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August 26, 1994

To: Members of the Executive Board

From: The Secretary

Subject: Officially Supported Export Credits - Developments and Prospects

The attached paper on developments and prospects in officially supported export credits provides background material to the report on the financing for developing countries and their debt situation (EBS/94/167, 8/23/94), which is tentatively scheduled for discussion on Friday, September 9, 1994.

As in previous years, it is planned that a suitably edited version of this background paper will form the basis for publication in the Fund's World Economic and Financial Surveys series. The revised text will reflect Executive Directors' comments and delete certain sensitive material.

Mr. Kuhn (ext. 36555), Mr. Horvath (ext. 38529), or Mr. Jarvis (ext. 35661) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

Officially Supported Export Credits - Developments and Prospects

Prepared by the Policy Development and Review Department

(In consultation with other departments)

Approved by Jack Boorman

August 25, 1994

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I. Introduction

This paper reports on recent developments and examines prospects in officially supported export credits, providing background information for the report "Financing for the Developing Countries and Their Debt Situation" (EBS/94/167, 8/23/94) to be discussed by the Executive Board in September, 1994. The main issues arising in export credit finance are set out in Section V.2. of that paper; Section VI contains issues for discussion.

This paper has been prepared on the basis of discussions by the 1994 export credit mission with staffs of export credit agencies and government departments concerned with export credits. 1/ The staff visited Austria, Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, the United Kingdom, and the United States in the period February to May 1994. Discussions were also held with the staffs of the Berne Union in London, the Commission of the European Union in Brussels, the OECD Secretariat in Paris, and with World Bank staff. The paper is the fifth staff study of developments and prospects for export credits. The last paper (SM/89/219, 10/27/89) was discussed by the Executive Board on November 29, 1989 and was published in the World Economic and Financial Surveys Series in May 1990. It is also intended to publish a suitably edited version of the current paper.

The main focus of this paper is on export credit financing for the developing countries and economies in transition. The paper examines the recent changes in the environment in which official export credit agencies operate, and discusses the potential and limits of export credits in the financing of developing countries, and economies in transition. The paper is organized as follows:

Chapter II discusses the significance of officially supported export credits in total financing for developing countries and economies in transition. It describes the recent increase in the volume of export credits and the recent institutional changes in export credit agencies. It also discusses recent developments in the financial position of export credit agencies.

Chapter III examines the major issues currently facing export credit agencies, including risk assessment, the limitations of export credits, the difficulties agencies have in reacting appropriately to deteriorations in the policy environment in competitive markets, the continued extensive use of mixed credits by agencies, and agencies' policies on low-income rescheduling countries. Chapter III also covers two issues of particular interest: lending to the private sector and the challenges posed by the economies in transition.

1/ The mission consisted of Mr. Kuhn (head), Mr. Horvath, Mr. Jarvis, and Ms. Hernandez (assistant), all of PDR; not all participated in all legs of the mission.

Chapter IV provides a description of agencies' cover policies in the major export credit markets. It also includes a separate and more detailed section on cover policies for the economies in transition.

The paper also contains annexes on export credit agencies and institutions visited (Annex I), statistical issues (Annex II), the OECD Consensus (Annex III), and policies towards rescheduling countries (Annex IV).

II. Trends and Developments

This chapter examines recent trends and developments in officially supported export credits. The institutional arrangements for providing official export credit support, which differ widely from country to country, and the basic features of official support for export credits are summarized in Box 1. 1/ This Box also contains background material on the basic principles underlying officially supported export credits, explanations of some of the key concepts used in the paper and a description of the main instruments used by export credit agencies.

