

**OFFICIALLY SUPPORTED EXPORT CREDITS  
IN A CHANGING WORLD**

Prepared by Jian-Ye Wang, Mario Mansilla,  
Yo Kikuchi, and Siddhartha Choudhury

June 2005



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# CONTENTS

<b>Frequently Used Abbreviations</b>	<b><a href="#">vi</a></b>
<b>Preface</b>	<b><a href="#">vii</a></b>
<b>Chapter I. Overview</b>	<b><a href="#">1</a></b>
<b>Chapter II. Trends and Developments in Export Credits</b>	<b><a href="#">4</a></b>
Volume of Export Credits	<a href="#">4</a>
Allocation of Export Credits	<a href="#">8</a>
Financial Position of Export Credit Agencies	<a href="#">9</a>
Structural Changes in Major Market Segments	<a href="#">10</a>
<b>Chapter III. Factors Affecting Officially Supported Export Credits</b>	<b><a href="#">14</a></b>
Government Policies	<a href="#">14</a>
Private Sector Competition	<a href="#">15</a>
Other Factors	<a href="#">17</a>
<b>Chapter IV. The Changing Role of Official Export Credit Agencies</b>	<b><a href="#">20</a></b>
Subsidies, Distortionary Interventions, and the Role of Public Agencies	<a href="#">20</a>
Strengths and Constraints of Official Export Credit Agencies	<a href="#">22</a>
<b>Chapter V. Challenges Facing Official Export Credit Agencies</b>	<b><a href="#">23</a></b>
Complementing the Private Sector	<a href="#">23</a>
Financing for Low-Income Countries	<a href="#">24</a>
Trade Finance in Financial Crisis	<a href="#">25</a>
Export Credit Agencies in Developing Countries	<a href="#">25</a>
<b>Appendixes</b>	
I. Technical Note on Export Credit Statistics	<a href="#">27</a>
II. Mandate and Scope of Operations of Selected Export Credit Agencies	<a href="#">30</a>
III. Recent Developments in the OECD Arrangement on Guidelines for Officially Supported Export Credits	<a href="#">31</a>
IV. Financing for Low-Income Countries and Countries in Crisis from Selected Export Credit Agencies	<a href="#">34</a>
V. Aircraft Financing Supported by Selected Export Credit Agencies	<a href="#">36</a>
VI. Risk Management in Export Credit Agencies	<a href="#">37</a>
VII. Strengths and Constraints of Public and Private Trade Finance Providers	<a href="#">40</a>
VIII. Reinsurance and Export Credit Agencies	<a href="#">41</a>
<b>Glossary of Terms</b>	<b><a href="#">43</a></b>
<b>Bibliography</b>	<b><a href="#">47</a></b>

**Boxes**

2.1. The Trade Finance Market and Official Export Credit Agencies	<a href="#">5</a>
2.2. Institutional Environment of Arrangements for Officially Supported Export Credits	<a href="#">6</a>
2.3. Official Export Credit Agencies in Emerging Market Economies: China and India	<a href="#">12</a>
3.1. Multilateral Development Banks and Trade Finance	<a href="#">18</a>

**Figures**

2.1. Officially Supported Export Credits: New Commitments	<a href="#">4</a>
2.2. Officially Supported Export Credits: Outstanding Commitments	<a href="#">7</a>
2.3. Composition of External Debt of Developing Countries Owed to Official Creditors	<a href="#">8</a>
2.4. Officially Supported Export Credits: New Commitments Relative to Total Exports	<a href="#">9</a>
2.5. Medium- and Long-term Export Credits: New Commitments Relative to Capital Goods Exports	<a href="#">9</a>
2.6. Twenty Main Recipients of Export Credits: Share in Berne Union Agencies' Portfolio	<a href="#">10</a>
2.7. Composition of Long-Term Officially Supported Export Credits by Sector	<a href="#">11</a>
2.8. Export Credit Agencies: Net Cash Flow	<a href="#">13</a>
3.1. Foreign Direct Investment and Commercial Bank Lending to Emerging Market Economies	<a href="#">16</a>
3.2. Selected Private Export Credit Insurers: Premium and Exposure	<a href="#">17</a>

**Tables**

2.1. Selected Export Credit Agencies in OECD Countries: Ratio of Medium- and Long-Term New Commitments to Capital Goods Exports	<a href="#">7</a>
---	-------------------

**Appendix Figures**

A5.1. Aircraft Financing Supported by Selected Export Credit Agencies	<a href="#">36</a>
A8.1. Capital and Reserves of Top Ten Reinsurers, 2002–03	<a href="#">42</a>

**Appendix Tables**

A1.1. New Export Credit Commitments by Type of Recipient Country, 1988–2003	<a href="#">27</a>
A1.2. Export Credit Commitments Outstanding, 1988–2003	<a href="#">28</a>
A2.1. Mandate and Scope of Operations of Selected Export Credit Agencies	<a href="#">30</a>
A4.1. ECA Financing for Low-Income Countries	<a href="#">34</a>
A4.2. ECA Response to Countries in Financial Crisis	<a href="#">35</a>
A7.1. Strengths and Constraints of Public and Private Trade Finance Providers	<a href="#">40</a>
A8.1. Reinsurance of Short-Term Business by Official Export Credit Agencies	<a href="#">41</a>

The following conventions are used in this report:

- . . . to indicate that data are not available or not applicable;
- to indicate that the figure is zero or less than half the final digit shown;
- between years or months (for example, 1991–92 or January–June) to indicate the years or months covered, including the beginning and ending years or months;
- / between years or months (for example, 1991/92) to indicate a fiscal or financial year.

“Billion” means a thousand million; “trillion” means a thousand billion.

“Basis points” refer to hundredths of 1 percentage point (for example, 25 basis points are equivalent to  $\frac{1}{4}$  of 1 percentage point).

Minor discrepancies between constituent figures and totals are due to rounding.

\* \* \*

As used in this report, the term “country” does not in all cases refer to a territorial entity that is a state as understood by international law and practice. As used here, the term also covers some territorial entities that are not states but for which statistical data are maintained on a separate and independent basis.



## FREQUENTLY USED ABBREVIATIONS

ADB	Asian Development Bank
AIG	American International Group
ATI	African Trade Insurance Agency
BIS	Bank for International Settlements
COFACE	Compagnie Française d'Assurance pour le Commerce Extérieur (France)
COMTRADE	Commodity Trade Database (United Nations)
EBRD	European Bank for Reconstruction and Development
ECA	Export credit agency
ECGC	Export Credit Guarantee Corporation of India
ECGD	Export Credits Guarantee Department (United Kingdom)
ECO	New Zealand Export Credit Office
EDC	Export Development Corporation (Canada)
EFIC	Export Finance and Insurance Corporation (Australia)
FCIA	Foreign Credit Insurance Agency (United States)
HIPC	Heavily Indebted Poor Countries
IDB	Inter-American Development Bank
IFC	International Finance Corporation (World Bank Group)
IFI	International financial institutions
IMF	International Monetary Fund
JBIC	Japan Bank for International Cooperation
KfW	Kreditanstalt für Wiederaufbau (Germany)
MIGA	Multilateral Investment Guarantee Agency (World Bank Group)
MPR	Minimum premium rate
NCM	Nederlandsche Credietverzekering Maatschappij (Netherlands)
NEXI	Nippon Export and Investment Insurance (Japan)
OECD	Organization for Economic Cooperation and Development
SACE	Servizi Assicurativi del Commercio Estero (Italy)
SCM	WTO Agreement on Subsidies and Countervailing Measures
SINOSURE	China Export and Credit Insurance Corporation
VaR	Value-at-Risk
WTO	World Trade Organization



## PREFACE

This study is intended to assess the issues of government involvement in international trade finance stemming from the recent changes in global financial markets. It attempts to summarize the information available concerning the disparate responses by public and private sector trade finance providers to these developments, based on discussions with representatives of official export credit agencies and private trade finance providers, and a survey of market participants conducted from October 2003 to May 2004. The study also updates developments in officially supported export credits. The last comprehensive review of official export finance by the International Monetary Fund staff was published in 1995 (Kuhn, Horvath, and Jarvis).

This study was prepared in the Official Financing Operations Division of the IMF's Policy Development and Review Department under the general guidance of Martin Gilman. Lisandro Abrego, Corinne Delechat, and Alberto Espejo made contributions at various stages of the study. The work benefited from comments by staff in the Policy Development and Review Development and other IMF departments. Helpful comments on early drafts by Kimberly Wiehl of the Berne Union, Janet West of the Organization for Economic Cooperation and Development, and Piper Star of the U.S. Export-Import Bank are gratefully acknowledged. The treatment of the issues in this study reflects the views of the authors and does not necessarily represent the views of the International Monetary Fund or its Executive Directors.

The authors are grateful to Aminata Toure for research and to Esther George, Maria Fernanda Gusmao, and Lorna Campbell for secretarial assistance. David Einhorn of the External Relations Department edited the manuscript and coordinated production of the publication.



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Official export credit agencies (ECAs), a key pillar of the international financial architecture in the second half of the twentieth century, financed a significant share of exports from industrialized countries and provided larger debt financing for developing countries than either multilateral or bilateral creditors. Since the early 1990s, however, the world has changed dramatically. As noted in a conference in 2000 on the role of the U.S. Export-Import Bank in the twenty-first century, private credit insurance companies have “increasingly occupied the market” while “government-insured export business tends to account for a shrinking share of total exports in the major exporting countries.”<sup>1</sup> Indeed, globalization, fueled by privatization and trade and capital liberalization, has significantly altered the landscape of international trade finance in recent years.<sup>2</sup> Yet there are more ECAs than ever before, as developing countries launch agencies of their own.

This study takes stock of developments in officially supported export credits since 1995. Following a precipitous decline in the overall level of activity during the 1980s, new export credit commitments by official export credit agencies quadrupled between 1988 and 1995.<sup>3</sup> Since then, the export credit business has been affected by several financial crises in emerging markets. At the same time, the activity of ECAs has evolved, shaped significantly by the environment in which they operate, particularly gov-

ernment policies and the willingness and capacity of the private sector to provide trade finance.

These developments raise important issues. In particular, with the recent changes in global finance, what role do official export credit agencies play today? Is there a need for continued government involvement in international trade finance? What are the key challenges facing public agencies in industrialized countries? What are the implications for developing countries and the new agencies that have been set up in those nations to promote export development? This study addresses these questions by assessing the available statistical evidence, summarizing the various responses by public and private trade finance providers, and drawing policy implications that may have consequences for countries. The aim is not to deny the well-known political and budgetary constraints in dealing with these issues, which, if adequately addressed, would help ensure balanced and sustainable trade and growth in the world economy.

This study is based on discussions with representatives of export credit agencies during the period from October 2003 to May 2004. A survey of 27 agencies provided valuable insights. The statistical analysis relies primarily on data provided by export credit agencies to the International Union of Credit and Investment Insurers (known as the Berne Union) and the Organization for Economic Cooperation and Development (OECD). These data are not with-

<sup>1</sup>See Hufbauer and Rodriguez, 2001, p. 8.

<sup>2</sup>The changing world of trade finance has been widely recognized (see the Berne Union Yearbooks over the past several years) and the subject of review by export credit agencies and industrial experts (see Export Credits Guarantee Department, 2000a; Export Credit Office, 2002; Export Finance and Insurance Corporation, 2001; Organization for Economic Cooperation and Development, 1998, 2001, 2003; Becker and McClenahan, 2003; Cruse and others, 2003; Moran, 2003; Barovick, 2004). Stephens, 1999, p. 29, notes that developments during the period have been “more rapid, more frequent, and more significant” than before (see also Stephens and Smallridge, 2002). Aspects of these developments were described in recent staff reviews of agencies that provide official financing to developing countries (Ross and Harmsen, 2001; Gilman and Wang, 2003).

<sup>3</sup>See Kuhn, Horvath, and Jarvis (1995).

out limitations (see Appendix I for more details), and thus caution is needed in their interpretation. In particular, the databases may not capture export credits supported by agencies or export-import banks in developing countries that are either small or not primarily credit insurers. Analysis of the changing trade finance marketplace is also made difficult by the lack of comprehensive and reliable data on other trade finance providers, particularly private sector providers.<sup>4</sup>

Financial flows facilitated by official export credit agencies are large in comparison with official development assistance and gross lending by international financial institutions to developing countries. However, the importance of officially supported trade finance has been declining relative to the rapid expansion of world trade and total capital flows to developing countries. Available evidence suggests that the private sector now provides most credit insurance in the short-term market in OECD countries. Medium- and long-term officially supported export credits relative to total capital goods exports in these countries have continued a declining trend since the late 1970s. In contrast, new ECAs have been set up in emerging market economies and their business has been growing, but their overall scale has remained relatively small. Low-income countries are getting a smaller share of officially supported export credits.

Underlying these developments is a sharp reduction or elimination of explicit subsidies in OECD countries through the Arrangement on Guidelines for Officially Supported Export Credits (known as the OECD Arrangement), the privatization of ECA activity in industrial countries and state-owned enterprises in developing countries, the rapid growth of foreign direct investment and intrafirm trade, the

increased availability of trade finance from local sources in emerging markets, and the rise of the private sector and other new trade finance providers. These developments have led to changes in the role played by official export credit agencies, particularly those in industrialized countries, and raise questions regarding the need for continued government involvement in the future.

