Export Credits: Review and Prospects

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ABSTRACT

A substantial proportion of developing country imports is financed by credits extended by exporters through a number of channels, with a variety of durations and terms. This paper focuses on officially-supported export credits which are extended to importers in such countries on the basis of a guarantee/insurance provided by an institution or agency which is supported by the government of the exporting country.

The paper presents a brief history of the use of such export credits, examining the beginning of official support for export credits and the impact of the debt crisis of the 1980s on their use. Substantial differences in the organizational structure of individual export credit agencies (ECAs) and in the scope of services they provide are presented, as is the evolution and role of international coordination in setting the terms of export credits.

The strains placed upon international export credit systems in the past decade are analyzed at length, including the deterioration in the financial position of ECAs which was an outgrowth of the widespread debt crisis of 1982. ECAs’ responses to these stresses, and their effect on flows of export credits to developing countries are also considered. In order to improve credit quality and better understand the end-use of capital-goods contracts of large value with components that are financed by multilateral institutions, ECAs now have a greater interest in exchanges of information with the World Bank and in working together to cofinance Bank-supported projects.

Current issues facing officially supported export credit systems and future prospects for the use of export credits constitute the second half of the paper. The function of ECAs has increasingly come into question, and reducing the official role in favor of privatization of export credit systems is being attempted. Movement toward harmonization of terms and “the free play of market forces” is increasing in the terms offered for export credits, including premiums, cover policies, and repayment terms.

The issue of export credit financing for Eastern European countries and states of the Former Soviet Union is also explored, along with issues of relevance to such credits, such as operational and securitization issues.

The paper concludes with an analysis of the prospects for officially supported export credits from the perspectives of both recipient developing countries and providers. Private flows will continue to be confined to better country risks, while longer procurement planning frameworks and the use of innovative approaches may overcome some of the disadvantages of generally “tied” official export credits for less creditworthy borrowers.

From the “supply side,” country risk assessment is expected to continue to play a key role in cases of large value contracts. The paper presents a number of regional perspectives regarding the availability of export credit support. Overall, the paper predicts a slow growth in ECA flows to developing countries in the short term, and accelerated flows in the medium term based on successful economic reform measures in a wide range of developing countries.
ACKNOWLEDGMENTS

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We wish to thank these institutions for exchanging their views of this subject with us, and for providing comments on an earlier draft of this paper. Our colleagues at the World Bank also reviewed this paper and shared their useful comments.

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Export Credits: Review and Prospects is the second internal discussion paper to be published under the auspices of the CFS Discussion Paper Series. Cofinancing is one of the major functions of CFS, and cofinancing with Export Credit Agencies (ECAs) has been and continues to be a major source of financing for public sector projects in developing countries. Many developing countries are now relying increasingly on the private sector to implement projects in areas traditionally reserved for the public sector, however—including power, water supply, and telecommunications, among others. Limited or non-recourse financing of private sector-sponsored projects poses special problems and risks for these countries, and ECAs have generally been slow to enter into such transactions.

Besides reviewing the overall development of export credit finance, this paper examines the special issues involved in ECA support for private sector project finance and the role of ECAs in financing projects and the operational issues involved in such finance.

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Chapter One

A Brief History up to 1982

1. A substantial proportion of developing country imports is financed by credits extended by exporters (usually through their bankers) or banks to developing country importers. While such trade credits of short duration (say up to six months) for exports to more creditworthy countries are often arranged by exporters’ banks at the banks’ own (or together with the exporters’) risk through normal banking channels, credits of longer duration (appropriate for export of capital goods and major project equipment) or those extended to importers in less creditworthy countries are usually extended by exporters or bankers on the basis of a guarantee/insurance provided by an institution or an agency which is supported by the government of the exporting country. The focus of this paper is on these officially supported export credits.

2. The year 1982 ended with the widespread debt crisis, dramatically reshaping the attitudes and policies of external lenders, including providers of officially supported export credits, towards lending to developing countries. It will be therefore useful to divide this review into two periods, the first relating to the period up to 1982 and the second covering the subsequent years until the present.

1946-1982: A Period of Rapid Growth

3. The Export Credit Guarantee Department (ECGD) of UK represents the beginning of official support for export credits. It was set up in 1919, soon after the end of the first World War, with the establishment of the British credit insurance scheme. The primary motives for setting up the scheme were “supporting industry and thus employment, and meeting competition.” It was expected to operate “taking one year with another,” at no cost to the taxpayer, balancing its premium income with the outgo on account of administrative expenses and settlement of claims. Many other governments also established Export Credit Agencies (ECAs) in the late 20s and 30s with similar objectives. For example, the Export Insurance Department (EID) of the Japanese Ministry of International Trade and Industry (MITI) commenced operations in 1930, while the Export-Import Bank of the United States was chartered in 1934.

4. The post-World War II era saw a rapid expansion in the activities of ECAs. The activities of the ECGD, for example, increased ten fold between 1946 and 1958. ECAs were established in the remaining industrialized countries and there was a revamping and strengthening of the export credit schemes where ECAs already existed. Concerns about avoiding a collapse of international trade, as occurred in the interwar years, was certainly a factor in this strengthening and proliferation of officially supported schemes. It has also to be noted that until the late 1960s, private commercial banks and capital markets had very little appetite for term lending to developing country borrowers; officially supported export credits—particularly those with medium and long terms—were seen as being essential for supporting the export of capital.

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1. As the paper will outline, there are great variations in the form, status, structure and ownership of such institutions or agencies between different countries.
2. Review of Status Options for ECGD April 1989 by Mr. R.T. Kemp, commissioned by UK government.
goods, major industrial plants and transport equipment such as ships and aircraft, especially to developing countries.\(^3\) The flows of export credits to developing countries grew rapidly and constituted a substantial portion of the overall debt flows in the late 1960s and early 1970s; as Table 1 (below) indicates, export credit flows continued to be robust and further increased throughout the 1970s. Their proportion to total debt flows, however, declined as private commercial bank lending to developing countries increased with the development of the Eurocurrency market, whose capacity expanded rapidly with the inflow of petrodollars from 1972 onwards.

**A Variety of Approaches**

5. While all ECAs have been set up by industrialized countries (as also by a large number of developing countries) with the same objectives, i.e., the promotion of national exports and meeting competition,\(^4\) there are substantial differences in the organizational structure of individual ECAs and in the scope of the services they provide. In many countries, this objective is sought to be achieved by giving specific responsibilities to a number of institutions. A broad-brush picture of these variations is attempted in succeeding paragraphs.\(^3\)

6. **Scope of Services:** The basic service provided by each ECA is that of guaranteeing or insuring a national exporter or a banker who extends credit to an overseas borrower for financing the export of goods and services from the ECA's country against risks of non-payment involved in such lending. In the most restricted form, such guarantee or insurance "cover" may be extended by the ECA only against "political" or "sovereign" risks (i.e., broadly, cases of nonpayment arising from acts or omissions of the borrower's government over which the borrower has no control), the exporter or the banker being responsible for non-payment on account of "commercial" risks (i.e., risks within the control of the borrower or risks which can be addressed by the borrower through private insurance, or losses arising from contractual breaches for which the borrower can be expected to seek redress through the normal legal process). In most cases, the ECAs' cover is extended against both types of risk, partly because it is quite difficult, in practice, to distinguish between "political" and "commercial" risks. Such cover is extended for risks arising during the "preshipment" period as also the "post-shipment" period. In case of the short-term (ST) credits, an ECA will generally extend such cover to an exporter on a "wholesale" basis (i.e., require the exporter to seek cover either for his entire export business globally or in respect of all his transactions with a specified group of countries, so that the ECA can cover a reasonable spread of risks), while for me-

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3. The debt crises of Brazil and Indonesia in the '60s mainly related to official debt, including officially supported export credits.

4. Pursuant to which objective, usually only goods and services which are wholly or predominantly of domestic origin are eligible for support of the various ECAs. However, see paragraph 16.

5. The salient features of the Export Credit support provided by the OECD governments are available in the OECD publication titled *The Export Credit Financing Systems in OECD Member Countries*. National programs of Export Credits of most OECD Countries and some developing countries, available to Bank staff through All-in-One, provide similar information.

