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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

EXPORT MARKET DEVELOPMENT GRANTS LEGISLATION AMENDMENT BILL 2006

EXPLANATORY MEMORANDUM

(circulated by authority of the Minister for Trade, the Hon Mark Vaile MP)

EXPORT MARKET DEVELOPMENT GRANTS LEGISLATION AMENDMENT BILL 2006

OUTLINE

1. This bill amends the *Export Market Development Grants Act 1997* (the Act) to:

   - continue the Export Market Development Grants (EMDG) scheme to the end of the 2010–11 grant year and provide for a review of the scheme, with a report to the Minister for Trade by 30 June 2010
   - increase the overseas visit allowance from $200 to $300 per day
   - allow Austrade to deem certain applicants eligible when they do not technically meet the Act's current 'principal status' requirements
   - modify the scheme's Australian origin rules so that (1) goods coming into their final form in Australia must be 'made in Australia' to be eligible and (2) for other goods to be eligible, Austrade must be satisfied that Australia will derive a significant net benefit from the sale of those goods outside Australia
   - make applicants' expenses eligible when they are incurred to increase the return on the disposal of intellectual property and know-how to a related company
   - separate the claimable expense categories for overseas representatives and marketing consultants, cap expense claims for overseas representatives at $200 000 per claim and for marketing consultants at $50 000 per claim
   - revise the rule covering changes in business ownership to make it clearer for applicants and easier to administer
   - allow Austrade to grant special approval status, including approved body status, for five years rather than three
   - provide that the eligibility of cash payments made by applicants is limited to $10 000 per claim
   - ensure that the scheme's rules clearly set out Austrade's power to disregard any unsubstantiated, unreasonable, uncommercial or non-bona fide expense claim
   - remove the export performance test from the EMDG scheme
   - ensure that, as intended, commission payments remain ineligible for the scheme
   - correct minor errors in the Act
   - repeal the *Export Expansion Grants Act 1978*.

PURPOSE OF THE BILL

2. Continue the Export Market Development Grants (EMDG) scheme to the end of the 2010–11 grant year and provide for a review of the scheme, with a report to the Minister for Trade by 30 June 2010.

   Under the current EMDG Act, 2005–06 is the final grant year.

   This amendment bill continues the scheme for five years until the 2010–11 grant year, for which grants would be paid in the 2011-12 financial year. The bill also provides for an independent review of the scheme to start no later than 1 January 2010 and to report by 30 June 2010.

3. Increase the overseas visit allowance from \$200 to \$300 per day.

   Under the current EMDG Act, expenses of \$200 are claimable for each day of an overseas marketing visit that is spent furthering the approved promotional purpose for which the visit was made.

   This amendment bill increases the claimable overseas visit allowance to \$300 per day.

4. Provide that Austrade can deem eligible certain applicants that do not technically meet the Act's current 'principal status' requirements.

   Under the current EMDG Act, most categories of applicant must be the principal or intended principal in export transactions. This means that they must own the products being promoted for export and must be the seller or intended seller of these products to foreign residents, rather than being for example an agent of the seller.

   However, some exporters, for legitimate reasons, use business structures that involve one company owning the product and another promoting it within a group of related companies. Under the current Act, these exporters may not be entitled to EMDG support because the entity promoting the product does not own it and so does not meet the scheme's requirements.

   The principal status requirements remain an important element of the scheme and will be retained. However, to allow the requirement to be applied more flexibly, this bill will enable Austrade to deem certain applicants eligible when they do not technically meet the current principal status requirements. This will only apply in strictly limited situations — for example, when a company closely related to the applicant owns the product intended for export.

5. Modify the scheme's Australian origin rules so that:

   - goods coming into their final form in Australia must be 'made in Australia' to be eligible, and

   - for other goods to be eligible, Austrade must be satisfied that Australia will derive a significant net benefit from the sale of those goods outside Australia.

   Under the current EMDG Act, goods are eligible if they are manufactured in Australia and have at least 50 per cent local content, or if they are manufactured offshore and at least 75 per cent of their components' value meets the 50 per cent Australian content requirement. Goods that meet neither test may still be eligible if Austrade determines that the Australian input in those goods is sufficient to ensure that Australia will derive a significant net benefit from their export. However:

- there are some practical difficulties in applying the Australian content rules, and

- the current EMDG Act does not provide guidance on how to determine significant net benefit, nor does it provide for ministerial guidelines to assist Austrade's decision-making.

This amendment bill replaces the Australian content requirements and instead provides that goods are eligible if they are made in Australia. Rules for defining 'made in Australia' will be set out in ministerial guidelines. The ministerial guidelines are likely to be similar in concept to the certificate of origin criteria used by Australian chambers of commerce. These take into account such matters as whether a product is mined, grown, raised or substantially transformed in Australia.

This bill also provides that other goods (those not made in Australia) will be eligible only if Austrade is satisfied, in accordance with ministerial guidelines, that Australia will derive a significant net benefit from their sale outside Australia. The ministerial guidelines may require Austrade to take into account issues such as job creation, location of R&D activities, value added and/or economic benefits to Australia.

This amendment allows both goods that are made in Australia and goods that are not to be eligible for EMDG purposes (as does the current Act). However, all the other scheme provisions governing eligibility for grants will continue to apply. Therefore, determining that a good is eligible will remain a necessary but not a sufficient condition for a grant to be paid.

The introduction of the two ministerial guidelines ('made in Australia' and 'significant net benefit') will make it easier for applicants to clarify whether their goods are likely to be eligible and will increase the transparency and accountability of Austrade's decision-making about the eligibility of goods.

6. <u>Make applicants' expenses eligible when they are incurred to increase the return on the disposal of intellectual property and know-how to a related company.</u>

   Under the current EMDG Act, any expenses incurred by an applicant to increase royalty or licence income streams resulting from the disposal of its intellectual property or know-how to a related overseas company are excluded. This means that applicants cannot receive EMDG support if they export intellectual property or know-how through their foreign subsidiaries, even though some Australian companies export intellectual property through subsidiaries for legitimate business reasons.

   This amendment bill removes this exclusion and enables applicants to claim reasonable expenses related to promoting their intellectual property or know-how through related overseas companies.

7. Separate the claimable expense categories for overseas representatives and marketing consultants, cap expense claims for overseas representatives at $200 000 per claim and for marketing consultants at $50 000 per claim.

   Under the current EMDG Act, applicants are entitled to claim up to $250 000 per claim for the combined expenses of two eligible expense categories, namely overseas representation and consultants expenses. The Act enables an applicant to claim up to $250 000 for one or other of these categories or for any combination of the two.

   This bill provides for the two expense categories to be capped separately with overseas representatives capped at $200 000 per claim and marketing consultants at $50 000 per claim. This measure will reduce the risk of over-claiming in regard to the salary costs of consultants that may be de facto employees.

8. Revise the rule covering changes in business ownership to make it clearer for applicants and easier to administer.

   Some businesses change ownership with the new owner carrying on a similar business to that previously carried on by a former owner. Under the current EMDG Act, Austrade must attribute any grants paid, expenses incurred and other things done by the former owner to the new owner. This prevents a business from circumventing the Act's seven grant limit. It also means that a new owner buying a business during a grant year is entitled to claim any eligible promotion expenses incurred in that year by the original owner before the change of ownership.

   Under the current EMDG Act, decision-making about change of ownership has two steps. First, the continuing business provisions are applied whenever two businesses are similar as a result of one business selling or transferring an activity or entering into some other arrangement with another business. Second, applicants may apply for exemption from the continuing business provisions on the basis that the two businesses are substantially different.

   This amendment bill does not change the intent or scope of the Act's change of ownership provision. However, it sets out the rule more clearly and should be easier for applicants to understand and for Austrade to administer.

   The amended provision will apply if a person is carrying on a business which is similar to one carried on previously by another person, and the two businesses are similar to such an extent that Austrade is satisfied that the new business should be treated as a continuation of the old. In making this determination, Austrade will take into account the relevant ministerial guidelines.

9. Allow Austrade to grant special approval status, including approved body status, for five years rather than three.

   Under the current EMDG Act, Austrade may allow some special categories of applicant to apply for grants, namely approved bodies, approved joint ventures and approved trading houses. These approvals may be granted for three years and, at Austrade's discretion, renewed for further three-year periods.

Under this amendment bill Austrade may grant special approval status for five years rather than three, both for initial approval and for renewals. This will reduce administration for both applicants and Austrade.

10. Provide that the eligibility of cash payments made by applicants is limited to $10 000 per claim.

Under the current EMDG Act, applicants may claim the eligible export promotional expenses that they have incurred and that have been acquitted. Most payment methods are accepted for this purpose, including cash payments.

This amendment bill limits the eligibility of cash payments made by applicants to $10 000 per claim.

For the purposes of this measure, 'cash payments' are those where the applicant pays off the expenses by physically transferring currency to the person to whom the expenses are payable.

For example, an applicant that carried cash overseas and paid this cash as salary to their overseas representative would have made a cash payment for the purposes of the Act.