1. The share of export credits in debt financing

Officially supported export credits represent a large share of total debt, accounting for more than 20 percent of the US$1.7 trillion in total indebtedness of the developing countries and economies in transition to all creditors at end-1992 (Table 1). 2/ Official support for export credits has been the most important instrument of debt financing by official bilateral creditors for developing countries. Export credits outstanding represent 37 percent of the indebtedness of developing countries and economies in transition to all official creditors and thus exceed debt to multilateral creditors including the Fund, by a significant margin. For the twenty main recipients of export credits, which include all major debtor

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1/ Throughout this paper the convention is adopted of referring to the activities, policy stance, and financial position of the export credit agency. It should be understood that the agencies have varying degrees of independence in these matters and that where the agency is a private firm the reference is exclusively to its government-mandated business. The term "governmental authorities" is used to refer to the Ministry or Ministries under whose guidance the agency operates or that are represented on its Board of Directors.

2/ According to a recent comprehensive survey of external indebtedness by the OECD. The main data sources used in this paper are the OECD, the Berne Union (The International Union of Credit and Investment Insurers), and published and other material produced by individual export credit agencies. However, there are a number of problems in analyzing the volume of export credits from the available statistics. This issue is discussed further in Annex II.

Box 1. Fundamentals of Officially Supported Export Credits

Basic principles

The purpose of officially supported export credits is to facilitate and promote national exports. Export credit agencies achieve this goal either by providing export finance directly or, more frequently, by providing guarantees or insurance of privately financed transactions. Export credit agencies have also been the channel for export subsidies. At its heart, the business of export credit agencies is an insurance business, and much of the language of officially supported export credits is derived from the world of insurance.

Only a small part of world trade benefits from officially supported export credits. Generally, the financing risks associated with trade are taken either by the importer, by the exporter or by private insurers or financial institutions which act as intermediaries between the two, for a fee. The need for officially supported export credits only arises when these actors are not prepared to cover all of the risks associated with an export credit at an acceptable price.

The rationale for official involvement is that there is some market failure in private export credit insurance. Some profitable transactions are too large for the private sector to insure. Official export credit agencies may also have at their disposal information, in particular about sovereign risk, that is not available to the private sector. Moreover, in cases where debt-servicing difficulties arise, export credit agencies act collectively in the Paris Club to adjust repayment terms to the needs of debtor countries, improving the prospects of ultimate repayment. All of these features may make it possible for official export credit agencies to provide cover without subsidy or loss on business that private sector insurers would not take because this risk of loss is too high or too difficult to predict or because the potential loss involved is too large. That said, export credit agencies have made very substantial cashflow losses in recent years, some of which will never be recovered.

Form of support

Export finance involves two basic types of risk:

- the commercial risk of importers not able to raise sufficient local currency funds to acquire foreign exchange for payments; and
- the political risk or "country risk" of exchange restrictions ("transfer risk") or other unexpected government actions which prevent importers from making payments on a timely basis.

All agencies covered in this study have put in place systems to insure or provide guarantees against political risks, including transfer risk, and many also cover commercial risks; some also reinsure such risks taken by private institutions. Moreover, most provide at least one of three forms of "financing support": direct credits, refinancing or interest subsidies. Financing support can be given in conjunction with basic insurance and guarantee facilities.

Export credits are generally divided into short term (usually below one year), medium term (between one and five years) and long term (over five years). The maturities of export credits are closely linked to the type of exports. Short-term credits are provided for consumer goods and raw materials, medium-term credits for capital goods, and long-term credits for heavy investment goods, large projects, and civil works. Insurance can also cover pre-shipment risk, arising from the buyer's failure to make the purchase as contracted, without provision of credits.

Export credits can take the form of suppliers credits (extended by the exporter) or buyers credits, where the exporter's bank or other financial institution lends to the buyer (or his bank). Buyers' credits often afford greater flexibility to importers, especially if extended in the form of a general line of credit covering a wide variety of goods from the exporting country.

Relationship to governments

An export credit agency can be a department within a Ministry, an independent governmental agency, or even a private firm operating under instruction from, and for the account of, the government. Of the cases studied here, Austria, Germany, and the Netherlands conduct their export credit insurance programs through private companies (OeKB, Hermes, and NCM). Short-term export credit insurance in the United Kingdom is also conducted through a private company (NCM-UK). In most cases, agency activities are subject to ministerial, and usually interministerial, guidance and review. They also rely on governments for financing, which can take a variety of forms.

