CHAPTER IV

THE CHANGING ROLE OF OFFICIAL EXPORT CREDIT AGENCIES

The evidence and analysis in the preceding chapters indicate that, while the promotion of national exports remains the principal role of official export credit agencies, the focus of these agencies has been changing, with notable differences between industrial and developing countries. Official ECAs in industrial countries continue to fill in the trade finance gaps in markets where private sector financing is unavailable or insufficient; but in recent years, a significant share of ECA support has gone to keep national exporters competitive in global markets by countering foreign government support provided to competitors. This is particularly the case in sectors with economies of scale and noncompetitive market structure, such as aircraft and military equipment.

Many of the newer official agencies in developing countries are playing a more traditional role, including in the short-term market, in supporting the efforts of their export industries to gain a foothold in world markets. These export enterprises are either relatively new in foreign trade or lack access to financing from commercial sources. The recently launched African Trade Insurance Agency (ATI) represents a multinational effort to promote trade and investment in low-income countries with public-private risk sharing arrangements.[1] In emerging market countries, some ECAs also play the role of supporting national exporters in certain sectors (e.g., aircraft) by partially offsetting the trade finance advantages provided by ECAs of industrialized countries to the competitors of their national exporters.[2]

As indicated earlier, many official export agencies have mandates to play other public policy roles, such as serving as an instrument to deal with instability in the trade finance market. Some ECAs sought to help mitigate the interruption of trade finance during the Asian crisis (e.g., the export-import banks of Japan and the United States in the cases of Indonesia and Korea, respectively).[3] However, virtually all major ECAs went off cover or raised their premiums during the crises of the late 1990s, and more recently in Argentina, where many of them remain off cover (Appendix IV). This suggests that the incentive structure induced most official ECAs to be procyclical, behaving in ways similar to private creditors and insurers during crises.[4]

Subsidies, Distortionary Interventions, and the Role of Public Agencies

There are various arguments for government involvement in trade finance, but the key economic rationale is essentially twofold: to counter foreign government subsidies or “self-defense,” and to address “market imperfections” or “market gaps.”[5] Over the past two decades, there has been a broad consensus among policymakers and market participants in OECD countries that using government

[1]The ATI is a pan-African initiative to facilitate access to, and improve the terms of, trade finance for importers and exporters in participating African countries. The ATI has seven founding member countries (Burundi, Kenya, Malawi, Rwanda, Tanzania, Uganda, and Zambia) and is open to all African countries. It is supported by the World Bank and the European Union and works closely with private underwriters—such as Lloyd’s of London and Atradius, and, more recently, under a cooperation agreement with Zurich Emerging Markets—in the provision of export credit and political risk insurance for trade and investment transactions.

[2]Trade financing is often an important element in global sales. ECAs in industrialized countries typically have better credit ratings than emerging market ECAs and hence their trade finance gives additional advantages to the exporters that benefit from such support in the competition with emerging market exporters.

[3]See International Monetary Fund (2003) on how these two institutions reacted to support operations during the crisis.

[4]During the Asian crisis in the late 1990s, an OECD press release stated that member governments and their ECAs would try to continue to make facilities available to Asia.

[5]See Ray (1995) and Hufbauer and Rodriguez (2001).

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subsidies to sweeten export finance, and the subsidy competition that results from that process, is not only unfair and distortionary but also costly and wasteful. The best way to level the trade finance playing field is to eliminate such subsidies. Under the OECD Arrangement and the WTO Agreement on SCM, much has been achieved in this regard but more still needs to be done in eliminating explicit subsidies. While Berne Union ECAs have recorded positive cash flows consistently since 1995, official ECAs continue to benefit from an implicit subsidy because the cost of using government-provided capital is not explicitly accounted for.[6] Until such implicit subsidies are removed, possibly through a multilateral framework, it is difficult to judge the efficiency of an official ECA as compared with private sector operators.[7]

The rise of the private sector, combined with the declining activity in the second half of the 1990s, led to calls for a reexamination of the role of public agencies in many OECD countries (e.g., Australia, Canada, Japan, New Zealand, the United Kingdom, and the United States). The resulting reviews, which often entailed consultations with the private sector, generally acknowledged gaps in the export credit market where the private sector is unwilling or unable to provide financing. For instance, researchers commissioned by the U.K. Export Credits Guarantee Department (ECGD) to review its business interviewed bankers, private insurance and reinsurance brokers, and capital goods exporters and found no current appetite in the private sector for underwriting ECGD's book of risks. Private insurers and reinsurers all considered political risks to be difficult to quantify over the medium and long term.[8] The U.S. Export-Import Bank, which has an explicit policy of not competing with the private sector, recognizes that there is a role for ECAs in higher-risk markets (e.g., sub-Saharan Africa), multibillion-dollar transactions, nonstructured medium-term export financing to noninvestment grade borrowers, and small business exporters.[9] This assessment was broadly shared by private trade finance providers. Between the importers in countries with full and reliable access to private market financing (relatively low risk markets) and those that rely primarily on grants and other highly concessional development assistance (very high risk markets), there are countries and importers in the middle of the risk spectrum that official ECAs can usefully serve. However, the provision of export finance by a public agency to fill market gaps, where warranted by national and international interests, does entail costs. Efforts should be made to guard against possible moral hazard problems, and to prevent ECA financing from being used as a pretext to channel distortionary subsidies.