This study finds that, considering the private sector's growing appetite and capacity, the trend toward a reduced level of business supported by official export credit agencies in industrialized countries is likely to continue. However, private sector appetite at present remains limited in certain markets, particularly long-term credits, very large projects, small- and medium-sized enterprises, and markets considered relatively risky, such as a number of low-income countries. In these circumstances, official export credit agencies may be able to play a useful role by filling in the market gaps, where national and international interests warrant, while continuing to curtail distortionary subsidies under the OECD Arrangement and the World Trade Organization (WTO) Agreement on Subsidies and Countervailing Measures (SCM).

The study highlights the key challenges facing official export credit agencies, including complementing the private sector, facilitating financing to low-income countries while helping maintain these countries' debt sustainability, and playing a positive role in the area of trade finance in international efforts to address emerging market financial crises. Strengthening the capacity of official export credit agencies to serve as reinsurer and coinsurer may help them to meet the challenges ahead. ECAs in developing countries face an additional challenge to ensure that limited public resources are best used for economic development. Joining the

<sup>4</sup>Aside from the lack of reliable sources, several other problems in private sector trade finance data make it virtually impossible to estimate the global amount of external trade finance provided to developing countries. For commercial banks, only a subset of developing countries' external borrowing is identified by purpose, and of that, only data on commitments (not disbursements, repayments, or the stock of debt) are reported. In addition, it is difficult to distinguish bank loans that are guaranteed or insured from those that are not. There clearly are some overlaps between bank lending data and exposure data reported by credit insurers. Finally, survey data from suppliers and purchasers do not usually distinguish between domestic and international sources of finance (see World Bank, 2004).

international effort to eliminate export subsidy competition, including following the OECD Arrangement, would help in this regard.

Chapter II of this study presents available evidence on the levels and composition of officially supported export credits from both developed and developing countries, as well as recent structural changes in key segments of the market. Chapter III analyzes the factors contributing to recent developments, particularly

the decline in officially supported export credits relative to exports in OECD countries. The changing roles of, and the main constraints faced by, official export credit agencies in comparison with the private sector and multilateral development banks are discussed in Chapter IV. The study concludes with a discussion of the challenges facing official export credit agencies, pointing to the areas in which the role of those agencies may be enhanced.

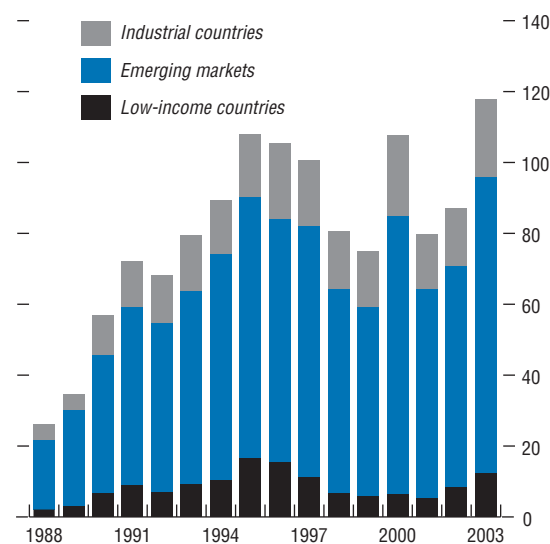
Official export credit agencies were established originally to promote national exports in situations where the private sector was reluctant to do so due to high political and commercial risks. Because their support for exporters also gives importers access to finance (through buyer or supplier credit), 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.<sup>1</sup>

<sup>1</sup>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.

<sup>1</sup>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 Official 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 devel-

oping 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 <sup>1</sup>	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.

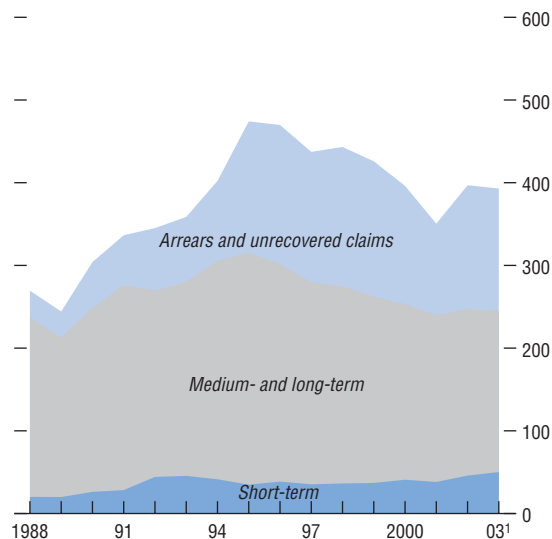
<sup>1</sup>The figures for 1979 are from Cruse and others (2003), except for Germany, for which the figure is in percent of total exports as reported in the 2002 Euler-Hermes Annual Report.

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)

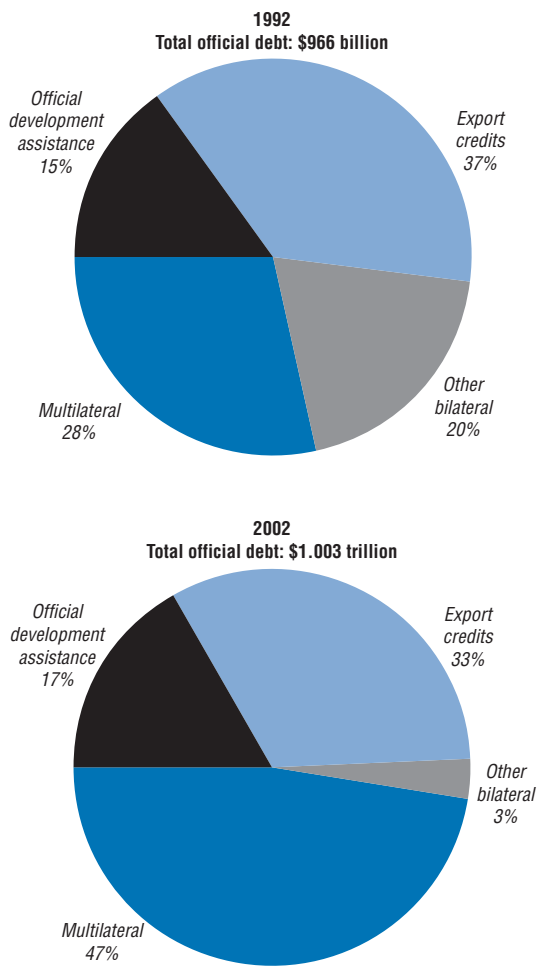


Source: IMF estimates based on Berne Union data.

<sup>1</sup>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 HIPC 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.

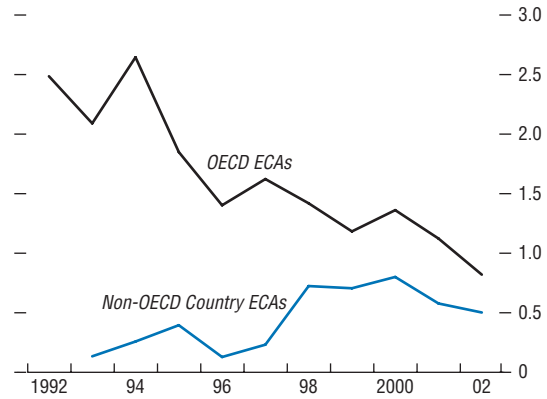
The sectoral allocation of medium- and long-term export credits has also undergone significant changes since the early 1990s. The share of credits going to the transport sector almost doubled, while the share of financing for communications, energy, and mineral resources projects, as well as services, 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

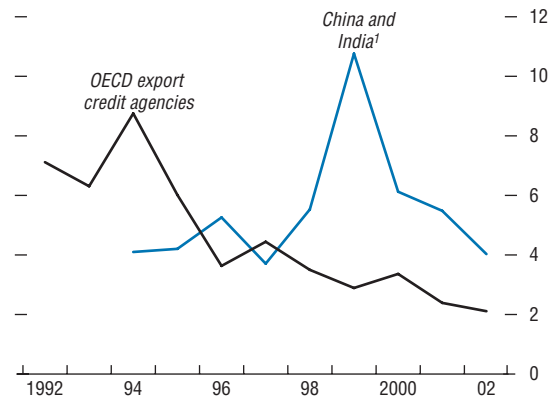
**Figure 2.4. Officially Supported Export Credits: New Commitments Relative to Total Exports (In percent)**



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)**

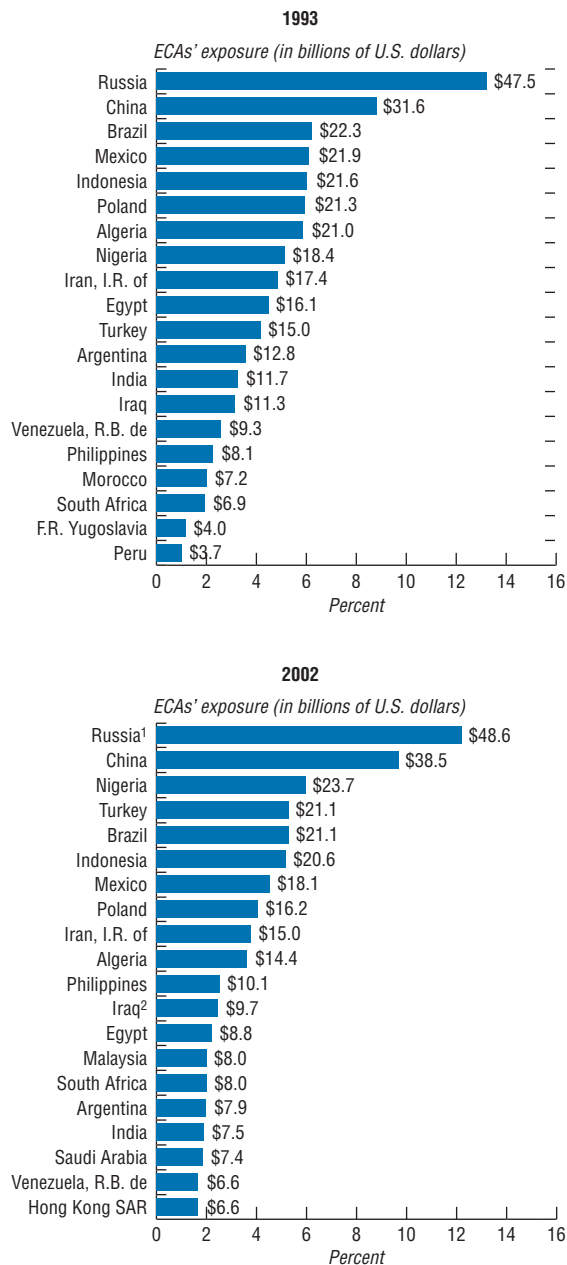


Source: IMF staff estimates based on data from the Organization for Economic Cooperation and Development, China Export-Import Bank, Berne Union, and the UN COMTRADE database.

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.

<sup>1</sup>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.  
<sup>1</sup>Including the former Soviet Union.  
<sup>2</sup>Mostly commitments made before 1992.

transparency.<sup>2</sup> Capital market discipline and reduced availability and credibility of sovereign counter-guarantees by importing countries, especially the poorer ones, have also added to the incentives for ECAs to improve risk management.<sup>3</sup>

### 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.<sup>4</sup> 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

<sup>2</sup>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.

<sup>3</sup>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.

<sup>4</sup>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.<sup>5</sup> These insurers are investing large amounts in information technology products and services, including for smaller exporters.<sup>6</sup>

### 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.<sup>7</sup> 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.<sup>8</sup> 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

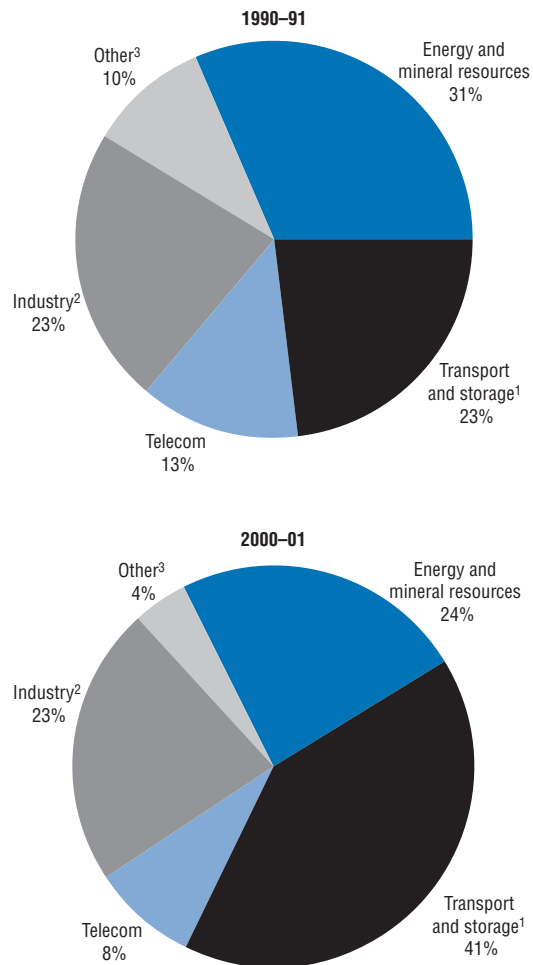
<sup>5</sup>For instance, COFACE has subsidiaries or branches in 57 countries and offers local services in 91 countries through its partners in the Credit Alliance network, united by shared credit risk management (COFACE Annual Report, 2003).

