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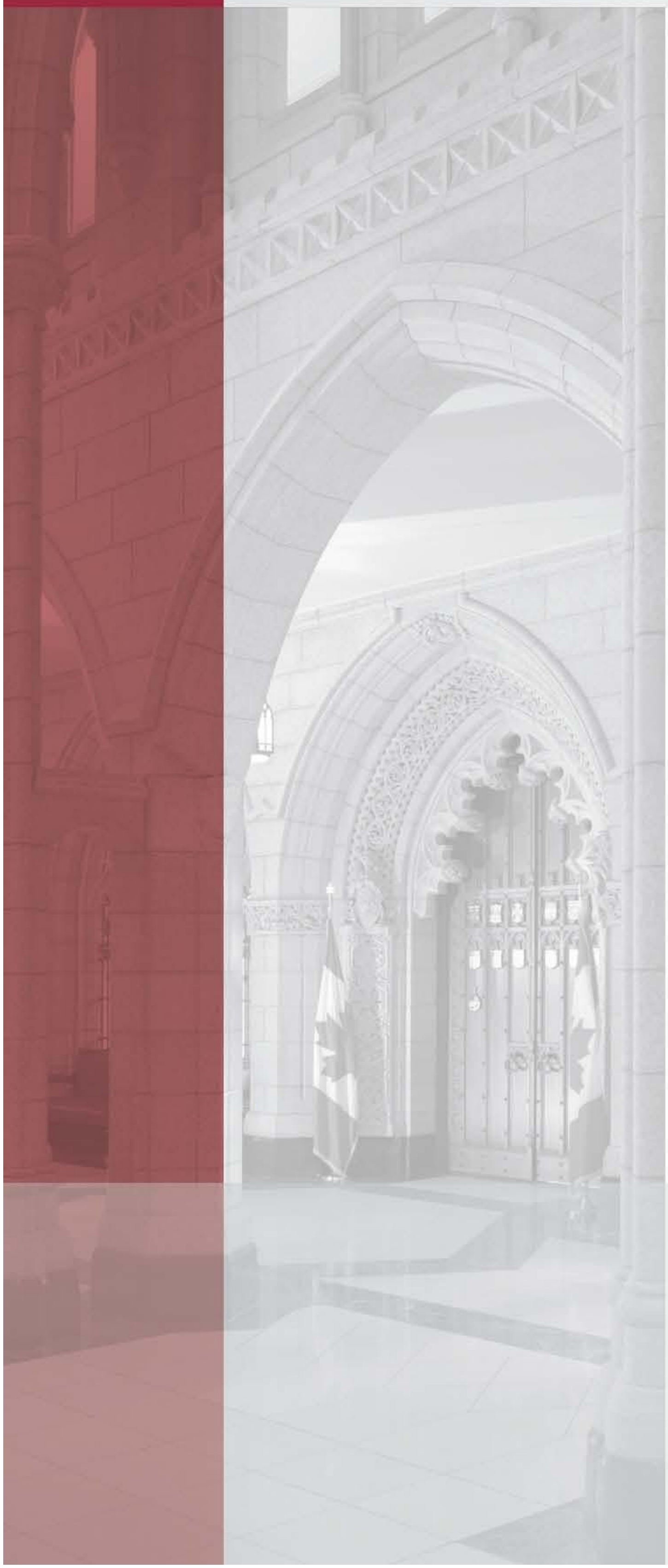

# Study on the 2008 Legislative Review of Export Development Canada

The Honourable Consiglio Di Nino
*Chair*

The Honourable Peter Stollery
*Deputy Chair*

**Standing Senate Committee on Foreign Affairs and International Trade**

June 2009

Ce rapport est aussi disponible en français.
Des renseignements sur le comité sont donnés sur le site :
www.senate-senat.ca/foraffetrang.asp.

Information regarding the committee can be obtained through its web site:
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# THE COMMITTEE

## The following Senators have participated in the study:

The Honourable Consiglio Di Nino, Chair of the committee
The Honourable Peter Stollery, Deputy Chair of the committee

and

The Honourable Senators:

Raynell Andreychuk;
Eymard G. Corbin;
Dennis Dawson;
Pierre De Bané, P.C.;
Percy Downe;
Suzanne Fortin-Duplessis;
Jerahmiel S. Grafstein;
Frank Mahovlich;
Hugh Segal; and
Pamela Wallin.

## Ex-officio members of the committee:

The Honourable Senators Marjory LeBreton, P.C. (or Gérald Comeau) and James Cowan (or Claudette Tardif).

## Other Senators who have participated from time to time in the study:

The Honourable Senators Kinsella, Massicotte, Peterson, Prud’homme, P.C., Stratton and Zimmer.

## Staff of the committee:

Natalie Mychajlyszyn, Analyst, Parliamentary Information and Research Service, Library of Parliament;
Jennifer Paul, Analyst, Parliamentary Information and Research Service, Library of Parliament;
Karen Schwinghamer, Senior Communications Officer;
Debbie Murphy, Communications Coordinator;
Sylvie Simard, Administrative Assistant; and
Denis Robert, Clerk of the committee.

# ORDER OF REFERENCE

Extract from the *Journals of the Senate*, Tuesday, February 24, 2009:

"The Honourable Senator Comeau moved, seconded by the Honourable Senator Di Nino:

That the Standing Senate Committee on Foreign Affairs and International Trade be empowered to review and report on the 2008 Legislative Review of Export Development Canada, tabled in the Senate on Tuesday, February 10, 2009.

The question being put on the motion, it was adopted."

Paul C. Bélisle
*Clerk of the Senate*

# SUMMARY OF RECOMMENDATIONS:

**Recommendation 1**

The committee recommends that the Government of Canada continue the mandate of Export Development Canada (EDC), which includes the promotion of Canadian businesses abroad by providing services at all stages of the business cycle, and make adjustments as appropriate.

