CHAPTER II TRENDS AND DEVELOPMENTS IN EXPORT CREDITS

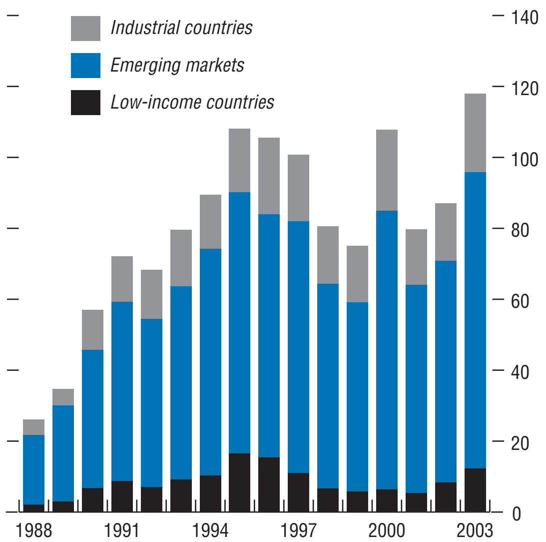
Official export credit agencies were established originally to promote national exports in situations where the private sector was reluctant to do so due to high political and commercial risks. Because their support for exporters also gives importers access to finance (through buyer or supplier credit), and because most agencies also provide insurance for outward direct investment, these institutions have played a significant role in financing for developing countries. However, official export credit agencies are not a homogenous group. Their key mandates and the institutional arrangements for providing official export credit support are summarized in Boxes 2.1 and 2.2. The first box also presents background information on the trade finance market, including key trade finance providers besides official export credit agencies.

Volume of Export Credits

Official support for export credits has remained the most important debt financing instrument of official bilateral creditors for developing countries. New commitments by official export credit agencies have shown a procyclical pattern, falling substantially in the wake of the financial crises in Asia and Eastern Europe in the second half of the 1990s (Figure 2.1). Nevertheless, the volume of export credits has remained large in comparison with official development assistance and gross lending by the international financial institutions.[1]

[1]Available data indicate that new (mostly medium- and long-term) commitments by Berne Union members averaged about $85 billion each year over 1998–2002; gross official development assistance and gross international financial institution lending amounted to about $67 billion and $60 billion per year, respectively, over the same period. Figures on export credit are based on Berne Union data, which do not capture agencies or export-import banks that are not members of the Berne Union. Figures on official development assistance and gross lending by international financial institutions are based on data reported in Gilman and Wang (2003) and World Bank (2004).

Figure 2.1. Officially Supported Export Credits: New Commitments
(In billions of U.S. dollars)



Source: IMF staff estimates based on Berne Union data.
Note: All maturities not including refinanced and rescheduled amounts.
[1]Preliminary estimates based on quarterly reports from export credit agencies.

Box 2.1. The Trade Finance Market and Official Export Credit Agencies

International trade and investment transactions entail risks and require financing and related services. A host of private and public sector intermediaries and guarantors are active in supporting trade finance. Key private sector players include commercial banks, suppliers, customers, private insurers, and reinsurers. Other private sector trade finance providers include nonbank finance companies and capital markets, including the bond and forfaiting markets. The main public sector providers of trade finance are official export credit agencies and multilateral development banks.

Commercial banks play a central role in the traditional trade finance system, under which they provide not only the channel through which payment is transferred from importer to exporter, but also financing against the security of traded goods. While banks may take some risks in the process, insurance by private or public insurers is typically required when transactions entail higher nonpayment risks.

Export finance involves two types of risk. Commercial risk includes the default or insolvency of the buyer and, sometimes, the refusal of the buyer to accept the goods (repudiation). Political risk involves nonpayment on an export contract or a project due to actions by an importer's host government. Such actions may include intervention to prevent the transfer of payment, cancellation of a license, acts of war or civil conflict, or enactment of laws and other measures taken by the host country government.

Export credits are generally divided into short-term credits (usually defined as business with a maximum credit length of one year, although in practice most short-term business involves 180 days or less); medium-term credits (between one and five years); and long-term credits (five years or more). The maturities of credits are closely linked to the types of exports. Short-term credits are provided for consumer goods, spare parts, and raw materials, while medium- and long-term credits are extended for capital goods and large projects.