<sup>6</sup>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.

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

<sup>8</sup>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.

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

<sup>2</sup>Includes various manufacturing activities.

<sup>3</sup>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.

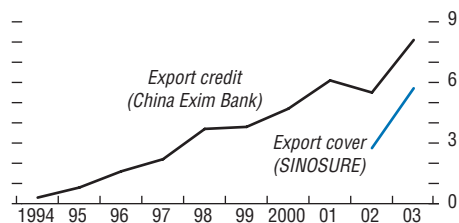
India also has two official export credit agencies: the Export-Import Bank of India (Eximbank India) and the Export Credit Guarantee Corporation of India (ECGC). The ECGC is a member of the Berne Union.

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**

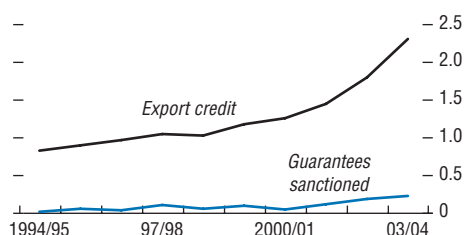
(In billions of U.S. dollars)



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.<sup>9</sup> In response to these changes, some ECAs now accept guarantees provided by nonsovereign entities (local governments or banks).

### Investment Insurance

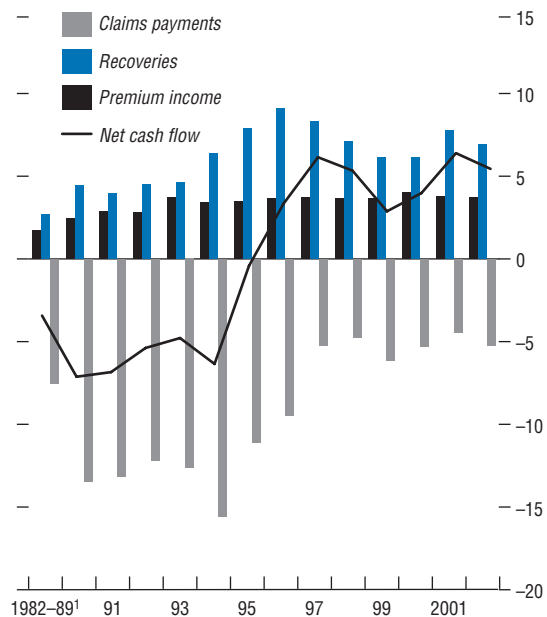
Since the late 1990s, private insurers have expanded significantly in this market, offering new capacity and products. Private sector investment insurers (e.g., American International Group [AIG], Zurich Emerging Market Solutions, Sovereign Risk Insurance Limited, and Lloyd's of London) have shown a 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.<sup>10</sup> 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.

<sup>9</sup>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.

<sup>10</sup>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.

**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.

<sup>1</sup>Average for those years.

The decisions of the OECD governments to further reduce subsidies and to downsize government-supported businesses in the early 1990s were key factors in setting in motion the retreat of official agencies as suppliers of short-term export credits in industrial countries. Both national and international policies have also had a direct impact on the level, destination, and sectoral allocation of officially supported export credits. The subsequent rise of the private sector represents a fundamental force reshaping the landscape of international trade finance, with long-term implications for official agencies.

There are other factors that are affecting official export credit agencies' core market—which is the financing of capital goods exports to developing countries. On the supply side, these factors include the availability of trade finance from local sources in emerging markets, innovations to attract capital market financing, and the emergence of trade finance facilities in multilateral development banks. Demand-side factors include changes in the importer countries.

The evolution of this core market also has implications for the role of official agencies in the years ahead. Although these changes suggest an increasing marginalization of the official agencies relative to their traditional core business, the number of such agencies has continued to grow as developing countries follow the lead of most OECD countries.

## Government Policies

### Reduction of Explicit Subsidies

The sharp reduction of explicit subsidies as a result of the OECD Arrangement and the World Trade Organization (WTO) Agreement on Subsidies and Countervailing Measures (SCM) has been one of the key reasons for the decline in ECA activity relative to exports in OECD countries.<sup>1</sup> During the 1970s, expensive subsidy competition in export finance among major industrial countries not only distorted the market but also became an increasing drain on government budgets, as evidenced by the large cash outflows from the ECAs. The OECD Arrangement, established in April 1978, has played an important role in promoting free and fair trade by reining in government subsidies on export credits.<sup>2</sup>

Over time, the scope and coverage of the OECD Arrangement have expanded from disciplines on interest rates and repayment terms of export credits to, among other things, risk premiums on credit insurance and tied aid credits. In April 1999, the so-called Knaepen Package of the OECD Arrangement went into effect, providing a new discipline on minimum premium rates for the country credit risk for medium- and long-term officially supported export credits, irrespective of whether the importer or borrower is a private or public entity.<sup>3</sup> The package applies to all OECD member governments that are participants in the Arrangement. It recognizes the need to

<sup>1</sup>WTO rules permit the use of development assistance but preclude the use of subsidies that distort international trade and are more for the benefit of domestic exporters than poorer countries.

<sup>2</sup>The Arrangement set minimum fixed rates of interest, minimum down payments, maximum lengths of credits, and standard repayment terms on export credit facilities.

<sup>3</sup>Pierre Knaepen was the chairman of a Working Group of Experts mandated by the participants in the OECD Arrangement in 1994 to develop proposals on guiding principles for setting premiums and related conditions (see OECD, 1998 and 2004).

converge on risk premiums so as to level the playing field and to meet the Item (j) provision of the WTO Agreement on SCM (see Appendix III). Item (j) requires export credit agencies to break even over the long term, that is, to charge premiums at adequate levels to cover long-term operating costs and losses. It applies not only to OECD countries but also to all other members of the WTO, further dissuading the use of subsidies in trade financing.<sup>4</sup>

More recently, reviews of the disciplines governing export credits have focused on the consistency between the WTO and the OECD Arrangement, and have examined, among other things, issues relating to export credits with a floating interest rate provided by private banks under ECA insurance cover.<sup>5</sup>

### Privatization of ECA Short-Term Activity

The U.K. government began the privatization trend in 1991 with the sale of the short-term credit insurance business of its Export Credits Guarantee Department to NCM of the Netherlands. The U.S. government followed suit with termination of its exclusive underwriting relationship with the Foreign Credit Insurance Agency (FCIA) in 1992.<sup>6</sup> COFACE of France was privatized in 1994. While sales or transfers (e.g., Sweden and Finland) directly moved the export credit agencies' short-term business to private hands, there has also been silent privatization in which private insurers, acting as an agent of the government, have insured more and more business on their own accounts, leading to a declining share of government account business in total business (e.g., NCM of the Netherlands,

and COFACE since 1994). Outside the OECD area, South Africa terminated the arrangement under which the government reinsures the country's export credit agency in 2001, while Singapore has recently privatized its official export credit agency.

### Competition Policies

The retreat by official ECAs from the short-term market in OECD countries has also been a direct consequence of government actions that provide more room for private companies. The European Commission set guidelines in 1997 discouraging governments in the European Union (EU) from insuring "marketable risk" (short-term commercial credit risk contestable in the private market) in OECD countries (excluding Mexico and Turkey), while allowing private insurers and reinsurers within the EU to underwrite any risks they are willing to cover.<sup>7</sup> The U.S. Export-Import Bank has shifted its short-term business focus to small and medium-sized exporters who cannot find cover in the private market, based on a general policy of not competing with the private sector in this area. More recently, the government of Japan announced the end of the monopoly on short-term export credit insurance by the state-owned company, Nippon Export and Investment Insurance (NEXI), as of 2005.

## Private Sector Competition

### Globalization and Intrafirm Trade

Net foreign direct investment in emerging markets has risen dramatically since the early

<sup>4</sup>As specified in Articles 1 and 3, and Annex 1 of the WTO Agreement on SCM.

<sup>5</sup>The WTO Agreement on SCM considers official support for export credits provided in conformity with the interest rate provisions of the OECD Arrangement as not being prohibited subsidies (the "safe haven" clause). However, recent case law in the WTO found that the OECD Arrangement, as it stands, does not "protect" export credit practices taking the form of floating interest rate arrangements. Reaching consensus on official support under floating interest rate arrangements would help ensure effective regulation of subsidies provided in this area of export finance. The recent WTO rulings on disputes over regional jet aircraft financing between Canada (an OECD Arrangement participant) and Brazil (a nonparticipant) have underscored the importance of resolving these remaining issues.

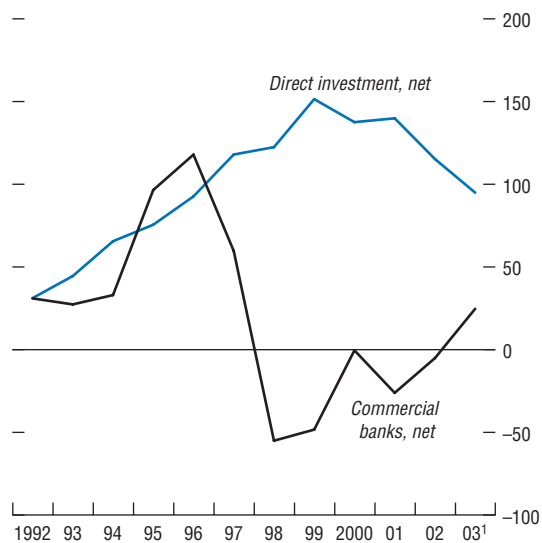
<sup>6</sup>The U.S. Export-Import Bank's book of short-term business was split. The FCIA as a private entity took what it wanted for its account, with the U.S. Export-Import Bank assuming the rest.

<sup>7</sup>See Godier (2001).



1990s (Figure 3.1). As a result, the share of international trade occurring through cross-border production networks, where multinational corporations produce each stage of a final good in a different location, has grown significantly.<sup>8</sup> The long-term relationships required for network production reduce the need for many of the traditional security arrangements for trade finance (e.g., letters of credit), and hence the demand for ECA services.<sup>9</sup>

**Figure 3.1. Foreign Direct Investment and Commercial Bank Lending to Emerging Market Economies**  
(In billions of U.S. dollars)



Source: Institute of International Finance.  
 Note: For a group of 29 emerging market countries, including China, India, Brazil, and Indonesia.  
<sup>1</sup>2003 figures are estimates.

**Private Insurers**

Private trade credit insurance has registered strong growth since the mid-1990s and now dominates the short-term market. In political risk insurance (medium- and long-term), new players have entered the markets (e.g., Sovereign and Zurich, as shown in Figure 3.2), and others have returned with a strong presence (e.g., Chubb). The number of insurers in the market almost doubled during the 1990s. Some insurers (e.g., AIG, Sovereign, Zurich) have pushed out the tenor of their cover to 15 years and per risk capacity.<sup>10</sup> Some large private insurers have established a presence in major emerging markets (e.g., COFACE and AIG) and used their financial strength and high credit ratings to package and securitize trade risk for large customers. Increased private sector participation reflects an improvement in the ability of private insurers to analyze and manage trade credit and investment risks. Since the late 1990s, large private reinsur-

<sup>8</sup>OECD data show that during the 1990s, the share of intrafirm trade in goods exports increased slightly in the United States (from 32 percent in 1992 to 36 percent in 1999), but rose sharply in Japan (from 17 percent in 1992 to 31 percent in 1999).

<sup>9</sup>For instance, letters of credit are not commonly used in China’s “export processing trade,” which, according to China Customs Statistics, accounted for 55 percent of the country’s exports of more than \$430 billion in 2003. Export processing trade refers to certain transactions in which a foreign entity purchases Chinese manufactured goods, or has raw materials and components processed on a consignment basis in China. In addition, foreign direct investment (more than \$50 billion a year) has provided financing for a large part of China’s capital goods imports, dampening the demand for ECA financing.

<sup>10</sup>See James (1999) and Mackie (2003).

ers, such as Munich Re, Swiss Re, and others, have also provided political risk support.

