment in Australia's export industries – and are pleased to be able to share our insights gained from Australian exporters' experiences to this inquiry and recommendations for the Committee's consideration.

The financial and related professional services sector plays a significant role in facilitating or restricting the growth of Australian exports. Blanket decisions on industry-wide divestment and the refusal of products and services to exporting businesses can have negative implications for our national economic growth and recovery from Covid-19, the creation and sustainment of local jobs, and Australia's strategic interests.

Underpinning Australian exports must be a financial services sector that recognises exports are not a side-pursuit for local businesses. For most industries, our domestic market is not big enough to provide commercial viability for businesses to operate, let alone invest in the innovation and growth required to deliver world-leading and competitively priced products and services to Australian consumers – including public, government and military customers.

The federal government has recognised the importance of exporting businesses through the *Modern Manufacturing Strategy*, which has identified defence and resources technology and critical minerals processing amongst six National Manufacturing Priorities. This policy focus on supporting manufacturers in the defence and resources industries, along with Australia's continued pursuit of free trade agreements, have been welcomed by Australian businesses in these industries. We welcome the opportunity to present additional recommendations that build on this support for Australian exporters.



Recommendations

CMAX Advisory recommends the Committee consider opportunities to:

1. Build understanding of the importance of exporting businesses to Australian economic growth, job creation and strategic interests amongst the financial services sector and broader public.
2. Acknowledge the role Australian defence businesses play in addressing the country's strategic security needs, today and into the future.
3. Acknowledge the continued role resources and mining businesses will play in Australia's economic success and the process of decarbonising the economy.
4. Review Export Finance Australia's policies to ensure alignment with extant government policies such as the Defence Exports Strategy and Modern Manufacturing Strategy.
5. Explore how Export Finance Australia could be given a role in facilitating private investment in Australian exports by espousing the strategic requirements and strict regulatory regimes that apply to defence and other companies.
6. Improve financial institutions' understanding of the strict regulatory environment in which defence companies export, and potentially provide endorsement on the compliance of individual exporters applying for financial services.
7. Consider regulatory or program options to ensure defence companies fulfilling Australian government contracts can attract financial support for that program.
8. Explore how the government can alleviate financial services provision issues through direct engagement with financial providers to explain the strategic importance of exporting industries.
9. Encourage government departments to grow their industry expertise to ensure a greater understanding of the challenges facing exporting business in the public service.
10. Continue to pursue opportunities for new free trade agreements that provide value to Australian exporting industries.

Contribution of Australian export industries

Exports are crucial to the continued success of Australian industry. Given Australia's relatively small population and customer base, it is simply not feasible for many Australian companies to operate sustainably, grow, and create resilient supply chains without pursuing overseas markets. This is particularly true in the defence and resources sectors. Both industries contribute significantly to the economy, rely heavily on exports and are often subject to public debate on their roles in the community.

With the support of the government, exporters in these industries could benefit from improving awareness of their contributions to Australia amongst the financial services sector and broader public.

Recommendation 1: Build understanding of the importance of exporting businesses to Australian economic growth, job creation and strategic interests amongst the financial services sector and broader public.

Defence

Australia's defence industry is growing to meet the significant challenges of our changing security environment. The Department of Defence estimates the local defence industry consists of over 3,000 businesses, many of whom are small and medium enterprises (SMEs), employing tens of thousands of workers across a vast range of roles including highly skilled, technical positions. Much of this economic activity is dependent upon a strong export market as this provides the longer-term work pipeline that maintains a consistent workforce. For many Australian defence businesses, exports comprise most of their total revenue and are critical for their continuing investment in local jobs and innovation.

While the economic benefits of defence industry exports are important, these exports are also directly relevant to meeting Australia's strategic defence interests. Exports are critical to grow and maintain a sovereign industrial capability that is trusted to develop and sustain our warfighting capacity, including during a period of conflict where global supply chains are interrupted.

Given that domestic customer demand is smaller scale and can be intermittent, businesses cannot grow sustainability or build resilient domestic supply chains without exports. The most obvious example of this is in Australia's shipbuilding industry, which for years experienced a boom-and-bust cycle, moving from project to project. This meant that between contracts the industry suffered significant losses of local capability and workforce, which then had to be rebuilt when a new project was established. Such risks are mitigated through a strong pipeline of export contracts to rely upon between domestic contracts.

Defence exports also provide a valuable strategic tool for Australia to support our global security partners in responding to shared threats and adversaries, as well as providing valuable R&D and intellectual property creation, with flow-on effects for Australia's universities, the communication sector, and other manufacturers.