Key Mandates of Official ECAs

All official ECAs in industrial countries or emerging markets share a common goal—to promote national exports and international investment. Quite a few ECAs have other public policy objectives, such as serving as a "shock absorber" during times of economic crisis and financial market contractions, or as an instrument of a government's international policies (see Appendix II).

The rationale for official involvement is often that there are some market failures in private export credit insurance (e.g., due to lack of information or constraints on the size or tenor of transactions). The official sector may have advantages in obtaining certain information (e.g., on sovereign risk) and in dealing with debt servicing difficulties collectively through the Paris Club. Public funds are allocated to support the national ECAs to promote exports where the private sector (the importer, exporter, private insurer, and financial institutions) is unwilling to cover all risks associated with an export credit at an acceptable price.

Scope of Operation of Officials ECAs

The most important export promotion program of ECAs is export credit insurance or guarantees. A few ECAs have a direct lending scheme under which an export loan is provided by a government-owned or controlled export-import bank.

Only a relatively small part of world trade benefits from officially supported export credits. Over 90 percent of world trade takes place on the basis of cash or on very short-term credit. The need for credit insurance increases as the risk of nonpayment or delayed payment rises, usually owing to the lack of credit standing of a trading partner, uncertainties in the importing country, or the long duration of trade credit. Credit insurance thus tends to be used in trade with developing countries, trade in capital goods, and in projects with medium- and long-term financing.

Box 2.2. Institutional Environment of Arrangements for Officially Supported Export Credits

The first official export credit agency, the United Kingdom's Export Credits Guarantee Department (ECGD), was established in 1919. By the 1970s, most member countries of the Organization for Economic Cooperation and Development had an ECA. More recently, official ECAs have been set up in many developing countries as an important tool for export development.

Major Institutional Models

- *Government department/facility.* Within the OECD countries, the United Kingdom and Switzerland operate their export credit agencies as government departments. In certain developing countries, special export credit facilities are offered via either the central bank or the ministries of commerce or industry.
- *State-owned corporations/agencies.* The most common form of delivery for export credit facilities is via an autonomous institution owned by the government. However, institutional arrangements vary widely. Some agencies provide only insurance or lending, while others combine both under one roof. In Asia, many countries have separate institutions to handle direct lending and insurance (e.g., China, India, Indonesia, Japan, Korea, Malaysia, and Thailand).
- *Private company as agent.* In some countries, the government has an exclusive arrangement with a private company, such as COFACE in France, Euler-Hermes in Germany, and Atradius (formerly Gerling-NCM) in the Netherlands. The company concerned provides the initial risk analysis and issues policies for the government account. When a private company acts as an agent for the government, all risks are taken by the government.

Regulatory Authorities

Official ECAs organized as a government department or a state-owned entity often operate under a charter or legislation that gives them clearly defined powers and responsibilities. They have varying but often high degrees of independence. However, all agencies that rely on financial support from governments are ultimately accountable to those governments or parliaments. For private insurers acting as an agent, a government ministry is usually the "guardian authority" that directs overall policies for government account business. The private account business is regulated by the relevant corporate and/or insurance authority.

Under the auspices of the OECD, the participants in the OECD Arrangement negotiate and implement the Arrangement disciplines. The Arrangement sets limits on the terms and conditions for export credits provided by OECD member countries and an institutional framework for orderly use of export credits (see Appendix III).

The Berne Union and Prague Club

All of the OECD export credit agencies and many of the ECAs in emerging market economies are members of the Berne Union. As of November 2004, there were 54 Berne Union members from more than 40 countries. Most members are the official ECAs of their respective countries. The Berne Union operates as a forum for information exchange on the trade finance industry and on particular countries.

The Prague Club was formed in the early 1990s to support the development of new ECAs in Central and Eastern Europe that were too small to become members of the Berne Union. As of the end of 2003, the Prague Club had 25 members and two observers from more than 20 countries in Europe, Africa, and Asia.