## Other Factors

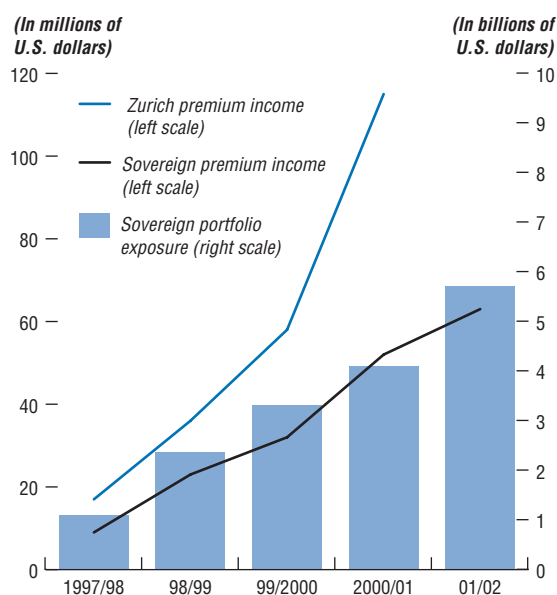
### Trade Finance Facilities of Multilateral Development Banks

Multilateral development banks are relatively new to trade finance, although the World Bank's Multilateral Investment Guarantee Agency (MIGA) has long been in the business of promoting foreign direct investment in developing countries through political risk guarantees or insurance as well as advisory services (Box 3.1). Major regional development banks have set up trade financing facilities over the past several years, and while their size is still modest compared with financing provided by official ECAs, these facilities constitute an additional source of trade finance to developing countries. The facilities have been designed to be part of the multilateral banks' tool kits for development financing, but some of them have played an important role in mitigating the impact of a generalized loss of access to trade finance in recent financial crises.<sup>11</sup>

### Local Banking Capacity in Emerging Markets

The development of local banking capacity in emerging markets has eclipsed the ECAs' role as the main financier of capital equipment imports, particularly in Asia. The volume of medium- and long-term activity (excluding project and aircraft financing) in China and other Asian emerging markets by export credit agencies in OECD countries has been stagnant since the mid-1990s, notwithstanding rapid import growth in these countries.<sup>12</sup> Available data from the Bank for International Settlements (BIS) indicate that, while cross-border lending by OECD-based commercial banks to developing countries increased by about 40 percent between 1990 and 2001, local bank lending in developing countries

**Figure 3.2. Selected Private Export Credit Insurers: Premium and Exposure**



Sources: Sovereign Risk Insurance Limited and Zurich Emerging Markets Solutions.

<sup>11</sup>See International Monetary Fund (2003).

<sup>12</sup>See Chang (2002).

**Box 3.1. Multilateral Development Banks and Trade Finance**

The **International Finance Corporation (IFC)**, which is part of the World Bank Group, offers trade financing through a variety of instruments, including partial guarantees of bank financing related to confirming letters of credit, purchase of trade-related notes issued or guaranteed by local banks and extension of trade credit lines to local banks, and financing to exporters. Trade financing support by the IFC to crisis-affected countries totaled about \$1 billion in 2003 (World Bank, 2004).

The **Multilateral Investment Guarantee Agency (MIGA)**, also part of the World Bank Group, provides political risk insurance to investors and lenders. It frequently acts as a syndicate leader for large transactions and is an important player in investment insurance and the reinsurance market, accounting for about 5 percent of investment insurance worldwide.

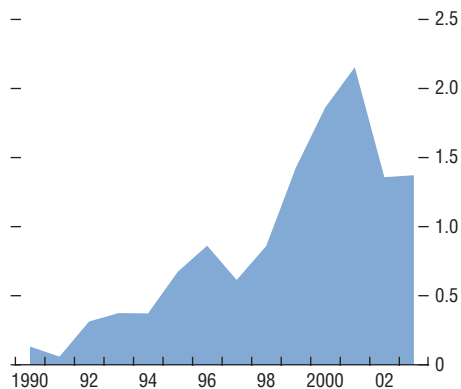
The **European Bank for Reconstruction and Development (EBRD)** provides trade finance to private sector firms through its Trade Facilitation Program (TFP). Started in 1999, the TFP offers guarantees against both commercial and political risks. Instruments covered by EBRD guarantees include letters of credit, trade-related promissory notes, and advance payments guaran-

tees and bonds. In 2003, the TFP financed close to 500 transactions totaling more than 900 million euros. Transactions supported by the EBRD are mostly short term (within a year).

The **Asian Development Bank (ADB)** has its own trade finance programs, which consist of a guarantee facility and a revolving credit facility, each covering commercial and political risk. The former allows local banks access to short-term trade credit from international and regional banks and covers up to 80 percent of the trade instruments (letters of credit, standby letters of credit, and bankers' acceptances). The short-term lending facility provides credits to local banks that on-lend to private enterprises engaged in international trade. During the Asian financial crisis, the ADB made trade financing available to a number of countries, including Thailand, Pakistan, and Indonesia.

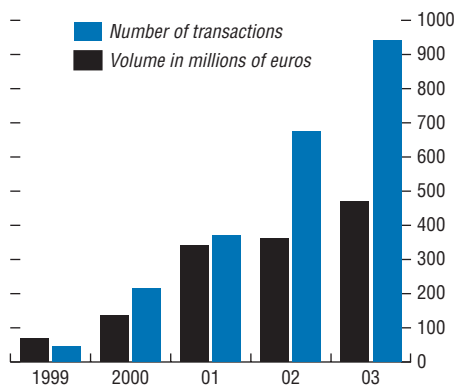
The **Inter-American Development Bank (IDB)** approved \$1 billion for a Trade Finance Reactivation Facility in March 2003 to finance private firms engaged in international trade. The facility follows the EBRD model and offers guarantees covering trade finance instruments (such as letters of credit) issued by local commercial banks, thereby providing comfort to international banks.

**Investment Guarantees Issued by the Multilateral Investment Guarantee Agency**  
(In billions of U.S. dollars)



Source: Multilateral Investment Guarantee Agency.

**Trade Facilitation Program Transactions by the European Bank for Reconstruction and Development**



Source: European Bank for Reconstruction and Development.

increased by a factor of 11, with the volume of local bank lending exceeding cross-border lending by a large margin. This structural shift reflects strategic refocusing by international banks to reduce cross-border exposure and risk after the financial crises in the late 1990s, and the fact that many of these banks established subsidiaries and expanded operations in emerging market countries.

### Capital Market Financing

During the past decade, capital market financing has gained ground vis-à-vis other forms of debt financing to emerging markets.<sup>13</sup> Access to capital markets, which includes securitization, factoring, and forfaiting, has provided emerging market economies with an opportunity to diversify their trade finance sources. Countries with market access are therefore likely to use these alternative sources of financing where available at terms comparable to those offered by official ECAs. In addition, given attractive yields, capital market investors have been drawn to emerging markets' trade

and project finance—especially to investment grade countries—by the ability of structured finance to minimize risk.

### Changes in Importer Countries

It also seems axiomatic that official ECAs' core markets—subinvestment grade developing countries—become less reliant on officially supported export credits as their per capita income grows and creditworthiness improves. Unless countries currently relying primarily on concessional development assistance move up the development ladder to become substantial users of official export credits, ECAs' core market could continue to shrink. Available data suggest that this may well be the case—the top 10 recipients of officially supported export credits have not substantially changed over the past 10 years, but at the same time, official ECAs' exposure to some large users has fallen (see Figure 2.6). With the increased availability of local financing capacity (e.g., in China, Brazil, Mexico, Russia), the market presence of ECAs in these countries may become smaller.

<sup>13</sup>Cline (2001) notes that net bank lending to emerging markets fared significantly worse than net lending through bonds and other nonbank sources (e.g., supplier credits and nonresident purchases of domestic treasury bills) following the financial crises of the late 1990s. The share of bonds and other nonbank lending in total external debt held by emerging markets rose from 23 percent in 1992 to 39 percent in 2002, whereas the share of commercial banks declined from 35 to 26 percent and that of official bilateral creditors fell from 27 to 19 percent.

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.<sup>1</sup> In emerging market countries, some ECAs also play the role of supporting national exporters in certain sectors (e.g., aircraft) by par-

tially offsetting the trade finance advantages provided by ECAs of industrialized countries to the competitors of their national exporters.<sup>2</sup>

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).<sup>3</sup> 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.<sup>4</sup>

### 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.”<sup>5</sup> Over the past two decades, there has been a broad consensus among policymakers and market participants in OECD countries that using government

<sup>1</sup>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.

<sup>2</sup>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.

<sup>3</sup>See International Monetary Fund (2003) on how these two institutions reacted to support operations during the crisis.

<sup>4</sup>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.

<sup>5</sup>See Ray (1995) and Hufbauer and Rodriguez (2001).

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.<sup>6</sup> 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.<sup>7</sup>

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.<sup>8</sup> 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.<sup>9</sup> 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

<sup>6</sup>Official ECAs are not required to earn appropriate return on the notional capital needed to support the contingent liabilities of their portfolio.

<sup>7</sup>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.

<sup>8</sup> See National Economic Research Associates (2000).

<sup>9</sup>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).

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.<sup>10</sup> 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.<sup>11</sup> 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.<sup>12</sup> 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.<sup>13</sup> 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.”<sup>14</sup>

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.<sup>15</sup> 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.

<sup>10</sup>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).

<sup>11</sup>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).

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

<sup>13</sup>See Alington (1999) and Salinger (1999).

<sup>14</sup>Barovick, 2004, p. 24.

<sup>15</sup>For instance, information and leverages obtained through official bilateral channels.

### Complementing the Private Sector

Over the past decade, the private sector has grown to become capable of providing trade financing adequately and competitively in certain markets previously dominated by official export credit agencies. Official ECAs also have to deal with two other sources of competition originating from economic development in recipient countries: the expansion of domestic banking capacity, and improved access of borrowing countries to other sources of international financing as their income level and creditworthiness rise. The current top markets of ECAs may eventually become self-sufficient in meeting the financing needs for their capital goods imports and even in large project financing. (For instance, such was the case in Spain in the 1960s, Korea in the 1980s, and Mexico and possibly China more recently.) If these factors continue to develop, official ECAs' share in world trade may decline further. Especially in OECD countries, official ECAs are facing the challenge of private sector competition and an associated adverse selection problem—how to break even while covering the riskiest segments of the market.

Some official export credit agencies have reacted to these developments by entering into risk sharing arrangements with other public and private insurers on the assumption that political risks would be underwritten by official agencies and commercial risks would be underwritten by the private insurer or commercial banks, or even the project sponsor.<sup>1</sup> In recent years, official export credit insurers have increasingly taken part in reinsurance agreements with other official agencies and private reinsurers, especially

for political risk. A recent survey of Berne Union members shows that official ECAs reinsure about 70 percent of their short-term business (see Appendix VIII). There may also be a trend, especially in OECD countries, for the public agencies to act as a reinsurer. Several European governments have moved partially in this direction by providing a political reinsurance window for their chosen underwriting agencies. Some governments, such as the United Kingdom and Denmark, have maintained backstop national interest account reinsurance facilities after withdrawal from short-term business.<sup>2</sup>

Representatives of official ECAs and private insurers broadly share the view, as evidenced in recent surveys and discussions with staff from the International Monetary Fund, that governments should not do what the private sector is capable of doing and that national agencies should complement, rather than compete with, the private sector. This could be achieved by:

- Fostering private sector development by providing room for private creditors and insurers, where the private sector is capable, to do more, including in medium- and long-term export credit and investment insurance markets. In this regard, periodic review of private sector capacity and public agencies' services would facilitate adjustment when needed.
- Standing behind the private sector by acting as a reinsurer of qualified private underwriters.<sup>3</sup> This would encourage competition among private sector insurers and allow public agencies to focus on public policy objectives. It would also allow public agencies to retain the necessary means to influence private trade financing flows.

<sup>1</sup>See Wilkinson (2004).

<sup>2</sup>See Export Finance and Insurance Corporation (2001).

<sup>3</sup>There is a widely shared view in the market that private reinsurance capacity, as well as private sector lending, is cyclical, drying up when the market becomes riskier (National Economic Research Associates, 2000).



- Working alongside private underwriters by sharing risks as a coinsurer or coguarantor.
- Filling in market gaps when the private market retreats, including meeting possible additional demand arising from implementation of the Basel II Accord on banking regulation.

The Basel II Accord is expected to strengthen the links between risk assessment and capital requirements of commercial banks. This may have an impact on the appetite of international banks for cross-border lending, including trade finance to emerging markets. Because ECA guarantees from OECD countries will continue to carry a zero- or low-risk rating, ECA-supported assets should remain attractive and could be in greater demand. Developments in insurer capital adequacy rules, such as the European Union's Solvency II, may also increase demand for underwriting risks by official ECAs.

### Financing for Low-Income Countries

Many low-income countries have seen their share in world trade decline.<sup>4</sup> Yet foreign trade and investment represent a key engine of growth that could pull these countries out of persistent poverty. Trade finance may be a constraint to many low-income countries increasing their participation in the world economy. Indeed, there is a sizable amount of exports from developing countries that has little or no access to trade credits.<sup>5</sup> There also are large gaps in terms of the risk mitigation tools available, as well as between the perception and reality of low-income countries, especially in Africa. Official export credit agencies could play a useful role in filling in these gaps, thereby facilitating foreign trade in low-income countries, including intraregional or South-South trade. The challenge is how to provide such support while helping to maintain external debt sustainability in these countries.

<sup>4</sup>See World Trade Organization (2004).

<sup>5</sup>According to *International Trade Finance* (December 2003), cash-in-advance is the recommended or preferred payment arrangement for about 20 developing countries. Exports from these countries amounted to \$80 billion in 2003.

<sup>6</sup>See Mudde (2003).