Agreements between export credit agencies

The members of the Export Credit Group (ECG) of the OECD participate in the Arrangement on Guidelines for Officially Supported Export Credits (the "Consensus") which provides an institutional framework for orderly export credit markets with the aim of preventing an export credit race where exporting countries compete on the basis of financing terms (Annex III). It sets limits on the terms and conditions for export credits with a duration of two years or more. The most important conditions are

- a cash payment of at least 15 percent of the value of the export contract;
- maximum repayment terms of 8 1/2 years (5 years for relatively rich and 10 years for poor countries);
- minimum interest rates linked to market rates;
- minimum levels of concessionality for "tied-aid" financing.

Guidelines on short-term credits have been established by the Berne Union (International Union of Credit and Investment Insurers).

Table 1. Developing Countries and Economies in Transition: Composition of External Indebtedness, 1992

	All developing countries and economies in transition			Twenty largest recipients of export credits 1/		
	(US$ billions)	Shares (in percent) in total debt	Shares (in percent) in official debt	(US$ billions)	Shares (in percent) in total debt	Shares (in percent) in official debt
Export credits	357	20.6	37.0	252	26.3	48.0
ODA	146	8.4	15.1	80	8.3	15.2
Other bilateral 2/	188	10.9	19.5	49	5.1	9.3
Multilateral	275	15.9	28.5	144	15.0	27.4
Total official	966	55.6	100.0	525	54.7	100.0
Banks and other	765	44.4	...	435	45.3	...
of which: short term	(358)	(20.7)	...	(177)	(18.4)	...
Total	1,731	100.0	...	960	100.0	...

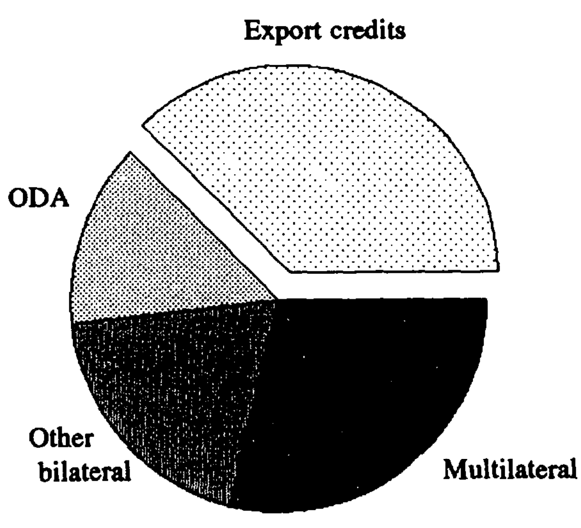
Sources: OECD; and Fund staff estimates.

1/ For countries covered, see Chart 2.

2/ Including debt to non-OECD bilateral creditors, of which some US$132 billion is owed to the countries of the former CMEA, largely representing claims of the former Soviet Union which are now held by the Russian Federation.

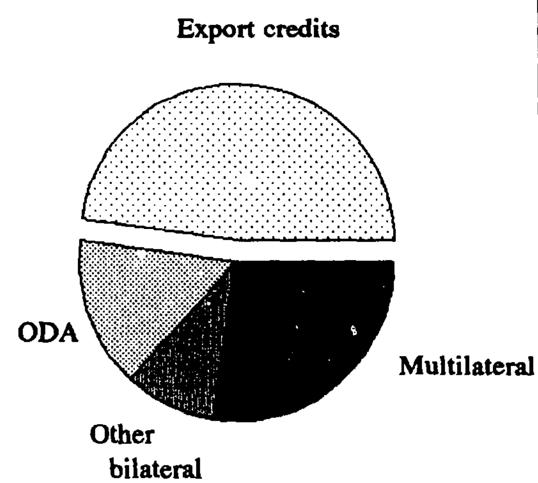
Chart 1: Composition of Debt owed to Official Creditors, 1992

A. All Developing Countries



Total official debt: US$966 billion.

