The Changing Nature of Export Credit Finance and Its Implications for Developing Countries

World Bank Staff Working Paper No. 409

July 1980

Prepared by: Albert C. Ciauskas
Economic Analysis and Projections Department

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THE CHANGING NATURE OF EXPORT CREDIT FINANCE
AND ITS IMPLICATIONS FOR DEVELOPING COUNTRIES

A Background Study for World Development Report, 1980

Official support for financing exports has become a complex, highly-subsidized form of assistance to promote foreign sales, especially of manufactures and capital goods. Spurred on by sharper competition among industrialized countries, the evolution in export finance has important implications for developing countries. One is the availability of a growing source of external capital on terms below prevailing market costs. Another is the emergence of the more advanced developing countries as providers of subsidized finance to promote their own rising exports of manufactures.

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THE CHANGING NATURE OF EXPORT FINANCE 
AND ITS IMPLICATIONS FOR DEVELOPING COUNTRIES

I. Introduction

By the mid-1950's, postwar industrial recovery had largely been completed, and the output of engineering goods, ships, power plants and the products of other industrial sectors with a high degree of technology grew rapidly. Competition to export these items, which were relatively costly, also sharpened. Buyers' markets began to develop in the industrial countries and one of the means utilized by exporters to facilitate sales was to extend financial accommodation in the form of relatively short-term supplier credits. Developing countries also became important outlets of manufactured goods and required credit for purchases which could not be financed out of their own resources or concessional assistance.

Increasingly, governments began to develop various forms of financial support, such as the blending of public with private funds, and the provision of refinancing facilities and subsidized interest in order to soften the terms of export finance and thus enhance the competitiveness of their exporters. Such financial assistance was usually made available in conjunction with insurance coverage, official programs for which had been established in pre-war years to protect exporters from commercial and political risks.

1/ Commercial risks cover default and insolvency of buyers. Political risks mainly involve acts of governments which delay or prevent the transfer of foreign exchange. See Annex 1 for details.

2/ In this report, the terms "preferential financing" or "preferential support" will denote official measures designed to reduce the cost of export credit lending below comparable market terms.
shipbuilding, the desire to ensure energy supplies, and even the pursuit of political objectives. More recently, with slower growth in the industrialized countries, official support for manufactured exports, especially capital goods, accelerated markedly as a means of taking up the slack in their economies. As the subsequent sections will indicate, such support has evolved into a complex array of preferential financing and insurance facilities with repayment terms today for developing countries often in excess of ten years and interest at fixed rates about 9 percent on the average, well under prevailing market costs.

These officially-supported export credits, which consist of both public and private (including commercial bank) funds, have grown rapidly over the past two decades. Net disbursements in 1978 from OECD members to developing countries amounted to $13 billion, exceeding for the first time net bilateral ODA flows but still substantially less than non-trade related and non-supported private bank lending at market terms which amounted to $22 billion.

Another development of considerable potential importance has been the emergence of a number of industrially more advanced developing countries which have also established programs of insurance and financial support for "non-traditional", i.e., manufactured exports, including Argentina, Brazil, India, Israel, Mexico, South Korea, Taiwan and Yugoslavia.

Thus far, available evidence suggests that these more advanced developing countries have been able, despite intensified competition from developed countries, to expand their manufactured exports. An interesting -- and potentially troublesome -- question is to what extent a deepened recession...

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1/ The term "OECD" in this report is synonymous with "DAC", the Development Assistance Committee of the OECD. Developing countries as used in this report refer to the OECD listing of these countries unless otherwise stated.
in the OECD countries might aggravate competitive pressures for continued subsidization of export finance to the possible detriment of the middle-income countries.

On the other hand, these considerations need to be balanced against the potentially-beneficial results to developing countries of a large source of external finance on terms that are increasingly less market-oriented at a time when other forms of external finance (such as private bank lending not directly tied to trade financing) might become more vulnerable to adverse developments in industrialized countries.

This report does not analyze the economic and financial issues underlying export credit subsidization and in particular whether this is a sensible use of scarce resources for developing countries. Its purpose rather is to alert Bank staff to the evolution in export credit and insurance facilities and to discuss the implications for developing countries of such changes.

II. Growth of Export Finance to Developing Countries

Export finance as used in this report denotes three main types of credits. The first, and one of its earliest forms, is supplier credits which, as the name implies, are extended directly to foreign buyers by the exporters themselves with repayment periods generally up to five years. Due to competitive pressures, a system of credits extended directly by private banks in the exporter's country to foreign buyers or borrowers was developed in the late 1950's as a sounder means for providing longer repayment terms. These private bank loans are usually called buyer credits. Both of these forms of private export credits are eligible for official support in varying degrees in industrialized countries through refinancing facilities, subsidized interest and insurance against commercial and political risks. The third category consists

1/ Short-term credits with repayment terms less than one year are not included in this paper.
of official export credits which are extended by an increasing number of
governments either to their own exporters, or more frequently to foreign buyers,
often in association with private export credits and, like buyer credits, are
generally characterized by repayment periods in excess of five years. All
three forms of export credits are today supported by governments to the extent
required to bring them generally into conformity with international norms
for lending terms as will be noted in a later section.¹/

Private export credits to the Third World supported by OECD member
countries have been growing at a rapid and accelerating pace. In 1959, for
example, the net flow of private export credits supported by OECD member
countries amounted to $320 million. Twenty years later, in 1978, the net flow
had risen to $9.7 billion. Of these credits, informed sources estimate that
more than half now consist of private bank buyer credits.

Official export credits have also grown since the late 1950's when
the US was virtually their sole provider. Aggregate data for official export
credits, however, are available only for later years, but they serve to
illustrate the particularly rapid expansion of this form of export finance
from net flows of $700 million in 1974 to $3,500 million in 1978. The three
categories of export credits combined amounted to $13.2 billion in net flows
during 1978, slightly exceeding bilateral ODA flows for the first time whose
own growth was slowing and whose availability was chiefly limited to poorer
recipients. On the other hand, the principal recipients of OECD-supported
export finance are currently such rapidly industrializing countries as Korea,

¹/ See also Annex 1 for glossary of export credit terms.
Brazil, Mexico, Taiwan, Yugoslavia, Greece and the Philippines. Another indication of the increasing importance of export finance to these countries is that a growing proportion of manufactured imports by the developing countries are being covered by export credits. The table below summarizes these developments.

Table 1

<table>
<thead>
<tr>
<th></th>
<th>1959</th>
<th>1974</th>
<th>1978</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Net flows of export credits officially-supported by OECD</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. Private</td>
<td>320</td>
<td>2,480</td>
<td>9,687</td>
</tr>
<tr>
<td>b. Official</td>
<td>n.a.</td>
<td>691</td>
<td>3,498</td>
</tr>
<tr>
<td>c. Total</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1) Nominal</td>
<td>320</td>
<td>3,171</td>
<td>13,185</td>
</tr>
<tr>
<td>2) In terms of 1978 dollars</td>
<td>922</td>
<td>4,408</td>
<td>13,185</td>
</tr>
<tr>
<td>2. Net flows of bilateral ODA from OECD</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1) Nominal</td>
<td>4,001</td>
<td>8,257</td>
<td>13,123</td>
</tr>
<tr>
<td>2) In terms of 1978 dollars</td>
<td>11,523</td>
<td>11,477</td>
<td>13,123</td>
</tr>
<tr>
<td>3. Exports of manufactures from industrial to developing countries (excluding OPEC)</td>
<td>n.a.</td>
<td>59,500</td>
<td>95,800</td>
</tr>
<tr>
<td>4. Line 1(c)(1) as % of line 3</td>
<td>5.3</td>
<td>13.8</td>
<td></td>
</tr>
</tbody>
</table>

\(a/\) Based on the export price index for industrial countries expressed in terms of US dollars (1975=100):

<table>
<thead>
<tr>
<th></th>
<th>1959</th>
<th>1974</th>
<th>1978</th>
</tr>
</thead>
<tbody>
<tr>
<td>1959</td>
<td>43</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1974</td>
<td>89</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1978</td>
<td>124</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(Source: IFS Yearbook for 1979).