**Recommendation 2**

The committee recommends that international offices of EDC be located where they would be the most effective for Canadian companies, including separately from Canadian diplomatic missions.

**Recommendation 3**

The committee recommends that EDC maximize the cultural, human and social abilities of Canada's diaspora communities including when staffing its offices, particularly those outside of Canada, in order to exploit opportunities for Canadian business.

**Recommendation 4**

The committee recommends that EDC expand its role in the short-term export credit insurance market as demand warrants.

**Recommendation 5**

The committee recommends that the Government of Canada create a broker advisory panel whose mandate would be to ensure that the activities of EDC are carried out for the benefit of a competitive business environment.

**Recommendation 6**

The committee recommends that EDC make publicly available information that is, to the extent possible, consistent with the information that its private-sector competitors are required to provide to the Office of the Superintendent of Financial Institutions (OSFI).

**Recommendation 7**

The committee recommends that the Government of Canada evaluate, and report to Parliament on, the continued need for EDC's presence in the domestic credit market and that, as provided by legislation, Parliament be given ample time to study the issue.

**Recommendation 8**

The committee recommends that the Government of Canada establish greater coordination between EDC and Investment Cooperation (formerly Industrial Cooperation Program) in order to enhance trade using existing tools and resources.

**Recommendation 9**

The committee recommends that section 25 of the *Export Development Act* be amended by specifying that responsibility for the ten-year legislative review be undertaken by each Chamber of Parliament.

# THE TEN-YEAR LEGISLATIVE REVIEW OF EXPORT DEVELOPMENT CANADA: WHERE WE ARE AND WHERE WE NEED TO BE

## INTRODUCTION

Export Development Canada (EDC) is a federal Crown corporation mandated under the *Export Development Act* to "support and develop, directly and indirectly, Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities."[1] In particular, it offers short-, medium- and long-term credit insurance; it also provides financial services, bonding and guarantees, political risk insurance, direct loans to buyers and lines of credit in other countries to encourage buyers to purchase Canadian products.

This study by the Standing Senate Committee on Foreign Affairs and International Trade is part of the legislatively mandated ten-year review of the *Export Development Act*.[2] The objective of the review is to assess how EDC is evolving, and should continue to evolve, to address the competitive demands of international trade on behalf of its stakeholders, and to make recommendations where appropriate.

In compliance with its legislative obligations, the committee examined the report commissioned by the Department of Foreign Affairs and International Trade and carried out by International Financial Consulting Inc. (IFC), entitled *The Legislative Review of Export Development Canada* which was released in December 2008 and tabled in the Senate on February 10, 2009. In carrying out the study, the committee held six meetings in March 2009 and heard from twelve witnesses. We also received several written submissions.

Canada continues to depend on trade and, without a doubt, EDC plays a valuable role in promoting Canadian trade and international commercial interests. Its value cannot be overstated in light of the significance of trade for Canada's economy. With exports of goods and services representing 34.5 per cent of gross domestic product (GDP) in 2008, trade plays a vital role in the Canadian economy. Merchandise exports amounted to $484 billion in 2008, an increase of $33 billion from the previous year. Furthermore, service exports amounted to $67 billion in 2006 (the most recent data available), a slight increase from the previous year.[3]

The committee undertook this study under exceptional circumstances. The economic downturn was taking hold and, as part of its response, the Government of Canada introduced its 2009 Budget that announced a temporary expansion in EDC's mandate. Moreover, following the conclusion of the committee's consultations, in May 2009, the Minister of Finance increased

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[1] *Export Development Act* (R.S., 1985, c. E-20), available at http://laws.justice.gc.ca/en/E-20/index.html.
[2] The *Export Development Act* required an initial review of the legislation five years after adoption, followed by a ten-year review. The first review was carried out in 1998 by Gowling, Strathy and Henderson, and the Act was subsequently studied by the Standing Senate Committee on Banking, Trade and Commerce. The committee's report was tabled March 2000 and a federal response was released in June 2000.
[3] Data are from Statistics Canada and the OECD Economic Outlook.

EDC's long- and short-term borrowing limits from $7 billion to $9 billion and from $6 billion to $8 billion, respectively, in order to meet the increased demands for its services. As a result, developments directly affecting EDC were unfolding in real time during the course of our consultations, a situation that has affected the pertinence of this report. At the appropriate time, we intend to study more comprehensively EDC's expanded mandate.

In this context, the report summarizes the testimony that was presented to the committee and provides our comments on EDC's current and newly assigned operations. It also offers recommendations that we believe will improve EDC's operations and the future competitiveness of Canada's exporters.

# THE CHANGING GLOBAL ENVIRONMENT AND EDC'S VALUE IN IT

## A. What the Witnesses Said

Any effort to ascertain the value and appropriateness of EDC's mandate must begin with an assessment of the context in which it and Canadian businesses operate. In this respect, the committee notes the tremendous changes in the global environment and the structure of world trade that have occurred since the last review of EDC. Several witnesses alluded to these changes, which can be categorised according to how firms interact with each other, the emergence of new markets in the global economy and the worldwide economic slowdown.

There was general consensus among the committee's witnesses that the nature of international business now reflects less national-based processes and more global supply chains or integrative trade.[4] Canadian Manufacturers & Exporters emphasised that, to be successful, Canadian businesses have to operate in a manner that reflects a global supply chain that sources parts and inputs from different parts of the world: "It is not just really making a product; it is delivering value to your clients through a tangible good."[5]

In its testimony to the committee, the Automotive Parts Manufacturers' Association described the integrated manufacturing process for the auto sector: "[I]t is not unusual for a part to cross those borders six or seven times before a vehicle arrives at the dealer lot from which it is sold."[6]

Furthermore, according to IFC, the intellectual property and design of a product are becoming increasingly important aspects of international trade: "[I]t is no longer a case of 'made in' or even 'made by' but rather it is 'conceived by' or 'designed by.' In other words, the intellectual property of companies and the value creation is about the designing."[7]

Moreover, the emergence of new markets in the global economy, including Brazil, China, India and Russia, has generated new opportunities and challenges for export-oriented Canadian businesses. According to Dessau Inc, Canadian companies need to be more aggressive and creative in order to meet the challenge of a more competitive playing field.