On the other hand, an applicant would not make cash payments if, for example:

- the applicant paid cash into a bank, then had the bank transfer the funds to the overseas representative's account as a salary payment or

- the applicant paid cash into a bank, then had the bank transfer the funds to the overseas representative's account from which the representative then drew cash to pay creditors.

11. Ensure that the scheme's rules clearly set out Austrade's power to disregard any unsubstantiated, unreasonable, uncommercial or non-bona fide expense claim.

Under the current EMDG Act, Austrade can disallow expense claims if it believes that the expenses are unreasonable or that an applicant has set up business arrangements designed to improperly obtain a grant.

This amendment bill merges these two provisions to clarify Austrade's powers to disregard expenses that are unreasonable, uncommercial or non-bona fide or those that result from structuring arrangements entered into for the sole or dominant purpose of obtaining an undue increase in EMDG entitlement.

The amended provision (section 96) states that Austrade must notify the applicant of its intention to disregard the expenses and take into account the applicant's response. Any decisions made under this provision would be subject to review by the Administrative Appeals Tribunal.

12. Remove the export performance test from the Act.

Under the current EMDG Act, applicants are entitled to receive two EMDG grants regardless of whether they achieve any export sales. To receive a third and subsequent grants, applicants other than approved bodies and approved trading houses must achieve some export sales. This is because the formula for calculating grants limits the amount payable to a specified percentage of the applicant's export income.

This amendment bill removes all references to the export performance test from the Act and removes all supporting references to export earnings from the Act. This will remove some anomalies and inconsistencies associated with the test.

13. Ensure that, as intended, commission payments remain ineligible for the scheme.

Under the current EMDG Act, all commissions, discounts, credits and similar transactions that are based on the level of sales made by an applicant are intended to be ineligible. However, due to the technical wording of the relevant provision, the Act may not have this legal effect in all cases and may only apply if the commissions etc. are paid to a customer of the applicant.

This amendment bill clarifies the current rules to ensure that all expenses incurred as commissions, discounts and other amounts including salaries, retainers or fees that are based on the level of sales will be ineligible, irrespective of the person or entity to whom they are paid.

14. Correct minor errors in the Act.

The current Act provides that the costs of administration of the EMDG scheme are to be paid out of the money appropriated by parliament for the scheme and that these administration costs must not exceed 5 per cent of the appropriation amount for the 'grant year'. This reference to grant year is incorrect as parliament does not appropriate money for the grant year. Rather, it appropriates money on a financial year basis with the financial year being by definition later than the grant year for which EMDG grants are paid.

This amendment bill corrects this error by providing that the costs of administration of the EMDG scheme must not exceed 5 per cent of the appropriation amount for that financial year.

The bill also corrects an incorrect reference in section 72(3) of the EMDG Act. It should refer to paragraph 73(1)(b) rather than to paragraph 73(b).

15. Repeal the *Export Expansion Grants Act 1978.*

The *Export Expansion Grants Act 1978,* under which the Export Expansion Grants (EEG) scheme was administered, lapsed on 30 June 1983. There are no matters outstanding under this Act and there is no purpose in retaining it. This amendment bill repeals the *Export Expansion Grants Act 1978.*

FINANCIAL IMPACT

Expenditure under the Act is set through annual Appropriation Acts. A capping mechanism ensures that expenditure under the scheme is limited to the amount appropriated.

REGULATION IMPACT STATEMENT— REVIEW OF THE EXPORT MARKET DEVELOPMENT GRANTS SCHEME

Executive summary

The purpose of this regulation impact statement (RIS) is to explore the merits of continuing, ceasing or replacing the Export Market Development Grants (EMDG) scheme.

The RIS draws on the public and industry input to the 2005 EMDG review carried out by Austrade, and on the findings of independent research, undertaken by the Centre for International Economics (CIE), on the effectiveness of the EMDG scheme in assisting Australia's current and aspiring exporters.

The results of the CIE research showed that:

- the EMDG scheme induces export promotion, boosts exports, improves the sustainability of small to medium-sized enterprises (SMEs), and has a positive impact on export culture
- the positive impact of the EMDG scheme is greatest for smaller firms (with $15 million annual income or less—i.e. over 90 per cent of EMDG clients) with restricted access to other sources of finance.

The CIE research was not definite about the efficiency of the EMDG scheme in inducing economy-wide benefits in excess of economy-wide costs. Nevertheless, with positive export inducement rates – found to be characteristic of firms facing funding constraints and typical of many of the small owner-entrepreneurial businesses that characterise EMDG recipients – the CIE research suggests a positive net economic benefit, even with low spillovers of benefits from EMDG recipients to non-EMDG recipients.

The following options are considered as part of the RIS:

1. Continue the EMDG scheme.
2. Allow the EMDG scheme to lapse on 30 June 2006.
3. Introduce tax deductions for eligible export promotion expenditure.
4. Introduce a discretionary grants scheme.
5. Introduce a loans scheme for eligible exporters.

Overall, the evidence suggests that the EMDG scheme is effective in supporting current and aspiring exporters. It is therefore recommended that the scheme continue until the end of 2010–11, and that there be a legislative requirement to review the scheme, with a report to the Minister for Trade by 30 June 2010.

INTRODUCTION

This regulation impact statement (RIS), which includes an assessment of impact on trade, will explore the merits of continuing, ceasing or replacing the Australian Government's principal financial assistance program for aspiring and current exporters, the Export Market Development Grants (EMDG) scheme.

Under the scheme, assistance is provided to small and medium-sized Australian exporters committed to and capable of seeking out and developing export business by reimbursing part of their promotional expenses.

An EMDG grant is a taxable grant that partially reimburses money (up to 50 per cent) spent by eligible businesses during the financial year on specific export promotional activities to any overseas market, with the exception of New Zealand. A business may receive seven grants of up to $150,000 per year (subject to available funds).

Any Australian business may apply for a grant if it:

- exports eligible goods, services, intellectual property rights and/or know-how; and
- spends at least $15,000 each year on eligible export promotion (first year applicants may combine expenses incurred over two years to reach this requirement); and
- has income of not more than $30 million for the year.

Austrade may also give approval for industry associations, joint ventures and trading houses to apply.

In the 2004–05 financial year $123.9 million and 3277 grants were paid to Australian small and medium businesses to assist them with the costs of export marketing and promotion. For grants relating to the 2003–04 grant year, the average grant was $37 145, the median grant was $22 643, and 77 per cent of businesses receiving EMDG assistance reported annual income of $5 million or less.

After the last formal review of the EMDG scheme in 2000, the government extended the scheme for five years. As a result, the last grant year under the current EMDG Act will be 2005–06, for which applications will be received in 2006–07.

The 2004-05 review was undertaken by Austrade in accordance with section 106A of the *Export Market Development Grants Act 1997*. Under section 106A the Minister for Trade was required to cause Austrade to conduct the review and provide him with a written report making recommendations about the continuation of the scheme by 30 June 2005.

The report of the 2004–05 review is at www.austrade/exportgrants/review. This RIS was prepared as part of the review.

1. PROBLEM/ISSUE IDENTIFICATION

1.1 The benefits of exporting

Exporting brings macroeconomic, microeconomic and social benefits to Australia. It allows the imports which contribute to Australia's standards of living. Exporting underpins the economy's microeconomic foundations and contributes positively to an overall internationalisation process.

Macroeconomic effects

There is evidence that export growth is linked to broader economic growth, with one econometric study based on Australian time series data concluding that causation in this case runs from export growth to economic growth, and that therefore 'export promotion is a viable strategy for promoting economic growth in Australia'.[1] A substantial body of research also suggests that openness to trade and globalisation has a strong positive impact on per capita income. According to a study by Frankel and Romer, 'increasing the ratio of trade [exports plus imports] to GDP by one percentage point raises income per person by between one-half and two percent'.[2]

As the economy grows and living standards improve, Australians consume more imports. In effect, exports pay for these imports.

As Australia builds up a strong export sector, we will face fewer balance of payments or external constraints on growth over time. That is, as we grow and consume more imports, our export earnings will allow us to maintain our levels of consumption.

Australia's savings and investment rates influence the amount of capital inflow and outflow and the state of our external accounts. Improved export performance makes it easier for the economy to grow without facing pressures from the rest of the external account.

Microeconomic benefits

Microeconomic reform is a key factor in Australia's improved macroeconomic performance.

Over the past 20 years, Australia has increasingly opened up its economy, by floating the exchange rate, reducing tariffs and implementing a range of microeconomic reforms.

At the same time, increases in growth and productivity have helped to absorb major external shocks, such as the 1997–99 Asian financial crisis and the 2001 dot.com crash. Output, employment rates and living standards have also risen.

Exporting encourages microeconomic reform by facilitating economies of scale, competition, and innovation and learning.