Sources: Export credit data from DAC Chairman's Reports. Manufactures data from International Trade 1978/79. (GATT)
An alternate, and for some years now, the single largest source of external financing for developing countries has been private bank lending, to a considerable extent but not exclusively channeled via the Eurocurrency markets. According to the DAC, net flows of private bank lending unassociated with export financing amounted to $22.2 billion in 1978, as compared with $13.2 billion for officially-supported export finance (including private bank buyer credits). Major differences between the two sources of international capital flows are the generally untied nature of unsupported private bank lending and its variable rate structure. The former of course contrasts with export credits which are linked to specific transactions inhibiting the borrower's flexibility of choice in the use of the funds. On the other hand, fixed-rate financing below market costs associated with supported export finance can imply substantial savings in debt servicing, particularly in view of the generally higher cost and volatility of bank lending rates.

III. Lending Terms

Virtually all countries with significant industrial sectors today provide financial support for exports sold on a medium- or longer-term basis, typically at fixed rates below market costs. Some -- like the US, Japan, Canada, Australia and Korea -- finance part of the export credit directly through official institutions (e.g., Export-Import Banks). The more common method is to do so through the commercial banking system, with governments

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1/ It is estimated in World Development Report, 1980 (Washington, D.C.: World Bank, 1980) that net flows to developing countries of private bank lending during 1978 were $23 billion. The WDR figure consists of credits guaranteed by developing countries, including buyer credits. The OECD figure excludes buyer credits but includes other private bank credits not guaranteed by developing countries.

2/ This is true to the extent that prices to the foreign buyer of the financed goods are not raised to offset the effect of subsidized financing. See p.10 for private bank lending rates.
refinancing a portion of the export credits and subsidizing the difference between market and fixed rates. Increasingly, however, most governments are becoming directly involved in export financing with international competition in lending terms and conditions escalating sharply. It may be helpful, therefore, to look at some aspects of officially-supported export finance where friction among the major trading countries has been particularly marked.

**Interest Rates** - One of the principal such areas, and one of the most controversial, is interest rates. This is hardly surprising because the structure of interest rates as well as other aspects of monetary conditions (such as inflation and exchange rates) are different for different countries. Such differences have tended to fluctuate widely in recent years, especially since the quadrupling of oil prices in 1973-1974.

The major exporting countries intensified their financial support for private exporters during this period, sometimes at considerable budgetary cost. This accelerated the process, begun in the early 1960's, of substantially insulating the terms of export credits from conditions in domestic as well as international money markets. Officially-supported export credits have now come to be characterized generally by interest rates lower than those prevailing on money markets for comparable maturities, by being fixed rather than variable, and by their relative stability in comparison with other

---

1/ The UK Government increased its expenditures on interest rate subsidies from £95 million through April 1975 to £220 million in fiscal year 1976/1977 alone.

2/ For an account of earlier developments, see "The Use of Commercial Credits by Developing Countries for Financing Imports of Capital Goods," IMF Staff Papers, Volume XVII, No. 1, March 1970.
money market rates.\textsuperscript{1} Moreover, with the onset of recession and inflation in many of the industrialized countries, competition for export markets sharpened and mutual accusations by official export credit agencies of increasingly concessional terms offered on export credits became commonplace.

Attempts to ease such competition led to a broad general understanding among all OECD countries in 1978, sometimes referred to as a "Gentlemen's Agreement" but officially termed "The International Arrangement on Officially-Supported Export Credits". These guidelines are voluntary and do not constitute an official agreement. Rather they set up international norms for lending terms which specify minimum interest rates on officially-supported export credits to all recipient countries based on their per capita income and the repayment terms of the underlying credits. These rates remained unchanged for about two years, despite the considerable rise in the cost of money in a number of industrial countries during this period, and particularly during the first quarter of 1980. Also, due to prevailing competition, the specified minimum interest rates tended to become maximum rates. All of this implied a substantial outlay in the subsidies required to maintain export credits on fixed terms at the favorable rates specified in the Arrangement.

On July 1, 1980, the minimum rates were raised slightly by one-quarter of one percent for the poorest countries and three-quarters of one percent for all other countries. These revised interest rate guidelines are currently the following:

<table>
<thead>
<tr>
<th>Countries with per capita GNP</th>
<th>2-5 years (as %)</th>
<th>Over 5 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under $1,000</td>
<td>7.50</td>
<td>7.75</td>
</tr>
<tr>
<td>$1,000 - $3,000</td>
<td>8.00</td>
<td>8.50</td>
</tr>
<tr>
<td>Above $3,000</td>
<td>8.50</td>
<td>8.75</td>
</tr>
</tbody>
</table>

\textsuperscript{1} The term "fixed" signifies the same interest rate throughout the full repayment period of an underlying export credit whereas "stability" refers to relatively small changes in fixed rates on new export credits.
The cost of an officially-supported export credit, however, is usually somewhat higher than shown above due to various charges and fees incorporated in the lending terms to borrowers. Since more recent comparative data on these effective interest rates are not yet available, they are shown on Table 2 as of mid-1979 for four major exporting countries and are compared with the yield on government bonds of similar maturity.

The close convergence of the export credit interest rates of these countries,

Table 2

(Percent per annum; June of each year)

<table>
<thead>
<tr>
<th>Effective Costs of Officially-Supported Export Credits (over 5 years) a/</th>
<th>Government Bond Yields (long-term)</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>5.7</td>
</tr>
<tr>
<td>Italy</td>
<td>5.9</td>
</tr>
<tr>
<td>United Kingdom b/</td>
<td>5.5</td>
</tr>
<tr>
<td>United States c/</td>
<td>6.0-7.0</td>
</tr>
</tbody>
</table>

a/ For "good" risks. "Poor" risks in recent years were generally 1/2 to 1
percentage point higher. These are said to be typical borrowing costs for countries with per capita GNP under $1,000.

b/ US dollar credits (see following section).

c/ The lower rate is considered "exceptional" and results when the US Export-Import Bank lends a higher percentage of the credit portion.

d/ Average for year.


This includes the rate and fees charged by official export credit agencies on the official component of an export credit (normally less than 100 percent of the credit), the cost of official insurance against commercial and political risks, and the interest and fees charged by private banks on their share of the balance of the export credit not financed by official agencies. The official portion of export credits is said to be rising which is another way of softening the effective cost to the borrower.
as a result of official financial support, is in sharp contrast to the widely divergent interest rates prevailing in their domestic markets.

