Australian Institute of Export

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EMDG UNDERFUNDING SITUATION

BACKGROUND

- Following the 1996 election the former Government imposed a funding cap on the Scheme, with 5% of the allocation earmarked for administration costs incurred by Austrade, effectively reducing the total amount available to exporters.
- Since then the criteria has been varied on a number of occasions with the objective of keeping expenditure within the funding cap, thereby creating uncertainties for exporters.
- In 6 of the 10 years since the funding cap was imposed in 1996, Austrade did not spend its budget allocation, with surplus funds returned to the Government.
- The EMDG budget in 2007/08 was $156.88 million (including 5% for Austrade's admin). For 2008/09, this has been **reduced** to $150 million.
- From 2004/05 to 2007/08, the practice was that Austrade paid grants of up to $70k in full. Firms receiving provisional grant assessments of between $70k and the maximum $150k receive an initial $70k on assessment, and some or all of the balance as a second stage payment in June.
- For the three years from 2004/05 to 2006/07, Austrade had enough funds to pay all grants in full.
- Austrade has advised that 2006/07 EMDG claim lodgements (being processed in the 07/08 financial year) were up by 11.4% and the amount claimed was 26.8% higher than the previous year.
- Accordingly, Austrade had insufficient funds to pay EMDG claims, paying only 24.4% of the second stage entitlements, effectively reducing the maximum grant which is set by legislation at $150,000 to only $89,533.
- The new Government has introduced amendments to improve EMDG, including increasing the budget allocation by $50 million, but this will not apply until 2008/09 EMDG claims are lodged and paid in 2009/10.
- Despite the horrific shortfall in 2007/08 funding, the Government has actually **reduced** funding for 2008/09, meaning that the funding shortfall faced by exporters in 2007/08 will be even worse in the current financial year.
- Accordingly, the Government has reduced the initial payment amount from $70,000 to only $40,000, to avoid Austrade running out of money before the end of the current year.

IMPACT

- Approximately **900** Australian firms had their claims substantially reduced in 2007/08.
- Austrade estimated that the shortfall in funding for 2007/08 was **$28 million**. This figure will be higher in 2008/09, even if the number of applicants and amount claimed does not rise, as the total <u>EMDG budget has been reduced</u> by more than $6 million.
- Reducing the initial payment threshold to $40k will increase the number of exporters that will suffer by having their 07/08 EMDG claims reduced. The affected firms could rise to 2,000.
- Many firms suffered severe impact on their cash flow as a result of the drastically reduced second stage payment in 07/08 which comprised **only 24.2 cents in the dollar**. Many will have undertaken extensive export promotion in 2007/08, in reasonable anticipation that their grant would be paid in full. The late advice of the reduced payout left them with little chance to reduce or adjust their export marketing undertakings.

- Unless export marketing expenditure collapses as a result of shattered confidence in EMDG and external factors, it is likely that the Government's additional $50 million to be provided in 2009/10 will be insufficient.

CONSEQUENCES

- Due to the uncertainty about EMDG funding, companies will reduce their export marketing activities and expenditure. This is contrary to the intentions of the EMDG program, which is to encourage firms to increase their promotional expenditure by sharing the cost and risk of overseas marketing, in the expectation that additional export revenue will be derived.
- The reduced marketing activities will diminish the chances of generating sustainable export markets for Australian products, services, IP and know-how.
- There will be negative flow-on consequences for the domestic economy, including the potential for reduced employment growth, and diminished sourcing of materials and services from local sub-contractors, causing hardship throughout the local business community.

WHAT DID THE GOVERNMENT SAY?

"But we will not wait for the [Mortimer] review to respond to industry calls for changes in a number of key areas. The results of the review will guide Labor's policy response beyond 2008-09 but reform must start immediately if we are to arrest the slide in export performance." [Nov 2007, Trade Policy Statement]