> International competition has heated up considerably and the massive entry of China, India and Brazil into developing countries has altered the landscape. They are taking very impressive steps to set up for the long term in African, Asian and Latin American markets. They are seriously threatening Canadian presence in these markets. We need to get off the beaten path, do more and better,

[4] *Evidence*, 40th Parliament, 2nd Session, Issue no. 4, pp. 5-6.
[5] *Evidence*, 40th Parliament, 2nd Session, Issue no. 4, p. 21.
[6] *Evidence*, 40th Parliament, 2nd Session, Issue no. 4, p. 29.
[7] *Evidence*, 40th Parliament, 2nd Session, Issue no. 2, p. 10.

> otherwise as Canadians, we will be out of these very important markets.[8]

The global economic slowdown has also affected the environment in which EDC and Canadian businesses operate. The committee is concerned about the impact on Canadian businesses of the dramatic economic slowdown in the United States, Canada's primary trading partner, and the reduced availability of credit, a vital element for any business. As the committee heard from the Canadian Bankers Association, "[T]here is no doubt that there is a credit problem. We have had large sections of what have formerly been active lenders either shrunk down, not growing as much or completely pulled out, so there is a need for more credit."[9]

The impact of reduced financing for Canadian businesses and for the economy is potentially devastating, particularly as exports account for over one-fifth of Canada's gross national product (GNP) and manufacturers are responsible for two-thirds of Canada's exports.[10] A significant number of witnesses reinforced this view, including the Forest Products Association of Canada:

> [C]redit is a necessary precondition for business working. Credit is like oxygen. You can be competitive, brilliant, have great markets and good profit margins. If you cannot get credit, if you cannot renew credit, if your suppliers cannot get credit, if your customers cannot get credit, business does not happen. … This is absolutely vital.[11]

Some Canadian businesses access EDC's resources and expertise as they seek to operate in the challenging and changing economic environment. EDC's ability to respond to a changing environment is due, in part, to an expansion in its overseas representation, particularly in emerging economies such as China, India and Russia. Indeed, the relative importance of emerging economies as trading partners for all Organization for Economic Co-operation and Development (OECD) countries is increasing. As a result, international representation is a necessary component of competitiveness for Canadian businesses. Such a presence is imperative as export credit agencies of other countries have a strong presence in foreign countries and promote their national business interests, at times resulting in a competitive disadvantage for Canadian exporters.

These export credit agencies, and their foreign offices, are proliferating overseas, as stated in IFC's presentation to the committee.[12] Dessau Inc. also supported the value of EDC's international presence:

> Opening EDC offices abroad is a step in this direction, and hopefully there will be many more. Competition among export support agencies has become very fierce. Furthermore, we should

[8] *Evidence*, 40th Parliament, 2nd Session, Issue no. 4, p. 45.
[9] *Evidence*, 40th Parliament, 2nd Session, Issue no. 3, p. 79.
[10] *Evidence*, 40th Parliament, 2nd Session, Issue no. 4, p. 19.
[11] *Evidence*, 40th Parliament, 2nd Session, Issue no. 3, p. 63.
[12] *Evidence*, 40th Parliament, 2nd Session, Issue no. 2, p. 23.

> not hesitate to copy our competitors when they do something good.[13]

A similar point was made by the Conference Board of Canada: "We have to become much more aggressive, knowing that countries like China or India will be the dominant growth markets for the world economy for the next ten years. Certainly, the EDC has signalled their understanding of that. They are opening offices in these markets and trying to build more capacity."[14]

The Automotive Parts Manufacturers' Association concurred with this positive assessment of EDC's international presence:

> We need EDC to ensure we keep a level playing field with our competitors. In the last three years, the [Automotive Parts Manufacturers' Association] has led trade missions to Russia, India, China, Hungary, Slovakia, the Czech Republic and Japan and, over the last ten years, we have led trade missions to almost every country in the world that is a significant producer of vehicles and parts for them. EDC has generally participated in those trade missions and we need them to continue to participate. ... They publish [country analysis] information, and it is available to other Canadian companies, especially to the small and medium enterprises ... that do not have the ability to gather this information on their own.[15]

## B. What the Committee Recommends

The committee believes that the changing global business environment, in the context of both the current economic crisis and ongoing transformations, underline the need for continued flexibility in EDC's services in order to enhance the competitiveness and global presence of Canadian companies, particularly exporters. We were encouraged to hear that EDC recognises the changes in the global environment and is responsive to the evolving needs of Canadian businesses.

## Recommendation 1

> **The committee recommends that the Government of Canada continue the mandate of Export Development Canada (EDC), which includes the promotion of Canadian businesses abroad by providing services at all stages of the business cycle, and make adjustments as appropriate.**

[13] *Evidence*, 40th Parliament, 2nd Session, Issue no. 4, p. 45.
[14] *Evidence*, 40th Parliament, 2nd Session, Issue no. 4, p. 17.
[15] *Evidence*, 40th Parliament, 2nd Session, Issue no. 4, p. 30.

The committee recalls the comments made by the Minister of International Trade about the advantages of the co-location of EDC offices with Canada's diplomatic missions and the establishment of separate offices if deemed appropriate. We are also cognizant of the IFC report's comment about EDC's lack of authorization to establish overseas offices independent of the Department of Foreign Affairs and International Trade, unlike other federal Crown corporations such as the Canadian Commercial Corporation.[16] While the committee appreciates that co-location of EDC and diplomatic offices may be advantageous in some cases, we believe that this situation should be examined on a case-by-case basis.