Table 2 also sheds some light on how interest rates for officially-supported export credits in 1979 compared with those of earlier years. Data on the costs of officially-supported export credits are available back to 1966, indicating that interest rates have in fact risen substantially in nominal terms since that time. Looking at the rates for money of comparable maturities, however, we see that officially-supported export credits appear to be cheaper in relation to the cost of money in most instances in 1976 and 1979 than they were in 1966.

From the viewpoint of the borrower, the relative stability and generally lower costs of officially-supported export credits can be contrasted to unsupported private bank lending with variable interest rates adjusted every six months as reported in Eurocurrency markets:

<table>
<thead>
<tr>
<th>Table 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>(June of each year, in percent)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>1976</th>
<th>1978</th>
<th>1979</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eurodollar deposit rates at or near end of month</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6.8</td>
<td>9.2</td>
<td>10.5</td>
<td></td>
</tr>
<tr>
<td>Most-frequently-quoted spreads above LIBOR a/ for developing countries</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.875</td>
<td>1.375-1.85</td>
<td>0.5-1.125</td>
<td></td>
</tr>
</tbody>
</table>

a/ London Inter-Bank Offer Rate. In addition to spreads, Eurocurrency credits also carry various bank fees. During March 1980, LIBOR rates fluctuated at the 19-20 percent levels, declining by mid-April to about 17 percent, and 10 percent by end-June.

Difficulties with Standardized Interest Rates - The exceptional turbulence in the money markets of the major trading currencies in recent years has given rise to two sets of somewhat off-setting problems. One is that exporters in countries with strong currencies (like Germany, Japan and Switzerland) have been able to offer interest rates well below the guidelines established in the Arrangement. The other is that foreign buyers have at times preferred transactions denominated in depreciating currencies. In any event, both developments have tended to favor foreign buyers and have emphasized the difficulty of establishing international norms for credit terms when substantial disparities exist in exchange rates, inflation and interest costs in the major trading countries. The problem resulted in considerable acrimony within the OECD, leading to an internal study of the feasibility of a common set of credit terms for countries with divergent monetary policies and histories. The study is said to have created a better appreciation of the issues involved. The current trend of thinking in the OECD is allegedly favoring one of two possible solutions: a minimum interest rate for officially-supported export credits linked to the yield on government bonds for equivalent maturities in a particular currency, or a standard minimum interest rate expressed in terms of a basket of currencies, such as the SDR.

The difficulties encountered with differing exchange rates and interest costs is also being tackled in more pragmatic ways. For example,

1/ It was for this reason that "effective" costs of officially-supported interest rates were not shown above for Germany as recourse to such support was reportedly the exception during the 1976-1978 period. Since that time, interest costs in Germany have risen closer to the Arrangement norms. This situation was also applicable to Switzerland, and, to a lesser extent, to Japan.

2/ Among these is its emphasis on the major importance of changes in exchange rates in determining relative competitiveness.
a number of countries are now insuring export credits denominated in other currencies. This practice was initiated on a large scale in 1977 by the UK's ECGD when it made available insurance as well as subsidized financing for British export credits in Eurocurrencies, especially Eurodollars, whose rates at that time were substantially lower than for sterling. This represented an unusual measure as most export credit insurers normally linked their support to export credits denominated in their own national currencies. Since Eurocurrencies are available only at short-term and at variable rates, the ECGD guaranteed an agreed rate of return to banks financing export credits at fixed rates in Eurocurrencies and, in a large step toward becoming a direct export lending agency, undertook to assume the underlying Eurocurrency financing should any bank feel obliged to terminate its lending in Eurocurrencies prior to the expiration of the maturity of the export credit. The second year (1978/79) of the UK's foreign currency scheme saw a steep increase in fixed rate finance away from sterling. By value, 76 percent of all fixed-rate financing was in non-sterling currencies supported by the ECGD (mostly US dollars), generally at rates slightly lower than for sterling (about 25 basis points). Through the end of April 1980, the ECGD announced that it had supported foreign currency loans (mainly buyer credits) valued at $5.5 billion.

These changes by one of the oldest and most innovative official export credit insurance agencies have important implications for the future of national systems of export credit finance. Financing exports in Eurocurrencies blurs the distinction between export credits and Eurocurrency credits which are normally not associated with trade financing. For the UK, it has opened up a large source of international finance for national exports
and substantially reduced the budgetary cost of subsidized support. In effect, the UK Government, largely for internal budgetary reasons, assumed the role of financial intermediary in Eurocurrency markets, bearing the credit risks and costs involved in transforming variable rate Eurocurrencies into fixed rate, cheaper finance.

Following the British example, France is prepared to insure export credits denominated in Eurocurrencies and Sweden in US dollars. Canada recently introduced cover for export credits denominated in a number of different currencies. Italy not only insures export credits in foreign currencies, but, like the British, also provides interest rate subsidies on such financing. Singapore, a developing country, subsidizes interest rates on export credits denominated in US dollars. Germany will insure aircraft contracts in US dollars and the US Export-Import Bank now offers cover in all freely convertible currencies. Japan is also said to be considering a program of official support for non-yen denominated loans.

Repayment Terms - The International Arrangement also specifies guidelines for repayment terms which, like those for interest, are related to the per capita income of borrowing countries. These have remained unchanged since the adoption of the Arrangement in 1978:

---

1/ This obviously depends on the exchange rates and interest costs of the relative currencies. For the UK, the costs of refinancing a much smaller proportion of sterling credits has resulted in a decrease in ECGD refinancing costs from £ 505 million in 1976/1977 to £ 140 million in 1978/1979. The cost to ECGD of supporting a fixed rate on US dollar-financed export credits amounted to only £ 2.3 million in 1977/78.
Export creditor sources estimate that, in practice, repayment periods might average 3 years for under 5-year credits, and 8-1/2 years for over 5-year credits. For major export sectors, the US Export-import Bank has reported the following repayment terms "usually associated" with export credits officially supported by six industrialized countries:

Table 3
(in years as of mid-1978)

<table>
<thead>
<tr>
<th></th>
<th>France</th>
<th>Germany</th>
<th>Italy</th>
<th>Japan</th>
<th>UK</th>
<th>US</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cement plants</td>
<td>7-8</td>
<td>7-8</td>
<td>7-8</td>
<td>7-8</td>
<td>7-8</td>
<td>7-8</td>
</tr>
<tr>
<td>Petroleum refineries</td>
<td>8-10</td>
<td>8-10</td>
<td>8-10</td>
<td>8-10</td>
<td>8-10</td>
<td>8-10</td>
</tr>
<tr>
<td>steel plants</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commercial jet aircraft</td>
<td>10-12</td>
<td>10-12</td>
<td>-</td>
<td>-</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Nuclear power plants</td>
<td>10-12</td>
<td>10-12</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>10-12</td>
</tr>
</tbody>
</table>

1/ Certain exceptions to the above should be noted. The Arrangement sets uniform repayment terms on ground satellite stations (8 years) and conventional power plants (12 years). Completely excluded from the Arrangement are repayment terms for agriculture, aircraft, nuclear power plants and ships. Separate OECD agreements govern maximum repayment terms on commercial vessels (except LNG tankers) and commercial jet aircraft (8 and 10 years respectively).
The virtual absence of competitive differences on average transactions as shown above is somewhat misleading, since it does not reflect sharpening competition reported by export credit agencies on individual transactions, especially more recently for commercial jet aircraft between the European and US suppliers. Nevertheless, export credit agencies indicate that, by and large, competition on repayment terms is currently less intense than on interest rates and other important elements associated with export credits, such as the financing of downpayments and local costs.