REASONS TO PROVIDE ADDITIONAL FUNDING TO ENABLE EMDG CLAIMS TO BE PAID IN FULL

- It is generally accepted that a major reason why the recovery from Great Depression took longer than expected was because international trade was greatly restricted. It is also agreed that recovery from the current Global Financial Crisis will be enhanced by encouraging greater international trading activities. Accordingly, the Government should be taking every step to encourage Australian businesses to maintain their existing markets and develop new ones. Underfunding EMDG acts as a disincentive.
- Failure to provide sufficient funding for 2006/07 and 2007/08 EMDG claims would be **a failure by the Government to honour a pre-election promise** to commence **immediate** reform of EMDG.
- The Government has said that it will support and expand infrastructure – **EMDG is vital infrastructure for exporters**.
- EMDG spending is not inflationary, as the grants are mostly spent on *overseas* marketing activities.
- From an inflation perspective, it makes sense to **support** exporters, to increase the component of GDP that comes from export trade, rather than inflation-prone domestic activity.
- However, reviews have shown that **EMDG does increases productivity**, as well as providing other economic and social benefits.
- It makes no sense to improve EMDG in 2009/10 if exporters are totally disillusioned and the program is on its knees by then thanks to the Government's refusal to support exporters and keep its election promises.
- Exporters that receive reduced export grant payments will view the Government as a major debtor that has defaulted.
- EMDG is designed to **encourage** firms to spend more on export promotion; not paying full grants will actually **discourage** them from spending, the complete opposite of the program's intentions.
- Inadequate EMDG funding actually restricts export activity, therefore impeding the effectiveness and ability of the program to enhance our export performance and improve our balance of trade.

- The companies that have taken the greatest risks to increase their exports, by spending sufficiently significant sums on export promotion to qualify for grants in excess of $70,000 in 2007/08 and $40,000 in the current year, are the ones that will suffer from the EMDG budget shortfall. Surely, these are the firms that the Government should be **supporting rather than punishing** for their export marketing activities?
- Research has shown that exporting can significantly increase productivity, an area where Australia has lagged in recent years. Clearly, there is a nexus between productivity and export performance where improving one enhances the other.
- This is an opportunity for the Government to demonstrate that it is genuinely committed to providing "a strong future" for this important sector of the economy as portrayed in the Trade Policy Statement last November.
- A review of EMDG several years ago used independent econometric analysis to determine that each dollar of grant generated an additional **$12** of export revenue for Australia, that wouldn't otherwise have been generated. On that basis, underfunding EMDG by $28 million in 2007/08 cost Australia **$336m** of lost export revenue. The Mortimer Review (see below) showed an even greater multiplier effect.
- Much reference has been made of the so-called "Henry Test", named after Treasury Secretary Ken Henry, where policies were judged on whether they improved the productive capacity of the economy. Every review of EMDG over the last 30 years has found that it **does increase productive capacity** by helping to create and increase export markets for Australian goods and services. If EMDG passes the 'test' of good policy, it should be fully funded and supported by the Government.

WHAT DO EXPORTERS WANT?

Certainty of finance through a **fully-funded** EMDG program, providing the confidence to know how much it will ultimately cost them to go to additional trade fairs, send more free samples, commit to extra advertising, create new marketing materials, engage marketing consultants, undertake more trips to prospective markets, and set up promotional offices overseas. If exporters don't know how much these activities will cost them, they won't undertake these additional activities that would otherwise lead to extra export revenue for Australia.

OUTCOMES FROM THE MORTIMER REVIEW

- EMDG 'can be considered both **effective** and **efficient** in supporting the development of Australia's exports' (page 1, column 1);
- Each EMDG dollar generates **$13.50 to $27** of exports (page 1);
- The funding cap and uncertainty about the grant 'substantially negate the objective of encouraging exporters to commit their own additional resources to export promotion' (pages 1-2);
- It is 'imperative that the issue of funding **uncertainty** be resolved as it unnecessarily diminishes the value and public repute of the scheme' (page 2);
- The Review notes that funding for 07/08 claims will be under pressure with anticipated excess demand, and 'recommends that this be addressed'. As the rest of the recommendations revolve around ways to ensure that applicants receive their full entitlements, Mortimer is clearly requesting that additional funds be provided to ensure that 07/08 claims are paid in full.

EXPORT MARKET DEVELOPMENT GRANTS

MAXIMUM GRANTS

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BALANCE GRANT PAYOUT

CLAIM YEAR	**MAXIMUM GRANT $**	**INITIAL PAYMENT $**	**BALANCE GRANT PAYOUT**	**MAXIUMUM GRANT PAID- $**
1996/97	200,000	50,000	100%	200,000
1997/98	200,000	60,000	98.94%	198,519
1998/99	200,000	60,000	100%	200,000
1999/2000	200,000	60,000	100%	200,000
2000/01	200,000	60,000	75.62%	165,875
2001/02	200,000	60,000	32.84%	105,979
2002/03	200,000	50,000	74.52%	161,786
2003/04	150,000	50,000	100%	150,000
2004/05	150,000	70,000	100%	150,000
2005/06	150,000	70,000	100%	150,000
2006/07	150,000	70,000	24.42%	89,533
2007/08	150,000	40,000	**?**	**?**