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**Table 1**

**Export Credit and Total Debt Flows to Developing countries 1970-1982**

<table>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Net Export Credits</td>
<td>2.20</td>
<td>1.60</td>
<td>2.95</td>
<td>8.51</td>
<td>10.27</td>
<td>12.62</td>
<td>12.97</td>
<td>8.70</td>
</tr>
<tr>
<td>2. Net Debt Flows</td>
<td>6.43</td>
<td>12.02</td>
<td>23.38</td>
<td>33.86</td>
<td>87.67</td>
<td>60.21</td>
<td>78.70</td>
<td>72.32</td>
</tr>
<tr>
<td>Percentage 1:2</td>
<td>34.3</td>
<td>13.3</td>
<td>12.6</td>
<td>25.1</td>
<td>21.6</td>
<td>21.0</td>
<td>16.5</td>
<td>12.0</td>
</tr>
<tr>
<td>3. Gross Export Credits</td>
<td>5.38</td>
<td>6.53</td>
<td>9.58</td>
<td>18.17</td>
<td>22.33</td>
<td>29.31</td>
<td>31.84</td>
<td>29.61</td>
</tr>
<tr>
<td>4. Gross Debt Flows</td>
<td>13.23</td>
<td>20.34</td>
<td>35.94</td>
<td>50.41</td>
<td>59.84</td>
<td>101.35</td>
<td>122.67</td>
<td>117.42</td>
</tr>
<tr>
<td>Percentage 3:4</td>
<td>40.7</td>
<td>32.1</td>
<td>26.7</td>
<td>35.9</td>
<td>28.1</td>
<td>28.9</td>
<td>26.0</td>
<td>25.2</td>
</tr>
</tbody>
</table>

*Source: World Bank CRS database. Excludes credits repayable in one year or less.*
dium- and long-term (MLT) business, cover is normally extended to exporters on the basis of individual contracts.

7. A number of ECAs also provide additional cover against certain other risks such as risks for the exporter of foreign exchange movements between the dates of tendering and the date of the contract becoming effective, if he is quoting in a currency other than the domestic currency of the exporting country, performance bond insurance against unjustified calling of such bonds by borrowers and so on.

8. Apart from the above guarantee/insurance services, official support for financing of exports (particularly with medium- and long-term credits) is provided in a variety of ways. In some countries, export-import banks have been established in the official sector to directly provide medium and long-term export credits, either entirely on their own or in association with private banks, the latter often being covered against the risks of external lending by the concerned ECA. In other countries, long-term financing is raised by a separate export credit finance corporation (which may be either owned by the government or an association of private banks, or jointly by both) which onlends the needed funds (wholly or in part) to commercial banks which actually undertake the export credit transactions, with credit guarantee or insurance being provided by the ECA. Yet another variation is the refinancing of the longer maturities of export credits provided by commercial banks by the central bank or a specialized public sector financial organization. Some ECAs combine both functions acting as a guarantor and a direct lender. In addition, ECAs are usually responsible for administering any interest rate subsidies provided by respective governments on export credits extended by exporters or private banks.

9. Organizational Structures: ECAs range from being a government department, like the ECGD of UK, or a government agency, like the Swedish Export Credits Guarantee Board (EKN), or a wholly owned but substantially autonomous government institution such as the Export Development Corporation of Canada (EDC), to being a wholly private or a semi-private credit guarantee organization which does a substantial amount of business on its own account but also conducts export credit business on behalf of the government, such as the HERMES of Germany. As noted earlier, direct official support for the financing of export credits may be extended by institutions other than the organization responsible for credit guarantee or insurance. Association of trade and industry (the principal users and beneficiaries) with export credit activities is arranged usually by appointing representatives of these interests to the Board of Governors, Supervisory Board or Advisory Board of the concerned ECA.

International Coordination of Terms of Export Credits

10. In the immediate post-1946 years, terms and conditions of support offered by export credit agencies were set independently by each ECA. Initially, practically all the business was short-term in nature with most of the credits being repayable within six months and, until the mid-sixties, a repayment term of more than five years was very unusual. Interest was usually charged at market rates. The premiums were set at modest levels ranging between 0.1 to 5-6% of the contract value, depending on the individual ECA and on the term of the credits; premiums charged by an ECA for various developing country market varied, if at all, over a relatively narrow range.

11. However, with the progress of reconstruction of the industrialized countries affected by the Second World War and an acceleration in international demand for capital goods and major plants, including from developing countries, competitive considerations led to lengthening of the repayment periods and a subsidization of interest rates. In these early years, many countries viewed export credits as a means of providing development aid which also encouraged such trends, so that matching the repayment profile of the credit with the payback period of the investment became an important consideration. These developments led to

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6. Export credits, because of official support, are generally offered in national currencies. For competitive and other reasons, in some cases, ECAs do, however, also guarantee/insure credits in other currencies. In the latter case, the cover is sometimes denominated in the national currency, the foreign exchange risk being then taken by the supplier and/or the lending bank.

7. Even today, over 80% of the officially supported export credits extended, reflecting the overall composition of international trade, are short-term, supporting the exports of commodities, raw materials and consumer goods. A good proportion of such short term business is in respect of credits extended to other developed countries.

8. For example, the Kemp report points out that loans under section 3 of the ECGD act 1949 were the standard method of providing development aid in the 1950s. Also see the UN publication Export Credits and Development Financing: National Export Credit Systems, 1969.
As the volume of export credits grew, so did the concerns of the guardian authorities of ECAs of the industrialized countries.
payments (usually called downpayments) equal to a minimum of 15% of the (export) contract value; participants in the Arrangement agreed not to provide official support for such cash payments other than insurance or guarantees against the usual pre-credit risks;

b) The maximum repayment term to be eight and one-half years for all countries other than those classified in the Arrangement as Category III or relatively poor countries, where the term may be extended up to 10 years;\(^{14}\)

c) Minimum interest rates (subject to revision from time to time) were set for credits with three different repayment periods\(^ {15}\) and for the three categories of countries, where credit was provided with official financing support.\(^ {16}\) As the rates adopted thus formed a matrix, these rates are often referred to as the "matrix" interest rates. These rates were to be the same for all currencies.

It provided for procedures for information and consultation whereby the participants might deviate from these parameters in specific cases. A limit of 15% was placed on the extent to which local costs (i.e., to be incurred in the borrowing country) related to the export contract may be covered in the credit amount. It may be noted, however, that the Arrangement did not (and still does not) cover the terms or fees/premiums to be charged for the guarantees/insurance provided by the ECAs.

15. As the Arrangement was negotiated and managed through the OECD with formal recogni-

14. The initial categorization of countries into relatively rich (Category I), intermediate (Category II) and relatively poor (Category III) countries was revised in July 1982. Countries with a per capita GDP of over $4,000 per the 1981 World Bank Atlas (1979 data) were placed in Category I and countries eligible for IDA credits and all other countries and territories whose GNP would not exceed IDA eligibility levels were put in Category III; the rest of the countries were put in the intermediate Category II. This resulted in the reclassification of some countries from Category III to Category II. It was agreed, however, that such reclassified countries would be eligible for credits with a maximum repayment term of 10 years.

15. 2-years, 5-8.5 years and 8.5-10 years. It may be noted that these rates are fixed for the duration of the credit period.

16. Defined as support by way of direct credits, refinancing or interest rate subsidy. Thus the provisions regarding interest rate minima are not applicable where official support is limited to "pure" cover (i.e., only credit insurance or guarantee). In most countries, private lenders (mainly commercial banks) are unlikely, however, to extend MLT credits at fixed interest rates on the basis of pure cover.

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**Chart 1:**

**Interest Rates, 1977-1991**

Notes:

i) Consensus Rate: (rounded to nearest half year) for export credits to Category II countries with repayment periods of over five years.

ii) National Rates: government long-term bond yields (average for year).
tion of GATT, a complete elimination of interest subsidy was no longer a pressing necessity from that perspective.17 As Chart 1 shows, the Consensus rates remained well below the domestic interest rates in several currencies until the beginning of the 1980s.

16. The European Commission under its mandate under the Treaty of Rome has also been seeking coordination in the terms of export credits amongst the EC countries. One of its concerns is that the national export credit schemes of EC countries do not hinder the progress of economic integration of the EC countries. Thus, in 1965, it was decided that "any EEC [EC] country must automatically insure and finance goods and services supplied by another member country if these account for 30-40% of an export contract concluded by one of the former country's residents." Similarly in the same year it laid down a procedure for prior consultation among the EC countries when extending credits with repayment periods of over five years. In the deliberations on the Arrangement and in the OECD Trade Committee's Group on Export Credits and Credit Guarantees, the Commission has the authority to speak on behalf of the EC countries where general issues relating to export credit policies are concerned. The individual ECAs and their guardian authorities, however, continue to have the discretion and competence to decide specific cover policies in respect of various export markets and set limits for new exposure in them.

17. The illustrative list of export subsidies prohibited under Article XVI of the GATT includes the following two items relating to export credits."

"j) The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programs, of insurance or guarantee programs against increases in the cost of exported products or of exchange risk programs, at premium rates, which are manifestly inadequate to cover the long-term operating costs and losses of the programs."

"k) The grant by governments (or special institutions controlled by and/or acting under the authority of governments) of export credits at rates below those they actually have to pay for the funds so employed (or would have to pay if they borrowed on international capital markets in order to obtain funds of the same maturity and denominated in the same currency as the export credit), or the payment by them of all or a part of the costs incurred by exporters or financial institutions in obtaining credits, in so far as they are used to secure a material advantage in the field of export credit terms."