<sup>7</sup>Many ECAs already offer cover for local currency financing. See Hodgson (2003).

To achieve external debt sustainability, many low-income countries have benefited from various debt relief initiatives, including the HIPC Initiative. In addition, many of these countries have adopted policies to restrain public sector borrowing on nonconcessional terms under economic programs supported by international financial institutions. Under these circumstances and against the general backdrop of a lack of creditworthiness in many poor countries, official export credit agencies could:

- Target viable private sector borrowers and projects that do not require sovereign guarantee, particularly in countries with improved creditworthiness.
- Participate in public-private risk sharing arrangements such as the Africa Trade Insurance Agency as a reinsurer or coinsurer. Coinsurance is an area that attracts private interest and could be further explored to facilitate trade financing to developing countries.<sup>6</sup>
- Explore ways to make the best use of the competitive advantages of ECAs in markets with little or no access to private market financing, including processing traditional trade finance, arranging financing for projects, and supporting local currency financing where warranted,<sup>7</sup> while maintaining prudent risk management.

Providing cover without a sovereign guarantee exposes export credit agencies to the risk associated with the operation of domestic bankruptcy systems in low-income countries. These poorer nations, and developing countries in general, therefore need to pay particular attention to developing creditor rights, including the legal framework and enforcement mechanisms for insolvency, as well as to building a credit culture and creditworthiness, in order to attract externally provided trade financing.

## Trade Finance in Financial Crisis

In the context of an international effort, with crisis country authorities adopting the appropriate macroeconomic and structural reform measures to address the root causes of the crisis, official export credit agencies could play a constructive role in crisis resolution and in the subsequent recovery by helping to restore confidence and supporting or providing financing where warranted. The challenge is how to do this in the face of the technical and financial constraints discussed earlier in this report (see Chapter IV), and in a way that minimizes the risk of moral hazard on the part of private lenders.

Because most short-term trade finance is now provided by the private sector, the direct extension of short-term trade credit by governments may not be feasible. Accordingly, an ECA intervention to provide cover would need to be crafted to fit the contours of financial markets. Specifically, an effective approach would probably use the established business relationships and expertise of banks and private credit insurers, but shift some of the risk from the private sector to ECAs, so as to encourage banks to maintain exposure without assuming more credit risk or needing to accumulate loan provisions. Official export credit agencies and their guardian authorities could:

- Strengthen the ability of ECAs to act as a reinsurer and coinsurer.
- Explore ways for export credit agencies in noncrisis countries to play more of a counter-cyclical role, especially in the recovery from crises, by playing a signaling role, facilitating

medium- and long-term financing for investment in emerging markets, and, where possible, rolling over or expanding short-term credit lines, including the expiring maturities of originally longer-term credits.

- Complement multilateral development bank trade finance facilities in a concerted effort to restore confidence and facilitate the resumption of private sector financing.

## Export Credit Agencies in Developing Countries

For developing countries that set up export credit agencies to promote exports and development, an additional challenge is to use the limited resources to fill in the market gap in risk mitigation and trade financing, rather than to serve subsidy or commercial policy purposes. The experience of the ECAs in industrial countries from the 1970s through the 1990s has clearly shown that international subsidy competition is costly and ultimately counterproductive. It has also shown that individual countries have much to gain by joining multilateral efforts to eliminate export subsidies. The OECD Arrangement on Guidelines for Officially Supported Export Credits provides a framework of rules that has helped strengthen the WTO discipline on subsidies. Already, some emerging market ECAs have opted to follow the OECD Arrangement in their operations. More countries joining such an effort would help promote a level playing field in international trade and increase the efficiency of official export finance.

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The quantitative analysis of this study is based on three statistical sources: Berne Union quarterly reports; *Creditor Statistics on External Debt*, published jointly by the Organization for Economic Cooperation and Development (OECD), the Bank for International Settlements (BIS), the International Monetary Fund, and the World Bank; and annual reports of export credit agencies (ECAs). A survey on export credit agencies conducted by IMF staff also provided useful information that supplements the data from other sources for analyzing the current situation, trends, and challenges that ECAs are facing in the market for trade financing. However, these databases rely ultimately on the individual agencies for data, and each agency uses definitions and concepts that are different, sometimes in important ways. Difficulties also arise from the increasingly complex linkages among various channels of official bilateral financing with direct credits or insurance for credits funded by the private sector. This study has not attempted to reconcile data from different sources, but it has used the different data in complementary fashion to analyze financing supported by ECAs.

### The Berne Union

As part of its efforts to exchange information and expertise among members, the Berne Union conducts a quarterly survey among member agencies about their trade financing operations. The survey compiles quarterly data on trade financing operations from each member agency, including data for more than 60 developing countries and economies in transition (see Appendix Tables A1.1 and A1.2). Those data have been provided to IMF staff on a confidential basis for their use in analyzing various aggregates for individual debtor countries.

**Table A1.1. New Export Credit Commitments by Type of Recipient Country, 1988–2003**  
(In billions of U.S. dollars)

	Industrial Countries	Emerging Markets	Low-Income Countries	Total
1988	4.3	19.7	2.1	26.1
1989	4.5	27.1	2.9	34.6
1990	11.2	39.0	6.7	56.9
1991	12.9	50.4	8.8	72.1
1992	13.8	47.5	7.0	68.3
1993	15.8	54.6	9.1	79.5
1994	15.1	64.0	10.2	89.4
1995	18.0	73.6	16.5	108.2
1996	21.5	68.6	15.3	105.5
1997	18.9	70.9	11.0	100.8
1998	16.3	57.6	6.7	80.5
1999	15.9	53.3	5.8	75.0
2000	22.8	78.6	6.4	107.8
2001	15.5	58.8	5.3	79.6
2002	16.3	62.5	8.3	87.1
2003 <sup>1</sup>	22.1	83.6	12.3	117.9

Source: IMF staff estimates based on Berne Union data.

Note: Table includes all maturities, not including refinanced and rescheduled amounts.

<sup>1</sup>Preliminary estimates based on quarterly reports from agencies.

The Berne Union data series is reported in the way most agencies actually maintain their books, which includes outstanding commitments, outstanding offers, payments due, arrears, refinanced and rescheduled amounts, unrecovered and not-written-off claims, and new short-, medium-, and long-term commitments. The concept of “new commitments” encompasses insured principal and, in most cases, interest on undisbursed as well as disbursed credits. Investment insurance includes the amount invested in the host country while excluding interest and reinvested earnings and interest on insured loans.

Some of the limitations of the Berne Union database are related to data comparability. Berne Union data may not be readily comparable with other types of debt statistics because they may not accurately reflect trends in new disbursements. In other cases, the database includes insurance for certain transactions that are not exports, in particular insurance against

**Table A1.2. Export Credit Commitments Outstanding, 1988–2003**  
(In billions of U.S. dollars)

	Short-Term	Medium- and Long-Term	Arrears and Unrecovered Claims	Total
1988	20.1	216.9	32.5	269.5
1989	20.0	192.8	31.5	244.3
1990	26.2	222.1	55.7	304.0
1991	28.3	247.7	60.5	336.5
1992	44.2	225.7	75.2	345.1
1993	45.5	234.5	78.7	358.6
1994	41.4	263.8	96.9	402.2
1995	34.9	280.8	158.4	474.2
1996	38.6	263.1	168.0	469.8
1997	35.3	244.1	157.9	437.3
1998	36.4	238.5	168.3	443.2
1999	37.0	225.3	163.6	425.9
2000	40.9	212.6	142.7	396.2
2001	38.2	201.6	110.7	350.5
2002	45.8	201.7	149.5	397.0
2003 <sup>1</sup>	50.1	195.1	147.8	393.0

Source: IMF staff estimates based on Berne Union data.

<sup>1</sup>Preliminary estimates based on quarterly reports from agencies.

exchange rate movements or insurance of pre-shipment risks that do not involve export credits. Moreover, the amount of new commitments is subject to sizable changes from one quarter to another as a result of new information on the funding of large projects.

### The OECD/BIS/IMF/World Bank

The OECD compiles its information on trade credit from reports made by export credit agencies in its member countries. The OECD publishes data on export credits and other financial flows in *Creditor Statistics on External Debt*, jointly with the BIS, the IMF, and the World Bank. The OECD export credit secretariat also compiles regular reports on stocks and on new flows of commitments of officially supported export credits with maturities of more than two years. This information is publicly disseminated via the OECD website.

Trade credit comprises official export credits, which are medium and long term by nature, and officially guaranteed or insured suppliers' credits. Arrears and officially guaranteed rescheduled amounts on officially guaranteed or insured financial credits are included. These data consist of credit extended to both the public and private

sectors in the borrowing country. For most countries, trade credits with an original maturity of one year or less include funds awaiting disbursement. Data can change significantly between different issues and publications due to delays in reporting agencies' financing operations.

### Survey of ECA Activity

A total of 27 ECAs (mostly Berne Union members) answered the questionnaire prepared by IMF staff from late 2003 to early 2004. Qualitative information includes an assessment of recent trends in the business, main recent regulatory and institutional changes, views on private sector competition, new instruments and modalities of financing, participation in public-private partnership structures, developments in risk management and control systems, practice and policies on reinsurance, and country risk assessment. Quantitative questions were aimed at determining the composition of new commitments, pricing, reinsurance, and product information. Responses to the questionnaire were useful to verify trends and new developments in official export credit financing and in assessing private sector participation in the trade financing market. Quantitative information helped complement and elucidate trends already observed in the Berne Union and OECD databases.

### ECA Annual Reports

This study has relied on other publications for information on trade financing, in particular publications of the OECD, the Multilateral Investment Guarantee Agency of the World Bank Group, and multilateral development banks such as the World Bank, as well as annual reports of ECAs through their own websites. The latter include, in particular, COFACE of France, the U.K. Export Credits Guarantee Department, Euler-Hermes of Germany, the U.S. Export-Import Bank, the Export-Import Bank of China, the Export-Import Bank of India, and other official and private credit insurers (e.g., American International Group, Sovereign, and Zurich).

## International Trade Data

International trade data on the direction of trade were obtained from the Commodity Trade Database (COMTRADE), which is maintained by the United Nations Statistical Division through the World Integrated Trade Solutions system. COMTRADE keeps information on more than 130 countries on exports and imports by commodity and partner country. The concept of “capital goods exports” used in this study corresponds to the COMTRADE data series on exports of machinery and transport equipment goods.

## Countries Included in the Calculation of Figures 2.4 and 2.5

OECD countries: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Hungary, Italy, Japan, Korea, Luxembourg, Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States.

Non-OECD countries/regions: Argentina, Brazil, China, Hong Kong SAR, India, Indonesia, Israel, Malaysia, Singapore, South Africa, Sri Lanka, Zimbabwe.

# MANDATE AND SCOPE OF OPERATIONS OF SELECTED EXPORT CREDIT AGENCIES

**Table A2.1. Mandate and Scope of Operations of Selected Export Credit Agencies (ECAs)**
*(As of year-end 2003)*

	OECD ECAs							Emerging Market ECAs		
	COFACE (France)	ECGD (UK)	EDC (Canada)	FINNVERA (Finland)	HERMES (Germany)	JBIC (Japan)	SACE (Italy)	U.S. Exim	Exim (China)	Exim (India)
<b>Ownership</b>	Private corporation with government account	Department of government	Public agency	Public agency	Private corporation with government account	Public agency	Public agency	Public agency	Public agency	Public agency
<b>Mandate and Objectives</b>										
Promoting national exports	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Other public policy roles	...	Take into account "the Government's international policies"	...	"Provide risk finance to supplement the market"	Eligibility "in terms of foreign policy and development aid"	Provide assistance to developing countries and contribute to the stability of the international financial order	...	Act as "shock absorber" during times of economic crisis and financial market contractions	Implement state policy in trade and finance; enhance sino-foreign economic cooperation	Coordinate work of institutions engaged in financing of exports and imports
<b>Scope of Operations</b>										
Insurance/guarantee	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Reinsurance <sup>1</sup>	...	Yes	...	...	Yes <sup>2</sup>	...	Yes	...	...	...
Direct lending	...	...	Yes	Yes	...	Yes	...	Yes	Yes	Yes

Sources: Organization for Economic Cooperation and Development and websites of export credit agencies.

<sup>1</sup>Reinsurance with other export credit agencies known as "one-stop shops" is not included.

<sup>2</sup>Under own corporate account.

# RECENT DEVELOPMENTS IN THE OECD ARRANGEMENT ON GUIDELINES FOR OFFICIALLY SUPPORTED EXPORT CREDITS<sup>1</sup>

The Organization for Economic Development and Cooperation's Arrangement on Guidelines for Officially Supported Export Credits was established in 1978. Its main purpose is to provide a framework for the orderly use of officially supported export credits. The Arrangement encourages competition among exporters based on the quality and price of goods and services being exported rather than on the most favorable officially supported financial terms. The Arrangement is a gentlemen's agreement among its participants; it is not an OECD act. Most OECD countries are represented in the participants, and membership is by invitation of current participants.<sup>2</sup>

The Arrangement applies to officially supported export credits with repayment terms of two years or more. Official support may be provided in different forms: export credit guarantee or insurance (pure cover), financing support (direct credit, or direct financing and refinancing, and interest rate support), or any combination of the above. The OECD Arrangement also applies to tied aid. Military equipment and agricultural commodities are excluded from the application of the Arrangement, and special guidelines (Sector Understandings) apply to civil aircraft, nuclear power plants, and ships.