Grace Periods - In the discussion above, care was taken to specify "repayment terms" rather than "maturities." This is due to an important characteristic of export credits, i.e., their lack of explicit periods of grace. Payments normally commence six months after the "starting point" as defined by the Berne Union and adopted by most export creditors. This is the point in time when an importer receives delivery of the financed goods or takes possession of a completed plant. There is usually thus an implicit grace period in the financing of capital goods exports between the signing of an export contract and the delivery of the goods, equivalent to the manufacturing period. In the case of capital goods exports and overseas plants, these periods can sometimes be relatively lengthy depending on the construction time (often two or more years). When private source funds are combined in a financing package with official export credits, the latter often cover the later maturities with a grace period equivalent to the length of the commercial financing.

1/ It will be noted that the 10-12 years repayment period on commercial jet aircraft tends to exceed the OECD limits.

2/ The international association of export-credit insurance agencies.

3/ In World Bank usage, the grace period is the interval of time between the date of a loan commitment and the first repayment of principal.
Implicit grace periods are not included in the Arrangement but should be kept in mind when assessing the impact of export credit terms on developing borrowers or comparing export credits with other financial flows to these countries. In general, because of the increasing time required to produce capital goods, implicit grace periods are believed to be lengthier today than in earlier years although evidence is not readily available. They are also said on occasion to be prolonged for competitive purposes.

**Terms Recapitulation** - Officially-supported export credits to developing country borrowers (with per capita income under $1,000) are estimated to have the following "average" lending terms, taking into account the increases authorized after June 30, 1980.

<table>
<thead>
<tr>
<th>Category</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>a. Medium-term (1 to five years)</strong></td>
<td></td>
</tr>
<tr>
<td>repayment period</td>
<td>3 years</td>
</tr>
<tr>
<td>grace period</td>
<td>1-1/2 years 1/</td>
</tr>
<tr>
<td>Maturity</td>
<td>4-1/2 years</td>
</tr>
<tr>
<td>effective interest rate</td>
<td>8.50 percent 2/</td>
</tr>
<tr>
<td><strong>b. Long-term (over 5 years)</strong></td>
<td></td>
</tr>
<tr>
<td>repayment period</td>
<td>8-1/2 years</td>
</tr>
<tr>
<td>grace period</td>
<td>2-1/2 years 3/</td>
</tr>
<tr>
<td>maturity</td>
<td>11 years</td>
</tr>
<tr>
<td>effective interest rate</td>
<td>8.75 percent</td>
</tr>
</tbody>
</table>

1/ This includes one year of manufacturing plus the customary six-month period following delivery after which amortization commences on a semi-annual basis.

2/ The effective interest rate consists of the 7.50 percent minimum specified for developing countries in medium-term transactions, plus a 1 percent estimate for insurance and bank charges.

3/ This consists of a two-year period for manufacturing plus the standard six-months after delivery. Three-year manufacturing periods are not uncommon, however.
About 60 percent of the export credits currently supported by OECD countries are estimated to have repayment periods in excess of five years.

**Grant/Subsidy Elements** - The conventional discount rate of 10 percent, widely employed to measure the concessionality of lenders' credit terms, is less appropriate in times like the present when the opportunity costs of money are considerably higher in the markets of most of the major lending countries. As a constant yard-stick, however, the conventional discount rate is useful for purposes of comparison 1/ with other forms of capital flows. Applying this conventional rate against the average terms shown above we obtain a grant element of 3.17 percent for the medium-term and 4.75 percent for the long-term export credits. Adding another year to the manufacturing period would raise the grant element to 5.26 percent for the latter credits. These grant elements, of course, are well below the 25 percent threshold required by DAC for aid flows, but considerably above those for unsupported private bank lending which has been characterized by negative grant elements for some time.

If we employ the yields on government bonds as a reasonable proxy for the opportunity costs of capital to governments, we obtain results that would be a closer approximation to the concessionality, or subsidy, involved at different times which depends on the changing levels of interest costs. Under the latter method, we see below that the grant/subsidy elements for officially-supported export credits were mostly negative in 1966 and mostly positive in 1979 for the four major lending countries shown in Table 2.

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1/ For an explanation of the grant element and how to compute it, see World Bank, Possible Improvements in Techniques of Lending, A Study by the Staff of the World Bank requested by the United Nations Conference on Trade and Development (IBRD, April 1970).
Table 4
(as percent)

<table>
<thead>
<tr>
<th></th>
<th>Government Bond Yields</th>
<th>Export Credit Interest Rates</th>
<th>Subsidy Elements</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>France</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1966</td>
<td>5.1</td>
<td>5.7</td>
<td>-2.3</td>
</tr>
<tr>
<td>1979</td>
<td>9.0</td>
<td>8.6</td>
<td>3.0</td>
</tr>
<tr>
<td><strong>Italy</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1966</td>
<td>5.3</td>
<td>5.9</td>
<td>-2.3</td>
</tr>
<tr>
<td>1979</td>
<td>13.6</td>
<td>8.0</td>
<td>17.0</td>
</tr>
<tr>
<td><strong>United Kingdom</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1966</td>
<td>6.8</td>
<td>5.5</td>
<td>4.8</td>
</tr>
<tr>
<td>1979</td>
<td>12.8</td>
<td>8.3</td>
<td>14.2</td>
</tr>
<tr>
<td><strong>United States</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1966</td>
<td>4.7</td>
<td>7.0</td>
<td>-8.9</td>
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<tr>
<td>1979</td>
<td>8.5</td>
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<tr>
<td>1979</td>
<td>8.5</td>
<td>8.3</td>
<td>0.7</td>
</tr>
</tbody>
</table>

Note: See Table 2 for government bond yields and export credit interest rates.

1/ To derive subsidy elements, government bond yields were used as the discount rates in place of the conventional 10 percent.

Within the limits of the sample chosen, this calculation lends support to the general contention that official support for export credits has risen substantially since the 1960's. The cost of subsidies on export credits officially-supported by OECD countries has been estimated in the OECD study mentioned earlier as ranging between $3 to $5 billion during 1979. Obviously, countries with higher bond yields and weaker currencies stand to "benefit"
proportionately more in a competitive sense from an international regime of uniform export credit interest rates than countries with lower interest rates and appreciating currencies.

IV. Other Factors Affecting Cost of Export Credits

In addition to interest rates and maturities, other developments in recent years have tended to assume considerable weight in the determination of the overall cost of export finance for the borrower. Among these are support for export credits denominated in currencies other than those of the lender (discussed earlier), the use of mixed credits (i.e., concessional funds blended with export credits), and special support for exports to selected foreign markets and for certain industrial sectors.1/

Mixed Credits - This technique of export financing, developed by France in the later 1950's, is of particular importance to developing countries. Public concessional funds were explicitly combined with private export credits to finance downpayments and local costs associated with large projects in which French commercial interests were involved. Essentially a variant of tied aid, mixed credits were in time extended beyond the more limited financing of downpayments and local costs and came to be incorporated within the framework of agreements with developing countries.

Several other countries also adopted the mixed credit technique, with national variations, such as the Japanese, Germans and Swiss, but its leading practitioner over the years has been the French. In their system, the concessional funding is said to be limited usually to about 20 percent of the total financing package but may go as high as 50 percent in exceptional circumstances, such as in mixed credit financing provided to countries like India. According to French officials, a possible credit such

1/ Details on support programs for selected markets and sectors will be found in Annex 2.
as this might include one-half of the combined amount on terms of 25 years' maturity, inclusive of 6 years' grace, and 3 percent interest per year. The other half might be supported as a long-term export credit of ten years with official insurance and preferential financing at rates specified in the Arrangement.