"Provided, however, that if a signatory is a party to an international understanding on official export credits to which at least twelve original signatories to this Agreement are parties as of 1 January 1949 (or a successor agreement has been adopted by those original signatories), or if in practice a signatory applies the interest rate provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export credit subsidy prohibited by this Agreement."

18. From page 2 of BIS publication Export Credit Insurance and Export Credit 1969.
17. The officially supported export credit systems have come under great strain during the last decade, starting with the onset of the widespread debt crisis in 1982. Until that time, the premium income of the ECAs, together with the interest income on the reserves and recoveries in respect of claims paid earlier, was more than sufficient to meet any claims made on them by the suppliers or private creditors that they had insured or guaranteed. The BIS review of ECAs in 1969 noted that “in no country have the insurers suffered losses of any size, since in most cases they have been able eventually to recover from the debtor the amount of claims paid to the creditor.” The position continued to be equally satisfactory until the beginning of the 1980s. As the Kemp report on ECGD notes, “the experience of ECGD is typical of that of the major export credit agencies. Since trading accounts began to be kept in 1930, cash surpluses were recorded for every financial year except two in the early fifties, when there were heavy claims payments due to delays in transfer from Brazil, until 1981-82. By 31 March 1982 the cumulative (notional) cash surplus had risen to £481 million.” The picture has, however, changed drastically since then. In the last eight or nine years, operations of all major ECAs and practically all the other OECD ECAs have been running in deficit. The surpluses and reserves built up in the earlier years were fully wiped out and the operations of the ECAs have been sustained by subventions of one sort or the other (depending on the structure of individual ECAs) from government treasuries. This direct dependence of the ECAs on budgetary support from their respective governments, together with the altered economic policies the governments of the major ECAs adopted in the 1980s, have been amongst the key factors in shaping ECA policies and approaches in the last decade. Other important factors to note are, first, the move towards a single EC market, second, the radical political and economic changes in the countries of Eastern Europe and the former USSR and third, the attempts of the Consensus participants and DAC members to minimize distortions in aid and trade arising from the use of tied aid funds and the various schemes of associated financing, involving the combined use of aid and commercially motivated funds, including officially supported export credits. Principal aspects of these developments are discussed in the succeeding paragraphs.

18. The Financial Position of ECAs which, as noted above, appeared quite sound until 1982, deteriorated quite sharply thereafter. ECA outstandings for a number of debt-affected countries were restructured either by rescheduling the existing payment terms or by refinancing (i.e., by

19. Developments in the ECA policies in the last decade have been the subject of four IMF staff papers. The first, Export Credit Cover Policies and Payments Difficulties, was published in August 1985 as Occasional Paper No. 37. The subsequent three papers on Officially Supported Export Credits were published in the World Economic and Financial Survey series in July 1986, February 1988 and May 1990, respectively. They cover most of the issues discussed in this section in more detail.

20. See footnote 18 above.
21. See footnote 2 above.
22. It is notional in the case of ECGD since as a government department any surplus at the end of the financial year is surrendered to the government Consolidated Fund.
issuing a new guarantee to a private sector lender in support of a credit on longer terms, the proceeds being applied to the payment of the present debt). The rescheduled debts had to be assumed by the ECAs and the insured/guaranteed claimant (either a supplier or a private lender) had to be paid, affecting the cash flow of the ECAs. Since the profit and loss position of ECAs is difficult to determine due to uncertainties as to the ultimate recovery of arrears and restructured credits, the cash flow of the ECAs is a commonly used indicator for taking a view of their financial position. It needs to be noted, however, that a cash flow deficit is not a measure of the eventual operating loss as the claim payments made by the ECAs are likely to be recovered, at least in some measure; cash deficits of different ECAs are also not fully comparable because of the differences in the accounting treatment of arrears and restructured debt. The cash flow deficits do, however, give an overall picture of their liquidity position and of the extent of cash support—in one way or the other—which the ECAs may need from their government treasuries. Chart 2 gives the net cash flow position of the OECD ECAs during the ten years 1981-1990. The cumulative negative cash flow up to the end of 1990 has been estimated as exceeding SDR 25 billion.

19. A point to note is that most of the negative cash flows relate to MLT credit business of the ECAs. This is mainly because ST credits are not normally subject to rescheduling under the Paris Club restructuring, which minimizes claims in respect of such credits. Because of this, ECAs kept ST cover open for many countries which rescheduled their MLT export credits during the 1980s and for which credits, consequently, ECAs went off-cover or operated on a very restrictive basis. This was no doubt helpful to the concerned borrowing countries in sustaining the essential imports financed by such ST credits; it also meant that the ECAs’ premium income on account of ST business did not fall as drastically as in the case of MLT credits. Another, and perhaps more important, factor contributing to the near balance in cash flows for ST business was that a very major part of the short term business is in respect of exports to OECD countries and, therefore, was not affected.

23. Defined as premium interest and recoveries received, less claims paid and operating expenses.
24. For example, a refinanced credit will not result in an immediate cash outflow while a rescheduled credit will.
25. Source for the information in Chart 2 and the estimate of cumulative negative cash flow is the OECD.
by the debt crisis. Also worth noting is that a substantial part of the claims paid by ECAs in respect of MLT credits related to credits extended before the onset of the extensive debt crisis in late 1982. This was on account of the concept of a fixed "cut-off" date which was developed quite early in the extensive rescheduling exercises which were undertaken in the Paris Club for addressing this crisis. Under this concept, it was mutually agreed amongst the Paris Club creditors that only those export credits which had been extended before a particular date would be rescheduled and that this date would remain unchanged in any further rescheduling(s) which may become necessary for ensuring orderly service of the official debt of the same borrowing country. Adherence to this approach has probably enabled the ECAs to reopen MLT cover for debt affected countries (which had made some progress in adjustment and towards recovery) somewhat earlier than would have been the case, as the ECAs have had a reasonable assurance that any new credits which they might support would not be drawn into a rescheduling, at least in the near future.  

20. **Cover Policies of the ECAs:** The response of the ECAs to the onset of the debt crisis was to immediately go "off-cover" in respect of the debt-affected countries which fell into arrears and/or asked for rescheduling of official debt. The resumption of cover would only be considered after a unilateral agreement had been reached (in the Paris Club) and a bilateral agreement reached with the ECA concerned (or with its guardian authority) and, possibly, until a first payment under the new agreement had been made; the process of resumption of cover typically took well over a year. This was because in the initial years of the crisis, there were few ground rules about the credits which would be included in the debt restructuring and about how future credits would be treated. In subsequent years, as the ST debts were seen to be excluded, ECAs tended to remain on cover for ST business as long as such debt was being serviced regularly and the country concerned confirmed that it would not seek the inclusion of ST debt in restructuring. ECAs continued to go off-cover for MLT credits whenever a rescheduling seemed imminent or was requested, though the resumption of cover became quicker as soon as it was clear that the cut-off date remained unchanged and a rescheduling agreement had been reached in the Paris Club. However, such resumption of cover for MLT credits was generally on a very restricted basis, given the fragile economic condition of such countries and the continuing risk perceptions of the ECAs.

21. As a consequence, net export credit flows to developing countries declined sharply and finally turned negative in the late 1980s; the last couple of years have shown a modest revival. Table 2 below summarizes the position of the flows.

<table>
<thead>
<tr>
<th>Source: World Bank DRS Database. Excludes credits repayable in one year or less.</th>
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<tbody>
<tr>
<td>7.71</td>
<td>5.26</td>
<td>0.63</td>
<td>-2.57</td>
<td>-3.47</td>
<td>-2.00</td>
<td>7.40</td>
<td>1.24</td>
</tr>
<tr>
<td>62.44</td>
<td>45.55</td>
<td>34.51</td>
<td>26.73</td>
<td>17.63</td>
<td>23.99</td>
<td>25.48</td>
<td>28.74</td>
</tr>
<tr>
<td>12.3</td>
<td>11.5</td>
<td>1.8</td>
<td>-9.6</td>
<td>-19.7</td>
<td>-8.4</td>
<td>29.0</td>
<td>4.3</td>
</tr>
<tr>
<td>29.89</td>
<td>24.73</td>
<td>22.53</td>
<td>15.27</td>
<td>17.35</td>
<td>16.30</td>
<td>29.07</td>
<td>22.54</td>
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<tr>
<td>104.83</td>
<td>92.36</td>
<td>86.79</td>
<td>88.49</td>
<td>90.86</td>
<td>98.84</td>
<td>94.90</td>
<td>103.52</td>
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<tr>
<td>28.5</td>
<td>26.8</td>
<td>26.0</td>
<td>17.3</td>
<td>19.1</td>
<td>16.5</td>
<td>30.6</td>
<td>21.8</td>
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26. A forum in which creditor countries meet with the debtor to consider a request for the rescheduling of debt service payments on loans extended or guaranteed by their governments or official agencies. The Paris Club has neither a fixed membership nor an institutional structure and its meetings are open to all official creditors that accept its practices and procedures. For historical reasons, officials of the French Treasury preside over the meetings of the Paris Club and provide the Secretariat and the meetings take place in Paris.