The OECD Arrangement has evolved over time. With the aim of eliminating interest rate subsidies, consensus up until the mid-1990s placed limitations on cash down payments (minimum 15 percent of export contract value), the repayment period (maximum 5 to 10 years, depending on per capita income of borrowing

countries), and interest rates that benefit from official financing support (minimum rates or currency-specific commercial interest reference rates). There were also restrictions on the provision of tied aid.<sup>3</sup> Since then, the Arrangement has been broadened to include premiums for credit risk and project financing. Export credit agencies in OECD member countries also adopted common approaches on environmental impact (see below). The most recent modification to the text of the Arrangement, intended to improve consistency with World Trade Organization rules and to enhance transparency for nonparticipants, was agreed upon in late 2003 and became effective in January 2004.

## Minimum Risk Premium

While the minimum interest rates or commercial interest reference rates (based on the yields of government bonds in the secondary markets) help to eliminate interest rate subsidies, they provide no guidance on premiums charged to cover nonpayment and other risks. In April 1999, after four years of intensive work by the Working Group of Experts, headed by Pierre Knaepen, a new discipline on minimum risk premiums, known as the Knaepen Package, came into force. Under this new consensus, participants are required to charge risk premiums, in addition to the interest charge, to cover sovereign and country credit risks, regardless of whether the buyer or borrower is a private or public entity. The minimum premium rate (MPR) is based on a set of agreed-upon principles. Key factors determining the MPR include

<sup>1</sup>This appendix is based on OECD (2004) and related OECD documents published on the OECD websites.

<sup>2</sup>Current participants are Australia, Canada, the European Community, Japan, Korea, New Zealand, Norway, Switzerland, and the United States.

<sup>3</sup>See Kuhn, Horvath, and Jarvis (1995) and OECD (1998) for a description of developments up to the mid-1990s.



country risk classification, risk horizon, the extent of cover, and applied risk mitigating technique.

Country risk classification is divided into eight categories ranging from negligible risk to the most risky. Determination of the classification takes into account both quantitative and qualitative assessment of a borrowing country's financial and economic developments as well as its payment records. Risk classification is closely monitored and subject to periodic review (at least once a year). This risk premium discipline does not apply to official export credits for ships, nor to large aircraft.

### Flexibility for Project Finance

Increasing demand for project financing, including for private infrastructure projects, has led to the adoption of special guidelines to allow flexibility in the application of the OECD Arrangement for such transactions.<sup>4</sup> For instance, the requirements of a maximum repayment period of 10 years, payment in semiannual equal installments, and a maximum grace period of six months may be too restrictive to accommodate project financing that relies on the cash flows of the projects for debt servicing. In view of this, participants agreed to introduce flexibility with regard to a number of features of the Arrangement, including the timing of the first repayment, the repayment profile, and the maximum repayment period. These understandings went into effect in September 1998 for an initial trial period of three years; they have since been extended several times.

<sup>4</sup>Project financing is defined under the OECD Arrangement as “financing of a particular economic unit in which a lender is satisfied to consider the cash flows and earnings of that economic unit as the source of funds from which a loan will be repaid and to the assets of the economic unit as collateral for the loan.” For more details, see West (1999) and “Project Finance: Special Guidelines on Flexibility for a Trial Period,” available via the Internet at [www.oecd.org/document/38/0,2340,en\\_2649\\_201185\\_2668454\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/38/0,2340,en_2649_201185_2668454_1_1_1_1,00.html).

<sup>5</sup>Early discussions are summarized in the 1998 Statement of Intent on Environment and the Action Statement adopted by the OECD Working Party on Export Credits and Credit Guarantees (ECG) in February 2000, the ECG Agreement on Environmental Information Exchange for Larger Projects adopted in 1999, and the 2001 Draft Recommendation on Common Approaches on Environment and Officially Supported Export Credits. See West (2004) for more details.

### Common Environmental Approach

While in the past most export credit agencies had their own environmental guidelines, harmonization and stronger common approaches would help protect the environment and foster fair competition among export credit providers. Following successive early discussions, OECD members agreed in December 2003 to strengthen their common approaches for identifying and evaluating the environmental impact of infrastructure projects supported by their governments' export credit agencies.<sup>5</sup> The agreement takes the form of an OECD Recommendation, which is an official OECD action. Key elements of the agreement include the following:

- Projects should, in all cases, comply with the environmental standards of the host country. When the relevant international standards (those of the World Bank, and, where applicable, regional multilateral development banks) are more stringent, these standards should be applied.
- Projects are classified into three categories based on their potential environmental impact and subject to different monitoring and reporting requirements. For projects that have a significant adverse environmental impact, an environmental impact assessment is required.
- Participating export credit agencies will seek to make environmental information, particularly environmental impact assessments, publicly available 30 calendar days before final commitment.

## Anticorruption and Export Credits

In December 2000, the members of the OECD Working Party on Export Credits and Credit Guarantees adopted the action statement on bribery. The statement calls for appropriate measures to deter bribery before official

support for export credit is provided. Specific measures include, among other things, informing applicants about the legal consequences of bribery and denying claim payment or seeking the return of funds should bribery be discovered.<sup>6</sup>

<sup>6</sup>See “Action Statement on Bribery and Officially Supported Export Credits” available via the Internet at [www.oecd.org/document/45/0,2340,en\\_2649\\_201185\\_17785773\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/45/0,2340,en_2649_201185_17785773_1_1_1_1,00.html).

# FINANCING FOR LOW-INCOME COUNTRIES AND COUNTRIES IN CRISIS FROM SELECTED EXPORT CREDIT AGENCIES

**Table A4.1. ECA Financing for Low-Income Countries**

Issues	Industrial Countries' Official ECAs					Private Insurers with Government Account in Medium- and Long-Term Markets	
	ECA 1	ECA 2	ECA 3	ECA 4	ECA 5	Insurer 1	Insurer 2
Lending/cover for low-income countries	Limited. Creditworthiness of many countries (e.g., HIPCs) is not good; debt ceilings in the IMF program are a constraint	...	Limited and constrained by debt ceilings in IMF-supported programs; prospects for private sector involvement small; likely to offer ST credit in the foreseeable future	Lending is suspended when a country receives debt relief because it impacts the portfolio of the agency	Little business. Often constrained by IMF-supported programs; private sector creditworthiness not adequate	Business has decreased by almost 50 percent, although it has expanded in selected countries; no significant business opportunities	Limited. Often constrained by debt ceilings in IMF programs
Support to private sector versus sovereign entities	Depends on creditworthiness of sectors and country circumstances	Private sector more likely to receive support, but sovereign business also considered	Depends on sectoral risks; support in several low-income countries is only offered to private sector	All depends on creditworthiness of each sector	Decided on a case-by-case basis, though it considers sovereign risk superior	In many cases the cover policy for public buyers is more restrictive than for private buyers	Cover for low-income countries is limited to private sector
Cover of post-completion-point HIPCs	No MLT cover is available (with one exception)	Cover was never removed for country, only for sovereign entities	No for MLT, but there is ST lending/insurance	No. Insufficient creditworthiness and moral hazard	No. HIPCs are still off-cover (with one exception)	Provides cover only for selected ST business for private buyers	MLT available only in small amounts and mostly restricted to the private sector

Source: Based on a survey of Berne Union members conducted in 2004 (see Appendix I).

Note: The insurers presented in this table are among the largest in the sample. MLT: medium- and long-term; ST: short-term; HIPCs: highly indebted poor countries.

**Table A4.2. ECA Response to Countries in Financial Crisis**

Issues	Industrial Countries' Official ECAs					Private Insurers with Government Account in Medium- and Long-Term Markets	
	ECA 1	ECA 2	ECA 3	ECA 4	ECA 5	Insurer 1	Insurer 2
Immediate response to recent crises:							
Increased exposure	No	No	Yes	...	No	No	No
Reduced exposure	Yes	Yes, but from ongoing efforts to strengthen risk assessment and management	Not significantly	Yes, but it was demand-driven, not a result of a deliberate policy	Only in one case was there a significant reduction	Yes	Yes, especially MLT, partly from reduced demand; ST exposure was also reduced
Went temporarily off cover	Yes, for hardest-hit countries	...	Yes, but only in one case	...	Yes, but only in one case	Yes, especially for MLT business	Yes, on MLT cover for countries most severely affected
Maturities were shortened	...	...	...	No	No	No	No
Increased	Yes, risk premiums rose sharply for crisis countries	...	...	No	Yes, in line with OECD guidelines for sovereign risk; private risk premiums increased with country downgrades	Yes, in line with OECD guidelines	Premiums charged continued following OECD guidelines; they increased in some cases
Other responses	Generally restricts or suspends cover if a country is facing difficulties	Credit renewals and transactions in pipeline are more carefully scrutinized	...	In line with current policy, suspended lending to countries in arrears	Tried to maintain operations in countries that are strategic for exporters	Continued to provide ST financing but subject to stricter examination of buyer's creditworthiness	...
Crises led to long-term change in portfolio strategy or risk assessment	Yes, a more proactive risk management strategy was adopted	No	Risk assessment and management were strengthened	No	...	...	No change in strategy

Source: Based on a survey of Berne Union members conducted in 2004 (see Appendix I).

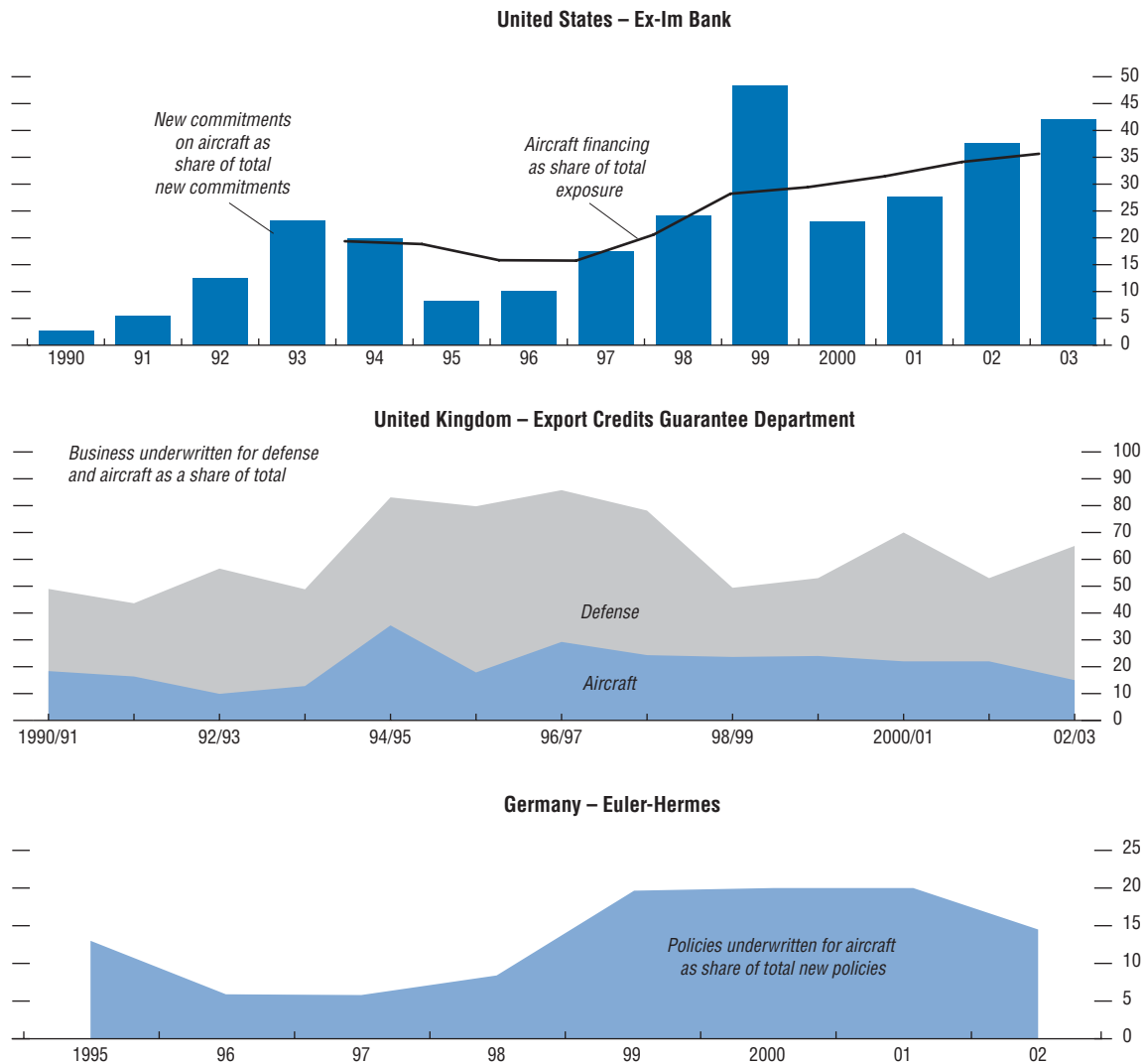
Note: The insurers presented in this table are among the largest in the sample. MLT: medium- and long-term; ST: short-term; HIPC: highly indebted poor countries; OECD: Organization for Economic Cooperation and Development.