## Recommendation 2

> **The committee recommends that international offices of EDC be located where they would be the most effective for Canadian companies, including separately from Canadian diplomatic missions.**

At the same time, the committee believes that EDC can do more to maximize the potential found in Canada's diaspora communities in order to facilitate and achieve successful international business relationships. We appreciate that EDC's first priority when staffing an office abroad should be the objective business skills and knowledge of an individual. However, we note that many of EDC's international offices are located in the home countries of Canada's diaspora communities. Individuals from these communities have vital business contacts and cultural insights and could add significant value to EDC's operations. Such individuals offer their human and social capital in addition to their knowledge of the local business culture, which can benefit Canadian businesses.[17]

## Recommendation 3

> **The committee recommends that EDC maximize the cultural, human and social abilities of Canada's diaspora communities including when staffing its offices, particularly those outside of Canada, in order to exploit opportunities for Canadian business.**

[16] Specifically, section 17 of the *Export Development Act* restricts EDC's independent authority to establish offices to anywhere in Canada. International Financial Consulting Ltd., *The Legislative Review of Export Development Canada*, December 2008, pp. 77-78.
[17] *Evidence*, 40th Parliament, 2nd Session, Issue no. 3, pp. 42-44.

# EDC AND THE PRIVATE SECTOR: COMPETING TO MEET THE NEEDS OF CANADIAN EXPORTERS?

## A. What the Witnesses Said

During the course of the study, the committee was told that EDC has an unfair competitive advantage over the private sector in a number of areas. For example, EDC's presence in the short-term (ST) export credit insurance market exceeds simply filling gaps in the market; EDC's backing by the Crown gives it an unfair advantage in raising capital; and EDC is not subject to the same financial reporting requirements as its competitors.

### 1. The Short-Term Credit Insurance Market and Other Services

Among EDC's many services, short-term export credit insurance covers political and commercial risks for non-payment of exports, and applies to goods and services sold up to two years' credit. In its report, the IFC estimated that more than 90 per cent of world exports are sold for cash or on credit of up to 180 days.[18]

According to witnesses, short-term export credit insurance is one service area where EDC is in direct competition with the private sector, particularly in the very short-term period of up to 180 days. Euler Hermes, Atradius and Coface are the three largest private-sector providers of short-term export credit insurance, with an estimated combined share of 85 per cent of the global market.[19] However, these three private-sector insurers make up less than 25 per cent of the Canadian market. Although the market share of these companies is increasing in Canada, while that of EDC is falling, EDC continues to dominate the Canadian market for short-term export credit insurance.

Both Euler Hermes and Atradius argued that EDC should withdraw from the short-term export credit insurance market. As indicated by Euler Hermes:

> I reiterate our concern and opposition to IFC's main recommendation that EDC's mandate remain unchanged. The facts presented to IFC by Euler Hermes Canada and other competitors reflect the reality of fundamental changes in the global economic environment over the last decade and call out for EDC to withdraw from the short-term credit insurance market.[20]

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[18] International Financial Consulting Ltd., (December 2008), p. 23.

[19] These companies have such advantages as credit information on buyers worldwide as well as significant income from premiums paid worldwide. This income in 2007 is reported as follows: Euler Hermes US$2.7 billion, Atradius US$2.6 billion and Coface US$1.6 billion. Comparatively, EDC's income from premiums paid was C$0.98 billion in that year.

[20] *Evidence*, 40th Parliament, 2nd Session, Issue no. 3, p. 53.

A similar point was made by Atradius:

> We strongly recommend to you that EDC withdraw from the role of primary insurer and shift to a role of re-insurer in the short-term export credit insurance.[21]

EDC provided the committee with a different perspective, and argued that, in its provision of short-term insurance and other financing services, it takes on a higher level of risk compared to its private-sector competitors and, therefore, provides more needed services to Canadian businesses wishing to expand. It is able to do so by setting aside capital with a specific allocation towards relatively higher-risk, lower-grade investments. Furthermore, EDC is able to remain in the market longer than a private-sector insurer, thereby holding a credit limit open for an extended period of time. According to IFC, "EDC, apart from being owned by government, is Canada first; it makes a decision to support a buyer perhaps longer than the private sector."[22]

Moreover, the presence of EDC in the market is particularly important during economic downturns. Several of the witnesses said that, as the financial crisis worsened, both credit and insurance became relatively more expensive and private-sector insurers largely vacated the market. Thus, as market gaps become apparent and grow larger, Canadian exporters rely on the services provided by EDC.

According to the Forest Products Association of Canada:

> Our companies are reporting to us that in the area of receivables and insurance the private insurers have completely vacated the market for those markets to which we export, which would be, for example, U.S. newspapers and U.S. housing. […] EDC has stepped in behind the private insurers in a major and significant way, which has allowed our companies to keep receiving that sort of insurance. That is one example.[23]

The Automotive Parts Manufacturers' Association agreed:

> The regular financial institutions have almost abandoned the automotive industry as a place to do business. Certainly, these institutions are not doing any new business. They may have retained existing business, but there is no new business to be had. EDC was the only significant institution with the appetite for a little more risk, and it was able to step in and give financing where other financial institutions did not.[24]

[21] *Evidence*, 40th Parliament, 2nd Session, Issue no. 2, p. 47.
[22] *Evidence*, 40th Parliament, 2nd Session, Issue no. 2, p. 21.
[23] *Evidence*, 40th Parliament, 2nd Session, Issue no. 3, p. 65.
[24] *Evidence*, 40th Parliament, 2nd Session, Issue no. 4, p. 31.