Competing in international markets increases competitive pressures on Australian exporters. On average, businesses that compete internationally improve their productivity, efficiency and performance because they are forced to compete with the world's best. The results of research undertaken by the Centre for International Economics (see below) showed that 70 per cent of respondents believe exporting has helped make their operations more efficient.[3]

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[1] Paul 1998, pp. 144–150
[2] Frankel and Romer 1999, pp. 379–399
[3] CIE 2005, p. 57

Exporting benefits Australian businesses by assisting them to:

- increase the size of their potential market—with greater demand for their goods or services, businesses can expand production and exploit economies of scale (that is, spread their unit costs over a larger base)
- spread risk over a higher consumer base
- achieve higher levels of productivity than non-exporters—which also helps to raise the economy's average level of productivity
- become more innovative—an exporting business 'learns' from its international exposure and is more likely to create new goods or services than non-exporters. According to the Australian Bureau of Statistics' Business Longitudinal Survey in 1997–98, nearly half of all exporters planned to introduce a new good or service, compared with only 15 per cent of non-exporters.[4]

Exporting also benefits non-exporting businesses if they can draw on others' experiences of exporting through knowledge spillover—which also benefits the domestic economy and the nation's overall economic performance. The CIE, in its analysis of the EMDG scheme, noted that spillovers depend on a range of factors, including:

- the extent to which a new foreign market is different from existing markets;
- the extent to which exporting encourages innovative changes in products, more efficient ways of doing things and development of new intellectual property;
- the extent to which other competing Australian firms can free-ride on the initial investment once a market has been opened;
- the potential size of the new market; and
- the extent to which lessons learned in one new market can be transferred to the development of other markets.[5]

Social benefits

Exporting is part of an overall internationalisation process that benefits the Australian economy and society.

Exporting benefits employees by improving labour market outcomes. Exporters tend to pay higher wages and offer better conditions and more job security than non-exporters. Evidence from the Australian Bureau of Statistics' Business Longitudinal Survey showed that, in 1997–98, exporters paid each full-time equivalent employee an average of $46 000 per annum, compared

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4 Harcourt 2001, p. 11
5 CIE 2005, p. 10

with $28 600 being paid on average by non-exporters. The data showed that exporters paid better than non-exporters regardless of firm size.[6]

Exporters contribute to net job creation by improving productivity and efficiency. By investing in education and training, exporters also help to improve job quality by providing more interesting work and better career paths. According to the Australian Bureau of Statistics, in 1997–98 some 77 per cent of exporters provided training, compared to 56 per cent of non-exporters.[7]

The strong link between exporting and employment creation is a key factor in Australian Government trade policy:

> Trade benefits all Australians … Trade generates jobs and a better standard of living for all Australians. In fact, around one in five Australian jobs are directly or indirectly connected to exports. In regional Australia the link is even stronger—around one-quarter of regional jobs rely on Australia's ability to export.[8]

Exporting encourages cultural exchange with other countries, improves tolerance, and helps inspire learning about the world. It can strengthen social cohesion, especially through improved economic conditions in regional Australia.[9]

Exporting and immigration are also linked. In Australia, a large proportion of small exporting companies are run by immigrants. They use their networks and links with their countries of origin to increase their market size.

Exporting helps to promote the rich culture of Aboriginal and Torres Strait Islander peoples, and a range of Indigenous industries benefit, especially in tourism and the arts.

1.2 Barriers to export

Despite a range of economic reforms over the past 20 years, there are still a number of obstacles discouraging Australian firms, especially SMEs, from entering into export markets. Only a small proportion of Australian firms are engaged in export activity. In 2001 there were 25,000 Australian exporting firms, representing 4 per cent of the business community. This is below the rate of comparable economies.[10] 'Thirty-five per cent of Australian small businesses have reported exporting as feasible for them but do not plan to do so.'[11]

The main barriers to exporting for many small and medium Australian businesses include the real and perceived risks associated with new export ventures, a lack of financial resources and export marketing skills, and limited access to knowledge and overseas networks. In recent times, incidents such as SARS and terrorism have also undermined the efforts of exporters. These barriers to exporting are discussed below.

Risk and uncertainty

Exporting is often viewed as riskier than producing for domestic markets. Exporters have to deal with institutional and administrative barriers in overseas countries, fluctuations in exchange rates and variability in prices, as well as cultural and language constraints. It is also necessary to

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6 Harcourt 2001, pp. 5–6
7 Harcourt 2001, p. 8
8 DFAT 2005, chapter 1
9 Australian Trade Commission 2001, p. 2
10 Australian Trade Commission 2001, p. 4
11 Shaw and Hughes 2004, p. 7

identify potential customers in foreign markets, estimate the costs involved in exporting, and develop effective plans and distribution channels. Being competitive and having a good product or service, while crucial, do not guarantee success.

SMEs, because of their size and often limited range of activities, face particular difficulties in embarking on new export ventures. Unlike larger firms, which tend to be more diversified, SMEs typically have little scope for dispersing the risks inherent in entering new export markets.

High costs

The costs associated with developing new export markets can be prohibitive, especially among SMEs. Lenders are often cautious in their assessment of risk, making it difficult for exporters to obtain the funds necessary to finance new export activity. The government's 2001 *Report on the Review of Export Credit and Insurance Services* found that private market capacity for medium term export finance is limited. The Report noted that the private sector largely avoids this class of business on the basis of its scale, tenor and risk.[12]

Attitudinal constraints

While an export culture where firms think globally is developing in Australia—and there are a growing number of enthusiastic and successful exporters—they are small in number. Many firms still view international markets as a threat, rather than an opportunity for growth. This is seen in the results of the research undertaken by the Centre for International Economics (see below), which showed that risk and uncertainty (and lack of capital) are major constraints to export promotion. Data collected during the 1990s as part of the Australian Bureau of Statistics' Business Longitudinal Survey showed that only 2 per cent of non-exporting firms intended to export within three years. These findings suggest that increasing the number of exporters in Australia depends on changing attitudes and improving the intention to export.

Lack of information

A lack of information about the benefits of exporting and upcoming opportunities, and/or the know-how to enter into export markets, is constraining many would-be Australian exporters, especially smaller firms. SMEs tend to be less well networked and have inferior access to information than larger companies. Smaller Australian firms are likely to be lesser known than their larger counterparts overseas, making it difficult to break into new markets.

1.3 Externalities/spillovers arising from export activity

The benefits of exporting are not confined to the exporting firm, but are often shared with the wider community. For example, exporting improves an economy's employment and labour market outcomes, and transfers knowledge back to the domestic economy as firms learn about international best practice and adopt new ideas and technologies. However, if left solely to market forces, there is a risk that the benefits to the wider community of exporting would not be optimised.

Externalities from exporting cause a divergence between private and social benefits and costs, meaning that exporters will not make the best decisions in terms of overall social welfare.

Products and services will not meet export market opportunities unless these opportunities are known to exist. This is true for all potential sales opportunities, but the difficulties in the way of

[12] DFAT 2001, p. 26

tapping foreign markets, often with different languages and customs, are commonly greater than those confronting penetration of local customer bases. Costly mistakes are an intrinsic hazard of ‘trailblazers’ or ‘first movers’ from which followers can learn. However, there is usually no way the first mover can recover the cost of his or her mistakes from those who have learned from them. In consequence the first mover might not be prepared to be as adventurous as the national economic interest might require. He or she might not be able to afford the altruism involved.

The experience of competing in distant markets might lead to the discovery, and implementation, of new ways of doing business, the adoption of new technologies and product innovations, and the establishment of improved distribution networks that enable the producer to lift his or her performance. Implementation of the new techniques should be worth something to this trailblazing producer, but the gain will be reduced if fellow local producers quickly copy the innovations. A desirable procurement of knowledge will be curtailed by an inability to offset costs of acquisition by its full benefits. Large firms continuously operating in major overseas marketplaces can pick up benefits as routine by-products of normal operations, but the same is not self-evidently true of the small operator covered by the EMDG scheme.

‘Reputational externalities’ arise when a firm’s overseas marketing activities build up product reputations and market presence for other Australian firms, as well as their own. Because the initial firm cannot charge subsequent Australian exporters for this benefit, the private benefit from exporting will be less than the public benefit.[13]

The results of the research undertaken by the Centre for International Economics (see below), revealed that 40 per cent of respondents believe they are learning from other exporters. Moreover, about 30 per cent of those surveyed believe their exporting activities are helping their competitors. These results indicate the existence of positive social spillovers arising from the export activities of Australian firms.

The EMDG scheme aims to close the gap between the private and social benefits and costs of exporting by meeting some of the promotional expenses firms encounter in entering new export markets and thereby inducing additional exports. The CIE research showed that for EMDG recipients, export promotion decisions are mostly influenced by export opportunity and cost factors. By reducing the cost of export promotion, the EMDG induces additional export promotion and exports, thereby helping to address the market failures associated with the externalities, or spillovers, that arise from export activity.

2. SPECIFICATION OF DESIRED OBJECTIVES

Given the obstacles and market failures set out above, government intervention seeks to increase the number of SMEs that develop into new exporters, increase the number of SMEs that achieve sustainability in export markets and generate additional exports, and further develop an export culture in Australia.