# AIRCRAFT FINANCING SUPPORTED BY SELECTED EXPORT CREDIT AGENCIES

Aircraft financing accounted for an average of 38 percent of new commitments by the U.S. Export-Import Bank during 1999–2003, compared with an average of 13 percent for the first half of the 1990s.

Similarly, major European export credit agencies also allocated a significant share of export credits for aircraft sales, and in some cases military exports. Most export credit agencies do not report transactions and export credits for military goods.

**Figure A5.1. Aircraft Financing Supported by Selected Export Credit Agencies**  
(In percent)



Sources: U.S. Ex-Im Bank Annual Reports; U.K. Export Credits Guarantee Department Annual Reviews; and Euler-Hermes 2002 Annual Report.

Export credit agencies have strengthened their risk management in recent years by enhancing risk analysis and control and by adopting new tools and methods in light of developments in the international financial industry. These techniques allow credit insurers to measure and control their exposure to a wide range of risks that are intrinsic to their activities. Generally, export credit insurers are exposed to two types of risks: those related to their underwriting activities per se, and risks derived from the fluctuation of key exogenous variables (e.g., interest rates, exchange rates). Accordingly, risk management aims at avoiding underwriting and financial losses with reasonable statistical confidence levels based on capital level, tolerance to risk exposure, and targeted credit rating.<sup>1</sup> The tool kit available for risk mitigation includes risk classification systems, portfolio diversification instruments (including reinsurance; see Appendix VIII), and asset liability management instruments (including hedging and value-at-risk techniques).

### Country Risk Classification

Export credit insurers use risk classification systems to rank borrowing countries in terms of their debt repayment capacity. The Knaepen Package provided export credit agencies with a common system of country risk classification that can be used to calculate minimum risk premiums. All participants in the Organization for Economic Cooperation and Development's Arrangement on Guidelines for Officially Supported Export Credits have agreed to such a common system to price official support, taking into account the associated schedule of minimum risk premiums.<sup>2</sup> However, to further

enhance their risk assessment system, several agencies have adopted different country risk classification systems in order to reflect their own risk perception and sometimes to meet local legal requirements. For example, in the United States, the Interagency Credit Risk Assessment System determines the country classification and the level of country risk associated with transactions evaluated by the U.S. Export-Import Bank. This system, which is applied uniformly across various U.S. government agencies, has 11 sovereign risk categories and 9 nonsovereign risk categories. The Office of Management and Budget is responsible for assigning a risk premium to each category to reflect the corresponding expected losses. Similarly, the risk assessment system of the Japan Bank for International Cooperation (JBIC), the Japanese export credit agency, comprises 10 categories of sovereign risk and 14 of nonsovereign risk. Those ratings match the Japanese financial supervisory agency's inspection manual and are used not only to classify the JBIC's new lending operations but also to examine overall asset quality and the corresponding loan loss provisions. However, as OECD governments, both the United States and Japan must not undercut the minimum premium rates established for the OECD Arrangement.

The factors commonly used to formulate country ratings are very similar across ECAs. These include macroeconomic indicators; external debt and debt service indicators; records of payment and arrears (including to other ECAs); medium- and long-term economic projections; political, social, and geographic constraints; and performance under programs supported by the IMF and the multilateral development banks.

<sup>1</sup>For instance, the Atradius Annual Report 2004 states that its target is to keep its A-level rating by Standard and Poor's.

<sup>2</sup>See Appendix III for details.

Reflecting the experience of the recent emerging market financial crises, increasing attention has also been paid to banking sector analysis to assess factors that could lead to sudden capital outflows. The sovereign ratings by international credit rating agencies such as Moody's and Standard and Poor's also play an important role as benchmarks in the credit classification process.

Country risk classification can be used to formulate minimum risk premiums, estimate necessary provisioning, and determine maximum coverage ratios (ceilings). Some ECAs set only total exposure ceilings,<sup>3</sup> while others set country-specific ceilings. In the latter cases, if the existing exposure is approaching the ceiling allocated to a certain country, ECAs may (i) reduce their percentage of cover for new transactions in that country, (ii) reallocate unused exposure ceilings from other countries with similar risk profiles, or (iii) secure reinsurance from other ECAs and reinsurers.

### Nonsovereign Risk Classification

Traditionally, most official ECA operations involved publicly owned or sponsored projects. However, since the 1990s, ECAs have expanded their role in the financing of private sector projects.<sup>4</sup> As a result, some ECAs have developed well-structured nonsovereign risk classification systems to complement existing country risk classification. In addition to the traditional financial analysis indicators, the assessment of nonsovereign risk includes analysis of the banking system, legal system, business climate, and so forth. Normally, the credit ratings of sovereign debtors are higher than those of the private sector (this is the so-called sovereign ceiling), but there are exceptions where private entities with foreign exchange earning capacity are

assigned credit ratings at par or higher than that of the sovereign.

### Portfolio Diversification and Asset Liability Management

Generally, diversification of the credit insurance portfolio helps to reduce the possibility that a default by a particular debtor, or a shock affecting a particular industry or geographic region, will generate disproportionately large overall losses in a particular period of time. Portfolio diversification also allows ECAs to maintain the financial flexibility to adjust business strategies if necessary.<sup>5</sup> In this regard, ECAs periodically set short- and long-term exposure limits and credit ceilings by customer, sector, and country in the context of the overall business strategy and on the basis of their entire portfolio risk analysis (including value-at-risk techniques; see below). If necessary, risk managers can use reinsurance and coinsurance to rebalance their portfolio, while keeping a presence in target markets or sectors.

More general asset liability management policies aim at insulating the insurers' capital from adverse shocks typically related to interest and exchange rates. Hedging techniques help balance asset liability gaps arising from the mismatch of currencies (e.g., domestic versus foreign currencies) and interest rates (e.g., fixed versus variable rates). In addition, the term structure of assets and liabilities needs to be reasonably matched to keep a sound liquidity position while preserving the profitability targets.

Some insurers monitor their overall financial risk using value-at-risk (VaR) techniques. Risk managers apply stress tests (for instance, based on significant fluctuations of interest and/or exchange rates) to their asset portfolios to calculate the expected maximum loss for a predeter-

<sup>3</sup>Those ceilings are generally required by government regulations and can be set either on an annual basis, as a permanent criterion, or both.

<sup>4</sup>In countries where IMF-supported programs limit the accumulation of external debt in nonconcessional terms by the public sector, ECAs tend to remain open for cover with the private sector.

<sup>5</sup>See the COFACE Annual Report 2004.

mined period at a certain confidence level (i.e., the VaR). Generally, risk management policies set the maximum levels of acceptable VaR as a function of capital or total asset size. Risk management requires a permanent evaluation of the asset portfolio against those limits, leading to portfolio rebalancing if necessary.

### Other Risk Management Tools

Export credit insurers have developed innovative financial structures, sometimes in partnership with other insurers, that permit them to remain competitive while helping to mitigate risk within portfolio diversification guidelines. For instance, in the field of limited recourse financing (also called project financing), increased demand has required ECAs to develop the capacity to mitigate the risks associated with this type of financing. Under project finance arrangements, debt repayments depend on the project's capacity to generate revenues. Therefore, the key elements in this type of financing are the security package, involving existing or future assets, and the analysis of implementation risks. A failure in project implementation could have severe

adverse financial consequences for ECAs.<sup>6</sup> Some ECAs (for example, the JBIC in the late 1980s and the U.S. Export-Import Bank in the late 1990s) have established specialized project finance units in charge of the appraisal and financial structuring of projects. At the same time, some business lines continue to require special consideration. For instance, in the case of aircraft financing, which is a major area of operations for medium- and long-term ECA financing, most agencies have already introduced asset-backed, secured operations to better cope with the changing nature of risks and the evolving demand in the airline industry. Some of these agencies have even developed structures to securitize these asset-backed financings to access additional liquidity.

Cofinancing structures have also been used by some ECAs for projects that entail risks that are beyond their traditional expertise. For instance, cofinancing with multilateral development banks helps ECAs assess their projects' environmental and social aspects, based on the analysis undertaken by the multilateral development bank concerned, and mitigate the related risks as well as implementation and credit risks.

<sup>6</sup>In the case of sovereign guaranteed projects, ECAs can still ask the guaranteeing government for repayment, even if the project goes wrong.



# STRENGTHS AND CONSTRAINTS OF PUBLIC AND PRIVATE TRADE FINANCE PROVIDERS

**Table A7.1. Strengths and Constraints of Public and Private Trade Finance Providers**

	Official Export Credit Agencies (ECAs)	Multilateral Development Banks	Private Sector
Objectives	<ul style="list-style-type: none"> <li>Promote national exports and international investment</li> <li>Other public policy goals</li> </ul>	Facilitate economic development in developing countries	Make a profit
Allegiances	National governments and taxpayers	International community	Shareholders
Advantages	<ul style="list-style-type: none"> <li>Access to public funding</li> <li>Sovereign credit rating</li> <li>No need to pay dividends</li> <li>Ability to prevent losses and secure recoveries</li> </ul>	<ul style="list-style-type: none"> <li>Preferred creditor status</li> <li>Top-notch credit rating</li> <li>No need to pay dividends</li> </ul>	Flexibility and efficiency in operations
Constraints	<ul style="list-style-type: none"> <li>Break even over the medium term</li> <li>Might compete with the private sector (most ECAs)</li> <li>Loss in expertise in short-term business (most ECAs)</li> </ul>	<ul style="list-style-type: none"> <li>Possible impact on rating and cost of capital by more use of B-loan structure</li> <li>Might compete with the private sector (most ECAs)</li> </ul>	<ul style="list-style-type: none"> <li>Hard budget constraint; cannot suffer sustained loss</li> <li>Limited capacity in certain segments of the market (e.g., in terms of the type, amount, and period of export credits)</li> </ul>

Reinsurance is a practice by which one insurer (reinsured party) transfers risk to another (reinsurer). In exchange for unloading its risk, the reinsured party pays a premium to the reinsurer. Export credit insurers use reinsurance as an instrument to diversify their portfolios (e.g., in terms of country risk, sectoral allocation, or maturity profile), overcome exposure limits, and improve their ability to participate in transactions that otherwise might not be possible to underwrite (such as certain transactions or long-term exposure to high-risk markets). A recent survey of Berne Union members indicates that, on average, official export credit agencies reinsured more than 70 percent of their short-term business. Some official ECAs act as a reinsurer, providing reinsurance to other credit insurers (Table A8.1).

There are several modalities of reinsurance: (i) facultative reinsurance associated with some specific risks on a given transaction; (ii) a framework reinsurance agreement that enables one insurer to cover an entire project while allowing partner ECAs to reinsure parts of the transaction (typically for the risks associated with their own countries); and (iii) quota share reinsurance, a blanket reinsurance policy that covers a fixed portion of the total portfolio of the reinsured party.

There are also nonproportional policies under which the reinsurer will cover losses, up to a limit, above a certain threshold of agreed-upon portfolios. In some cases, reinsurance may be provided implicitly by a government or public agency (on the basis of the agency's bylaws). Finally, credit risk derivatives are financial instruments that can be used to transfer the risk of insurance transactions to third parties.

### Role of Private Reinsurers

Private reinsurers have shown increasing appetite for risks associated with export credits

**Table A8.1. Reinsurance of Short-Term Business by Official Export Credit Agencies (ECAs)**

Insurer	Percent of Short-Term Business Reinsured	Percent of Public ECAs that Reinsure Private Insurers
Official Insurers <sup>1</sup>	71	22
Private Insurers <sup>2</sup>	78	...

Source: Berne Union.

Note: Based on a survey of Berne Union members in 2003–04.

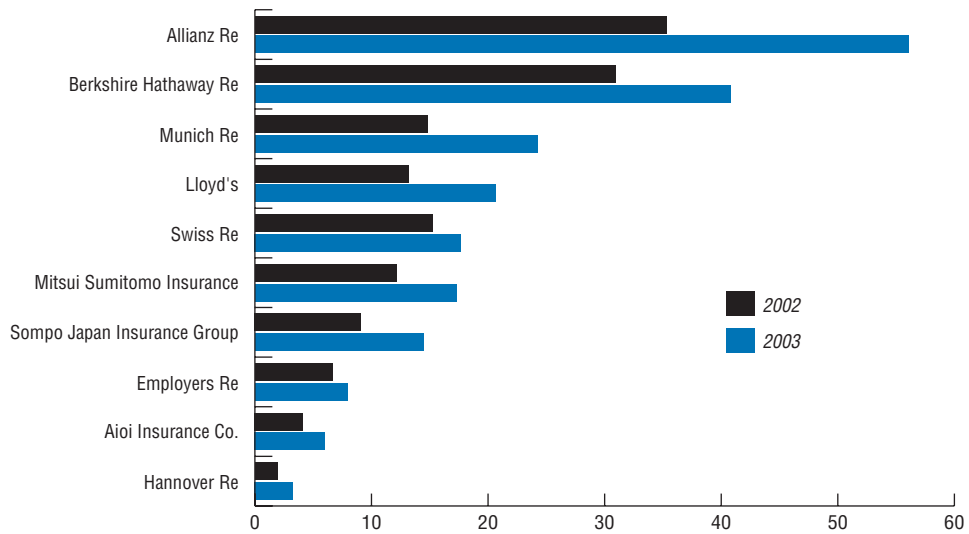
<sup>1</sup>Includes 27 respondent institutions.

