WEEK ON THE DRY SIDE 340

What are EFIC and the Wheat Board up to?

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The Export Finance Insurance Corporation is a statutory authority charged with insuring the probability that purchasers of Australian produce will actually pay up. In theory such insurance could be provided commercially, but no commercial insurer could compete with EFIC so long as its, so-called, 'National Interest Accounts' are supported by taxpayers.

An efficient market-driven system of export insurance should work like this: If a sale is made to a buyer who has only an 80% probability of paying then the cost of insuring that payment actually takes place should be 25% of the export price. Whether the seller insures or carries the risk himself, he would require 125% of the price he would receive for the same produce from a reliable buyer---the card price---in order to sell to that particular unreliable purchaser. Unreliable buyers, on the other hand, must expect to pay more than reliable payers---the probability of payment is factored into the price and the difference between, say, Iraq's price and the price paid by, say, Russian buyers is a measure of the risk of Iraqi default.

In Australia, exporters may go to the EFIC to offload the risk of overseas sales of Australian produced goods. As at 31/12/1988, EFIC was carrying nearly $1.5 billion of risk upon which payment was not in arrears. Over $900 million of this was for rural produce, mostly wheat. Of the total $1.5 billion, $900 million was insured in the, so-called, National Interest Account, wherein the premiums are kept low by government fiat. Of this $900 million, $860 million---i.e. nearly all of it---is rural produce---again mostly wheat.

It is probably no fault of the management and staff, but EFIC's commercial instincts are not sharp. In the case of Iraq, EFIC's premiums did not rise with the onset of war, nor when Iraq moved from one-year to two-year terms. In the end Cabinet, itself, added a surcharge.

In addition, since 30/6/1977 EFIC has paid out nearly $340 million to insured sellers, mostly to the Wheat Board.

The money has not subsequently recovered from defaulting buyers. Nearly all of this money is owed by only two countries. $285 million is owed by Egypt for wheat and nearly all of the remainder by Iraq for wool, hides and skins.

Total premium income received by the National Interest Account since its inception is only $79 million. Obviously there has been a mighty hidden subsidy which, if taken properly to account, explains and discredits the Wheat Board's claim that it has got 'top-dollar' for the Australian harvest. The Board has been selling to high-risk markets for the prices which are more or less appropriate in those markets and, since EFIC's debts are ultimately the taxpayers' debts, leaving the taxpayer to cover the risk. What is more, this has been hidden from the public gaze. Are these shades of WA Inc?

Since commercial soundness is very much a matter of judgement about which reasonable people may disagree, insuring the risks associated with commercial unsoundness is the last activity to place in the hands of a government monopoly. This is particularly the case when the insured risks are largely incurred by other government monopolies. Only the higgling of the market can establish the appropriate risk premiums. Only the likelihood of incurring losses which must carried by the insurers themselves will encourage them to charge appropriately high premiums. Only the appropriate premiums will send the signals to sellers which will cause them, in spite of self-interested intentions, to maximise the national interest.

Other grain sellers might wonder why the Australian Wheat Board undersells them in high risk markets to which the Board is highly addicted. The reason is simple: in these markets and only in these markets, wheat is effectively subsidised by taxpayers.

Now, I believe that, when the Coalition was discussing organisations which might be privatised, some Liberals regarded EFIC as an obvious candidate, but some Nats bitterly opposed the idea. Fancy that!

It is true that, having once created the monster, it is not easy to get out of EFIC's clutches. If cheap export cover were denied the Wheat Board now, then the Board might, in the interests of growers, cease to supply the Egyptian and Iraqi wheat markets. Then, those two countries would have little to lose by defaulting---the loss ~~will~~ would be inflicted upon EFIC and the taxpayers. It is hard to cover your rear in retreat! But retreat we must: since February, EFIC's exposure to Iraq has increased by a further $200 million. I think the following mode of retreat would be moderately safe.

The National Interest Account could be taken over by Treasury and the remainder of EFIC privatised. That would subject most new export-insurance business to market discipline.

The Treasury could publish accounts for the National Interest Account which contain appropriate provisions for bad debts and any shortfalls should be met from appropriations made by the Parliament for that purpose. That would make the hidden subsidies explicit by way of processes which are appropriate to Westminster government.

The Wheat Board is plainly not always using its monopoly in the national interest and I ~~can~~ know of no evidence that it is less inefficient than any other monopoly. It has just lost its monopoly of the domestic market. It should also be allowed to face competition from other grain traders in the export market. That would maximise the opportunities for sale to many markets and provide the insurance that the presence of many buyers offers sellers.

Finally, a word about the terminology which governments tend to adopt. Just as the German Democratic Republic is not democratic and the People's Republic of China not a republic, so, in Australia, something called a National Interest Account is unlikely to be in the national interest. The title gives it away: it serves private interests (mostly wheat growers) at national expense.

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