Recommendation 2: Acknowledge the role Australian defence businesses play in addressing the country's strategic security needs, today and into the future.

Resources and mining

The resources and mining sector in Australia has been strongly orientated towards exports, especially responding to, and fuelling, the development of North Asian economies for the past four decades. Coal, iron ore, and other resources have served as an important part of the Australian success story and have been critical to Australia's record 28-year run of economic growth. The resources boom has created and supported hundreds of thousands of Australian jobs and has provided significant value across the wider economy. Our financial services sector has provided necessary support to export-orientated resources and mining businesses to achieve this success and has benefitted commercially as a result.

The resources industry will undoubtedly continue to contribute to Australia's economic growth and will play a key role in our recovery from Covid-19. While debate over responses to climate change is at the forefront of any discussion the future of the sector, resources and mining companies will be essential partners in efforts to decarbonise the economy in Australia and globally. The industry itself has acknowledged this through its own investment in technological solutions – for instance carbon capture and storage – which is supported by the government's policy focus on this approach. The renewables revolution offers significant opportunities for the sector as investment in clean energy grows and demand for resources like rare earth minerals rises due to use in renewable technologies.

Recommendation 3: Acknowledge the continued role resources and mining businesses will play in Australia's economic success and the process of decarbonising the economy.

Approach of financial institutions to Australian export industries

Australia's financial institutions have been essential to the growth and success of Australian exporters to date, however there is now uncertainty this will continue to be the case, with some institutions divesting or refusing services to certain industries. This appears to be based on a perceived reputational risk where financial institutions assess the public and their broader customer base view certain industries in a negative light and demand a change in approach, which may include:

- Divesting holdings;
- Denying or withdrawing financial services;
- Making insurance terms prohibitive or refusing to supply insurance; and
- Refusing private banking services and residential mortgages to individuals associated with companies, such as board members.

CMAX Advisory is aware of anecdotal examples of each approach being taken by financial institutions towards Australian exporters in the defence and resources industries.

While all companies are required to factor reputational risk into their business dealings, some are preferencing this over a wider range of equally important considerations. This may occur alongside a failure to distinguish between a moral stance on complex issues and making sound financial investment decisions that may happen to be politically or socially charged. For example, given changing global market conditions and policy frameworks, an argument can be made to consider the longer-term financial risks associated with investment in carbon-intensive fossil fuel industries. In contrast, while financial institutions may elect to divest or refuse products and services to the defence businesses, this is based on an ideological objection to the industry, rather than an assessment of longer-term profitability or the necessity of a secure Australia for a prosperous economy.



There are also significant process and policy issues in how Australian finance providers factor in the unique operational needs of exporting businesses in the defence industry. For example, many private defence company facilities must comply with strict security and safety requirements as part of their domestic and export contracts, which involves extra expenditure in the design and construction of facilities. These are often poorly understood, or not acknowledged by the financial services sector.

CMAX Advisory is aware of examples where businesses have only been able to borrow the basic cost of a new meeting facility. Such a facility might cost a member of the public \$400,000 to build, but with mandated security and safety requirements, would cost a defence company \$1 million. In this scenario, many financial institutions would still value the facility at \$400,000, limiting the scope for businesses to borrow capital. It also creates issues with regards to how much such a facility can be insured for, and may lead insurers to apply an unnecessarily high risk profile to defence companies, driving up the cost of a compulsory expense.

Export Finance Australia

Export Finance Australia (EFA) provides government-backed finance to exporters at close to market terms. EFA must comply with all the prudential regulation and lending standards that a private provider would, which is good due diligence for the government. There is a risk the EFA will increasingly view defence and resources industries as risky and offer terms that are less competitive for businesses. To head off this risk, the government may consider reviewing EFA's policies to ensure they align closely with, and support, its own industry growth objectives under policies such as the *Defence Export Strategy* and the *Modern Manufacturing Strategy*.

The government could also consider expanding the remit of EFA to include assisting private companies in accessing private financial services. It would do this by providing advice to the companies, and also assuaging moral or ethical concerns amongst financial providers.

Recommendation 4: Review Export Finance Australia's policies to ensure alignment with extant government policies such as the *Defence Exports Strategy* and *Modern Manufacturing Strategy*.

Recommendation 5: Explore how Export Finance Australia could be given a role in facilitating private investment in Australian exports by espousing the strategic requirements and strict regulatory regimes that apply to defence and other companies.

Regulation of exporting businesses

Blanket approaches to divestment or refusal of services to exporting businesses do not acknowledge the strong regulatory frameworks that these businesses operate in, both here in Australia and internationally.