<sup>2</sup>Includes 7 respondent institutions.

and foreign direct investment, including political risk—the risk of expropriation, currency inconvertibility, and war and civil disturbances, among other events. These reinsurers now have a large capacity (see Figure A8.1), and their involvement has been particularly important for credit insurers with large short-term business portfolios. Partnership with commercial reinsurers also allows ECAs to increase their capacity to support medium- and long-term export financing.

Since the late 1990s, the private reinsurance industry has experienced a process of restructuring and consolidation, in part as a consequence of relatively low profitability accentuated by the effects of the September 11, 2001, terrorist attacks and by recent financial crises in emerging markets. Since then, some capacity has been added to the reinsurance industry through the injection of additional capital, but appetite for export credit risks is uneven across countries, and long-term credit risks are covered on a limited basis. To the extent that portfolio growth of credit insurers is supported by their ability to obtain total or partial reinsurance, constraints in the reinsurance market could limit credit insurers' capacity to provide trade financing, especially to relatively risky markets.

**Figure A8.1. Capital and Reserves of Top Ten Reinsurers, 2002–03**  
*(In billions of U.S. dollars)*



Source: Standard and Poor's.



## GLOSSARY OF TERMS

**Berne Union (International Union of Credit and Investment Insurers).** Founded in 1934, this organization now has among its members more than 50 of the largest export credit and/or investment insurers from both developed and developing countries. Institutions, not their governments, are members. The Union works for the acceptance of sound principles of export credit and investment insurance and the exchange of information and experience. The secretariat is in London, and members hold two general meetings each year as well as seminars and workshops for specialists.

**Buyers' credit.** Financial arrangement in which a bank or financial institution or an export credit agency in the exporting country extends a loan directly to a foreign buyer or to a bank in the importing country to finance the purchase of goods and services from the exporting country.

**Capacity.** The largest amount of insurance an insurer or a reinsurer is willing and able to underwrite, including the amount they retain and the amounts for which they automatically bind their reinsurers. Capacity may apply to a single risk, a program, a line of business, or an entire book of business.

**Claims payments.** Payments made by an export credit insurer, after the claims-waiting period, on insured or guaranteed loans when the original borrower or borrowing country guarantor fails to pay.

**Claims-waiting period.** The period that exporters or banks must wait after arrears occur and before the agency will pay on the corresponding claim.

**Coinurance.** Normally joint (but sometimes parallel) insurance on a project or contract involving two or more insurers, which could be official export credit agencies and/or private insurers.

**Commercial interest reference rates (CIRR).** A set of currency-specific interest rates for major

OECD countries. These rates are determined monthly based on the secondary market yield on government bonds.

**Commercial risk.** Refers primarily to the risk of nonpayment by a buyer or financial institution due to default, insolvency or bankruptcy, or failure or unwillingness to take delivery of the goods (i.e., repudiation). Usually excluded are cases where there are disputes between exporter and importer about product quality, delivery dates, performance, and the like. Claims will generally not be considered until these disputes are resolved. Also usually excluded are commercial risks on sales from exporters in one country to their subsidiaries in other countries.

**Commitment.** The amount under cover for a specific policy for which a premium has been paid or invoiced and is not yet due for payment by debtors.

**Confirmed letter of credit.** See "letter of credit."

**Country limit.** A quantitative limit on exposure set by many export credit insurers and international banks to monitor and control their total commitments in individual countries. Country limits apply usually to medium- and long-term business and only rarely include short-term business. They can have various forms, including annual maturities limits and contract limits.

**Cover.** The insurance provided by an export credit agency. Thus, for example, if some insurance facilities are available from such an agency for country X, that agency is "on cover" for that country. Conversely, where no insurance facilities are available, the agency is said to be "off cover." An agency's underwriting policy on a particular buying country is usually referred to as its cover policy for that country.

**Credit insurance.** The principal product of an export credit insurer. However, the term can

include both export credit insurance and domestic credit insurance (i.e., insurance on sales within a country). Credit insurance protects the insured party (normally the seller), in exchange for a premium, against a range of risks that result in nonpayment by the buyer. In export credit cover, both commercial and political risks are normally involved.

**Credit period.** The period from the time of delivery or acceptance of goods (for short-term business) or from the commissioning of the project (in project financing) until repayment is complete. Maximum credit periods are set for repayment periods. The starting point of credit for short-term business is set by the Berne Union agreements, and for medium- and long-term business by the Berne Union and the OECD Arrangement on Guidelines for Officially Supported Export Credits.

**Export credit, export credit insurance.** The main type of facility offered by an export credit agency. The term describes a range of facilities and can have different meanings in different contexts. Strictly speaking, export credit refers to the credit extended by exporters to importers (supplier credit) or the medium- and long-term loans used to finance projects and capital goods exports (buyer credit). It includes credit extended both during the period before goods are shipped or projects are completed (the preshipment period or precredit period) and the period after delivery or acceptance of the goods or completion of the project (the postshipment period or credit period).

**Export credit agency.** An institution providing export credit insurance, guarantee, and, in some cases, loan facilities. Such an institution is government-owned or controlled or, if it is a private company, operated on a government account.

**Export-import bank (eximbank).** A type of export credit agency that normally not only issues insurance but also lends directly. Some eximbanks also act as borrowers for import finance. There is no single model, and an

eximbank's organization, status, and functions usually differ from country to country.

**Exposure.** The total commitment of an export credit insurer with respect to a specific debtor or debtor country plus overdue payments, including unrecovered claims and rescheduled debts as well as debt service payments not yet due.

**Factoring.** A trade finance mechanism whereby an exporter sells receivables at a discount to a company (factor). Normally, after the factor has purchased a receivable, the importer or buyer pays the factor directly. The factors may or may not have recourse to the exporter in the event of nonpayment or delayed payment by the buyer or importer.

**Facultative reinsurance.** A type of framework reinsurance agreement under which the reinsurer retains the "faculty" to accept or reject each risk submitted by the reinsured party. It is mainly used by a reinsured party to reinsure parts of the risks or all the risks for which the party is unable to find reinsurance cover using other existing arrangements.

**Forfaiting.** An export finance mechanism involving the purchase at a discount of promissory notes or bills of exchange by a forfaitor. The payment instruments are normally guaranteed by a bank. The discount reflects financing costs until the payment due date and the risks involved.

**Government account.** Business that an export credit insurer underwrites on behalf of the insurer's home government. Typically, the premium (less any administrative charges) of government account business is passed on to the government in some way and the government funds claims payments.

**Insurance.** Insurance policies of various kinds are typically issued with respect to a range of risks against payment of a premium. For export credit insurance, the risks could embrace both political and commercial causes of loss, which may arise in the precredit period (before shipment) or during the credit period (after

shipment). Policies may be used by exporters (supplier credit) or by banks engaged in financing trade (buyer credit). For investment insurance, the risks are restricted to political risks. In both export credit and investment insurance, the insurance is against specified risks or classes of risk and is therefore conditional, although individual policies may be loosely referred to as guarantees.

**Letter of credit.** A document issued by a bank on behalf of one of its clients guaranteeing payment when all the conditions stated in the letter have been met. Letters of credit can take a variety of forms, but essentially they are a means of payment between an importer and exporter via their banks. The importer is sometimes called the opener, and the importer's bank the opening bank (or sometimes the issuing bank). The bank in the exporter's country is called the advising bank, and the exporter is called the beneficiary. A letter of credit may be revocable, which means that it can be canceled or modified by the importer or the importer's bank without prior approval from the beneficiary. Letters of credit can also be confirmed. This is done either on an open confirmation basis, in which case the issuing bank is aware of the confirmation, or on a silent confirmation basis, in which case the issuing bank and the importer or buyer may not be aware of the confirmation. Confirmed letters of credit reduce certain risks for exporters, such as the risk that the issuing bank may fail or be unable to transfer foreign exchange. Letters of credit are subject to widely accepted practices and procedures under the International Chamber of Commerce's Uniform Customs and Practices for Documentary Credits.

**Long-term business.** Traditionally, insurance or financing applied over a period of more than five years. But there is no generally accepted or precise division between long- and medium-term business.

**Medium-term business or credit.** Conventionally, business with a credit period of between one and

five years. However, under the OECD Arrangement, medium-term business is that with a credit period of two to five years. There are no universally accepted or generally applied divisions between short- and medium-term business, or between medium- and long-term business.

**National interest account.** Business for which an export credit agency provides cover, even if it does not meet the agency's normal underwriting criteria and standards, because the business is deemed by the agency's government or guardian authority to be in the broader interest of the agency's home country.

**Official creditor.** A public sector lender or insurer. Some official creditors, such as international financial institutions, are multinational. Others are bilateral—for example, individual creditor governments and their official agencies, such as central banks and export credit agencies when they are conducting business on a government account.

**Officially supported export credit.** An export credit supported (usually insured) by an export credit agency on a government account, rather than on its own account. The credit may be a supplier credit or a buyer credit. For medium- and long-term business, the extent of permissible official support is set by the OECD Arrangement (normally limited to 85 percent of the exported value, plus, where appropriate, the maximum permissible share of local costs, normally 15 percent of the exported value).

**Paris Club.** An informal group of creditor governments whose representatives have met regularly in Paris since 1956 to reschedule bilateral debts at the request of debtor countries. The French Treasury houses the group's secretariat. The Paris Club works on a consensus basis. It has no fixed membership and is open to all official creditors.

**Political risk.** The risk of nonpayment on an export contract or project as a result of action by an importer's or buyer's host government. Such action may include intervention to prevent the

transfer of payments (see “transfer risk”), cancellation of a license, or acts of war or civil war. Non-payment by sovereign buyers is also a political risk.

**Project finance.** Financing provided on the basis of the cash flow and viability of a project as the security for repayment rather than the general creditworthiness or financial strength of the buyer (or borrower or guarantor).

**Recovery.** Amounts collected from a debtor by an export credit agency, an exporter, or a debt collector after the export credit agency has paid a claim consequent to the debtor’s nonpayment.

**Reinsurance.** The practice whereby an insurer passes on to another insurer (called a reinsurer) part of the risk (and a portion of the premium income) of a policy it has written. Export credit agencies can be involved in reinsurance both as reinsurers and as reinsured parties. Export credit agencies receive reinsurance from their governments or purchase it in the private reinsurance market. There are several varieties of reinsurance (e.g., facultative, quota share, excess loss), but the basic principle is the same. Some export credit agencies (e.g., in the United Kingdom) are beginning to provide reinsurance to some private insurers against political risks in some countries.

**Securitization.** The use of facilities such as loans or guarantees to produce assets that are sold to investors in the capital markets.

**Short-term business or credit.** Transactions involving a maximum credit period, usually of 180 days, although under some definitions it can extend to 360 days and, in exceptional cases, to two years. For purposes of the OECD Arrangement, the medium term begins (and, by implication, the short term ends) at two years. Short-term business represents the bulk of the business of most export credit agencies and normally includes transactions in raw materials, commodities, and consumer goods. There is no universally accepted dividing line between short- and medium-term credit.

**Sovereign risk.** An obligation that carries the full faith and backing of the national government.

**Structured financing.** Refers to financial instruments devised to provide funding on the basis of identifiable assets rather than the credit standing of the borrower concerned. Includes securitization and forms of lending where the cash flow of the borrower is secured to pay off the lender.

**Supplier credit.** Credit extended by an exporter (supplier) to an overseas buyer as part of the export contract. Cover for this transaction may be extended by the export credit agency to the exporter. Such arrangements are much more common in short-term business. When they arise in the area of medium-term credit, the buyer normally makes a cash down payment (up to 15 percent) and then accepts bills of exchange or issues promissory notes for the balance at some stage before final delivery or acceptance of the goods.

**Trade finance.** A catch-all term applied essentially to the whole area of short-term business, especially that involving finance provided directly by banks issuing letters of credit.

**Transfer risk.** The risk that a buyer (investor) may make a deposit of local currency to pay for an international transaction (transfer profits and dividends) but find itself unable to convert the local currency into foreign exchange for the intended purposes. Such inconvertibility can happen even where letters of credit exist. The risk normally arises from restrictions imposed by host governments, through laws or regulations that have the force of law. Transfer risk is more complicated when a currency collapses, so that even though foreign exchange may still be available to purchase, its price will have risen sharply in local currency terms since the insured contract was signed (or the insured investment made).

**Value-at-risk (VaR).** Value-at-risk summarizes in a single number the total exposure of a portfolio or institution to market risk. Such a number indicates the expected maximum loss (or worse loss) over a particular time horizon with a given confidence interval.

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