The result, of course, has been to reduce substantially the effective cost of borrowing to the foreign importers of French exports, well below the terms established in the Arrangement and contrary to the normal practice of export credit agencies to refrain from supporting downpayments and local costs. Not surprisingly, this form of mixed financing has been criticized by those countries insisting upon the separation of concessional funds, which, at least in theory, are supposed to be development-oriented, from export credits. The latter, even with officially-supported preferential financing, are usually well below the DAC norm for qualifying as "aid" and of course are explicitly oriented toward export promotion.

France is reported to have granted 12 new mixed credits during 1978, having a total export value of close to $800 million with the concessional aid portion in excess of $100 million. Sectors supported by the mixed credits included agriculture, communications and transportation in Africa, the Middle East and Latin America.

Within the past two years, the pressures of intensified competition have led three major exporting countries (the UK, the US and Canada), to launch programs of mixed credit financing. The UK Government decided in 1978 to allocate five percent of its annual foreign aid budget for

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1/ The Italian Government is said to have received authorization as early as 1977 to employ mixed credits and extended its first mixed credit during the first half of 1980.
use in conjunction with traditional ECGD-supported export financing. 1/ A British aid official publicly explained that these funds would normally be used in a ratio of one to four with export credits and that "this form of mixed financing can be expected to play an increasing role in British efforts to win overseas contracts."

Toward the end of 1978, the US Export-Import Bank announced that it would henceforth match other countries' mixed credits on a selective basis, but through the use of its own reserves rather than budgeted aid funds. The first such case was the extension of a 6 percent interest rate on the full credit portion (normally, only 30 to 60 percent is financed directly by the Export-Import Bank) of an export contract to supply Cyprus an earth satellite ground station, whereas the scheduled rate for such a transaction would have been 8.125 percent. In August of 1979, the Export-Import Bank approved a $100 million line of credit to Tunisia on which its portion (50 percent) of each individual credit will be financed at 3.75 percent, resulting in a "blended" rate "between 5 and 5.5 percent." Repayment will extend for 25 years. These unusually liberal terms were said to match "the terms of the mixed credit supported by France." They imply a grant element of about 30 percent, well above the threshold of 25 percent for concessional aid. Three additional instances of mixed credit financing by the US Eximbank were a second financial package for Cyprus with a blended interest rate of 6 percent, and special arrangements for Greece and Colombia (for which details are not available).

1/ In 1978, UK aid disbursements amounted to $1.3 billion.
In a major policy change, Canada's Export Development Corporation (EDC) recently announced it would blend normal EDC export credit loans with concessional aid funds in markets of "special importance." Canada has in the past also employed "parallel financing" in which separate loan agreements are negotiated for aid and export credit funds rather than being combined as in mixed credit financing. Increasing use of both forms of financing is expected in support of Canadian exports.

V. **Export Credit Insurance**

Insurance today for privately-financed export credits, despite the rapid growth of preferential financing, still remains the most extensive form of official support, largely because the bulk of export credit insurance is issued for short-term credits (under one year) whereas preferential financing is generally made available only for export credits in excess of one year.

Export credit insurance is, strictly speaking, not a subsidized operation, since most agencies "pay their own way" through premium charges. Occasionally, losses are incurred in excess of premium income but these are normally covered from accumulated reserves. Official support is said rather to consist of governments' willingness to assume contingent liabilities for larger amounts of export credits and for transactions including greater potential credit risks than it is believed the private insurance sector would be prepared to do. This is also true of cover against "political" risks which mostly involve non-payment due to actions of governments.
More recently, official export credit agencies have substantially expanded and diversified their programs. The extension of export credit insurance is today a relatively technical and complicated process which is dealt with in more detail in Annex 1. Several unusual programs provided by a number of export credit insurance agencies are also given separate mention in the Annex. One of these is the extension of insurance cover against exchange rate risks, another is reimbursement of part of the price increases which may be incurred during a lengthy period of production and a third is insurance on bonds issued by private financial institutions to guarantee performance on very large projects, generally in the OPEC countries. The coverage of export credits in other than national currencies was mentioned earlier in the report. All these forms of export credit insurance illustrate its increasingly versatile nature which, while attuned primarily to the evolving needs of national exporters, has undoubtedly facilitated the flow of private capital to developing countries.

VI. Developing Countries

One of the more noteworthy changes in the nature of export finance has been the emergence in recent years of advanced developing countries as sources of manufactured exports and competitors of industrial countries at the same time as they continue to be recipients of substantial amounts of trade-related finance from the latter. For example, the previously-cited GATT report indicates that total exports of manufactures (including engineering goods) by developing countries (other than oil-exporters), as a proportion of global exports of manufactures, rose from 6.6 percent in 1974 to 8.1 percent
Exports of engineering goods from developing countries also increased proportionately to global exports of engineering goods during this period, from 3.6 percent to 4.3 percent respectively.

Comprehensive data are not available on the volume of export credits which these countries may be supporting to finance their growing trade in manufactures. Some notion of their expanding role is available, however, in reports that five developing countries had increased their insurance coverage or export credits from $5 billion in 1975 to $8.6 billion in 1978, a growth of 70 percent which was somewhat higher than that indicated for more industrialized countries during the same period. As to maturities, partial data available for 1979 indicate that about four-fifths of the export credits insured by these five countries fell into the medium-term range of one to five years.

As previously noted, preferential financing facilities are often made available in conjunction with insurance cover (especially for longer-term credits). An indication of the extensive financing facilities provided by one of the more advanced developing countries may be obtained in a study of the Korea system published by the IMF Survey. According to the report, Korea's programs are comparable in most respects to those of the industrial

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1/ Of LDC exports of manufactures, the GATT data show that the proportionate share to the industrial countries rose from 60 to 63 percent and to OPEC countries from 8 to 10 percent. The share of intra-developing country exports of manufactures, on the other hand, declined from 25 to 23 percent. Similar trade patterns were noted for engineering goods exports.

2/ Argentina, Hong Kong, India, Israel and Spain.

countries, including the terms on which it supports export credits.

The report also provides evidence of an important development in Korea's export trade, a shift from light manufactures to capital goods, including industrial plants.

In addition to those mentioned, other industrializing developing countries are known to have well-developed export credit insurance and financing systems. Prominent among these are Brazil, Mexico, Portugal, Singapore, Taiwan and Yugoslavia. A number of other developing countries are also beginning to offer, or are planning to institute, programs of insurance cover and/or subsidized financing as a means of encouraging industrial growth in order to achieve more balanced and faster development. Among these latter are Jamaica, Panama, Bangladesh, Turkey, Philippines and Morocco.

The financial costs of export credit subsidies, particularly in today's highly competitive export markets, are undoubtedly substantial for the developing countries. It remains to be seen to what extent such costs are proportionate to their benefits. The published report on Korea indicates that the country is employing various sources to fund its export credit support programs, including drawing on its foreign exchange reserves, borrowing on Eurocurrency markets, and, in at least one instance, borrowing from banks in a developed country market to finance the export of ships to that

1/ The Korean Export-Import Bank is currently providing foreign currency loans for about 70 percent of the value of an underlying export contract at a fixed rate of 8 percent per annum for repayment periods extending up to ten years.
country. The World Bank itself is beginning to provide some limited assistance, or planning to do so, in several countries such as Portugal, Panama and Jamaica, to assist them in setting up institutional arrangements for export credit insurance and related programs.