The private-sector insurers confirmed these concerns in explaining that they are relatively more risk averse. Specifically, Atradius testified:

> Like all industries, adjustment will occur in our sector as well, but, as much as possible, we must adhere to the principle that markets should decide on acceptable risks, not government. Does this mean somewhat more difficult credit? You bet. We will not be driven to taking unsound risks.[25]

Competition in short-term export credit insurance markets, as well as in markets for other services provided by EDC, is not explicitly regulated. Rather, EDC operates in a free market. At the same time, OECD member countries have agreed to a 'gentleman's arrangement' for Officially Supported Export Credits, which aims to ensure that export credits are not being used as subsidies. Furthermore, Canada can be challenged under the World Trade Organization (WTO) agreements if seen to be providing a subsidy through export credits. While the IFC report found that EDC's services are generally more costly than private-sector competitors, it also noted that EDC is competitive because it is generally able to provide more coverage to its clients, and because of its ability to tolerate more risk.

## 2. The Ability to Raise Capital

EDC is able to raise capital with more ease than its private-sector competitors in part due to its higher credit rating. Standard & Poor's AAA rating of EDC reflects the fact that EDC is 100 per cent government-owned; the provision of debt constitutes a direct obligation of the federal government and is a charge on, and payable out of, the federal government's Consolidated Revenue Fund. However, debt is generally financed by EDC's own resources, and EDC has been "financially profitable for every year except one."[26] Moreover, in its testimony, the Department of Finance stated, "although EDC had advantages in terms of its cost of funds, there was no evidence that EDC was passing along lower pricing on its loans or anything that would be seen as unfair competition." Although EDC's relatively higher credit rating makes it easier to raise capital, the cost savings are not passed on to the client. As a result, EDC's rating does not put it at an unfair advantage over its private-sector competitors.

As discussed above, EDC is financially self-sustaining and operates in accordance with corporate principles. Therefore, it is important to consider the financial implications of EDC withdrawing from the short-term export credit insurance market completely, or becoming simply the lender of last resort and a re-insurer. Without EDC in this market, fewer high-risk clients would likely be served by private insurers, which have less risk tolerance. Moreover, if EDC ended its participation in the short-term export credit insurance market, the relatively lower revenues that would result might limit the services it provides. Ultimately, the Canadian export community would be underserved.

[25] *Evidence*, 40th Parliament, 2nd Session, Issue no. 2, p. 46.
[26] *Evidence*, 40th Parliament, 2nd Session, Issue no. 3, p. 18.

## 3. Reporting, Accountability and Administrative Costs

The lack of transparency in respect of EDC's operations is also considered to provide a competitive advantage. The IFC report concluded that EDC should be required to be more transparent and accountable in the areas of short-term export credit insurance, and should provide public information consistent with what its private-sector counterparts are required to publish.

Part of these concerns relate to EDC not being subject to the financial reporting requirements of the Office of the Superintendent of Financial Institutions (OSFI). OSFI regulates and supervises federal financial institutions and federally regulated private pension plans, creating a framework that manages risk, contributes to public confidence and helps to ensure that these institutions and plans remain in sound financial condition. Accordingly, private-sector insurers provide detailed financial information to the OSFI, some of which is available publicly while other remains confidential. However, as confirmed by the Department of Finance, a federal Crown corporation cannot be regulated by the OSFI. Rather, operating at arms-length from the federal government, EDC is governed by the *Financial Administration Act* (FAA) and is audited by the Auditor General of Canada.

Currently, EDC does not publish comparable financial details regarding short-term export credit insurance; similar data are grouped together in the annual reports. Concerns in this regard were raised by both IFC[27] and EDC's private-sector competitors. For example, Atradius stated:

> EDC does not provide adequate financial information to its shareholders, nor does it need to comply with OSFI regulations. This is wrong. For example, up until the release of the report, it was impossible to get information on the short-term credit insurance business line, despite the fact that it is used by over 80 per cent of their customers and represents over 65 per cent of its business volume. I do not know whether EDC's accounts substantiate the consultant's conclusions, but neither do you.[28]

In its testimony, the IFC stated that a change to these reporting requirements was the primary recommendation resulting from the legislative review of EDC.[29] It informed the committee, "There is no reason to believe that EDC is doing anything wrong, but transparency goes a long way to build confidence in the market."[30]

However, these concerns must be balanced with the demands created by additional reporting and EDC's ability to remain competitive internationally. Some witnesses were concerned that if EDC publicly provides information at the transaction level, it may inadvertently assist the domestic private-sector competition, as well as export credit agencies (ECA) of other countries, thereby

[27] International Financial Consulting Ltd., (December 2008), p. 33.
[28] *Evidence*, 40th Parliament, 2nd Session, Issue no. 2, p. 46.
[29] *Evidence*, 40th Parliament, 2nd Session, Issue no. 2, p. 22.
[30] *Evidence*, 40th Parliament, 2nd Session, Issue no. 2, p. 22.

undercutting Canadian exporters. A delicate balance exists between accountability and transparency on one side, and the ability to remain competitive on the other side. This balance was addressed in the 2000 legislative review, which resulted in transparency requirements for many of EDC's practices. According to the Conference Board of Canada:

> EDC performs a different purpose. It is there as the Government of Canada to ensure that there is enough capacity in terms of insurance and financing for our exporters. It is a different beast, 100 per cent in the public sector, with oversight almost daily by the Department of Finance, Treasury Board and Foreign Affairs and International Trade Canada. ... Theoretically, it is an interesting notion but I do not think there is any more oversight required than what EDC already has from the Government of Canada. I hope that it can be as streamlined as much as possible to allow management to focus on its core job to provide service to Canadian exporters and investors.[31]

EDC issues public reports that indicate the benefits accruing to Canadian businesses through the services it provides, such as the number of jobs created, the number and size of companies served, and some estimates of the percentage of GDP arising from its support of Canadian exporters. Through EDC's environmental disclosure policy, the details of lending and equity transactions as well as the number of transactions that have not been approved are published on its website. EDC must first attain the approval of the commercial parties involved in the transactions, but it has never had a problem receiving this authority. In addition to the audits performed by the Auditor General, the Ministers of Foreign Affairs and International Trade, in conjunction with the Minister of Finance, provide oversight and ensure that EDC is fulfilling its mandate. EDC regularly meets with its shareholders, as well as with other federal departments, Crown corporations and financial institutions.