Bank-financed trade credits are important for many emerging market economies. However, such financial flows could be volatile in times of heightened global risk aversion or financial contagion. International banks, acting quite rationally individually, are likely to cut trade credit lines in the face of a building crisis, even though this is likely to exacerbate the severity of the crisis, and erode the quality of these and other creditors' claims. Mechanisms that helped mitigate this collective action problem in the 1980s are no longer operative. With long-term finance now provided predominantly by bondholders, the willingness of banks to maintain trade credit lines in difficult times has been significantly weakened, and bondholders are too diffuse to be able to provide short-term financing (or subordination to facilitate such financing being provided by others on a senior basis). In addition, developments in international

[6]Official ECAs are not required to earn appropriate return on the notional capital needed to support the contingent liabilities of their portfolio.

[7]Premium rates of official ECAs and private sector insurers are not directly comparable because the private sector does not currently offer the type of cover (in terms of risk horizon, risk exposure, and country of destination) available through the ECAs.

[8] See National Economic Research Associates (2000).

[9]About 75 percent of the U.S. Export-Import Bank's export finance in 2003 was in the area characterized as "no private sector finance available." The remaining amount was to "meet competition" (Export-Import Bank of the United States, 2004, p. 11 and p. 93).

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finance in recent years have blurred the boundary between trade credit and financial credits, thereby reducing international banks' confidence that payment priority would be granted by a country in crisis to trade credit over other types of short-term financing.[10] For these and other reasons, a crisis-induced collapse in trade finance has become a more serious problem, and a sudden loss of access to trade finance could not only depress trade but also compound the country's debt dynamics and hence deepen the crisis, as evidenced in recent financial crises.[11] Appropriate public sector intervention could help crisis resolution and facilitate the resumption of private sector financing.

The above discussion suggests that public agencies could play useful roles in two broad areas. First, in medium- and long-term markets, particularly large projects, and the market for small and medium-sized enterprises, private sector appetite and capacity are limited or unavailable.[12] In many developing countries, private sector trade finance providers have not yet developed to the point of being capable of meeting their trade sector's financing needs. Export industries in these countries often lack access to other forms of financing (e.g., suppliers' credits). In all these instances, public agencies could fill in the gaps in the type, amount, or period of cover that the private sector is unable to offer. Second, public agencies could provide a safety net at a time of high volatility in the private market and in cases where the private market suffers persistent losses and as a result undergoes significant retrenchment.

Strengths and Constraints of Official Export Credit Agencies

Where private markets have appropriate term and volume capacities, importers usually prefer market financing over ECA financing because private insurers tend to be more flexible and able to respond more quickly to events (Appendix VII). In some instances, they may be able to compete with official providers through discounts for large volumes and for diversified exporters. In addition, they tend to offer coverage for a wider variety of risks (business interruption, license cancellation policy, and contingency risks) compared with official ECAs.[13] However, commercial lenders and insurers are in the market for a profit. They may ". . . wax and wane: when markets get rough they tighten up, raise premium rates, lower the ceilings on policies, and close down in the riskiest markets."[14]

In principle, a key strength of the public agencies is their greater risk bearing capacity. These agencies are public policy instruments and, depending on the governing legislation, can be used when needed. They may have certain advantages in assessing sovereign risk, mitigating the risk of loss, and pursuing claims in the event of loss.[15] While financial situations vary from country to country, public agencies may have access to public funds and, in the case of export credit agencies in OECD countries, relatively low-cost funding from capital markets because of a credit rating that is usually at par with that of their sovereign. Official ECAs generally have a mandate to be financially self-sustaining. Many governments also require their ECAs not to compete with the private sector. In addition, having moved out of short-term markets, ECAs may no longer maintain technical capacity and expertise in handling short-term business. Official ECAs may find it difficult to undertake countercyclical operations in times of financial crises even when such actions are deemed to serve national and international interests.

[10]Trade finance transactions relying on traditional documentary procedures have fallen from over 90 percent of all transactions in the late 1980s to about 30 percent over the past several years (World Bank, 2004).

[11]Bank-financed trade credits declined by as much as 30 to 50 percent in Brazil and Argentina in 2002, by about 50 percent in Korea in 1997–98, and from $6 billion to $1 billion in Indonesia during the Asian crisis (see International Monetary Fund, 2003).

[12]In many cases, the availability of cover from private insurers for political risk events, including currency inconvertibility, is the exception rather than the rule.

[13]See Alington (1999) and Salinger (1999).

[14]Barovick, 2004, p. 24.

[15]For instance, information and leverages obtained through official bilateral channels.

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