Well designed and targeted intervention should contribute towards the government’s broader objectives of creating jobs in Australia, boosting our economic competitiveness, and building the long-term strength of the Australian economy.

[13] Further discussion of benefits of and obstacles to export can be found at: CIE 2005, Appendix A; Shaw and Hughes 2004; Australian Trade Commission 2001, chapter 1

3. IDENTIFICATION OF OPTIONS

The following options are considered in this RIS:

1. Continue the EMDG scheme.
2. Allow the EMDG scheme to lapse on 30 June 2006.
3. Introduce tax deductions for eligible export promotion expenditure.
4. Introduce a discretionary grants scheme.
5. Introduce a loans scheme for eligible exporters.

4. ASSESSMENT OF OPTIONS

4.1 Option 1: Continue the EMDG scheme

4.1.1 Review of the EMDG scheme

The 2004–05 review of the EMDG scheme considered the scheme's effectiveness and its cost/benefits.

Public input to the review was sought through the Minister's media release announcing the review and through Australia-wide advertisements. The majority of review input was provided by EMDG clients who have benefited from the scheme and from organisations representing them, and was overwhelmingly positive. The wider community which funds the scheme largely did not provide input. (See Consultation below.)

An economic analysis of the scheme was also carried out.

4.1.2 Economic analysis

In September 2004, following a public tender process, Austrade engaged the Centre for International Economics (CIE) to carry out independent research to assist Austrade in reviewing the EMDG scheme's effectiveness.

The following sections summarise the CIE research method and main findings.[14]

Methodology

One way to measure the effectiveness of the EMDG scheme would be to compare the export promotion expenditure and export sales of EMDG scheme recipient firms with those of similar SMEs that do not receive EMDG scheme grants. In practice it is difficult to identify a 'control group' of firms that do not use the program, but which are in all other respects comparable to those that do.

To avoid this difficulty, the CIE used an approach that did not require a control group. It built a model of a representative profit-seeking firm that undertakes export promotion activity, and then

[14] CIE 2005

examined how the export promotion expenditure and export revenue of the firm would change if the EMDG scheme grant were removed. Information from a survey of EMDG scheme grant recipients was used to give the model factual content.

In the CIE results, the sample of firms was divided into five groupings by size of annual income:

- **Group 1**—up to and including $1 million
- **Group 2—**greater than $1 million and up to and including $5 million
- **Group 3**—greater than $5 million and up to and including $15 million
- **Group 4**—greater than $15 million and up to and including $30 million
- **Group 5**—greater than $30 million.

Note: Group 5 firms are no longer eligible for EMDG scheme assistance, following the scheme changes effective for applications from 1 July 2004.

The CIE analysis first looked at what EMDG scheme recipients reported in the survey on a range of questions, including their source of funding for export promotion, the constraints they faced in doing additional export promotion, and how they would spend an injection of additional funds if these were to be received. The analysis then looked at the modeled results of the impact of the EMDG scheme funding on export promotion inducement and additional export sales.

Survey of EMDG scheme grant recipients

EMDG scheme survey forms were sent to 4449 firms. The effective population size was reduced to 2862 because of difficulties in making contact with a range of firms. Responses were completed by 770 firms—a 27 per cent response rate from these 2862 firms. Comparisons of data collected from the survey with Austrade's full population database indicated that the sample was representative of the full population of EMDG scheme recipients.

Survey results

EMDG scheme as a source of funding for export promotion. EMDG scheme recipients reported that around 60 per cent of funding for export promotion came from retained earnings. EMDG scheme funds represented nearly 20 per cent of export promotion funding, and they were the second largest and most important source of external funding. EMDG scheme funding was relatively more important for smaller EMDG scheme recipients in Groups 1, 2 and 3 ($15 million and less annual income).

Constraints to additional export promotion. In the CIE survey, all size groupings of EMDG scheme recipients said that lack of finance was the major constraint to doing more export promotion. Smaller EMDG scheme recipients in Groups 1, 2 and 3 ($15 million annual income and less) particularly reported lack of finance as the greatest constraint to doing more export promotion. For EMDG scheme recipients above $15 million annual income, risk and uncertainty, and trade barriers, were reported as of the same importance as lack of finance in constraining export promotion.

Preference for spending additional funds on export promotion. Survey responses indicated that, if extra funds became available, EMDG scheme recipients have a strong preference for spending those funds on export promotion. This preference increased as firm size decreased.

Modeling results

The CIE modeled the effect of the EMDG scheme by simulating the complete withdrawal of EMDG scheme grants. Estimates were made of the scheme's impact on additional export promotion expenditure and, through the estimated induced export promotion, on additional exports.

Impact of EMDG scheme on export promotion inducement

The CIE model assumed that profit-seeking behaviour would lead firms to increase their expenditure on export promotion to some optimal level, after which they might reach a point of diminishing returns where export promotion becomes relatively less effective in winning new sales. For example, visiting a sixth trade fair may produce fewer export sales than visiting the first five trade fairs.

However, if firms lack access to adequate funding, they might be unable to spend enough on export promotion to reach this optimal expenditure level.

The CIE model showed that, on average, a firm's response to receiving an EMDG scheme grant is related to its ease or difficulty in accessing finance.

For each dollar of EMDG scheme funding received, firms facing tight finance constraints but with the opportunity to gain increasing export sales return from additional export promotion, are likely to spend a dollar or more on extra export promotion. Under extreme finance constraints, the inducement effect on additional export promotion expenditure could be between $1.30 and $1.90 for each dollar of EMDG scheme grant.

The CIE modeled a scale of finance constraints. In general, for each firm size grouping, as the finance constraint eased the inducement effect of the EMDG scheme grant on extra export promotion lessened. When finance is freely available, the CIE concluded that the inducement effect on additional export promotion could be reduced to between $0.10 and $0.27.[15]

While the CIE noted that 'lack of capital is regarded as the major constraint to doing more export promotion by all groups', it also pointed out that 'as firms get larger, risk and uncertainty and trade barriers become more important and lack of capital less important'.[16]

Impact of the EMDG scheme on additional exports

The estimates of the impact of EMDG scheme grants on additional exports, as a result of the export promotion induced by the EMDG scheme, were expressed both as percentages of overall exports and in terms of export dollars.

The CIE provided a variety of model estimates. They varied by firm size, by degree of finance constraint, and by the scale of export sales return a firm could gain from additional export promotion.

For firms constrained by lack of finance, model results showed that the boost to exports per EMDG scheme grant dollar could be between $20 and as high as $220 over the future life of EMDG scheme-supported businesses, depending on the severity of the finance constraint. Alternatively, if all EMDG scheme recipients enjoyed ease of access to finance, the boost in exports per dollar grant could be between $7.50 and $28.

[15] CIE 2005, p. 82
[16] CIE 2005, p. 42

The following general observations summarise the CIE model results of the impact of the EMDG scheme, through inducing additional export promotion and hence additional exports, by size grouping of firms.

- The scheme's highest proportional return, in terms of percentage increases in firms' exports, occurred in the case of smaller EMDG scheme recipients in Groups 1, 2 and 3, that is with annual income of $15 million or less.

  For these firm size groupings, the scheme induced up to 50–60 per cent additional exports if the firms were faced with extreme finance constraints. The impact of the scheme was considerably smaller (though still important) for these firm size groupings where finance was not a serious constraint.

- In absolute dollar terms, the impact on additional exports was highest for firms in Group 3 with annual income from $5 million to $15 million, but fell away for the smallest firms in Groups 1 and 2 with annual income of $5 million and less (reflecting their smaller initial export earnings).

- The impact on additional exports for the largest EMDG scheme recipients in the CIE survey in Group 5 (annual income greater than $30 million—those no longer eligible for EMDG scheme grants) was high only in absolute dollar terms (not in percentage terms) and only when finance was constrained. If not faced with finance constraints, the impact of the scheme on additional exports, in both percentage terms and in absolute dollar terms, was considerably lower for these larger EMDG scheme recipients than for smaller recipients.

- For all firm size groupings, the impact of the scheme on additional exports was always substantially greater when finance was constrained than when funding was readily available.

Costs-benefits

The review also addressed the overall economic impact and value of the EMDG program.

In undertaking the analysis, the CIE focused on the social benefits, or positive spillovers, arising from the additional export activity generated by the EMDG scheme. The CIE suggested that, while survey responses indicated that the private benefits generated by the EMDG scheme are relatively large, the additional spillover benefits were likely to be equivalent to a small proportion of the private benefits obtained by exporters.

The difficulty in quantifying the economic impact is, firstly, to place dollar figures on the spillovers from exporting, especially since little previous research has been done on the subject. The CIE sought to answer this question by using work done on another activity, research and development (R&D), to place some illustrative figures around the limits of a plausible range of spillovers from exporting.