27. Credits to private sector borrowers, not guaranteed by the borrowing governments, have also been generally excluded from the rescheduling exercises undertaken after 1985.

28. The Paris Club agreements were generally dependent on the borrower reaching an understanding with the IMF on an appropriate stabilization program and the actual resumption of cover followed the conclusion of a bilateral agreement between the ECA's government and the borrowing country after the Paris Club accord.
22. The overall level of new MLT export credit commitments of the 22 participants in the Arrangement declined from approximately 60 billion SDRs in 1981 and 1982 to around 34 billion SDRs in 1988. Since then it has shown a rising, though uncertain, trend, the estimates for 1991, on yet incomplete data, being placed at approximately 46 billion SDRs. Most of this increase is in credits with repayment periods of up to five years and the level of such credits is close to returning, in nominal terms, to the 1981-82 level. However, the new commitments of credits with repayment periods of over five years (i.e., credits extended for major capital plant and equipment) continue to be quite low at around 8-9 billion SDRs, which is, even in nominal terms, half the level of around 18 billion SDRs for such credits in 1981 and 1982. It would also appear that the recent increases in new commitments are mainly on account of new credits extended to the republics of the former Soviet Union. It is therefore likely that the recent modest revival in net flows is as much because of a decline in the repayment obligations of the developing countries as it is because of increases in new flows.

23. The last decade saw considerable progress in the steps which had been initiated in the late 1970s for the reduction and eventual elimination of subsidies involved in setting the interest rates for export credits. Under the Arrangement of 1978, a change in the matrix of minimum interest rates had to be unanimously agreed amongst the participants. This involved prolonged negotiations. As a result, the matrix rates could not be refixed regularly so as to keep abreast of the market interest rates, which were also showing increasingly divergent tendencies for the various OECD currencies. This issue was addressed by a revision of the Arrangement in October 1983 when the participants adopted the Uniform Moving Matrix (UMM), which provided for a regular revision of the matrix interest rates every six months based on the fluctuations in the weighted average of long-term bond yields of the five SDR currencies. This matrix was to apply to all currencies used for extending export credits. However, in order to avoid placing providers of credits in low-interest currencies (notably Yen, Deutsche Mark and Swiss Francs at that time) at a commercial disadvantage, the participants agreed to establish "Commercial Interest Reference Rates" (CIRRs) for all OECD currencies used for providing export credits so that export credits could be extended at the lower of either the minimum interest rate set out in the matrix or the CIRR of the currency in which the credit was being extended.

24. The adoption of the UMM process considerably reduced the interest subsidy burden on government budgets of the high-interest currencies. Further steps at reducing the subsidies were taken in July 1987 and February 1992, from which dates export credits to Category I and Category II countries, respectively, can only be extended at the CIRR rates. Since February 1992, the SDR-based rate is an option available for extending credits to only the relatively poor (Category III) countries. The margins in setting the SDR-based rate have been also raised from time to time to minimize the subsidies. The expectation is that in the course of the next couple of years, credits to Category III countries will also only be available at the CIRR rates, thus substantially eliminating the subsidies provided in respect of interest rates.

25. It may be noted that the Arrangement presently does not cover the conditions or terms of insurance or guarantees but only the terms and conditions of the export credits that benefit from such guarantees or insurance. The cash deficits of ECAs in the last decade focused the attention of the agencies and their guardian authorities on setting

29. In this context, all credits with a repayment term of over one year.
30. All amounts mentioned in this paragraph are based on OECD data.
31. Ms. Janet Pearce's paper "Export Credit: The Next Phase" which was presented at a Chatham House Briefing in London in January 1981 sets out the various issues then under consideration and the position of various key participants in these issues.
32. The basis of determining CIRRs remained a matter of further consideration until June 1986, when a standard formula for fixing the CIRRs was adopted. Under this formula, CIRRs were to be set for each currency at a fixed margin of 100 basis points above a base rate defined as the yield on the secondary market for government bonds with a residual maturity of five years, unless otherwise agreed amongst the participants. This basis has been slightly revised in the recent agreement between the participants (commonly called the "Helsinki Package"). The participants now have the choice of either selecting the Treasury Bill rate for 5 year bills (T5) as the base rate or use TB3 for credits with repayment periods up to 5 years, TB5 for credits over 5 and up to 3.5 years and TB85 for credits over 8.5 years. The CIRRs are revised each month.
the premium rates at levels which reflect the risks being covered more realistically. An analysis attempted by the OECD secretariat, on the basis of the incomplete data the secretariat was able to collect from the Arrangement participants, suggests that the premium rates presently charged may be considerably less than the levels needed for the ECAs to break even, particularly in the case of MLT credits; though significantly lower rates were charged by the ECAs for ST business, the cash flow trends in the case of ST credits have tended, as earlier noted, to be in balance or even positive in the last decade. Another factor suggested is that premiums for ST credits may be charged more realistically by the ECAs because ST risks can be better evaluated than the risks attaching to MLT credits with their longer time horizons. It may be noted that this OECD analysis has not been accepted by all participants. There do seem to be two factors whose impact on these results may need to be further evaluated.

i) The data relates to a period when MLT credits extended to a number of countries were rescheduled and, as a consequence, the volume of claims paid out was very large. At the same time, because of the difficult economic situation of many developing countries which were large importers of capital goods in the past and because of the more restrictive cover policies of the ECAs, the fee/premium income of the ECAs on account of MLT credits had shrunk to a low level. In this situation, in the view of some participants, premiums for MLT credits may not be as under priced as estimated by the OECD secretariat;

ii) The comparatively favorable situation in the case of ST credits may also be, in some measure, due to the fact that ECAs usually extend cover for ST business on a “wholesale” basis, thereby ensuring a better spread of risks. MLT credits, on the other hand, are covered by “specific” policies (i.e., covering individual contracts). Thus, in aggregate, the quality of risks covered under ST cover may be better than the risk covered under MLT cover.

26. Many ECAs have revised their premium rates in the last decade, generally by raising them and making them more differentiated as between countries carrying different levels of risks, as perceived by the respective ECAs. The setting of premiums, especially for MLT credits, is, however, not feasible on an actuarial basis; the rates have to be set empirically, taking several factors into account. Different ECAs have followed different approaches and there are presently wide disparities in the premiums charged by various ECAs. There are increasing pressures for a greater degree of uniformity of approach amongst the ECAs in this aspect, and this is one of the important issues currently under discussion to which we will revert in the next section.

27. During this decade, participants in the Arrangement and the Development Assistance Committee (DAC) of OECD were also involved in devising ways in which aid and trade distortions arising from the use of Tied Aid Credits could be minimized. Such credits were a matter of concern, as they were seen as being used by the providers to secure a competitive advantage for the respective national exporters from the donors’ countries.

Following initial attempts at establishing guidelines for their use, the latest measures adopted in early 1992 have placed two major limitations on the use of such credits. These are:

a) Except for projects in least developed countries (LLDCs), tied aid credits will not be available for public or private projects that should be normally viable when financed on market or Arrangement terms,

b) Tied aid credits will not be available at all for countries which are ineligible for IBRD loans repayable in 17 or 20 years.

28. These limitations are expected to dampen considerably the use of tied aid credits in ways which can cause aid and trade distortions, though the exact criteria for applying the first limitation will probably need to be established during the process of implementation. Some other measures adopted for use of tied aid in large projects (>50 million SDRs) include a greater emphasis put on project priority and consultations with the World Bank in this regard, on determination of appropriate financing terms, and on the following of inter-

33. Tied Aid credits in this context include associated financing (use of export credits and other market funds in association with development aid funds), tied official development assistance (ODA) and partially untied ODA.

34. According to a study conducted by the DAC Working Party on Financial Aspects of Development Assistance, large (>500 million) tied aid commitments totaling over $5 billion were made by donors in each of the years 1989 and 1990.

35. In other words, countries which have graduated or countries which are only eligible for IBRD loans repayable in 15 years cannot receive tied aid credits.
national competitive procedures by the recipient countries. Both DAC and the Arrangement participants also agreed to study further the scope for untying aid and initial consideration of this issue has since commenced in the Working Party on Financial Aspects of Development Assistance of DAC.