Total exposure by official ECAs averaged about $380 billion during 2000–02 (Figure 2.2). Export credits represent a large share in developing countries' external debt, accounting for 34 percent of the $1 trillion in total external indebtedness to official creditors in 2002, down

Table 2.1. Selected Export Credit Agencies in OECD Countries: Ratio of Medium- and Long-Term New Commitments to Capital Goods Exports
(In percent)

	1979[1]	1990	2000	2003
Canada	. . .	4.2	4.3	4.3
France	19.0	10.5	2.6	3.6
Germany	8.0	3.6	4.5	1.5
Italy	. . .	9.7	5.1	3.0
Japan	13.0	2.5	3.5	3.7
United Kingdom	17.0	6.4	5.8	1.4
United States	13.0	6.0	3.6	2.8

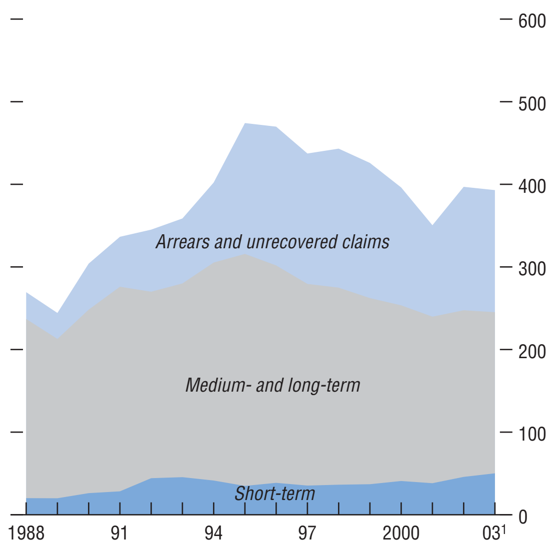
Source: IMF staff estimates based on data from the Organization for Economic Cooperation and Development and the UN COMTRADE database.
[1]The figures for 1979 are from Cruse and others (2003), except for Germany, for which the figure is in percent of total exports as reported in the 2002 Euler-Hermes Annual Report.

slightly from about 37 percent a decade earlier (Figure 2.3).

However, relative to total capital flows to developing countries or exports, export credits supported by ECAs in industrial countries have been on the decline. Preliminary estimates suggest that new commitments by official ECAs amounted to near 35 percent of total official and private lending plus foreign direct investment to developing countries in the early 1990s; the ratio declined to about 20 percent in 2000–02. Continuing a trend that started in the 1980s, export credits supported by official ECAs in OECD countries relative to their exports fell from 2 to 3 percent in 1992 to below 1 percent in 2002 (Figure 2.4). A more relevant measure—medium- and long-term officially supported export credits relative to capital goods exports—shows an even stronger declining trend in these countries. Such credits accounted for 7 percent of capital goods exports in OECD countries in 1992, but only slightly above 2 percent in 2002 (Figure 2.5). This decline occurred across all major ECAs but has been particularly pronounced in the United Kingdom, France, and the United States (Table 2.1).

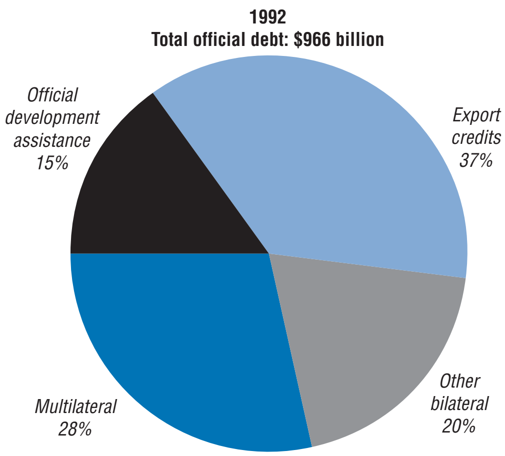
This broad picture masks significant differences between ECAs in developed and