The research on R&D funding suggested that spillover benefits (that is, the broader social benefits) range from 60–100 per cent of the private benefits of R&D. While noting that it is difficult to be precise about the size of general export-related spillovers, the CIE concluded that it would be plausible to expect that for every $1.00 of private benefit from EMDG-induced export activity, the economy would derive an additional spillover benefit of between $0.10 and

\$0.30.[17] The CIE report suggested that the evidence might point towards the additional spillovers being at the lower end of this range, though this cannot be viewed as a firm conclusion, given the series of assumptions on which it is necessarily based.

The second difficulty in quantifying the economic impact is to put dollar figures on the social costs of the EMDG scheme. The CIE attempted to do this by examining the deadweight losses that arise in taxing one group of the economy to subsidise another (in this case, EMDG recipients). Among the factors considered were the costs of administering the EMDG scheme, the compliance costs imposed on grant recipients, the costs to economic efficiency arising from taxation, and the potential inefficiencies generated by rent-seeking behaviour. Again, it was impossible to be precise about these costs. The CIE noted various studies estimating that the efficiency cost of raising income tax could be from 9 per cent to 303 per cent, with most estimates being between 20 per cent and 50 per cent. The CIE then used a midpoint estimate of 30 per cent, such that additional social costs would be around \$0.46 per dollar of net EMDG funding raised through the taxation system.[18]

To incorporate the economy-wide effects of the additional exports induced by the EMDG scheme, the CIE used the ORANI model of the Australian economy and simulated economy-wide effects in both the short and long run. In the long run, a tight labour market is assumed, so that increases in labour demand as exports increase lead to higher wages. This means that in the long run simulations, the initial increase in exports induced by EMDG leads to an increase in overall costs as well as an increase in real wages, and the net increase in exports falls. This is a careful assumption, characteristic of a full employment model, but may be generally less typical of the small, family-run businesses that often claim on the EMDG scheme.

To determine whether the EMDG scheme produces a net positive effect on the economy, the CIE compared the estimated present value of spillover benefits with the estimated social costs of operating the scheme. This comparison was presented in a matrix of possible benefit-cost ratios according to a range of spillover percentages and inducement rates (or extra export promotion expenditures per dollar of EMDG received). A benefit-cost ratio of 1 would indicate that the scheme just pays its way in national economic terms. Outcomes beneath unity would indicate a net cost to the economy, while results above unity would indicate positive economic returns. The CIE matrix of outcomes is shown on the following page.

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17 CIE 2005, p. 77
18 CIE 2005, p. 61

CIE matrix of outcomes: Benefit to cost ratios by spillover and inducement rates

		Spillover rates: Present values $ benefits per $ of EMDG				
		0.10	***0.15***	***0.20***	***0.25***	***0.30***
Export promotion inducement rates	***0.10***	0.14	0.21	0.28	0.36	0.43
	0.20	0.28	0.43	0.57	0.71	0.85
	0.30	0.43	0.64	0.85	1.07	1.28
	0.40	0.57	**0.85**	1.14	1.42	1.71
	0.50	0.71	1.07	**1.42**	1.78	2.14
	0.60	0.85	1.28	1.71	**2.14**	2.56
	0.70	1.00	1.50	1.99	2.49	2.99
	0.80	1.14	1.71	2.28	2.85	3.42
	0.90	1.28	1.92	2.56	3.21	3.85
	1.00	1.42	2.14	2.85	3.56	4.27
	1.10	1.57	2.35	3.13	3.92	4.70
	1.20	1.71	2.56	3.42	4.27	5.13
	1.60	2.28	3.42	4.56	5.70	6.84

Source: CIE model.

The range of outcomes presented spans both positive and negative results. When both spillover and inducement rates are low, net costs are evident (the benefit-cost ratio is below unity). But when inducement rates are robust, which was found to be characteristic of firms facing funding constraints, even low spillover rates return a positive impact (first column of the matrix). Clearly the chart provides a broad range of positive possibilities from plausible assumptions.

Taking into account all available evidence, the CIE concluded that it was difficult to be categorical about the net social benefit of the scheme. The CIE found that at a mid-level spillover rate, the scheme is likely to provide a small positive rate of return (a benefit-cost ratio of 1.42:1) if the export promotion inducement rate from EMDG grants is 50 per cent.

This finding is, to a large extent, a function of the mid-level estimates that were used to establish the key variables discussed above, such that any adjustment to the spillover or inducement rates would vary considerably the final outcome.

For example, should spillover and/or inducement rates be only slightly higher than the mid-levels, then the benefit to cost ratio rises significantly. For instance, if the assumed inducement rate of 50 per cent and the assumed spillover rate of 20 per cent are replaced with 60 per cent and 25 per cent, the benefit to cost ratio rises to 2.14:1.

Conversely, should the assumed inducement rate of 50 per cent and the assumed spillover rate of 20 per cent be replaced with 40 per cent and 15 per cent, the benefit to cost ratio falls to 0.85:1.

It should also be noted that the CIE limited its consideration of social benefits to those arising from externalities or spillovers, and not to other potential public benefits. These include reductions in cyclical risk brought about by the diversification of the Australian economy's export base. Such benefits, while also difficult to quantify, could be expected to impact favourably on the benefit-cost ratios presented in the CIE report.

Overall, due to the inherent difficulties in determining the real world economic impact of a program such as EMDG, the CIE analysis did not clearly quantify the economic value of the EMDG scheme. This inconclusive social verdict should however be set alongside the clear evidence that the scheme is associated with strong export gains.

Conclusion

The CIE research showed that the scheme induces export promotion, boosts exports, improves the sustainability of SMEs, and has a positive impact on export culture.

- The scheme induces export promotion.

    - The CIE concluded that if firms do not have access to finance to conduct optimal amounts of export promotion, providing them with EMDG scheme funding would help alleviate an important constraint and encourage substantial increases in expenditure on export promotion.

    - For firms facing tight finance constraints and the potential for increasing export sales returns from additional export promotion, the research results suggested that for each dollar of EMDG scheme funding received, firms are likely to spend a dollar or more on additional export promotion.

- The scheme boosts exports.

    - The CIE estimated that if all firms were constrained by lack of finance, the boost in exports per dollar grant could be between $20 and as high as $220 on average over the future life of EMDG scheme-supported companies, depending on the severity of these constraints. Alternatively, if all firms had access to finance, the boost in exports per EMDG scheme grant dollar could be between $7.50 and $28.

- The scheme helps SMEs into sustainable export.

    - Results from the research by the number of years in the scheme indicated that the scheme attracts firms that on average do not have long-term export experience, and that the longer these firms are in the scheme, the more they become financially self-sufficient and able to self-fund export promotion from retained earnings.

    - The analysis showed that EMDG scheme grants could raise the profits of small businesses (with annual income of $5 million or less) that are able to gain increasing returns from additional export promotion by over 30 per cent. This suggests that the scheme has considerable influence in assisting small firms achieve sustainability.

- The scheme has a positive impact on export culture.

- On the basis of the EMDG scheme's potential impact on the total growth of exports, the scheme is likely to be providing some boost to the development of an export culture in the surveyed firms. Survey responses were clearly positive on the benefits of exporting and export promotion.

- About 70 per cent of survey respondents believed exporting had helped make them become more efficient and had given them a four-year competitive edge over their domestically oriented competitors.

This suggests that the scheme plays an effective role in funding additional export promotion, particularly for smaller-sized firm of $15 million annual income and less which account for over 90 per cent of EMDG scheme recipients.

The evidence concerning the cost-benefits of the scheme is inconclusive. The CIE concluded that 'taking account of inducement rates and spillover rates, the evidence presented in this report suggests it is difficult to be categorical about the net social benefits of the scheme'.[19] Nevertheless, taking the CIE research into account, noting the cautious assumptions used in the analysis and other potential additional economic benefits, the EMDG scheme appears to be delivering adequate positive net social benefits.

4.1.3 Options for improved performance of the scheme

The Austrade review of the EMDG scheme identified a number of possible options for improving performance of the scheme. These focus on increasing the impact of the scheme by:

1. increasing the incentive for SMEs to internationalise by visiting overseas markets

2. updating the scheme to better support new and emerging export industries and practices

3. reducing risk and administration costs

4. improving the certainty of payment.

Most of these options are consistent with stakeholder feedback on the scheme.[20]

The package of options set out in the Austrade review report does not have a major impact on the structure of the scheme.

Two further modifications have been added to these options.

Firstly, the Austrade review proposed that any cash payment made by an applicant be ineligible for EMDG purposes. The purpose of this finding was to address the risks associated with applicants claiming large cash outlays which are at higher risk of being inappropriately portrayed as eligible payments, rather than the small cash payments that many applicants legitimately make for services such as ground transport, airport visas and trade show printing. It would therefore be appropriate that, rather than making all cash payments ineligible, only those over $10 000 per claim should be ineligible. This would rule out the larger, riskier uses of cash, while still allowing applicants to claim legitimate, smaller cash amounts.