As recipients, developing countries are absorbing an increasing share of all export credits officially supported by OECD members, which rose from 60 to 66 percent during the period of 1970 to 1976. While the possible benefit to developing countries of a large source of fixed-rate, subsidized finance has been emphasized in this report, it should be recognized that export credits have not always been effectively utilized or have been assumed in greater amounts than particular countries could afford. More recently, there has been a sharp increase in repayment difficulties attributable in large part to excessive borrowing of export credits. Among countries experiencing such difficulties are Turkey, Sudan, Zaire and Zambia. This has resulted in heavy payments on insurance claims, including those originating from export credits extended to Iran and Nigeria (where transfer delays rather than lack of foreign exchange is said to be the problem).

VII. Conclusion

Export support programs through preferential financing and underwriting of credit risks is resulting in a changed form of international finance hitherto characterized simply as "supplier credits." The course these credits are taking carry substantial implications for the developing countries.
For one, the volume of officially-supported export credits has been growing faster than concessional financing or even the export trade in manufactures and capital goods. Lending terms and techniques of export financing have been adapted to the evolving needs of such trade. Repayment periods have been lengthening; credits with amortization over five years are increasing as a proportion of total export credits and repayment over ten years is no longer exceptional. Interest rates are mostly fixed, stable and below market costs of comparable maturities. There is evidence to suggest, in fact, that officially-supported export credit interest rates have risen less than market costs of money in major trading countries over the past decade. Thus, the rising volume of export credits and the continued relaxation of lending terms and conditions, on the face of it, represent an important transfer of real resources to developing countries at less than their market value. Moreover, with private bank lending to developing countries coming under increasing pressure, preferential export finance to developing countries could play an expanded role in the "adjustment" process, particularly if industrial countries feel constrained to support weakened domestic economies.

There are some potential and actual drawbacks, however. The advantage to developing countries in particular transactions depends in large measure on the extent to which the benefit of subsidized export finance is in fact transferred to them or offset through higher prices and augmented profits of exporters. Also, since export credits are directly tied to the purchase

1/ Price, quality and service are considered by some export credit agencies at least as important as the underlying credit terms.
of the goods they finance, the importer foregoes much of the flexibility of private bank borrowing. Then again, the obverse of the potential benefit to the developing country importer of increased competition among industrial exporters is the threat posed to the emergence of advanced developing countries, the so-called NICS, as important exporters of industrial and capital goods. Competition on export credit terms between the OECD countries and some of the developing countries, such as Korea, has already occurred in the ship export sector. Furthermore, intensified export credit competition could also have negative repercussions on the external debt posture of those developing countries with imprudent management, since consideration of developing countries' absorptive capacities and underlying creditworthiness is generally subordinated to the overriding objective of export promotion.

As stated in the Introduction, this paper does not address itself to the underlying question of whether export credit subsidization is in itself economically justified, but rather attempts at this time to present the main features of present-day export finance and some of its implications for the countries of the Third World. In a broader sense, the rapid evolution and growth of subsidized export finance carries potential dangers for international trade which one observer characterized in this fashion:

"Subsidized export financing has been described as protectionism in reverse. It is certainly economic nationalism, and its effect on world trade could become as distorting and, in time, as paralyzing as that of straight protection.... Perhaps something like a GATT round of negotiations may eventually be needed to bring the financing of international trade back to reason."

1/ Balance of payments disequilibria due to excessive assumptions of export credits have been a recurrent factor in multilateral debt reschedulings since Argentina's in 1956. Also, IMF Stand-by Arrangements for developing countries often set limits on commercial borrowing, including export credits.

BACKGROUND DETAILS ON THE FUNCTIONING OF EXPORT FINANCE

1. **Export Credits** - These credits consist of loans directly tied to exports and range in maturity from under 90 days to extended terms of 10 years and more. Short-term credits (often termed "trade credits") are generally interpreted as those under 180 days and receive little or no support from governments with the important exception of insurance protection against political and commercial risks encountered in foreign trade.

   Export credits possess the following characteristics (apart from credit terms which were discussed in the body of the report):

   a. **Downpayments** - Buyers are obliged to make payments prior to shipment currently amounting to about 15 percent of contract value paid either at the time of contract signing or during the course of manufacture. The export credit itself thus amounts to the balance, that is, about 85 percent of the export contract. Increasingly, downpayments are also being financed on large transactions, but generally by lenders not directly associated with the transaction.

   b. **Local Costs** - Export credit support is normally limited to the foreign exchange costs involved, but, as with downpayments, export credit agencies are now more willing to provide insurance and financing up to 15 percent of the export contract for associated local costs.

      For competitive reasons, downpayments are occasionally reduced and local costs supported in excess of the customary 15 percent of contract value.

   c. **Grace Periods** - Export credits do not have explicit grace periods, since the term of the credit is reckoned from delivery of the goods or project
completion (i.e., upon disbursement). First principal payment is due six months later, followed by equal semi-annual installments. However, export credits involving capital goods and industrial plants may have relatively lengthy implicit grace periods of several years equivalent to the manufacturing or construction time during which commitment fees are sometimes required (generally about 0.5 percent per annum on the undisbursed amounts).

2. Export credits are divided into three main categories:

a. **Supplier Credits** - These are export credits extended by a supplier (exporter) to a foreign buyer (importer). Export financing on terms of up to five years is typically provided as supplier credits. The bulk of manufactured exports, outside of capital goods, is normally financed with supplier credits. Repayment terms on export credits are usually related to contract values so that consumer durables and light engineering goods, for example, are typically financed with supplier credits.¹/²

b. **Buyer Credits** - These are credits extended directly by a bank in the supplier's country to the foreign buyer or to a bank in the latter's country. (The terms supplier and exporter and the terms buyer and importer are inter-changeable.) The relatively long repayment periods (in excess of five years) and large amounts of credit associated with export financing of capital goods often impose a strain on the supplier's financial resources. As a result, buyer credits have become an increasingly popular instrument of export finance for capital goods with repayment periods of more than five years because the supplier is fully reimbursed at the time of delivery of the contracted goods or upon completion of a project.

¹/ A related consideration is the "economic life" of the financed goods, i.e., the time taken for the goods to be absorbed into the production process.
c. **Official Export Credits** - These are credits extended directly by some governments (e.g., the United States, Canada, France, Germany, Japan and Korea), either to their own exporters or to foreign buyers, often in association with private financing, to support export transactions requiring longer maturities and larger amounts of credit. Both in purpose and in the nature of the terms provided, official export credits are generally indistinguishable to foreign borrowers from private buyer credits supported with preferential refinancing and interest subsidies by governments in many capital goods-exporting countries. When official export credits are combined with private export credits, the former are repaid generally after the private lenders.