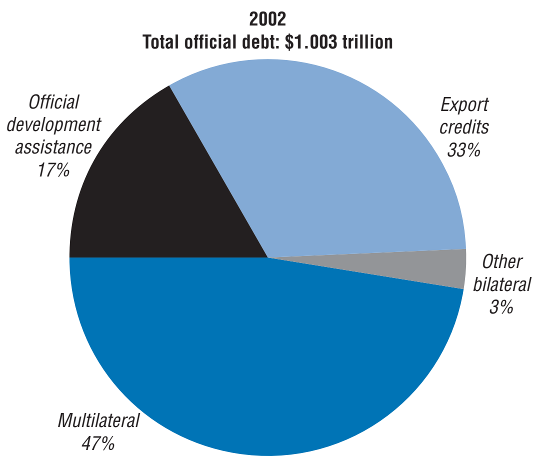
Figure 2.2. Officially Supported Export Credits: Outstanding Commitments
(In billions of U.S. dollars)



Source: IMF estimates based on Berne Union data.
[1]Preliminary estimates based on quarterly reports from export credit agencies.

Figure 2.3. Composition of External Debt of Developing Countries Owed to Official Creditors





Sources: Organization for Economic Cooperation and Development and IMF staff estimates.

developing countries. Officially supported export credits have become available in more developing countries following the establishment of new agencies in these countries. There are indications that official export credits supported by these agencies, at least in a few large ones (some of them—export-import banks—are not members of the Berne Union), have recorded impressive growth in their business over the last decade (Box 2.3). Available data suggest that officially supported export credits relative to exports in emerging market ECAs rose in the late 1990s. But in recent years, although continuing to increase in absolute terms, export credits supported by these agencies may have been outpaced by exports from these countries (Figures 2.4 and 2.5).

Allocation of Export Credits

Notwithstanding the Asian and Russian crises, emerging markets have received an increasing share of officially supported export credits. Emerging market debtors accounted for about 73 percent of the total stock of officially supported export credits in 2000–03, up from 65 percent in the first half of the 1990s. Export credits tend to be concentrated in a few countries—the top 20 recipients in emerging markets accounted for over 80 percent of the total exposure of ECAs in the last 10 years (Figure 2.6).

New export credit commitments to low-income countries have been declining since 1995, and this trend has not been affected by the world economic cycle. The share of new commitments to low-income countries (excluding India) declined from 15 percent in 1995–96 to about 8 percent in 2000–03. This trend is consistent with the findings of the survey of 27 key official ECAs (Appendix IV). ECAs in general tend to be quite cautious toward taking risks in low-income countries, especially heavily indebted poor countries (HIPCs), because of concerns about creditworthiness and business opportunities. Indeed, a number of ECAs have remained off-cover in many low-income countries, even in HIPCs that have passed the completion point (thereby receiving irrevocable debt relief committed under the HIPC initiative). There was a recovery in 2002–03, but it was concentrated in countries such as Vietnam that are not recipients of HIPC debt relief.

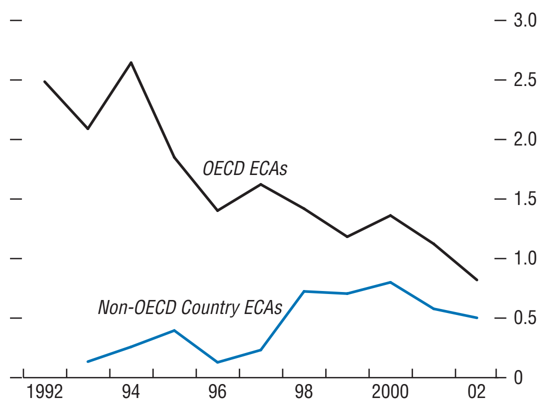
The sectoral allocation of medium- and long-term export credits has also undergone significant changes since the early 1990s. The share of credits going to the transport sector almost doubled, while the share of financing for communications, energy, and mineral resources projects, as well as services, has declined (Figure 2.7). Underlying this development is continued financial support for aircraft sales by key export credit agencies in OECD countries (Appendix V).