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[19] CIE 2005, p. 84
[20] Australian Trade Commission 2005, Appendix E

Secondly, it is proposed that the export performance test be removed from a continued scheme. The test has not been updated in line with other scheme changes and could be considered to have become excessively stringent for the smaller client base now targeted by the scheme and for some emerging industries which take longer to establish sustainable export markets. The test also discriminates against firms whose export earnings occur one or more years after they incur the export marketing expenditure that generates those earnings, or whose export earnings tend to fluctuate markedly from year to year due to factors outside their control—for example, rural exporters affected by drought. Finally, removal of the test would make the scheme less complex and therefore reduce compliance costs.

4.1.4 Compliance costs of a continued EMDG scheme

While participation in the EMDG scheme does give rise to business compliance costs, it should be noted that involvement in the scheme is voluntary, and that the benefits to participating firms strongly outweigh the costs of involvement.

The costs associated with participating in the EMDG scheme include the costs to firms of complying with the rules and regulations of the scheme and, where a firm chooses to do so, the costs of employing grant consultants to prepare the application for the grant.

According to the results of the CIE research, average compliance costs were about $3000 per firm per year. The CIE concluded that, as there are about 3000 firms that receive the grant each year, the total annual compliance cost is approximately $9 million.

Austrade has implemented a series of coaching and planning workshops with potential EMDG applicants to improve understanding of the scheme's rules and how to make best use of the scheme. The objective of these workshops is to assist applicants to lodge timely and accurate applications which lead to quicker and more certain grant payments and to minimise unnecessary compliance costs resulting from a lack of understanding of scheme requirements. The workshops have also improved EMDG services to businesses based in outer metropolitan, regional and rural areas.

Austrade is also developing an EMDG grants application kit on CD, which is scheduled for public distribution in 2006. This CD package will use multi-media techniques to make it easier for potential applicants to understand and apply for grants.

As noted above, removing the export performance test from the scheme would also simplify the scheme and reduce compliance costs.

4.2 Option 2: Allow the EMDG scheme to lapse without replacement

The EMDG scheme could be allowed to lapse after 2006–07, and not be replaced.

This could be justified on the grounds that the reforms initiated by Australian governments over recent decades—including the floating of the exchange rate, financial deregulation, microeconomic and industrial relations reforms, tariff reductions, tax system reform, and initiatives to open up overseas markets, most notably through free trade agreements such as the US/Australia FTA—have provided adequate support for export activity, and that no further interventions are needed.

However, market access initiatives and the EMDG scheme should be regarded as complementary strategies, the former aiming to open up overseas markets to our exporters, the latter aiming to overcome market failures to optimal export activity. Similarly, the EMDG scheme should be regarded as complementary to—rather than overlapping with—other Austrade programs such as TradeStart and the New Exporter Development Program, both of which focus on building firms' interest in export and bringing them to an initial state of export readiness and export activity from which they might then 'graduate' to EMDG.

Should the scheme be discontinued, there would be an immediate benefit equal to the annual budgetary cost of the scheme ($130 million – $150 million per annum in recent years) plus the cost of raising the taxes to fund that cost.

However, the costs of discontinuing the scheme would include potential loss of the economic benefits generated by the scheme, as set out above in 'Option 1. Continue the EMDG scheme'. The greatest adverse impact would be felt by smaller firms, as the CIE research showed that the scheme's highest proportional return, in terms of percentage increases in firms' exports, occurred in the case of smaller EMDG scheme recipients, that is with annual income of $15 million or less (i.e. 90 per cent of the EMDG client base).

4.3 Option 3: Provide tax deductions for export marketing expenditure

The existing scheme could be replaced with tax deductions for eligible expenditure on export promotion. This would allow firms to receive a tax deduction through the normal Australian Taxation Office assessment process.

This approach could have some benefits for SMEs because they would receive export promotion assistance through the self-assessing tax system, and would not have to apply separately for it as at present.

However, a tax-based approach would potentially increase the costs of obtaining the objective:

- Tax concessions can lack transparency as the amount of funding provided can be more difficult to identify in the Budget papers than a direct outlay program.
- Funding is difficult to cap through a tax concession program. A significant time lag can occur between when the concessions are provided and when the total costs of the scheme can be calculated. This can result in under-performing concessions or cost blow-outs.
- Benefits are only available to those businesses that pay tax. Many new exporting SMEs operate at a loss while they establish their markets. A tax-based system, instead of targeting support to small and emerging exporters (as per current government policy), could potentially deliver more assistance to larger, established exporters.

Support for replacing the current EMDG scheme with tax deductions for eligible export promotion expenditure received minimal support during the review consultation process. Of the 394 submissions received, only one advocated replacing the EMDG with a tax-based scheme.

4.4 Option 4: Introduce a discretionary export market development grants scheme

The rules-based EMDG scheme could be replaced with a discretionary grants scheme. Existing and potential exporters would be invited to prepare marketing proposals according to previously determined criteria. Grants would be allocated, not by legislated criteria as per existing EMDG arrangements, but by ministers or officials exercising discretion based on merit principles.

This approach could provide some benefits. Discretionary grants tend to be a flexible way of allocating resources, emphasising the recipients' responsibilities and, in theory, allowing funds to be targeted towards the 'best' candidates.

However, on the cost side, discretionary grants require evaluation and approval processes that are neutral and strict, as well as ongoing monitoring of recipients to ensure obligations are met.

It would also be difficult to ensure that the 'best' candidates are selected, with funding decisions resting with ministers and officials who may lack the expertise to make fully informed assessments. This is especially true of generic schemes, like the EMDG, which target the broader business community, rather than a select few industry sectors. To ensure the selection of the best candidates, scheme administrators would need to possess a sound knowledge of a wide range of industry sectors and practices, and of export market opportunities.

4.5 Option 5: Introduce an exporter loans scheme

The EMDG non-refundable grants scheme could be replaced with an exporter loans scheme.

This option could provide potential savings to revenue over the longer term as repayments are used to fund future loans.

Loans schemes have been used in the past to induce export activity, and have produced benefits. However, on balance, experience suggests that a grants scheme is more effective than a loans scheme in promoting the positive externalities arising from export promotion. This is because loans schemes are less likely to alter a firm's behaviour, particularly for the smaller firms and less experienced exporters now targeted by the EMDG scheme. That is, the private benefit-cost equation for the scheme's target group of firms considering whether to undertake export promotion is unlikely to be greatly altered by a loans scheme.

Support for replacing the current EMDG scheme with an exporter loans scheme received minimal support during the review consultation process. Of the 394 submissions received, only one advocated replacing the EMDG with a loans scheme.

5. CONSULTATION

In setting up the review, Austrade took into account all views submitted, including those of the business sector, industry associations, other government departments and agencies, and Austrade managers and staff. The majority of review input was provided by EMDG clients who have benefited from the scheme. While the invitation to submit submissions to the review was widely advertised, the wider community, which funds the scheme, largely did not provide input.

Public submissions

In announcing the review on 23 June 2004, the Minister for Trade, the Hon Mark Vaile MP, invited the business sector—through public submissions—to 'make their views about EMDG known and to suggest improvements'. This invitation was repeated through public advertisements throughout Australia.

A total of 394 public submissions were received. Of these, 341 were from businesses, 43 from industry associations and 10 from government departments and agencies.[21]

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[21] Australian Trade Commission 2005, chapter 4

The submissions covered a wide range of issues. The most common view was that the EMDG scheme is effective in encouraging export activity and that the scheme should continue. Funding certainty was also a strong concern. As well, many submissions suggested modifications to scheme provisions, especially to the overseas visit allowance, the seven-grant limit and scheme entry thresholds.

Overall, submissions showed:

- strong support for the scheme's continuation—227 submissions (58 per cent) expressed explicit support, and all other submissions (except one) reflected implicit support
- a widespread view that the scheme is underfunded, that the budget cap should be removed or at least indexed, and that the two-tier payment system should be reviewed—191 submissions (48 per cent) expressed this view
- significant support for increasing the $200 per day overseas visit allowance—181 submissions (46 per cent) claimed that the allowance is too low
- a common view that the scheme would better assist exporters to become sustainable if more than seven grants per applicant were available and if the $30 million annual income ceiling was raised—106 submissions (27 per cent) wanted the seven-grant limit raised and 61 submissions (15 per cent) proposed increasing the income ceiling
- a preference for quicker and easier payment of grants
- significant support for some other proposals, such as:
    - reducing the $15 000 minimum expenditure threshold and removing the $15 000 non-reimbursable amount
    - removing section 55 of the EMDG Act, which prevents exporters of intellectual property from claiming expenses related to sales through related companies
    - broadening the range of claimable expenses to include, for example, patent, packaging and labelling costs.

Review facilitator

Mr Peter Jollie AM was appointed by Austrade as an independent review facilitator. Using face-to-face meetings to discuss the EMDG scheme, Mr Jollie gathered the views of industry, government agencies and existing and potential exporters from around Australia. In total, 70 meetings were conducted between July 2004 and February 2005. Meetings were held in all state and territory capitals, as well as the Gold Coast, Cairns and Byron Bay.