Defence companies operate in a highly regulated environment and must comply with strict export controls in line with community expectations related to human rights. The development, export and use of Australian defence technologies are subject to incredibly strict regulations and export controls maintained by the Australian government and enforced under international law. Often these technologies are jointly covered by controls set and enforced by the United States, making them amongst the most closely regulated products in the world. Defence exports are subject to rigorous assessments to ensure they are not provided to parties who would carry out human rights abuses.



As such, Australian defence exporters are actively complying with Australia's obligations on human rights under international law. As this does not seem to be acknowledged by the financial services sector, there may be an appropriate role for the Australian Defence Export Office in legitimising or endorsing defence finance applications to ease bank concerns about their reputational risk. This will provide greater support to achieve the Australian government's own policy objectives to grow defence exports.

In limiting their services to Australian defence businesses, financial service providers are potentially also adding additional risk and cost to programs for the Australian Defence Force and other government customers that utilise public funds.

Recommendation 6: Improve financial institutions' understanding of the strict regulatory environment in which defence companies export, and potentially provide endorsement on the compliance of individual exporters applying for financial services.

Strategic implications for Australia

The failure of financial and related professional service providers to adequately service Australian exporters raises significant issues for Australia's own strategic requirements, especially with respect to defence and national security.

Where defence companies are not able to access financial services to support their export activities, this will likely result in less domestic defence production. This makes it more difficult for Australia to develop the technologies and industries the Australian Defence Force requires in order to acquire new sovereign defence capabilities and sustain existing ones, in case of a conflict. When financial services are provided to the defence industry, discriminatory costs for the provision of these services are passed on to the taxpayer through more expensive overall acquisition and sustainment costs as this is a built-in operating cost for all defence companies. Given the increasingly contested geopolitical and security environment in which Australia finds itself, both of these issues are concerning and the government should explore options to address this potential challenge to the national interest.

Recommendation 7: Consider regulatory or program options to ensure defence companies fulfilling Australian government contracts can attract financial support for that program.

The cumulative effect of these financial services practices is a decrease in national defence exports output, which is contrary to Australian government policy. High costs, lack of investment, and the non-provision of banking, insurance and other related services creates an unreasonable burden for defence companies to operate, putting a hamper on their ability to grow and create jobs. It also creates an unfriendly business environment that discourages investment and the creation of new businesses.

The economic effects of constraining exports are well documented, but in this case are exacerbated by the unique job-creation opportunities offered by the defence industry that:

- Develops and sustains large supply chains, sharing economic opportunity widely; and
- Has significant operations in regional and poorer areas across the country which desperately need investment and well-paid manufacturing jobs.

Supporting Australian exports into the future

The Australian government is actively and effectively pursuing a growth policy for Australian exports as a priority to stimulate economic growth and support job creation following the Covid-19 pandemic. In alignment with this, the government should continue to pursue free trade agreements and negotiate better deals for Australian exporters. It should also continue to invest in programs like the *Modern Manufacturing Strategy* that encourage joint investment in projects and encourage innovation amongst Australian businesses.

While these government policy objectives and corresponding initiatives are welcomed by Australian exporters, there is a growing risk these goals will be constrained by trends in the financial services sector to divest and refuse services to certain industries. The Australian government can explore opportunities to address this directly with the private sector and within its own bureaucracy.

As private institutions, companies have a right to their own corporate decision-making in the interests of their shareholders. However, businesses place high value in government endorsement and listen to government when it engages. Given this, a concerted effort from the Commonwealth should be made to both encourage investment in Australian exporters and discourage divestment from legitimate enterprises through engagement and messaging on the range of considerations for businesses to balance.

Recommendation 8: Explore how the government can alleviate financial services provision issues through direct engagement with financial providers to explain the strategic importance of exporting industries.

Recommendation 9: Encourage government departments to grow their industry expertise to ensure a greater understanding of the challenges facing exporting business in the public service.

Recommendation 10: Continue to pursue opportunities for new free trade agreements that provide value to Australian exporting industries.

ABOUT CMAX ADVISORY

CMAX Advisory is a leading strategic advisory firm for the defence, health, and national security sectors in Australia, servicing a diverse range of clients both in those industries and more. Since its establishment in 2004, CMAX Advisory has supported Australian exporting businesses to navigate complex regulatory and legislative frameworks. It has worked closely with industry and government to address policy considerations and support Australia's strategic and economic interests.

CMAX Advisory

18 National Circuit, Barton ACT 2600

Website: www.cmaxadvisory.com.au

Email: canberra@cmaxadvisory.com.au