29. In view of the experience of the last decade, ECAs have been exploring ways of improving their decision-making process for extending export credits. At the macroeconomic level, this effort at improvement of credit quality has meant a greater and more systematic attention to country risk assessment. In supporting individual capital goods contracts of large value, requiring financing with MLT credits, there is a much greater interest in knowing about the end-use of these goods (in other words, the quality of the project or the investment in which they would be utilized). For both these purposes, there is a greater interest in exchange of information with the World Bank and, where opportunities arise, of working together with the World Bank in cofinancing Bank-supported projects. Planned export credit cofinancing with the World Bank declined from a peak of $1.9 billion in FY 1983 to $0.4 billion in FY 1986. It has since revived and has reached an average level of $2.1 billion for the FYs 90-92. It is interesting to note that cofinancing amounts, which have come up to the level of pre-debt crisis years, now represent a much higher proportion of the new long-term export credits committed by OECD ECAs, which have declined from a level of SDR 18 billion in 1982 to approximately SDR 8 billion in 1991. ECAs have also shown interest in working with the World Bank for supporting private sector investments which may be expected to be more efficient and therefore better risks.
Chapter Three

Current Issues

30. The Role of Officially Supported Export Credit Systems has increasingly come into question during recent years. The cash deficits of the ECAs in the last decade, which had to be made good by the government treasuries, is no doubt a very important motivation. Changing views, particularly amongst the OECD members, about the role of the government and the public sector in supporting and directing export efforts of the private sector (and, more generally, the role of the government and the public sector in promoting economic growth) as also concerns, particularly in the EC, about providing a “level field” for the private credit insurers, have also contributed to this process.

31. On account of these considerations, the possibility of reducing the role of the government and the privatization of export credit systems has been considered in a number of countries. As noted above, the ST credit insurance business of the officially supported ECAs continued to break even through the debt crisis of the last decade. This side of the business has therefore seemed the most appropriate for privatization. This has already been accomplished in UK by the sale of ECGD’s ST business to NCM, a private Dutch credit insurance company.36 Norway is another country where privatization of ST business is being considered actively.37

32. Not all the ECAs or their guardian authorities are, however, pursuing this option. Officially supported export credits, even ST ones, are seen by some of them as being essential for maintenance of trade and commercial relations with a number of developing countries, which can be expected to run into adverse economic conditions from time to time. In times of such difficulties, it is unlikely that credit cover would continue to be available from private insurers. Such disruption of cover could further aggravate the economic difficulties of these countries, while also further compounding the problems of the external creditors. In this view, it is therefore important to continue official support for the ST business.

33. A related consideration is risk diversification. It is generally accepted that the private markets are not currently in a position to extend insurance for MLT export credits to most LDC markets against the kind of risks covered by officially supported ECAs.38 Continuing official support to MLT credits is seen as being necessary. In these circumstances, it is felt by some ECAs that privatization of the ST business, which is quite large in volume terms and which has continued to remain generally profitable, will further weaken the financial position of the official ECAs and impair their ability to support MLT credits. Others, however, question this perception, pointing out that many ECAs write most short term business on their own account and all MLT business on government

36. Which also insure export credits on behalf of the Dutch government.
37. Other countries, while retaining public ownership, are placing the ST business on more commercial lines. For example, COFACE, the French ECA, whilst having a majority of public holders in its equity, guarantee on its own account (i.e., completely separate from the state account) all commercial risks up to three years and short term political risks up to three years for most OECD countries.
38. This is supported by the inquiries we have been able to make about the private credit insurance market.
account. Most ECAs do, in any case, emphasize that there is no cross-subsidization of premiums charged by them for MLT credits by the premiums recovered on the ST business.

34. It thus seems unlikely that official support for export credit arrangements, even for some ST transactions, will be discontinued in most OECD countries within the next 5-10 years, though there may be reduction in the level of government support and some greater reliance on private sector reinsurance. However, there is now a greater resolve to ensure that officially supported export credit arrangements are made robustly self-sustaining. As interest subsidies are already on the way to being eliminated, the two principal ways in which the export credit systems can be made self-sustaining are, first, by adjusting the premiums to better reflect the risks being covered and second, by modulating the cover policy by putting quantitative restrictions on the total business and/or new business to be supported in any market which is adjudged as being in a high risk category.

35. The Role of Export Credits in Trade Promotion: Trade promotion remains the raison d’être of the official support for the ECAs. The cover policies of the ECAs and the premiums charged by them for their support of export transactions can be expected to continue to be influenced by this motivation. The developments of the last decade have, however, led to a growing consensus that such official support would need to be provided without public subsidies either in regard to the interest payable on the credits or in respect of the premiums to be charged to the (mainly private sector) exporters or to the financing commercial banks. With a continuing movement towards harmonization of the terms of export credits, this will mean (and most ECAs recognize it) that such credits will have to be used by exporters in an environment where the credit terms will not of themselves provide a significant competitive edge to a potential exporter, at least in markets which have reasonable access to such credits. This is consistent with the general principle, agreed amongst the Arrangement participants, that policies “for export credits should be based on open competition and the free play of market forces.”

36. Premiums: As noted earlier, some ECAs have already revised their premium structures upwards and, in order to better allow for the varying individual “country” risks, made premiums more differentiated. As a consequence, the disparities between the premiums charged by different ECAs for providing cover for export to any individual market have also widened. The highest premium charged for several developing country markets by an OECD ECA can presently be three or even four times the premium charged by another OECD ECA in the same markets and may be equivalent to 10-15% or even more of the credit value. The wide disparities which have now developed can thus place the suppliers required to pay relatively high premiums at a significant disadvantage, since the premiums are generally payable by the suppliers or exporters to the ECAs (and are usually costed into the contract price).

37. Competitive considerations have therefore led to pressures from some of the ECAs (and their guardian authorities), which have either revised their premiums or which want to do so, for the adoption of an uniform approach to this question amongst the OECD ECAs. With the emergence of a single market in 1993, the EC has an interest in ensuring that there is a substantial measure of uniformity in the setting of premiums by the EC ECAs so that exporters in the various EC countries receive similar export credit support at comparable costs. Differences in trade patterns and current exposures of individual EC countries may, however, justify some differences in the premiums charged by individual ECAs for achieving the agreed financial objectives. Both the OECD Export Credit Group and the EC are currently engaged in studying this issue.

38. Since the cash deficits of ECAs during the last decade were mainly on account of their MLT transactions and arose principally because of “sovereign” or “political” risks, attention has focused on developing approaches for setting premium rates for covering “sovereign” risks in respect of MLT business. There is, however, no consensus yet on how best to address this question. There is not enough reliable data about ultimate losses from past transactions for considering an actuarial approach. It is also questionable whether information:

39. A third way is to reduce the percentage of contract value to be covered, which is, however, less generally used.
40. Footnote 5 of the updated text of the Arrangement.
41. Cash deficits of the last decade are on account of rescheduled loans which are still outstanding and for which it would be difficult to estimate the ultimate loss.
42. Using the loss experience of the last decade as a guide for assessing risks of future debt defaults by individual countries may not also be appropriate; it is highly unlikely, given the experience of the immediate past, that either external creditors or most borrowing countries will pursue policies and act in ways which are likely to result in similar widespread and massive debt defaults.
tion about past losses could provide a reasonable basis for forecasting future sovereign or country risks. Attempts are therefore being made towards developing a forward-looking country risk assessment systems on which premiums could be based more realistically.

39. For example, ECGD has adopted the Portfolio Management System which seeks to match premiums closely to risks. It determines political risks premium rates on the basis of probabilities of default and expected loss for each specific market. A relationship between debt ratios and default has been determined on a sample of countries (including all of ECGD’s major markets) and their default experience in the 1980s; probability of default in the next 10 year horizon is then derived by using projected key debt ratios (debt service, debt to exports and debt to GDP) based on an economic forecast prepared for the particular country. These key debt ratios are then used to determine the probability of default on the basis of the aforesaid relationship. Next, an estimation is made of the period for which the default can be expected to persist. This enables a calculation to be made about the expected claims which would be made on ECGD. The expected loss is then worked out as a proportion of the expected claims, using different loss coefficients for countries with different perceived risks. This part of the risk assessment system is guided by the Bank of England Matrix for sovereign debt recoverability, which is used by UK commercial banks to determine their provisions on doubtful sovereign debts.

40. In the USA, the Export-Import Bank (USEximbank), along with other US government agencies responsible for providing foreign credits, have developed a market-based risk assessment system which is expected to be adopted by these agencies starting in US FY93. This common system was developed in order to meet the requirements of the Federal Credit Reform Act of 1990, under which each cross-border loan, guarantee or insurance transaction made by any US federal agency has to be scored in the budget on the basis of estimated financing and risk subsidies involved in that transaction. Financing subsidies are calculated as the difference between the interest charged on the transaction and the government’s cost of borrowing. Risk subsidies are calculated as the difference between the exposure fees charged and the expected losses due to non-payment. For each agency, the sum of all subsidies during each fiscal year can be no more than the amount appropriated by the Congress. The Eximbank board has decided, in principle, to adopt the inter-agency ratings and use them as the basis for setting cover policy and exposure fees (premiums).

