Submission No 3

Inquiry into Australia's trade and investment relationship with the economies of the Gulf States

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Joint Standing Committee on Foreign Affairs, Defence and Trade
Trade Sub-Committee

Australian Government

Export Finance and Insurance Corporation

Submission to Joint Standing Committee on Foreign Affairs, Defence and Trade

INQUIRY INTO AUSTRALIA'S TRADE AND INVESTMENT RELATIONS WITH THE GULF STATES

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Short Term Credit Insurance

EFIC no longer provides short-term credit insurance (covering non-payment by buyers under terms typically up to 180 days) to Australian exporters.

Following a Government review in 2000 which concluded that there was considerable private market capacity in the short-term credit insurance sector, there followed an international tender amongst prospective buyers of EFIC's short-term business. This led to EFIC and global credit insurer, GERLING NCM, entering into an alliance in February 2002, with a view to an eventual sale if alliance conditions could be satisfied. The outcome of the alliance demonstrated that GERLING NCM was able to successfully underwrite and reinsure all of EFIC's short-term business and deliver improved service levels to EFIC's credit insurance clients. On this basis, Government agreed to consummate the sale of EFIC's short-term business to GERLING NCM, which occurred on 30 September 2003. As a consequence, EFIC no longer provides short-term credit insurance to Australian exporters.

EFIC had ample capacity to cover short-term payment risks to the Gulf States (subject to the credit assessment of individual buyers) leading up to the divestment of its short-term business. We expect that private market capacity remains sufficient for these countries to satisfy the needs of Australian exporters.

Export Finance

EFIC's ongoing business covers medium term finance support for Australian capital goods exports, political risk insurance for Australian investments overseas, insurance for performance bonds or guarantees, and working capital guarantees to support finance for contractual performance of manufacturers where alternative security is not available for eligible exporters' banks.

Gulf country risk levels for risks in excess of two years

Broadly speaking, EFIC is in agreement with the OECD's country risk ratings of Gulf countries (see table). These attempt to measure the likelihood that a country will service its external debt. On a scale of 1 (high likelihood of repayment) to 7 (country in default), the OECD's ratings of Gulf countries range from 2 to 4. These ratings in turn more or less line up with sovereign credit ratings from ratings agencies Moody's, Fitch and Standard & Poor's. That is to say, except for Iran's rating, they are mid-to-low investment grade – neither speculative grade credits, nor gilt-edged Aaa/Aa credits.

	EFIC rating	OECD rating[a]	Moody's rating[b]	Fitch rating[b]	Standard & Poor's rating[b]
UAE	3	2	A2	Not rated	Not rated
Bahrain	3	3	Baa1	A-	A-
Qatar	3	3	A3	Not rated	A+
Saudi Arabia	3	3	Baa2	Not rated	A
Kuwait	3	2	A2	AA-	A+
Oman	3	3	Baa2	Not rated	Not rated
Iran	5	4	c	B+	Not rated

a See www.oecd.org Export Credit Arrangement
b Long term foreign currency ceiling
c Was B2 until June 2002, but then rating withdrawn 'because of U.S. government concerns that such ratings could be inconsistent with US sanctions on Iran.'

Note that the OECD ratings determine the minimum risk fees and premiums OECD export credit agencies such as EFIC can charge for credits of two years or more extended to these countries. (Political risk insurance cover, which is readily available in the private market, is not subject to such OECD minima.)

Broadly speaking, and all else equal, the lower the country risk, the more competitive can be the terms we offer an exporter or investor.

Country risk levels don't just affect our product pricing; they can also shape the amount of business we do in a country. Again, broadly speaking, the lower the country risk, the greater the volume of business we can do. Or equivalently, there will come a point in some risky countries where our ability to do more business prudently will be exhausted.

We have not, however, reached this point in any of the Gulf countries. We are in principle prepared to support Australian exporters and investors into all of these countries.

Use of EFIC's Export Finance Facilities for exports to the Gulf States

Over the last five years, EFIC's export finance facilities have supported approximately $116 million of export contracts to Iran, Jordan, Kuwait, Qatar and United Arab Emirates. The bulk of this support, for about $91 million of export contracts, has been to support about $23 million of performance guarantees required of Australian contractors by buyers in UAE, Kuwait and Qatar.

Apart from a small working capital guarantee to enable an exporter to obtain bank finance to perform a contract for a Jordanian buyer, the balance of support for these countries has been $21 million of medium-term buyer finance for $24 million of contracts, most of which was in Iran, with a small export finance loan in UAE.

EFIC has not provided any facilities for investment protection in any of these countries.

Our experience suggests that largely, there is sufficient finance available in these countries or from international commercial sources for buyers to engage Australian capital goods and services exporters without EFIC-supported finance packages.

The non-usage of EFIC's political risk insurance may reflect, on the one hand, low investment levels by Australian companies in some countries because of their perceptions of difficult regulatory environments (eg, Iran) and on the other hand, a perception by investors in other countries (eg, UAE) of low levels of political risk in a predicable investment climate.

The proportionally higher use of EFIC's performance bond facilities reflects the relatively severe conditions typically imposed by buyers in this region for financial guarantees required to underpin contract award in some Gulf States.

In the case of one large Australian company, however, EFIC supported an initial contract into the region to establish a track record for the company, which the local market then used as a basis to provide the capacity required for the significant ongoing business the company enjoys years later.

In short, EFIC has more capacity for exposure in each of the Gulf States than is currently being used. This reflects the ready availability of competitive finance from the private market, either locally or from international sources and the juxtaposition of uncompetitive regulatory environments and predictably low political risks in the region different for outward Australian investment.

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