EDC's administrative costs include both the direct costs of the services it provides and the appropriate share of overhead. When administrative expenses are calculated as a percentage of premium income, the ratio ranges from 40 per cent to 60 per cent between 2000 and 2006. The administrative expenses have continued to increase gradually over the period, while premium revenues have varied a great deal. Euler Hermes, a private-sector insurer, stated that EDC's cost ratio seemed too high; Euler Hermes' cost ratio is approximately 30 per cent, which it also considers to be high, thereby making profitability relatively more difficult. Atradius indicated that its cost ratio is higher than usual, which it attributed to the current financial situation. It should be noted, however, that – in the case of EDC – this analysis does not take into account the investment income which may, for example, be used to offset cash deficits in certain years.

EDC responded to these concerns and explained that 80 per cent of its revenues are derived from its lending program, such that EDC relies on insurance premiums for approximately 20 per cent of its revenues, earned through receivables insurance, bonds, foreign investment insurance, etc.[32] Furthermore, EDC's revenues are affected by the exchange rate between the US and Canadian

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[31] *Evidence*, 40th Parliament, 2nd Session, Issue no. 4, p. 14.
[32] *Evidence*, 40th Parliament, 2nd Session, Issue no. 3, pp. 29-30.

dollars, since most of its business is transacted in American dollars. Beginning in mid-2002, the Canadian dollar began to rise relative to the US dollar, which has negatively affected the value of EDC's revenues as they were stated in Canadian dollars. Administrative expenses are valued in Canadian dollars, leading to the expected result of a higher expense ratio. EDC informed the committee that "when you put all those administrative expenses into perspective, they run about 25 per cent on average of our operating income." Operating income combines the revenues from premiums and the net interest revenue, and a 25 per cent expense ratio was said to be lower than the average expense ratio incurred by a non-retail bank (35 per cent). Furthermore, EDC informed us that "[t]he actual increase in administrative expenses over the period is a direct result of the growth of the program, the related investment in technology and our increased market representation."[33] It should be noted that the total premiums collected under EDC's program were generally sufficient to cover its related claims costs as well as the administrative costs.

## B. What the Committee Recommends

### 1. Addressing Concerns about Predatory Competition

The committee acknowledges the competitiveness concerns presented by witnesses and recalls those concerns included in the IFC report, which indicated that, without doubt, EDC operates outside any "market gap" in respect of short-term export credit insurance and actively competes with private insurers in the short-term export credit business. These concerns do not suggest that EDC is operating in a manner inconsistent with its mandate or with government policy or improperly. Indeed, we note that the IFC report does *not* recommend that EDC change its activities or mandate in the short-term export credit insurance market.

After hearing the testimony of a number of witnesses, and following significant consideration, the committee agrees that EDC should remain in the short-term export credit insurance market. This market is growing in Canada, while the market share held by EDC is shrinking. Moreover, the presence of EDC alongside its private-sector competitors creates more competition among service providers, thereby enabling a greater degree of choice for Canadian businesses wishing to access these services. This trend is positive and, in our view, EDC is not "crowding out" the private sector.

## Recommendation 4

> **The committee recommends that EDC expand its role in the short-term export credit insurance market as demand warrants.**

The committee notes the recommendation in the IFC report that the Department of Foreign Affairs and International Trade establish a broker advisory panel to review and report on any alleged examples of predatory competition from EDC, as well as to provide EDC's Board of Directors and the Minister of International Trade with market intelligence. As envisioned by the IFC report, this panel – which would report annually – would examine individual complaints

[33] Letter to the Standing Senate Committee on Foreign Affairs and International Trade, 27 March 2009.

from private-sector insurers. We are mindful of the interests and incentives faced by the members of this panel, particularly with respect to whose interests the panel would serve.

## Recommendation 5

> **The committee recommends that the Government of Canada establish a broker advisory panel whose mandate would be to ensure that the activities of EDC are carried out for the benefit of a competitive business environment.**

### 2. Consistency in Reporting and Other Administrative Concerns

The committee believes that EDC should work to improve its transparency. In our view, greater transparency builds consumer confidence and enhances fairness among competitors. Specifically, EDC should take measures to improve public reporting of its financial transactions in the short-term credit insurance market. At the same time, the committee recognizes that EDC performs a purpose that is different from the financial institutions supervised by OSFI and, therefore, should neither be supervised nor regulated by it.

## Recommendation 6

> **The committee recommends that EDC make publicly available information that is, to the extent possible, consistent with the information that its private-sector competitors are required to provide to the Office of the Superintendent of Financial Institutions (OSFI).**

# ENHANCING THE ROLE THAT EDC CAN PLAY

## A. Recent Budget Measures

As part of its response to the current economic conditions and in order to meet the short-term financing needs of Canadian businesses, the Government of Canada has implemented a number of measures in respect of EDC. As the Minister of International Trade testified, Canadians "are facing extreme challenges the likes of which we have not seen for decades, and ... this particular organization, EDC, is able to help through this difficult time."[34]

As announced in *Economic and Fiscal Statement 2008* and *Budget 2009: Canada's Economic Action Plan*, EDC has received:

- $350 million to facilitate additional capitalization of loans;
- an increase in the ceiling of share capital to be purchased by the government from $1.5 billion to $3 billion;
- a temporary expansion of domestic powers, allowing it to provide financing solutions for domestic-oriented businesses;
- an increase in the Canada Account limit from $13 billion to $20 billion to ensure that the government has the direct capacity, if needed, to provide credit and meet the high-risk financing requirements of businesses in strategic, hard-hit sectors of the Canadian economy that are deemed to be in the national interest; and
- an increase in the contingent liability ceiling from $30 billion to $45 billion, thereby increasing the risks that EDC can underwrite and encouraging commercial banks to continue to advance loans and increase access to financing.