3. **Repayment Terms** - The evolution of repayment terms provides an interesting insight into the historical development of export credits. Up to the late 1950's, export credits insured by governments were largely restricted to an upper limit of five years. By that time, postwar industrial recovery was completed and the output of engineering goods, ships, power plants and other sectors with a high degree of technological advancement grew rapidly. Competition to export these items, which were relatively costly, also sharpened. Furthermore, the separation between aid funds for development and export credits as such became less distinct when the practice of tying aid credits was introduced at about that time. In addition, the US Export-Import Bank had been offering official export credits on terms beyond five years. The technique of buyer credits was thus developed in the late 1950's by European countries as a means for providing export credits with longer repayment terms than five years.

By 1978, about 60 percent of all export credits extended by OECD countries were estimated to have had repayment periods over five years.
Export creditor sources estimate that the repayment period for export credits in excess of five years might currently "average" about 8-1/2 years, and for all export credits over one year the "average" might be between 6-1/2 to 7 years (excluding implicit grace periods).  

4. **Insurance** - Virtually all countries exporting manufactured goods today provide substantial protection to their exporters against potential losses by means of insurance administered by public agencies or private companies acting on behalf of, or supported by, the public sector. Generally speaking, premiums are maintained at relatively low levels but designed to permit insurance operations to "pay their own way". Export credit insurance agencies, however, depend on government treasuries as insurers of last resort.

In addition to principal, export credit insurers also cover interest obligations. Broadly speaking, two main types of risk are covered:

a. **Commercial Risk** - This is usually defined as the possibility of non-payment arising from default by, as well as the insolvency of, the importer.

b. **Political Risk** - This refers principally to the possibility of government actions which prevent, or delay, the transfer of funds due on export credits. Such actions presuppose that the importer has deposited on time the due amounts in local currency. Many export credit insurance agencies also include under political risk such events as war, revolution, or other military-civil disturbances which prevent or delay contractual payments. Some also include physical disasters (such as cyclone, flood or earthquake).

1/ It is important to keep in mind that this report deals only with export credits officially supported by creditor governments. Data on private export credits unsupported by OECD members are available only on a fragmentary basis. Export credit agencies, however, believe that requests for their support are directly related to the maturities of the underlying credits, i.e., the longer the maturity (particularly when in excess of five years) the more likely the request for official support.
c. **Extent of Cover** - The day-to-day determination of cover for export credits is carried out by agencies which insure export credits either in their role as public sector entities, or else as private companies authorized to issue export credit insurance for their governments. As a rule, they operate within statutory limits of contingent liability, the ceilings for which are periodically reviewed and changed by national parliaments. Very substantial increases have been granted in recent years in line with rapidly-expanding business. Within these limits, agencies report that they follow a fairly pragmatic approach in assessing the creditworthiness of individual borrowing countries and importers, basing their judgment largely on past experience and current exposure.

The earliest form of official support for private export credits prior to World War II was the provision of insurance against political risks. Commercial risks were generally covered by the private insurance sector. Over a period of time, and especially since World War II, governments of the larger exporting countries either took over, or provided substantial financial backing for, commercial risk coverage, because the growth of export finance was such that private insurance companies were said to be unwilling or unable to carry the risks.

Export credit insurers undertake to pay a stipulated percentage of loss. This percentage has been gradually raised until, at the present time, a substantial number of countries offer maximum reimbursement for close to the full (up to 90-95 percent) amount of loss, including contractual interest, on buyer credits extended by private banks.\(^1\) In general, a higher percentage

\(^1\) As mentioned, export credit insurance agencies require a cash downpayment of 15 percent of the contract price and then undertake to reimburse the insured for a stipulated percentage of losses sustained on the balance extended as credit.
of possible reimbursement (usually 5 to 10 percent more) is available for buyer credits than for supplier credits. In fact, a number of countries now offer full (100 percent) reimbursement on private banks' buyer credits. These are the US, UK, Australia, Austria, Denmark, Finland (also on supplier credits), South Africa and Switzerland. Two other countries (Norway and Italy) offer full reimbursement on buyer credits under certain circumstances.

In practice, export credit insurance agencies seldom refuse to extend cover on all export credits to any one country at any one time, even though they may regard a certain country as generally uncreditworthy. Instead, a variety of techniques (often in combination) are said to be employed to take into account degrees of creditworthiness and to deal with different credit situations. For instance, export credit insurance agencies may charge higher premiums for higher risk categories or they may vary the amount of required downpayments and the percentage of cover. Other measures employed to restrict export credits insured to any one country include the fixing of annual maturities at certain limits (e.g., no more than $100 million of business outside the short-term field to be insured during one year), the imposition of ceilings on total insurance issued on credits irrespective of maturities, the placing of limits on the amounts of individual credits insured (e.g., no export credit in excess of $100,000 to be insured), or the specifying of maximum credit terms (e.g., no export credit with a maturity of over 360 days to be insured).

Three relatively new forms of export credit insurance deserve special mention in view of their potential effect upon the cost of export credits to lenders and borrowers.
Inflation Cover - One of the most unusual insurance programs, currently offered only by France, the U.K. and Finland, is inflation "risk" cover. The US Eximbank estimates that, in 1978, payments made by the French to offset cost increases incurred during the manufacturing period on capital goods intended for export amounted to approximately $500 million. The French program offers protection against price increases on capital goods occurring during a production period of at least 12 months and with a minimum contract value of 2 million francs for larger enterprises and accordingly lower values for smaller exporters. The French Government will reimburse the French exporters for all cost increases beyond the first 6.5 to 8.0 percent. These deductible amounts were raised in 1975 from 4.5 percent in view of the acceleration in French prices since that date. The premium for this coverage is one percent per annum on the eligible part of the contract plus a variable surcharge based on exchange rate movements.

The British program is less generous. Finland introduced inflation insurance shortly after World War II but has reduced coverage recently due to its high budgetary cost. Italy and Spain have allowed their inflation cost insurance to lapse due to administrative and budgetary difficulties. No other countries are known to offer this form of insurance which its critics (particularly the US) regard both as an unfair competitive practice and as an inappropriate underwriting risk.

Bond Insurance - Another relatively new underwriting development designed to meet a special need has been the establishment and growth of cover on bonds. Overseas buyers of capital goods and projects are said to be
demanding, on an increasing scale, that exporters give bonds to ensure performance in accordance with the terms of their contracts, or, in cases of exporters' non-compliance, to guarantee reimbursement of advance payments. With the growing size of contracts, particularly for large construction projects in the Middle East, private bond issuers (banks and surety companies) are said to have become reluctant to insure the increased risks without additional security. Thus a large number of export credit insurance agencies, including those in all the major exporting countries (except the United States), began to offer bond insurance in recent years, thereby significantly enhancing the ability of their capital goods and projects exporters to compete on large orders.

The ECGD was one of the first to do so in 1975 when it began to indemnify private bond issuers for the full amount of the bond required by an overseas buyer. During the first three years of the program's operation, the ECGD issued 100 guarantees supporting export contracts valued at £1.4 billion. Virtually all of these bonds were issued on behalf of UK exporters to the oil-producing countries of the Middle East.

In accordance with the trend toward specialization, most export credit insurance agencies authorized to provide this service now offer various types of bonds such as general performance, advance payment and bid bonds.¹/ Some developing countries such as Korea, with their own export

¹/ A bid bond is one which guarantees an exporter's acceptance of a contract awarded to him, while an advance payment bond guarantees repayment of advances made on a contract in case of its non-fulfillment.
insurance and financing systems, also extend bond insurance to improve their position in the extremely-competitive and lucrative markets of the oil exporting countries.