Financial Position of Export Credit Agencies

The financial performance of most ECAs has improved significantly since 1995. The net cash flows of Berne Union members, defined as the sum of premium income and recoveries minus claim payments, turned from deficit in 1981–95 to surplus since 1996 (Figure 2.8). This turnaround appears to be quite robust, as most official export credit agencies continued to record positive net cash flows during the emerging market financial crises in the late 1990s and early 2000s.

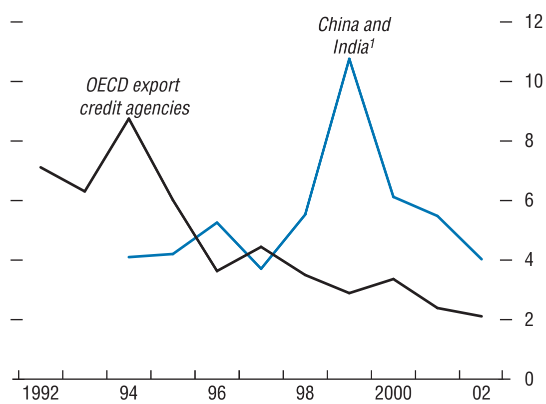
The improvement in risk management systems (Appendix VI) has contributed significantly to this turnaround in the financial performance of ECAs. Many ECAs have improved risk classification and assessment by introducing new techniques such as value-at-risk (see the Glossary of Terms) and strengthened the role of risk analysis in cover policy and in determining financial charges. Export credit agencies also have made efforts to bring their accounting close to private sector standards and to enhance operational

Figure 2.4. Officially Supported Export Credits: New Commitments Relative to Total Exports
(In percent)



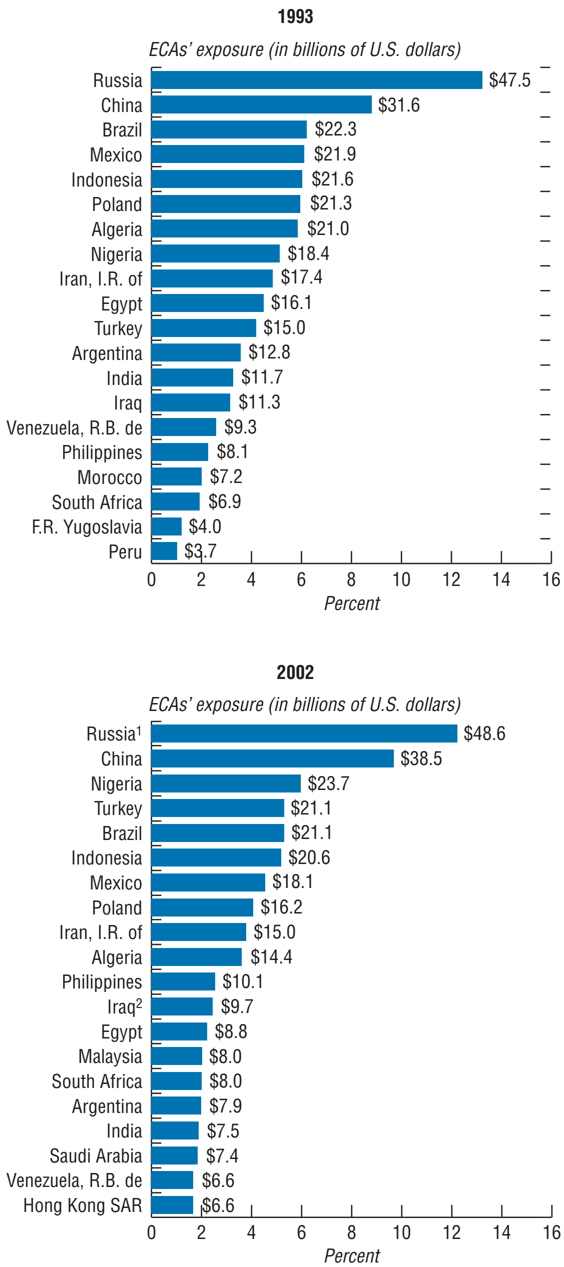
Sources: Organization for Economic Cooperation and Development, Berne Union, and UN COMTRADE databases.
Note: Simple average of all countries in the sample. A list of all of the countries included in the OECD and non-OECD samples is provided in Appendix I.