B. Twenty Main Recipients of Export Credits



Total official debt: US$525 billion.

Sources: OECD; and Fund staff estimates.

countries, export credits account for nearly half of their debt to official creditors (Chart 1).

Official financing through export credits has been provided to a wide range of countries, but the portfolio of export credit agencies remains heavily concentrated: 1/ the ten largest recipients of export credits account for about half and the largest twenty for nearly three quarters of export credit agencies' exposure (Chart 2). There have been significant shifts in the relative exposure across countries and these are discussed in Chapter IV. Total exposure has also increased sharply in recent years, especially since 1989.

Two trends underlie this rise in exposure. First, new export credit commitments have risen rapidly over the past years, driven in part by more aggressive export promotion as well as a resurgence of import demand by many developing countries. Second, there has been a substantial increase in agencies' exposure in the form of arrears and unrecovered claims (resulting from payments of insurance claims, usually in the context of Paris Club reschedulings). This reflects the effect of continued large debt restructurings for countries that had been in debt difficulties for some time (notably Brazil, Egypt, and Poland) but also the more recent emergence of debt-servicing difficulties in the former Soviet Union, Algeria, and Iran. The impact of these factors on developments in total exposure is shown in Chart 3. 2/

2. The volume of new export credits

a. Background: the contraction of export credits in the 1980s

The recent increase in the volume of new exports credits has been particularly striking because it followed a sharp fall in the overall level of export credit activity during the 1980s. New commitments of medium- and long-term export credits had dropped sharply from their peak of US$86 billion in 1982 to US$45 billion in 1988. 3/ Most debtor countries responded to balance of payments difficulties by cutting back public sector investment programs which reduced the demand for the imports financed through officially supported export credits. In other countries, where demand for imports and associated new financing remained strong, agencies

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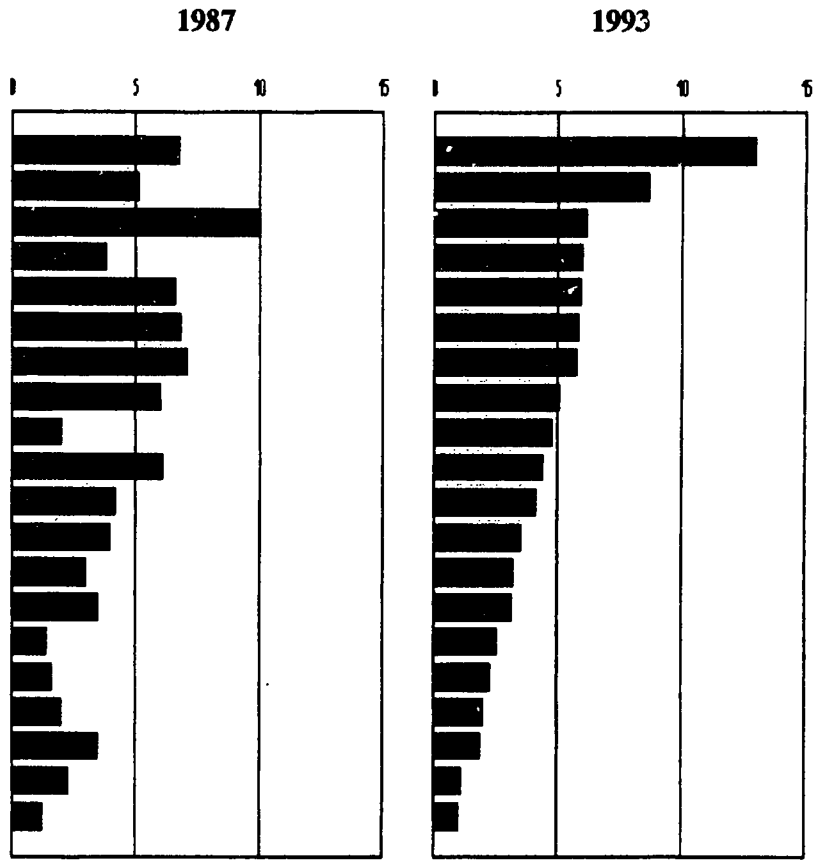
1/ Agencies' portfolios are typically concentrated on countries which fall into one of two categories: low-risk markets with high import potential, or high-risk markets where exporters are already well established or where the exporting country has particularly strong political interests.