41. Under this assessment system, countries are to be classified in 11 categories according to a graded scale of expected payment problems, based on conditions expected to prevail over the next five years. A scheme has been evolved to allocate individual countries in one or other of these categories, according to their present and future economic condition and prospects. It is recognized that this categorization involves a considerable element of judgment. A correlation has been developed between the Moody’s and Standard & Poor’s long-term bond classification and the first eight of the above categories. The average spread (difference) in yield of bonds of a particular classification and Aaa or AAA bonds is used to derive an estimate of the annual probability of non-payment. The expected loss on a transaction is calculated as the present value of the stream of expected non-payments over the entire transaction period. Chart 3 on the next page gives an indication of the current level of premiums being charged by the USEximbank in markets with varying risks, in relation to their loss expectations based on this new forward-looking assessment system. The USEximbank has not, however, yet begun setting its premiums based on this new risk assessment system, pending adoption of a comparable approach in this regard by other OECD participants.

42. Other ECAs are understood to have developed similar approaches, though perhaps not as elaborate and quantitative as either of the two

43. Based on the paper on Portfolio Management System presented by Mr. V. Lunn-Rockliffe, ECGD at the Berne Union Workshop on Country Underwriting and Treatment of Sovereign Debt held at Capetown, April 13-16, 1992.

44. Based on the paper From Ordinal to Cardinal Measures of Country Risk prepared by Mr. Daniel Bond, USEximbank for the above workshop.

45. For the remaining risk levels correlation with bonds is not feasible as regularly published information about bonds rated Caa and below (with which these higher risk levels would need to be correlated) is not available. In such cases, the US credit agencies have decided to use information from the secondary loan market. The Eximbank, in any case, does not provide cover of any kind for countries in categories below 8.
systems mentioned above. As both ECGD and USEximbank recognize, their approaches do involve a substantial measure of judgment and this would seem inevitable when attempting to relate present levels of premiums to future loss expectations. There are also two other questions relating to the setting of premiums for credit guarantees/insurance on which there are differing views. The first is whether retrieval of past losses should be a factor in setting premiums for future business. This is not generally regarded as a practical proposition. It is, however, widely recognized that the need to balance the accounts should influence the level at which future premiums are set and the experience of the last ten years would need to be taken into account. The second is regarding the extent to which premiums should be varied with the degree of risk. It is suggested that good insurance practice does involve a certain cross-support of the bad risks by the good risks in the portfolio. Attempts at establishing too close a linkage between premiums and the degree of risk by the establishment of several levels of premiums (corresponding to different risk levels) may not be very meaningful. In addition, differing levels of current exposures in a given market amongst the ECAs and varying perceptions of the future potential of that market amongst them are also factors which would impact the setting of premiums; all these factors would argue against total uniformity in the level of premiums.

43. While the need to conduct officially supported export credit business on a self-sustaining basis will no doubt move the ECAs towards revising their premiums upwards, competitive considerations will mean that these revisions are done more or less simultaneously by all or most of the OECD ECAs. The discussions in the foregoing paragraphs would suggest that harmonization of approaches to the setting of premiums is likely to be a long drawn-out process.

44. Cover Policies: In attempts to make their business self-sustaining, the ECAs also can and do restrict providing guarantee/insurance cover for transactions with the riskier countries. This is done in several ways. Short of going off-cover (being the extreme restriction), financial limits can be placed on new or total business. Cover can be made subject to guarantees in respect of payment and transfer. Limits also can be placed on the size of individual transactions (though this is done more with a view to make the limited cover available to a larger number of exporters). Irrevocable letters of credit

**Chart 3: Comparison of Expected Losses and Exposure Fees**

Source: Reproduced with the kind permission of Mr. Daniel Bond, USEximbank (See footnote 44 above).
(from domestic or international banks) may be insisted upon. Country risk assessments, to which, as noted above, a much greater attention is being paid, provide the basis for these cover decisions.

45. With a view to improving the quality of their country assessments, ECAs have been increasingly seeking the views of the IMF and the World Bank on the economic conditions and prospects of selected individual countries, and there is a long established practice of the World Bank and IMF staff participating in the semi-annual Berne Union meetings for this purpose. In recent years, a small group of Berne Union members, led by its current President, has also been visiting Washington every fall to further strengthen this exchange of information. During the last few years, interest has also grown in ascertaining the World Bank’s views about individual projects which the ECAs are asked to support with a view to improving the quality of credit assessment. The World Bank does try to share the information it has but has clarified that the World Bank can only be expected to have partial knowledge, which would be limited to comparatively large public sector projects in those sectors in which the World Bank is involved in a particular country. Thus, for many of the individual cover requests, the ECAs have to take decisions with only limited information about credit quality. For the “riskier” countries, for which ECA cover is, in any case, restricted by the overall ceilings adopted by the ECAs, this factor would tend to further limit the availability of credits.

46. It will be recalled that, currently, the cover policies of the ECAs of the EC countries, the terms of their cover and the premiums are set separately by each ECA in consultation with and with the approval of its guardian authority. The EC is now seeking harmonization in the approaches of the EC ECAs in respect of all these elements. While some progress has reportedly been made in the matter of terms of cover, we have noted that harmonization of methodologies for premiums is likely to take time. Convergence of approaches in cover policies of the EC ECAs can also be expected to develop gradually, given the very different levels of current exposure of individual ECAs in a number of markets and given the varying perceptions of future prospects of specific markets amongst these ECAs.

47. Export Credit Support for Private Sector Borrowers: Until very recently, a large proportion of MLT export credits to developing countries were extended either to government undertakings or to public sector borrowers. This was because major investments in most developing countries, particularly in the energy, power, transport and mining sectors (all requiring large capital plant and equipment) were, for the most part, undertaken by the government or the public sector as a matter of deliberate policy by most such countries. In most developing countries, ECAs also found it more feasible to extend support to credits for public sector borrowers with explicit or implicit guarantees from the host governments, since in this case their decision could be essentially based on their assessment of the borrowing country’s creditworthiness. An assessment of the investment’s own viability was not always given priority from a risk management perspective. Support for private sector borrowers, where necessary, was extended against guarantees provided by domestic (often public sector) financial institutions or international banks.

48. The developments of the last decade are leading to changes in this pattern of export credit lending. Many borrowing countries now see a much larger role for the private sector for the future growth of their economies. Foreign direct and portfolio investment in their economies is seen as an important means of mobilizing external capital. An example of this is the attempt of many developing countries at encouraging private sector investment in infrastructure sectors, heretofore reserved for the public sector, through so-called B.O.T. (Build-Operate-Transfer) or B.O.O. (Build-Own-Operate) projects, in which private sector project sponsors and their creditors are expected to mobilize the substantial finance required for such projects on a non-recourse basis, i.e., where the project assets are the only tangible security for the creditors and where the service of the equity and the loan capital is wholly dependent on the project revenues. As such projects, almost invariably, have large requirements of capital equipment, ECAs have received several proposals from prime contractors and equipment manufacturers for their support on this basis.

49. Project financing on a non-recourse basis requires the financiers—including the providers of debt—to depend wholly on the success of the project for their returns. The various risks which

46. It may be mentioned that the EC had earlier considered the feasibility of setting up a single European ECA as a way of achieving full harmonization. It is understood that while this proposal had the support of a number of the smaller EC members, the larger members were opposed. At least at present, the attempt is to seek harmonization amongst the national ECAs.
may affect the project need to be carefully evaluated and satisfactory measures taken for their containment, involving an elaborate contractual framework amongst the various parties involved, setting out each party's rights, obligations and liabilities. Other measures for risk containment, such as insurance, have also to be put in place. This has meant that even in industrialized countries, project financing on a wholly non-recourse basis has been feasible in a very limited number of cases, where the project sponsors have often included internationally well known, established contractors or multinationals, where the products were robustly profitable and where, in many cases, the revenue stream (particularly when available in foreign exchange through export of the project output) could be initially directed to an "escrow account" and made available for debt service on a preferential basis. A particular concern of most project creditors relates to the pre-production phase of project implementation. Creditors have therefore sought "limited recourse" to other assets of the project sponsors as a condition of their support, particularly until such time as project production is stabilized at a level sufficient to ensure regular debt service.

50. The difficulties of project financing either on a "non-recourse" or a "limited recourse" basis are far greater in a developing country. In addition to greater problems in project implementation, on account of factors such as lesser known project sponsors, inferior infrastructure, inadequately trained manpower, inefficient government procedures for obtaining the needed statutory and administrative clearances, etc., a crucial additional issue of "country" or "sovereign" risks arises, particularly for external creditors. These risks, which are not perceived as being significant in industrialized countries by these creditors, often are seen, in developing countries, as being much greater than the "project" or "commercial" risks which have to be addressed in any case. Such "sovereign" risks include not only the widely known ones such as compulsory appropriation or nationalization, rescheduling of debt obligations or of non-convertibility of revenues earned in local currency, but also include those of non-performance of public sector utilities or enterprises in fulfilling their contractual obligations vis-a-vis the project, e.g., for supply of inputs such as fuel or water, or for paying for the off-take of the project production, say of electric power. Without the needed assurances and undertakings from the host governments in this regard, external creditors are not inclined to support limited or non-recourse project financing in most developing country situations. As insurers or guarantors of such creditors, ECAs also have similar concerns. As a consequence, only a handful of such projects have been actually supported by ECAs on this basis. A couple of policy issues are mentioned below, whose resolution may facilitate a wider use of this technique.