Exchange Risk Insurance - Adopted by a large number of countries to protect their exporters from the vagaries of exchange rate fluctuations, particularly since the abandonment of fixed-rate parties, this form of insurance offers partial protection against potential losses due to such fluctuations. The view taken by agencies which do not yet offer such cover is that protection against exchange risks is a function more properly performed by the private sector through forward exchange contracts. An indication of the wide use made of this special form of official support is that France, during the first year of offering exchange risk insurance in 1971, underwrote such risks for export contracts valued at approximately 2 billion francs.

Various refinements and improvements have been instituted as agencies gained experience and exporters requested increased assistance during the recent years of foreign exchange instability. The ECGD now provides cover at the rate prevailing at the time when losses are incurred that have been insured against political and commercial risks, rather than as previously at the rate prevailing when ECGD cover commenced. Losses due to exchange fluctuations are reimbursed up to 10 percent. A more recent innovation is

1/ Among these are Austria, Belgium, France, Germany, India, Japan, the Netherlands, Spain, Sweden, Switzerland and the United Kingdom.
protection given to British exporters who are exposed to currency fluctuations between the time they submit a bid for an overseas order and the date the contract is awarded. The ECGD makes up the difference if the applicable forward exchange rates move by more than 3 percent during this period.

The French system covers contractual periods of at least one year from the date of the contract to the date of payment by the buyer/importer. The exchange rate insured is that in effect on the date of the contract. Fluctuations above a threshold of 2.25 percent vis-a-vis the French franc are fully reimbursed. The French have expanded their exchange risk cover recently to protect "small" exporters offering credit for periods less than one year.

Detailed accounts of three major European and one developing country's export credit insurance and financing systems were published in the IMF Survey as follows:


b. The French system in two issues: June 7 and July 5, 1976.


d. The Korean system in two issues: November 26 and December 10, 1979.
SPECIAL MARKETS AND SECTORS

1. Special Markets - An interesting development in the last few years has been the rapid acceleration in, and high volumes of, export credits insured by national export credit insurance agencies for trade with CPE and OPEC countries. The competition has been particularly intense among West European exporters resulting in very high country exposure limits. The objectives are said to comprise a mixture of political and economic reasons, including the desire to ensure adequate energy supplies from Middle-East oil exporters and to provide a desired stimulus to their own economies.

An indication of the intensity of the competition for exporting to one of the CPE countries, Poland, has been the severe negotiating difficulties encountered by OECD countries in setting a time limit (mid-1981) beyond which exceptional credit terms would no longer be extended to that country.

Few events illustrate the eagerness of industrialized countries to expand their national exports with public support — some of it reportedly at the expense of current undertakings on credit terms — better than the response to China's interest in greater commercial ties with these countries.

The volume of export credits extended by most OECD countries had been relatively low and stagnant until the last half of 1978. Within the short space of several months, press reports claimed that new export credits of about $20 billion had been offered to China by several of the larger OECD countries and that additional large credits were under negotiation.

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1/ As mentioned official insurance for export credits is often accompanied by financial support.
2. **Special Sectors** - Another important "national interest" consideration is the objective of assisting those sectors of a national economy that are depressed or vulnerable to foreign competition, or which may be considered sensitive for political or strategic reasons.

(a) One of the leading examples of a sector which reflects most of the above considerations is the ship-building industry. Competition has been reported as exceptionally keen during the past several years, with shipbuilders from different countries apparently under-bidding each other and export credit insurance agencies allegedly prepared to support them even when the lending terms were in contravention of international understandings. Some governments, like those of Germany and Japan, also provide financial assistance to their ship exporters by making available to them concessional funds mixed with private credits. An important implication for developing countries with large ship exporting programs of their own (such as Korea, Brazil, Spain, Taiwan and Yugoslavia) is the sharpened export competition from and among industrial countries in this sector.

(b) Other sectors where official support for export credits is growing particularly rapidly are those of aircraft and nuclear power plants. The UK, French and German governments have agreed to provide joint financial and underwriting support to sell the Airbus to foreign airlines on increasingly competitive terms. The German official export credit agency, the KfW, has even reported the use of grants from the federal budget "to enable German exporters to offer internationally competitive financing conditions." The US Export-Import Bank, in turn, has announced a co-financing arrangement with the Japanese and Italians to sell the Boeing 767. An interesting footnote

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1/ In most cases, the buyers will need to negotiate only a single credit agreement in which the US and Italian financing will be provided in US dollars and the Japanese in yen.
to the escalating rivalry in aircraft sales is that the US Export-Import Bank has obtained specific Congressional authorization to provide financing for US suppliers in support of their domestic sales "to meet foreign government-supported export credit competition." This highly unusual authorization is said to have originated in reaction to ECGD support of the sale of US (Lockheed) airframes to Pan American in order to ensure the export of Rolls Royce jet engines which constituted a small percentage of the total transactions. (Normally, official support is limited to national exports with only occasional small amounts of foreign content.)

With regard to nuclear power plants, the Germans have supported with preferential financing and insurance cover a multi-billion DM transaction with Brazil. The US Export-Import Bank recently announced its largest direct credit of close to $1 billion for a nuclear power plant contract with Korea at 8 percent and 15 years' repayment (not including construction time of about 7 1/2 years). Canada also recently awarded one of its largest officially-supported export contracts to date ($680 million) for the sale of a nuclear power plant to Romania. The UK and French Governments are also heavily engaged in the extension to developing countries of large amounts of officially-supported export credits in this sector.

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1/ It will be noted that the repayment terms are longer than specified in Table 5 for "average" transactions.
EXAMPLES OF OFFICIALLY SUPPORTED EXPORT FINANCE

A. United States Export-Import Bank (the Eximbank)

1. A credit agreement for $732 million was signed in November 1978 to support the sale of two nuclear power plants in Korea. The Eximbank's official export credit was extended at 8 3/8 percent interest. Insurance was provided on $97.6 million of non-Eximbank financing. Korea will pay $146.4 million as a downpayment (15 percent of the contract price of $976 million). The Eximbank portion of the credit is to be repaid in 15 years, the non-Eximbank in 3 years.

2. The Eximbank will provide $212.5 million as a direct official export credit to support the sale of American manufactured equipment and services for the expansion of a steel mill facility in Taiwan. The Taiwan firm will make a cash payment of $37.5 million, or 15 percent of the contract value. Eximbank's loan will be extended at 7 1/2 percent interest, with repayment in 20 semiannual installments beginning December 1982, six months after commercial start-up of operations. Construction time is estimated at three years.

3. The Eximbank is extending an official export credit of $40.9 million at 8 1/2 percent interest to support 40 percent of the sale of 6 Boeing 727 jet aircraft, spares and technical services to Mexico which will make a downpayment of $20.5 million, or 20 percent of the contract price. Private source financing of $40.9 million for the balance of the contract price will not be insured by the Eximbank. Repayment of the Eximbank credit will be in 20 semiannual installments beginning December 1981.

(Source: US Eximbank)
B. France

The following is a recent example of a mixed credit:

Indonesia negotiated a 900 million franc loan with the French Government to finance the construction of a new international airport at Jakarta. The loan will be divided into two portions, the first amounting to 40 percent of the total, to be paid back over 26 years at 3 percent interest with a ten year grace period, and a portion of 60 percent consisting of officially-supported export credits to be repaid over 10 years at 8 percent.

(Source: Financial Times, March 10, 1980 and Euromarkets Letter, April 4, 1980.)
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