Mr Jollie reported that throughout the consultations there was very strong support for the EMDG scheme's continuation, with many participants attesting to its value in assisting individual firms to become new exporters and in growing export markets. While stakeholders were asked whether they would advocate an alternative approach to helping SMEs develop into new exporters and achieve sustainability in export markets, there was almost unanimous support for the retention of the EMDG scheme.

Based on his discussions and feedback from his meetings, Mr Jollie concluded that receiving grants does change exporters' market behaviour and that the scheme should continue.

6. CONCLUSION AND RECOMMENDED OPTION

1) *Continue the EMDG scheme.* The industry views and research evidence gathered during the EMDG review process suggested that the scheme is an effective, well targeted program which advances the government's objectives for small and emerging exporters. It is particularly effective in addressing the cost barriers that deter SMEs from entering into export, and thus complements other government programs (such as TradeStart and Austrade's network of overseas offices) that assist SMEs to overcome attitudinal and information constraints.

2) *Allow the EMDG scheme to lapse without replacement.* This option would be inconsistent with the government's trade policy objective, particularly in terms of providing support and encouragement to small and emerging exporters. Abandoning the scheme without providing an alternative could give a negative signal to Australian industry and undermine ongoing efforts to develop an export culture in Australia.

3) *Provide tax deductions for export promotion expenditure.* Under this option there would be difficulties in capping the amount of available funding and a lack of transparency, and support would only be available to those exporting SMEs already operating at a profit.

4) *Introduce a discretionary export grants scheme.* This option would present difficulties in allocating funding to ensure the 'best' results.

5) *Introduce a loans scheme for eligible exporters.* This option is unlikely to achieve the objective of expanding Australia's exporter base. Loans schemes have been shown to be a less effective means of providing incentives to small and emerging exporters than other forms of assistance.

The qualitative and quantitative evidence gathered during the 2004–05 review of the EMDG scheme indicates that it is effective in increasing the number of SMEs that develop into new exporters, in increasing the number of SMEs that achieve sustainability in export markets, in generating additional exports, and in further developing an export culture in Australia. While the CIE research which attempted to quantify the cost-benefits of the scheme was inconclusive, it would appear that the EMDG scheme is also delivering adequate positive net social benefits.

It is therefore recommended that the Export Market Development Grants scheme continue until the end of 2010–11, and that there be a legislative requirement to review the scheme, with a report provided to the Minister for Trade by 30 June 2010.

7. IMPLEMENTATION AND REVIEW

Legislative amendment to extend the scheme will be required. A sunset clause providing for a five-year extension, with a review before the end of that period, would ensure accountability and give business, industry, governments and the broader community an opportunity to again review the program's performance. A five-year extension would balance the need for certainty with the need for accountability and transparency.

The extension of the scheme would involve the continued administration of the scheme by the Australian Trade Commission. Small and medium businesses would continue to access the scheme by making applications to Austrade using a standard application form, and would continue to be able to request both internal and Administrative Appeals Tribunal reviews of

Austrade decisions. Austrade would continue initiatives to minimise compliance costs, consistent with the government's regulation reform agenda, to improve EMDG services to businesses based in outer metropolitan, regional and rural areas, and to assist applicants to lodge timely and accurate applications which would lead to quicker and more certain grant payments. Austrade would also continue to seek efficiencies that minimise administration costs and provide accountability in the expenditure of public funds.

Regular reporting of the program's activities and outcomes would continue to be included in Austrade's annual report.

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EXPORT MARKET DEVELOPMENT GRANTS LEGISLATION AMENDMENT BILL 2006

ABBREVIATIONS

EMDG Act	*Export Market Development Grants Act 1997*
grant year	The year in which expenses are incurred by a grants applicant
Austrade	Australian Trade Commission
the scheme	The scheme of financial assistance to exporters covered by the *Export Market Development Grants Act 1997*

NOTES ON CLAUSES

<u>Clause 1</u> This Act may be cited as the *Export Market Development Grants Legislation Amendment Act 2006.*

<u>Clause 2</u> With the exception of item 34 of Schedule 1, the Act commences on the day on which it receives Royal Assent. Item 34 corrects an incorrect cross-reference and commences immediately after the commencement of item 19 of Schedule 1 to the *Export Market Development Grants Legislation Amendment Act 1999.*

<u>Clause 3</u> There are two Schedules amending the *Export Market Development Grants Act 1997.*

SCHEDULE 1—Amendment of the *Export Market Development Grants Act 1997*

<u>Item 1</u> This item amends item 1 in Diagram 3 in the Reader's Guide to reflect changes in the Act's eligibility of goods rules—refer to item 10.

<u>Item 2</u> This item removes a defined term from the Act—refer item 6.

<u>Items 3 to 5</u> These items remove defined terms from the Act—refer item 10.

<u>Item 6</u> This item removes all references to defining and measuring the amount of an applicant's export earnings.

<u>Items 7 to 9</u> These items make the Act compliant with the *Legislative Instruments Act 2003.*

<u>Item 10</u> Under the current EMDG Act, goods are eligible if they are manufactured in Australia and have at least 50 per cent local content, or if they are manufactured offshore and at least 75 per cent of their components' value meets the 50 per cent Australian content requirement. Goods that meet neither test may still be eligible if Austrade determines that the Australian input in those goods is sufficient to ensure that Australia will derive a significant net benefit from their export. However:

- there are some practical difficulties in applying the Australian content rules, and

- the current EMDG Act does not provide guidance on how to determine significant net benefit, nor does it provide for ministerial guidelines to assist or guide Austrade's decision-making.

This item replaces the Australian content requirements and instead provides that goods are eligible if they are made in Australia. Rules for defining 'made in Australia' will be set out in ministerial guidelines. The ministerial guidelines are likely to be similar in concept to the certificate of origin criteria used by Australian chambers of commerce. These take into account such matters as whether a product is mined, grown, raised or substantially transformed in Australia.

This item also provides that other goods (those not made in Australia) will be eligible only if Austrade is satisfied, in accordance with ministerial guidelines, that Australia will derive a significant net benefit from their sale outside Australia. The ministerial guidelines may require Austrade to take into account issues such as job creation, location of R&D activities, value added and/or economic benefits to Australia.

This item allows both goods that are made in Australia and goods that are not to be eligible for EMDG purposes (as does the current Act). However, all the other scheme provisions governing eligibility for grants will continue to apply. Therefore, determining that a good is eligible will remain a necessary but not a sufficient condition for a grant to be paid.

The introduction of the two ministerial guidelines ('made in Australia' and 'significant net benefit') will make it easier for applicants to clarify whether their goods are likely to be eligible and will increase the transparency and accountability of Austrade's decision-making about the eligibility of goods.

<u>Items 11 to 12</u> These items remove the defined term 'inbound tour operator' that is no longer required because of the removal of the Act's export earnings rules—refer to item 6.

<u>Item 13</u> Under the current EMDG Act, applicants are entitled to claim up to $250 000 per claim for the combined expenses of two eligible expense categories, namely overseas representation and consultants expenses. The Act enables an applicant to claim up to $250 000 for one or other of these categories or for any combination of the two.

This item provides for the two expense categories to be separately capped with overseas representatives capped at $200 000 per claim and marketing consultants at $50 000 per claim. This measure will reduce the risk of over-claiming in regard to the salary costs of consultants that may be de facto employees.

<u>Items 14 & 15</u> Item 38 refers.

<u>Item 16</u> Under the current EMDG Act, expenses of $200 are claimable for each day of an overseas marketing visit that is spent on furthering the approved promotional

purpose for which the visit was made. This item increases the claimable overseas visit allowance to $300 per day.

Item 17 — Section 35 of the current EMDG Act enables Austrade to determine whether any expenses incurred by an applicant are reasonable. In making this determination, Austrade is required to notify the applicant that certain expenses are not considered to be reasonable and invite the applicant to respond. This power to limit an applicant's claim to reasonable amounts continues to apply but has been merged with the current Act's section 96. This revised section clarifies Austrade's power to disregard expenses that are unreasonable, uncommercial or non-bona fide or those that result from structuring arrangements entered into for the sole or dominant purpose of obtaining an undue increase in EMDG entitlement—refer to item 38.

Item 18 — The current EMDG Act's paragraph 37(1)(c) requires that, to be eligible, goods made outside Australia must be made up wholly or principally from components supplied by the applicant. This item modifies this paragraph so that it is consistent with this amendment bill's changes to the eligibility of goods rules—refer to item 10.

Item 19 — Further to item 10, this item removes defined terms that are no longer required from a note to subsection 37(1) and adds a new note stating that the rules for assessing whether goods are made in Australia are subject to ministerial guidelines.

Item 20 — Under the current EMDG Act, most categories of applicant must be the principal or intended principal in export transactions. This means that they must own the products being promoted for export and be the seller or intended seller of these products to foreign residents, rather than being for example an agent of the seller.