As well, the Business Credit Availability Program (BCAP) has been established to enhance cooperation between private-sector financial institutions and federal financial Crown corporations, including EDC, in providing loans and other forms of credit support to businesses whose access to financing would otherwise be restricted. The program is intended to fill gaps in market access and lever additional lending by private-sector institutions.

## B. What the Witnesses Said

In addressing the committee, the Automotive Parts Manufacturers' Association remarked that:

> I think that insurance is absolutely essential, because receivable insurance is required in today's environment when customer viability is much more questionable than it was in the past. [Small and medium enterprises], especially, need some assurance that they will be paid. [ … ] They cannot afford to bet the farm on one or two companies without that kind of receivable insurance to ensure their customer does not drag them under, and yet it may be a great

[34] *Evidence*, 40th Parliament, 2nd Session, Issue no. 3, p. 9; *Evidence*, 40th Parliament, 2nd Session, Issue no. 2, p. 30.

> opportunity for them. Increasing contingency insurance, or liability, as they call it, is a good thing.[35]

In reaction to EDC's extended temporary mandate designed to fill a gap in the domestic market, the Canadian Bankers Association noted: "Extraordinary times call for special measures, and we understand and support the government's initiatives regarding EDC. We recognize and appreciate the government's emphasis that the powers be temporary in nature and that they not be used to displace private-sector lending."[36]

## C. What the Committee Recommends

### 1. Expanded Resources and Authorities

The committee feels that it is critically important to examine the November 2008 *Economic Update* and *Budget 2009* measures in respect of EDC within the context of our review and the report of the 2008 legislative review, rather than as mere pieces of legislation.

The committee is encouraged by the favourable testimony regarding EDC's additional powers and resources, and is pleased that witnesses feel that EDC is suitably positioned to respond to the current financial situation facing Canadian businesses and exporters.

However, the committee is cautious in its assessment of the temporary expansion of EDC's mandate in support of the domestic market. On the one hand, we agree that significant gaps in the market for domestic credit have emerged since the release of IFC's report. On the other hand, the first recommendation in the IFC report is that, barring significant changes in the market leading to large-scale gaps in domestic credit insurance availability, EDC should not re-enter the domestic credit insurance market. Furthermore, we are concerned with the wording of the enabling legislation that allows for a possible extension, by an Order in Council, of the two-year period in which EDC may participate in the domestic credit market.[37]

In light of the significance of these measures and the extraordinary economic conditions under which they were implemented, the committee believes that this temporary change in EDC's mandate merits further scrutiny. The IFC report states that "the notion of market gaps must be applied with some caution: gaps tend to ebb and flow over time, driven by myriad events and developments in market activity and public policy. As such, gaps that do not exist today may exist tomorrow and vice versa."[38] We agree with this statement, and recognize the need to monitor the economic environment and assess EDC's presence in the domestic market.

[35] *Evidence*, 40th Parliament, 2nd Session, Issue no. 4, p. 32.
[36] *Evidence*, 40th Parliament, 2nd Session, Issue no. 3, p. 72.
[37] 40th Parliament, 2nd Session, Statutes of Canada 2009, Chapter 2, An Act to implement certain provisions of the budget tabled in Parliament on January 27, 2009 and related fiscal measures, Received Royal Assent on 12 March 2009, Part 5, Division 3, Section 263 (2), p. 251, http://www2.parl.gc.ca/content/hoc/Bills/402/Government/C-10/C-10_4/C-10_4.PDF
[38] International Financial Consulting Ltd., (December 2008), p. 51.

## Recommendation 7

> **The committee recommends that the Government of Canada evaluate, and report to Parliament on, the continued need for EDC's presence in the domestic credit market and that, as provided by legislation, Parliament be given ample time to study the issue.**

### 2. The Need for Partnerships

The committee notes that some businesses have been able to take advantage of the Industrial Cooperation Program offered by the Canadian International Development Agency (CIDA) in order to support projects for which they have applied to receive EDC funding. At the same time, we heard concerns that inter-agency funding of large-scale and expensive development projects, which would include feasibility studies and training, carried out by private businesses is neither systemic nor coordinated. This situation complicates potentially valuable and beneficial initiatives by Canadians and permits competitors to procure them instead.

The committee acknowledges that there may be some benefit to greater inter-agency coordination of program support, particularly where objectives are complementary. In light of earlier studies, however, we also caution that such coordination should not be carried out in a way that requires commitments on the part of the recipient to purchase Canadian goods and services. In other words, we continue to be adamant that tied aid undermines aid effectiveness and increases costs.

Understanding that CIDA is currently holding consultations about whether the Industrial Cooperation Program should remain with it or whether elements of the program should be assigned to other agencies, the committee supports funding of development projects that meet EDC requirements and that are consistent with its mandate, whether these funds are assigned by CIDA or by another agency.

More generally, the committee supports partnerships, both with other Canadian governmental entities and the private-sector in the domestic market. In that regard, we believe that the establishment of Business Credit Availability Program is a useful development. We encourage this and other opportunities for continued dialogue and partnerships among EDC and relevant agencies and organizations. We feel that these types of dialogue provide valuable opportunities to minimize the overlap in services and to contribute to the goal of ensuring that the needs and complementary objectives of Canadians and Canadian businesses are met as efficiently and effectively as possible.