51. Repayment terms of export credits, which, in the case of OECD ECAs, are subject to certain maxima under the Arrangement have been seen, at least in some cases, as being an impediment in project financing on a limited or non-recourse basis. The prescribed maxima of 8.5 or 10 years for repayment terms, it is suggested, may not be adequate for infrastructural projects such as electric power stations or toll roads for which initial tariffs may need to be set at an excessively high level if export credit (and other) debt is required to be amortized within such short repayment periods. This is an on-going issue under discussion amongst the ECAs; while the need for some flexibility in repayment terms in such cases is appreciated, there is also reluctance to modify this important aspect of the Arrangement, on which agreement was reached after extensive negotiations. The Arrangement does have a procedural mechanism by which ECA participants in a project can agree amongst themselves to provide support for export credits not conforming to the Arrangement terms through the so-called "common line" approach. The use of this mechanism is possible only case-by-case; it has not been used so far for obtaining an agreement amongst ECAs on providing support on repayment terms which do not conform to the Arrangement. It has, however, been suggested that this approach would be facilitated, if an independent appraisal agency such as the World Bank were to provide an objective analysis justifying a modification in repayment terms in a particular case.

52. Escrow Accounts: As noted above, external creditors, including ECAs, consider escrow accounts (for receipt of export proceeds and for the preferential use of such receipts for debt service due to these creditors) to be a key element of the security arrangements which they would require for supporting private sector projects on non- or limited recourse basis, particularly in countries with marginal creditworthiness. Indeed, in such circumstances, similar arrangements have also been sought by these creditors for public sector projects. The

47. Please see paragraph 14 b) above for details.
IMF, the World Bank and other development institutions are concerned that the sequestering of foreign exchange income streams from the limited number of viable export oriented projects feasible in the borrowing countries would reduce the authorities' flexibility in facing external payment difficulties and make the management of foreign exchange and a move towards a liberal exchange regime, necessary for the development of outward-looking macroeconomic policies, more difficult. The interested private creditors and ECAs, however, point out that in the absence of this crucial security, the needed investments in large projects which would strengthen the country's access to external resources would not take place. While there is a growing recognition that such arrangements may need to be established for attracting the needed external loan capital for economically viable large private investments in "difficult" countries, a case-by-case consideration of individual projects is seen as being inevitable; here again the evaluation of the proposals by a development institution such as the World Bank is considered as being very helpful for ensuring that escrow accounts are established selectively, in cases where the advantages of doing so clearly outweigh the perceived disadvantages. The benefits of allowing such accounts in the case of public sector projects are less clear; for the World Bank and other multilateral development institutions this also raises the question of grant of waivers of the "negative pledges" provided by the borrowing country governments to these institutions when borrowing from them. Some modifications of the present policy are currently under consideration in the World Bank; here also a case-by-case approach seems inevitable.

In this background, it would be reasonable to anticipate that financing of private sector projects on a non- or limited recourse basis would be feasible only for large projects in selected cases. For the most part, ECA support for private sector investments in developing countries would be feasible only if acceptable guarantees are available from domestic or international banks and if reasonable assurances regarding transfer (convertibility) risks are provided by the concerned government or central bank authorities. In case of small- and medium-sized private sector enterprises, export credit support could be best channeled through local financial institutions who are prepared to take the credit risk, as it will not be feasible for the ECAs to directly assess the credit risks of such borrowers. An adequate infrastructure of financial institutions and a supporting legal framework will thus be needed for inducing MLT export credit flows to private sector.

54. Export Credits for Countries of the East-while Eastern Europe and the States of the Former USSR: Export credits have been an important source of capital for these countries. According to Berne Union data, for the period ending September 30, 1992, the total commitments (including interest) of its members in respect of the five principal East European countries, i.e., Bulgaria, Czechoslovakia, Hungary, Poland and Romania were US$18.75 billion, and in respect of the states of the former USSR they were US$41.06 billion. These together represent 20.03% of the total outstanding of the Union members in respect of 43 countries (including the countries in question) which are their major non-industrialized markets. Similarly, the arrears on account of MLT credits totalled $2.91 billion for these five East European countries and $1.49 billion for the former USSR states. Together they represent 20.33% of the total MLT arrears in the same 43 markets. These former U.S.S.R. and East European markets continue to be of interest to ECAs. As of September 30, 1992, the total offers extended were $7.28 billion for the five East European countries and $24.89 billion for the states of the former U.S.S.R. These offers represented 27.71% of the total offers outstanding in respect of the same 43 markets.

55. Against this background, the ECAs, particularly the European ones which have the larger exposures, are greatly concerned about future debt defaults by one or more countries in these regions of Eastern Europe and former USSR. They are also concerned about receiving adequate securities for any future business they transact. The legal uncertainties regarding the status of ownership of various assets and the very rudimentary financial systems in most of these countries are seen as major obstacles in providing support for private sector enterprises in this region. Despite the commitments and offers of the ECAs and the perception that these countries

48. The fact that foreign exchange controls have been abolished by a country may not be by itself an adequate assurance to external lenders of medium- or long-term resources till such an unregulated regime has operated for sufficient time and the economic condition of the country is seen to have stabilized to an extent where future foreign exchange shortages are considered unlikely.
can become major markets for exporters from OECD and other countries in the medium term, export credit flows to this region are unlikely to pick up rapidly in the near future, pending an improvement in these areas of concern to the ECAs.

56. It may be relevant also to mention a couple of Operational Issues of current interest. The first is the beginning made in the Securitization of export credit assets backed by the guarantees of USEximbank by some lending banks. For the present, the deals done relate to credits extended to Mexico, though USEximbank has shown willingness to consider similar transactions in respect of credits extended to other selected markets. This development represents an addition to products available in the market for asset backed securities, which market has grown dramatically in the United States in the last ten years. The main factors which have contributed to this growth are a) the interest on the part of the US-based banks to limit the volume of assets on their books in view of the increasingly stringent capital adequacy measures prescribed by bank regulators, coupled with the difficulties faced by these banks in raising fresh equity because of their poor operating performance and b) the existence in the US market of a large demand from institutional investors for high quality long-term paper. USEximbank's support was crucial for the development of this innovative approach, which has also been of some benefit to the borrowers in two ways. First, it is reported to have helped in some reduction of the borrowing costs. Second, and equally important, has been the reduction in transaction time for the exporters and the importers in finalizing the export credit deals. While some other ECAs, such as, for example, ECGD of UK, have interest in a similar program, no transactions have materialized so far. It would seem that the two factors responsible for growth of asset based securities in the US do not extend to other countries; the legal framework and structure of some of the other ECAs may also be additional factors.

57. The other issue, which is perhaps of some interest and relevance in the case of European export credits, relates to the credits extended through the so-called Second Windows. These credits are extended by the specialized credit institutions set up in a number of countries with government or public sector participation (from funds raised from the national or international capital markets) with insurance or guarantees obtained from the respective ECAs. In such cases, the interest rate discipline of the Arrangement would not apply prima facie because the ECA support is limited to only "cover" for the credit risk and does not involve any financing support such as refinancing or interest subsidy. The concern, however, is that the participation of government in a specialized financing institution may enable the institution to have access to the market on a preferential basis, enabling it to borrow and to lend at "below market" terms. This matter is to be further studied by the Consensus participants' group.

49. The essential steps in this approach are:

i) The US-based lending bank (LB) and USEximbank agree that LB can extend credits to finance US exports up to an agreed overall amount on its own account for exporting to an agreed market. The agreement covers the terms on which the credits will be extended (usual repayment period being five years), the nature of goods to be financed, stipulations about the US content of the goods, the size of individual credits and so on with a view to facilitate the next step;

ii) When a sufficient number of export contracts (with credit financing) have been extended by LB, it submits all these transactions for coverage by guarantees, the prior understanding being that in case any contract is not approved by USEximbank, financing of that contract (already extended by LB) will be at the risk of the LB. (In actual practice, by limiting the transactions to a fairly straightforward export of capital goods ["cookie-cutter" transactions], the risk of such rejection is minimized).

iii) Credits approved by the USEximbank are then "bundled" into sizable lots of $100 million or so and these provide the asset backing of securities placed with institutional investors by private placement. The USEximbank backing is the key to raising these securities to the investment grade required by these investors.
Chapter Four

Future Prospects

58. Future prospects of officially supported export credits may be considered from the perspective of the recipient developing countries and that of the providers (ECAs). For most of these recipients, in the 1990s, MLT export credits will be more accessible than private MLT debt flows. International commercial banks have very limited appetite for acquiring new MLT assets in most developing countries, not only because of the losses they have suffered in respect of LDC debt in the last decade, but also because of losses arising from other business such as commercial property loans in recent years and the more stringent regulatory regime which has developed as a consequence. Only a small number of developing countries presently have unrestricted access to private capital markets.