However, some exporters, for legitimate reasons, use business structures that involve one company owning the product and another promoting it within a group of related companies. Under the current Act, these exporters may not be entitled to EMDG support because the entity promoting the product does not own that product and so does not meet the scheme's requirements.

The principal status requirements remain an important element of the scheme and will be retained. However, to allow the requirement to be applied more flexibly, this item will enable Austrade to deem certain applicants eligible when they do not technically meet the current principal status requirements. This will only apply in strictly limited situations—for example, when a company closely related to the applicant owns the product intended for export.

Item 21 — Further to item 20, this item defines the situations where an EMDG applicant company is taken to be related to another entity that owns the products and is the intended seller. The types of entity that will be accepted as being related to an applicant will be: a company that the applicant controls or is controlled by in terms of section 50AA of the *Corporations Act 2001*; a company that has identical shareholding to that of the applicant; or a director of the applicant.

Items 22& 23 — These items remove one of the categories of excluded expenses from the table at section 40 of the Act (refer to item 28) and adds another (refer to item 29).

Item 24 Section 44 of the Act currently provides for expenses to be ineligible if they are incurred for a market declared by the minister to be subject to a trade sanction. This item removes the reference to paragraph 10(3)(b) of the Act from section 44 (as section 10 is to be repealed as part of removing references to measuring export earnings—refer to item 6) and provides that expenses will be ineligible if they are incurred for a country declared by the minister by legislative instrument to be subject to trade sanctions. This change in effect continues the existing provision but condenses it from two sections into one.

Items 25 to 27 Under the current EMDG Act, all commissions, discounts, credits and similar transactions that are based on the level of sales made by an applicant are intended to be ineligible. However, due to the technical wording of the relevant provision, the Act may not have this legal effect in all cases and may only apply if the commissions etc. are paid to a customer of the applicant.

These items clarify the current rules to ensure that all expenses incurred as commissions, discounts and other amounts including salaries, retainers or fees that relate to the level of sales made will be ineligible, irrespective of the person or entity to whom they are paid.

Item 28 Under the current EMDG Act, any expenses incurred by an applicant to increase royalties or licence income streams resulting from the disposal of its intellectual property or know-how to a related overseas company are excluded. This means that applicants cannot receive EMDG support if they export intellectual property or know-how through their foreign subsidiaries, even though some Australian exporters of intellectual property export through subsidiaries for legitimate business reasons.

This item removes this exclusion and enables applicants to claim reasonable expenses related to promoting their intellectual property or know-how through related overseas companies.

Item 29 The current EMDG Act provides that EMDG applicants may claim the eligible export promotional expenses that they have incurred and that have been acquitted. Most payment methods are accepted for this purpose, including cash payments.

This item limits the eligibility of cash payments made by applicants to $10 000 per claim.

For the purposes of this measure, ‘cash payments’ are those where the applicant pays off the expenses by physically transferring currency to the person to whom the expenses are payable.

For example, an applicant that carried cash overseas and paid it as salary to the applicant’s overseas representative would have made a cash payment for the purposes of the Act.

On the other hand, an applicant would not make cash payments if, for example:

- the applicant paid cash into a bank, then had the bank transfer the funds to the overseas representative’s account as a salary payment or

- the applicant paid cash into a bank and had the bank transfer the funds to the overseas representative's account from which the representative then drew cash to pay creditors.

Item 30 This item derives from the change in the wording of Division 3 of Part 8 of the Act—refer to item 38.

Item 31 to 33 These items derive from the removal of the Act's export earnings requirements—refer to item 6.

Item 34 This item corrects an incorrect reference in section 72(3) of the EMDG Act. It should refer to paragraph 73(1)(b) rather than to paragraph 73(b).

Item 35 Under the current EMDG Act, Austrade may grant approval to some special categories of applicant to apply for grants, namely approved bodies, approved joint ventures and approved trading houses. These approvals may be granted for three years and then, at Austrade's discretion, renewed for further three year periods.

This item provides that Austrade may grant special approval status for five years rather than three, both for initial approval and for approval renewals.

Items 36 to 37 These items make the Act compliant with the *Legislative Instruments Act 2003*.

Item 38 This item repeals Divisions 2 and 3 of Part 8 of the Act and substitutes rewritten rules for these.

Division 2:

Some businesses change ownership with the new owner carrying on a similar business to the previous owner's. Under Division 2 of Part 8 of the current EMDG Act, Austrade must attribute any grants paid, expenses incurred and other things done by the former owner to the new owner. This prevents a business from circumventing the Act's seven grant limit. It also means that a new owner buying a business during a grant year is entitled to claim any eligible promotion expenses incurred in that year by the original owner before the change of ownership.

Under the current EMDG Act, decision-making about change of ownership has two steps. First, the continuing business provisions are applied whenever two businesses are to any extent similar as a result of one business selling or transferring an activity or entering into some other arrangement with another business. Second, applicants may apply for exemption from the continuing business provisions on the basis that the two businesses are substantially different.

This item does not change the intent or scope of the Act's change of ownership provision. However, it sets out the rule more clearly and should be easier for applicants to understand and for Austrade to administer.

The amended provision will apply if a person is carrying on a business which is similar to one carried on previously by another person, and the two businesses are similar to such an extent that Austrade is satisfied that the new business should be treated as a continuation of the old. In making this determination, Austrade will take into account the relevant ministerial guidelines.

Division 3:

Under the current EMDG Act, Austrade can disallow expense claims if Austrade believes that the expenses are unreasonable (section 35) or that an applicant has set up business arrangements designed to improperly obtain a grant (section 96).

This item merges these two provisions to clarify Austrade's power to disregard expenses that are unreasonable, uncommercial or non-bona fide or those that result from structuring arrangements entered into for the sole or dominant purpose of obtaining an undue increase in EMDG entitlement.

The amended provision (section 96) provides that Austrade must notify the applicant of its intention to disregard the expenses and take into account the applicant's response. Any decisions made under this provision would be subject to review by the Administrative Appeals Tribunal.

Items 39 to 41 These items make the Act compliant with the *Legislative Instruments Act 2003*.

Item 42 This item provides for ministerial guidelines to be complied with by Austrade in determining whether goods are made in Australia and whether Australia will derive a significant net benefit from the sale outside Australia of goods that are not made in Australia—refer to item 10. The introduction of these two ministerial guidelines will increase the transparency and accountability of Austrade's decision-making for the eligibility of goods.

Item 43 This item provides for ministerial guidelines to be complied with by Austrade in applying the revised section 94 of the Act—refer to item 38. While guidelines for decision-making about changes in business ownership are currently in force, this item updates the Act's reference to those guidelines in line with the changes made by item 38.

Items 44 to 45 These items make the Act compliant with the *Legislative Instruments Act 2003*.

Item 46 The current EMDG Act provides that the costs of administration of the EMDG scheme are to be paid out of the money appropriated by parliament for the scheme and that these costs must not exceed 5 per cent of the appropriation amount for the 'grant year'. This reference to grant year is incorrect as parliament does not appropriate money for the grant year. Rather, it appropriates money on a financial year basis with the financial year being later than the grant year for which EMDG grants are paid.

This item corrects this error by providing that the costs of administration of the EMDG scheme must not exceed in any financial year 5 per cent of the appropriation amount for that year.

Item 47 This item provides for an independent review of the scheme to start no later than 1 January 2010 and to report by 30 June 2010. In conducting the review, submissions from the public must be called for and public hearings may be conducted.

Items 48 to 51 These items remove definitions that are no longer required because of the removal of the Act's export earnings requirements and the bill's modified product eligibility rules—items 6 and 10 respectively refer.

Item 52 Under the current EMDG Act, 2005–06 is the final grant year. This item continues the scheme for five years until the 2010–11 grant year, for which grants would be paid in the 2011–12 financial year.

Items 53 & 54 These items remove definitions that are no longer required because of the removal of the Act's export earnings requirements and the bill's modified product eligibility rules—items 6 and 10 respectively refer.

Item 55 This item provides that most of the provisions of this amendment bill apply to any grant year that commences on or after 1 July 2006. The grant year is the year in which applicants incur expenditure which they may include in a subsequent application for grant. Applications for grants are made after the grant year to which they relate is over. This means that in effect the amendments apply to applications received on or after 1 July 2007.

However, the amendment made by item 35 applies to approvals given on or after the day on which this bill receives Royal Assent.

SCHEDULE 2—Repeal of the *Export Expansion Grants Act 1978*

Part 1—Repeal of the Export Expansion Grants Act 1978

Export Expansion Grants Act 1978

Item 1 The *Export Expansion Grants Act 1978* under which the Export Expansion Grants (EEG) scheme was administered, lapsed on 30 June 1983. There are no matters outstanding under this Act and there is no purpose in retaining it. This item repeals the *Export Expansion Grants Act 1978.*

Part 2—Consequential amendments

Australian Trade Commission Act 1985

Items 2 to 4 These items remove references to the repealed *Export Expansion Grants Act 1978*.