Figure 2.5. Medium- and Long-Term Export Credits: New Commitments Relative to Capital Goods Exports
(In percent)



Source: IMF staff estimates based on data from the Organization for Economic Cooperation and Development, China Export-Import Bank, Berne Union, and the UN COMTRADE database.
Note: Simple average for all available country data in the sample. A list of all of the countries included in the OECD sample is provided in Appendix I.
[1]For India, only Export Credit Guarantee Corporation of India data; medium- and long-term breakdown not available for Eximbank India.

Figure 2.6. Twenty Main Recipients of Export Credits: Share in Berne Union Agencies' Portfolio
(In percent)



Sources: Berne Union and IMF staff estimates.
[1]Including the former Soviet Union.
[2]Mostly commitments made before 1992.

transparency.[2] Capital market discipline and reduced availability and credibility of sovereign counterguarantees by importing countries, especially the poorer ones, have also added to the incentives for ECAs to improve risk management.[3]

Structural Changes in Major Market Segments

Short-Term Business

The private sector has grown most substantially in the short-term market (usually defined as business with a maximum credit length of one year), replacing the government as the primary provider of coverage in almost every industrial country. The Compagnie Française d'Assurance pour le Commerce Extérieur (COFACE), one of the largest private export credit insurers, estimated that in 1999, more than 95 percent of the short-term business from European Union countries was already underwritten by the private sector.[4] The recovery workouts following financial crises in several emerging market economies have not altered this trend.

There has been significant consolidation within the industry, and credit insurers have become globalized. This is particularly evident in Europe, where mergers, privatization, and

[2]For instance, the U.S. Export-Import Bank has posted its risk mitigation techniques and products applicable to various importing countries on its website, and the list is periodically updated.

[3]For ECAs that use capital markets as a source of funding (e.g., KfW [Germany], the Export Development Corporation [Canada], and the Japan Bank for International Cooperation), credit rating by rating agencies is a key factor in determining funding cost. Such a rating can be different from sovereign rating if a bond issue is not guaranteed by the state.

[4]Export Finance and Insurance Corporation, 2001, p. 23. For private credit insurers with exclusive arrangements with their governments (e.g., COFACE, Euler-Hermes, Atradius), private sector business includes all businesses underwritten in their own accounts and excludes businesses underwritten in the government accounts.

cross-border expansion have produced a dominant clutch of big players such as COFACE, Atradius (formerly Gerling-NCM), and Euler-Hermes, which have also expanded to Asia and North America.[5] These insurers are investing large amounts in information technology products and services, including for smaller exporters.[6]

Medium- and Long-Term Business

Official export credit agencies continue to play a dominant role but face growing competition from the private sector in this market. Private sector insurers have in the past not been particularly interested in underwriting commercial and political risks on longer-term credits and large projects. However, recent years have seen more private facilities become available for medium- and long-term credit, offering comprehensive and combined risk and credit options, notwithstanding the drastic cutback following the September 11, 2001, terrorist attacks.[7] Medium- and long-term credit risks have also shifted from sovereign buyer risk or sovereign guaranteed risk to commercial and project risk, reflecting privatization and market-based reforms in many developing and transition economies.[8] As a result, commercial risks have become more significant in transactions with private or quasi-private buyers, and many capital goods projects—even infrastructure projects—are now handled on a project finance