In addition, we are encouraged by the recent announcement of collaboration between EDC and the private-sector insurers in Canada to facilitate up to $1 billion in new domestic credit. EDC will provide re-insurance for domestic receivables to private insurers, such as Atradius and Euler Hermes, to assist Canadian business in accessing credit.[39]

## Recommendation 8

> **The committee recommends that the Government of Canada establish mechanisms for greater coordination between EDC and Investment Cooperation (formerly Industrial Cooperation Program) in order to enhance trade using existing tools and resources.**

### 3. Ongoing Review

As the basis for its research and analysis, IFC engaged stakeholders in a series of town hall as well as one-on-one meetings arranged at the request of an individual. Stakeholders, which included the Canadian business community, private-sector competitors, civil society and individuals representing the Canadian taxpayer, were consulted on a variety of issues. Town hall meetings were held in Toronto, Vancouver, Calgary, Winnipeg, Montreal, Kanata, Halifax and Ottawa. While the committee acknowledges that IFC was pro-active in its attempts to advertise and raise awareness of its review process, we are concerned about the lack of consultation in Atlantic Canada, where only a single town hall meeting was held. It was also brought to our attention that representatives of EDC, the Department of Foreign Affairs and International Trade as well as various other federal departments and agencies were present at the town hall meetings. The committee is concerned that stakeholders did not have the opportunity to communicate their opinions openly to the IFC review team, as comments might be constrained in the presence of EDC, an agency on which some stakeholders depend for export financing and insurance services.

The committee is of the view that, given the dynamic nature of the world in which we live, the rather static nature of legislation, and the need to ensure that public policy goals are being achieved as efficiently and effectively as possible, Parliament – whether as a result of a statutory provision or as part of its oversight responsibilities – should review legislation periodically in order to ensure that its objectives are being met in the best possible manner. Certainly, as part of this review, stakeholder input – whether it occurs through private-sector organizations, public consultations by departments and agencies, or parliamentary hearings – should be broadly representative of those affected.

[39] Export Development Canada *Media Release* 14 May 2009. Available at: http://www.edc.ca/english/docs/news/2009/mediaroom_16447.htm

## Recommendation 9

**The committee recommends that section 25 of the *Export Development Act* be amended by specifying that responsibility for the ten-year legislative review be undertaken by each Chamber of Parliament.**

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# CONCLUSIONS

The committee believes that EDC's support of the Canadian export sector, whether independent or through partnerships with the private sector and/or other government agencies, is all the more significant in light of the increasing importance of trade and exports to Canada's economy and its growth, both in the current economic crisis and more generally. At the same time, we are convinced that the short-term additional measures and resources granted to EDC in recent months are critical in order to ensure that Canada's businesses remain competitive until the global economy recovers. While we are currently seized with the short-term imperatives of EDC because of the current economic conditions, we must not lose sight of the corporation's long-term value as Canadian businesses have much to gain. EDC's mandate remains relevant and beneficial to Canada's trade and investment.

Overall, the committee firmly believes that EDC is performing in accordance with its mandate and that, in the process, it is advancing the interests of Canada's businesses. Indeed, EDC's value has been reinforced by the actions it has been taking to support the credit and insurance needs of Canada's most vulnerable businesses and sectors in a changing global environment. In the end, we feel that Canadian businesses are positioned to emerge from the current global slowdown in a stronger position than they were when the financial crisis started. We note a number of continuing issues about EDC's transparency and are mindful of concerns raised by EDC's competitors about unfair advantages. At the same time, we are confident that the foundation on which EDC was built, including its short-term export credit insurance services, has survived the test of time and challenging circumstances.

# WITNESSES AND BRIEFS

**Amnesty International Canada**
(Brief)

**Atradius** (March 4, 2009; Issue 2)
Ian Miller, Chief Agent and Country Manager.

**Automotive Parts Manufacturers' Association** (March 25, 2009; Issue 4)
Gerry Fedchun, President.

**Canadian Apparel Federation**
Bob Kirke, Executive Director. (Brief)

**Canadian Manufacturers & Exporters** (March 24, 2009; Issue 4)
Jean-Michel Laurin, Vice-President, Global Business Policy.

**Canadian Bankers Association** (March 11, 2009; Issue 3)
Terry Campbell, Vice-President, Policy;
John Lancaster, Director, Financial Institutions and Trade.

**Conference Board of Canada** (March 24, 2009; Issue 4)
Glen Hodgson, Senior Vice-President and Chief Economist.

**Department of Finance** (March 4, 2009; Issue 2)
Lise Carrière, Chief, International Finance and Development Division, International Trade and Finance;
John Davies, Director, International Finance and Development Division, International Trade and Finance.

**Department of Foreign Affairs and International Trade** (March 10, 2009; Issue 3)
The Honourable Stockwell Day, P.C., M.P., Minister of International Trade;
Louis Lévesque, Deputy Minister of International Trade;
Robert Clark, Director General, Economic Policy Analysis Bureau.

**Dessau Inc** (March 25, 2009; Issue 4)
J. Denis Bélisle, Chairman of the Board.

**Euler Hermes Canada** (March 11, 2009; Issue 3)
Paul Flanagan, Chief Executive Officer.

**Export Development Canada** (March 10, 2009; Issue 3)
Eric Siegel, President and Chief Executive Officer;
Benoit Daignault, Senior Vice-President, Business Development
Rosemarie Boyle, Vice-President, Strategic Planning and

Corporate Communications. (Brief)

**Forest Products Association of Canada** (March 11, 2009; Issue 3)
Avrim Lazar, President and Chief Executive Officer;
Marta Morgan, Vice-President of Trade and Competitiveness.

**International Financial Consulting Ltd.** (March 3, 2009; Issue 2)
Diana Smallridge, President.

**Maxtech Manufacturing Inc.**
Kacee Vasudeva, Chairman and Chief Executive Officer. (Brief)

**Peerless Clothing Inc.**
Elliot Lifson, Vice-Chairman. (Brief)

# *Study on the 2008 Legislative Review of Export Development Canada*

Ce rapport est aussi disponible en français.

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www.parl.gc.ca
Or by telephone at 1-800-267-7362