59. Assuming that there are no major changes in the international economic environment—such as may be caused, for example, by an unsuccessful conclusion of the Uruguay Round or by unforeseen developments in the evolution of the single EC market, we have attempted, in the succeeding paragraphs, to foresee the likely developments in the field of export credits in the coming years.

Borrower’s Perspective

60. Private MLT debt flows can be expected to remain confined to the better country “risks” and be usually associated with projects whose implementation also provide some other benefits to the lending banks such as, for example, association of a corporate client as an investor, contractor or supplier, or the possibility of some supplementary business such as handling the banking transactions relating to the raw material imports or product exports related to the project on a continuing basis. Such banks would prefer to arrange a part of the project finance needed through export credits, so that a part of their lending exposure to the borrower’s country is reduced for that particular transaction. From the borrower’s perspective, export credit borrowing may thus help catalyze some complementary private flows.

61. As discussed above, in the future, MLT export credits are likely to be available only at market-based interest rates (in most cases, CIRR-based) and on payment of higher premiums to the ECAs. While the explicit subsidies provided by lending country governments to such credits may be thus largely eliminated, these credits will still have an element of implicit subsidy for most developing country borrowers in the sense that such MLT flows (either in comparable volume or terms) could not be obtained by these borrowers in the private market. 50

62. However, a point to note about premiums is that they are not directly a part of the credit terms. They are payable to the ECA, not by the borrower but by the supplier/exporter or by the lending bank. The costs of these premiums get reflected in the credit terms indirectly, either by the supplier/exporter increasing the price of the exports and

50 In his paper on Trade or Aid? (Institute of East-West Studies, New York, 1991) Mr. Daniel L. Bond defines “subsidies” from the point of view of the borrower and “costs” from the viewpoint to the lender. In future, according to this definition, “subsidies” can still be expected to be available to borrowers, but only to the extent that they can be provided without any “costs” to the lenders.
thereby the amount of the credit or by the lending bank charging larger front end fees and/or wider lending margins. To the extent the borrower is able to select the supplier/exporter or the lending bank on a competitive basis, some part of these premium charges could be expected to be absorbed by the providers of export credits in their profit margins and not passed through entirely to the borrower.

65. From the borrowers' perspective, officially supported export credits thus can be an external resource “additional” to what the borrowers can raise in the private market, and one whose direct financial costs are likely to be somewhat lower. There are, however, two offsetting factors which can add to the costs of export credits for the borrower. The first relates to the “tied” nature of export credits. Because of the official support, there are limitations on the proportion of “third country” goods and services which are eligible for ECA coverage. Due to concerns about these limits on “third country” content, this may result, particularly in the case of larger contracts for complete plants, in the bidders offering an assembly of project components which may not be the most viable technically, or the least costly in financial terms. This disadvantage can be minimized by resorting to competitive procurement to the extent feasible; for

51. Please note that these are approximate ballpark figures of the premiums being currently charged, based on our discussions with the major ECAs, the OECD secretariat and the Berne Union. While not precise in themselves, we believe that they represent the ranges quite realistically.

52. Minimum Indicative Rates of Straight Discounts on Money Market Basis. Source: Trade Finance, August 1992. They assume the issue of bills of exchange or promissory notes with the usual or guarantee of an acceptable local bank/ ministry/foreign trade organization, immediately available for discounting and repayable in equal semi-annual installments (each for a minimum $1 million or equivalent with a minimum transaction value of $3 million) for the period indicated above.

53. In the case of non-ECECAs, such “third country” content limitation is usually around 15% or so of the contract price. In the case of EC ECAs, where the “third country” is another EC member, greater flexibility is possible; up to 40% of the contract value for contracts below 7.5 million ECUs and up to 30% (or 3 million ECUs, whichever is greater) in the case of larger contracts.

<p>| Table 3: Export Credit Premiums for Selected Countries |
|---------------------------------|-----------------|-----------------|-----------------|</p>
<table>
<thead>
<tr>
<th>Country</th>
<th>Range of ECA Premiums</th>
<th>Equivalent Average Spread %</th>
<th>Indicative Forfaiting rates (US$)</th>
<th>Equivalent Spread % over US$ deposit rates for the same maturity</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>4.50-20.00 (Av. 9.56)</td>
<td>3.22</td>
<td>5.3750%/1 year</td>
<td>2.1</td>
</tr>
<tr>
<td>Malaysia</td>
<td>1.25-6.75 (Av. 4.00)</td>
<td>1.33</td>
<td>5.5625%/5 years</td>
<td>0.44</td>
</tr>
<tr>
<td>Mexico</td>
<td>4.50-16.00 (Av. 7.00)</td>
<td>3.00</td>
<td>6.8125%/3 years</td>
<td>2.8</td>
</tr>
<tr>
<td>Turkey</td>
<td>4.00-12.50 (Av. 7.00)</td>
<td>2.37</td>
<td>6.1825%/2 years</td>
<td>2.5</td>
</tr>
</tbody>
</table>

*Indicative maximum maturity of the paper which can be discounted in the forfait market.
the less creditworthy borrowers, the choice may, however, be limited.

66. The other disadvantage is in respect of transaction time. ECAs have a centralized system of decision making and, typically for MLT credit transactions of any significant value, a supplier or a lending bank can expect to get ECA approval for a transaction in a matter of months rather than weeks. Planning a longer lead time for procurement to be financed by export credits may help minimize costs arising from this factor. As noted earlier, the securitization approach developed recently by USEximbank has helped reduce these transaction times; some reduction in interest costs has also been possible. The use of such innovative approaches will need to be explored more systematically by borrowers. The ECAs who are able to support such innovative approaches may provide a competitive advantage to their exporters, particularly as the terms of export credits become more uniform.

The Supply Side

67. The experience of the last decade, as already noted, has led the ECAs to give more attention to “country risk” assessment and to the evaluation of project quality in cases of large value contracts. The availability and scope of ECA cover for MLT credits can, in future, be expected to depend mainly on these two factors. Based on our discussions with selected ECAs, the following regional perspective seems reasonable.

Sub-Saharan Africa: For most countries, MLT export credit cover will be available, if at all, on a very restricted basis. Zimbabwe, South Africa, Kenya, Ghana, Nigeria and Côte d'Ivoire are the most likely recipients of some limited flows.

South Asia: While India, Pakistan and, to a lesser extent, Sri Lanka, are seen as important markets with future potential, country risk concerns will limit availability of export credit support, though the available envelope for India may be enlarged quite readily if the economic program of liberalization, recently undertaken, succeeds and quickens growth.

East Asia: This region will, overall, continue to benefit from the current open ECA policies. ECA cover for Philippines can be expected to become more liberal pari passu with the progress of its economic reforms.

Middle East and North Africa: Political uncertainties and concerns may tend to limit cover availability, though the proximity of the Maghreb countries to the EC and their preferential access to EC markets will be a factor working in the other direction.

Latin America: Traditional trade patterns suggest that Latin America’s emergence from the debt crisis is likely to revive capital goods imports principally from North America and larger new export credit flows from USA and Canada can be anticipated. Other ECAs have also responded to the economic reforms undertaken by some countries in this region—Mexico and Chile being the two notable examples. European ECAs’ expectations of an increase in their business are, however, subdued; the North American ECAs are more optimistic.

Central and Eastern Europe and the Former USSR: While political and trade considerations have resulted in some limited MLT cover being made available by many ECAs, notably of the European countries, the weaknesses of the domestic banking systems, uncertainties about property rights, non-availability of acceptable securities, etc. have constrained actual commitments. Concerns about regular service of existing outstandings are also likely to affect future cover availability until there is sustained progress in political and economic stabilization.

68. Two supplementary factors likely to impact the future availability of MLT export credits are:

a) Given the greater attention which ECAs can be expected to pay to country risk analysis and keeping in view their basic objective of trade promotion, ECA cover availability may become very restricted for small countries with marginal economies, which are not seen as markets with some significant potential.

b) New approaches will need to be evolved for mobilizing ECA support for private sector projects. Such approaches are likely to be feasible, as discussed above, in countries with a reasonably viable financial sector. In the absence of the needed banking infrastructure, tapping MLT ECA resources may be difficult for the private sector in many developing countries.

69. Keeping the foregoing in view, one can anticipate a slow growth in ECA flows to developing countries in the near future; the pace of flows can be expected to accelerate in the medium term, assuming a reasonable success in the economic reform measures being undertaken by a wide range of developing countries.