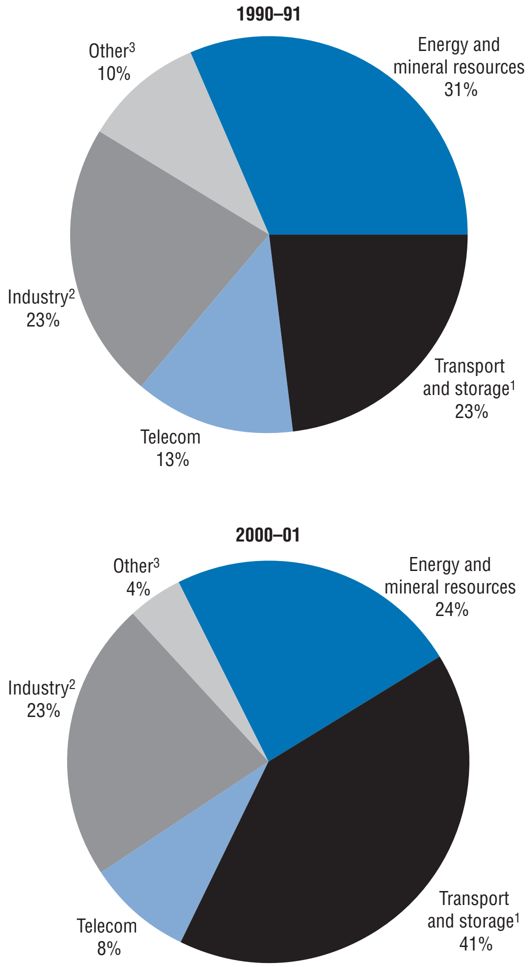
[5]For instance, COFACE has subsidiaries or branches in 57 countries and offers local services in 91 countries through its partners in the Credit Alliance network, united by shared credit risk management (COFACE Annual Report, 2003).

[6]See Melly (2001 and 2004). In general terms, small exporters are defined by the number of employees, the value of sales or turnover, or some combination of these.

[7]Medium- and long-term cover provided by private insurers declined in 2001–03 but started to recover more recently. See Mackie (2003).

[8]For instance, the U.S. Export-Import Bank's credits to public sector obligors or guarantors declined from 61 percent in 1999 to 54 percent in 2003.

Figure 2.7. Composition of Long-Term Officially Supported Export Credits by Sector
(Two-year average)



Source: Organization for Economic Cooperation and Development.

[1]Includes road, rail, water, and air transport, with the latter accounting for 80 to 90 percent of the sector's business in recent years.

[2]Incudes various manufacturing activities.

[3]Includes education, health, water supply, agriculture, forestry, fishing, construction, trade, tourism, and other services.

Box 2.3. Official Export Credit Agencies in Emerging Market Economies: China and India

China has two official export credit agencies: the Export-Import Bank of China (China Exim Bank) and the China Export and Credit Insurance Corporation (SINOSURE). The latter is a member of the Berne Union.

The China Exim Bank was founded in 1994 and is owned solely by the central government, with a mandate to promote national exports and support investment abroad by Chinese enterprises. It provides direct lending to exporters in China and foreign importers of Chinese capital goods and services, and guarantees for export-related transactions. Although not a member of the Berne Union, the China Exim Bank's medium- and long-term export credit operations generally follow the OECD Arrangement, according to the bank's 2003 Annual Report. The China Exim Bank's export lending has expanded rapidly, from less than $1 billion in 1995 to about $8 billion in 2003. Key sources of funding include bond issuances in domestic and international capital markets. The bank enjoys the same credit rating as the sovereign rating of China.

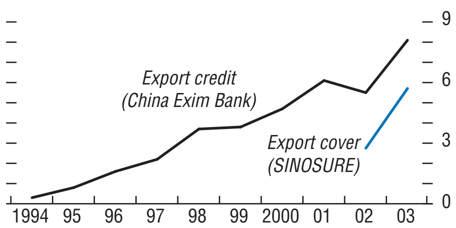
SINOSURE started operations in 2001 with capital from the state budget. Its goal is to support Chinese exports and investment abroad by offering credit insurance against country and buyer risks. Country risks include foreign exchange restrictions, expropriation, nationalization, and war. In 2003, the volume of new business reached a record $5.7 billion, accounting for 1.3 percent of China's total exports. Of this amount, short-term credit insurance totaled $4.3 billion, up 143 percent from 2002. Total premium income also grew rapidly, up 83 percent in 2003 from 2002. SINOSURE also made its first overseas investment covers in 2003, including Indonesia's Palembang Power Project.

India also has two official export credit agencies: the Export-Import Bank of India (Eximbank India) and the Export Credit Guarantee Corporation of India (ECGC). The ECGC is a member of the Berne Union.

Wholly owned by the Indian government, Eximbank India was established in 1981 to facilitate foreign trade. The bank provides financial assistance to its customers through funded (lines of credit, foreign currency, and other loans) and nonfunded (guarantees) programs. It also helps Indian companies identify new business propositions, search for overseas partners, negotiate alliances through its global network of institutions, and develop joint ventures in India and abroad. Between 1994/95 and 2003/04, the bank's loan disbursements grew almost 30-fold, from $48 million to $1.5 billion.

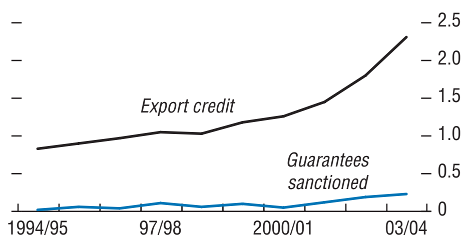
The ECGC was established by the Indian government in 1957 to provide insurance to Indian exporters against trade-related country and buyer risks. It also provides export-related guidance (including country credit ratings and creditworthiness of overseas buyers) and assists exporters in recovering bad debts. The ECGC earned a gross premium income of $95 million in 2003/04 as compared with $80 million in 2002/03.

China: Export Credit Activity
(In billions of U.S. dollars)



Sources: China Exim Bank, and the China Export and Credit Insurance Corporation (SINOSURE).

Eximbank India Export Credit Activity
(In billions of U.S. dollars)



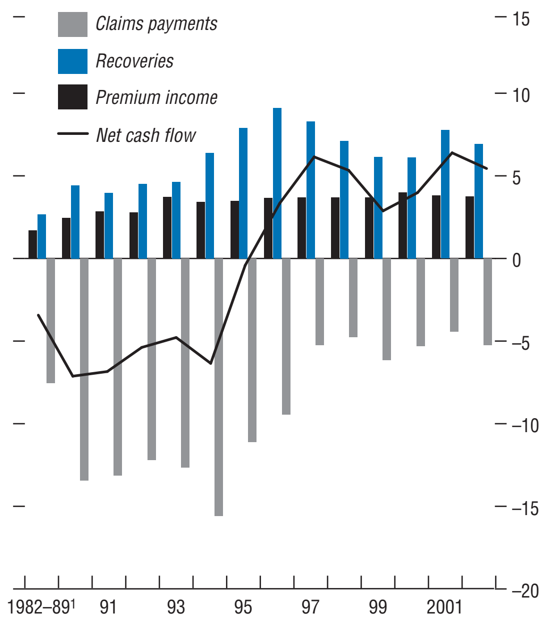
Sources: Eximbank India, Berne Union, and IMF staff estimates.

basis.[9] In response to these changes, some ECAs now accept guarantees provided by nonsovereign entities (local governments or banks).

Investment Insurance

Since the late 1990s, private insurers have expanded significantly in this market, offering new capacity and products. Private sector investment insurers (e.g., American International Group [AIG], Zurich Emerging Market Solutions, Sovereign Risk Insurance Limited, and Lloyd's of London) have shown a willingness to look at risk tenors ranging from 5–15 years, exceeding the private market's old 3-year limit on exposures to investors against political risk events in emerging markets.[10] With the substantial infusion of private capacity and skills, there has been more cooperation between private and public insurers in terms of coinsuring, reinsuring, and risk sharing in this area than in medium- and long-term export credit insurance.

Figure 2.8. Export Credit Agencies: Net Cash Flow
(In billions of U.S. dollars)



Source: Berne Union.
Note: Medium-, long-, and short-term credit insurance only. Investment insurance is not included.
[1]Average for those years.

[9]In project finance, the risks underwritten concern the viability and cash flows of the project itself rather than the financial strength of the buyer or borrower and/or the guarantor.

[10]Several factors may have contributed to this development. Although investment insurance has been a relatively small part of ECA business, it has fewer claim payments and more recoveries than other business. Moreover, investment insurance cases have been exempted from rescheduling under the Paris Club. It is also not subject to the requirements of the OECD Arrangement—there is no maximum length of credit or minimum premium rate for investment insurance.