2/ A more detailed description of the concepts of arrears and unrecovered claims, and of the concept of export credit commitments, can be found in footnote 1 of Chart 3.

3/ Also see Annex II, Table 1.

Chart 2. Twenty Main Recipients of Export Credits: Share in Agencies' Portfolio, 1987 and 1993

(In percent)

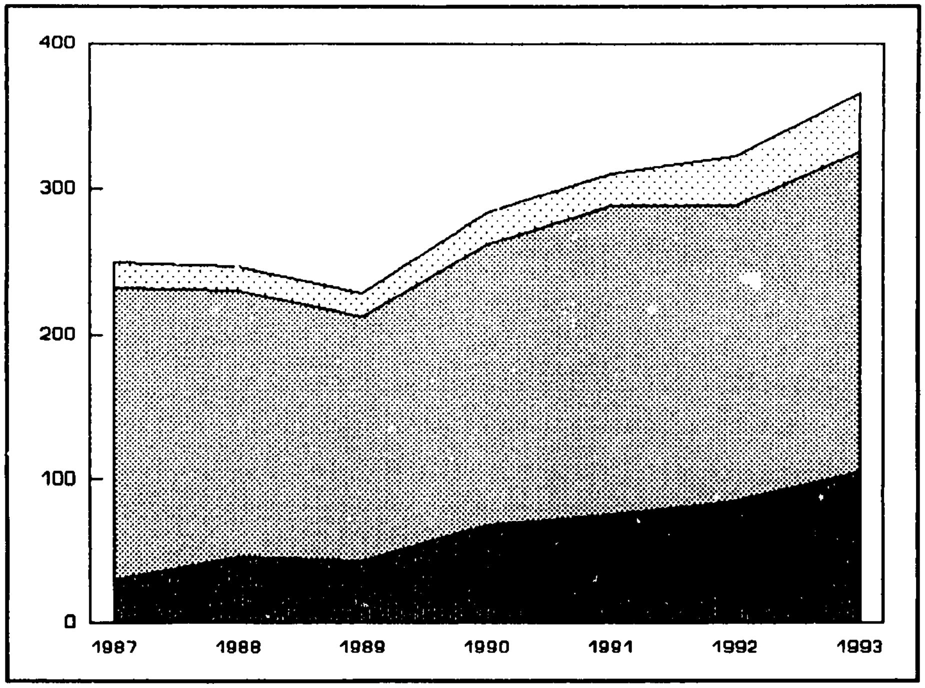


	Total exposure (US$ billions) 1987	Total exposure (US$ billions) 1993
Russia and ex-USSR	16.8	47.5
China	12.7	31.6
Brazil	24.8	22.3
Mexico	9.4	21.9
Indonesia	16.4	21.6
Poland	17.0	21.3
Algeria	17.6	21.0
Nigeria	14.9	18.4
Iran	5.0	17.4
Egypt	15.1	16.1
Turkey	10.5	15.0
Argentina	9.8	12.8
India	7.4	11.7
Iraq	8.6	11.3
Venezuela	3.4	9.3
Philippines	4.0	8.1
Morocco	4.9	7.2
South Africa	8.7	6.9
Former Yugoslavia	5.7	4.0
Peru	3.0	3.7

Sources: Berne Union; and Fund staff estimates.

Chart 3. Export Credit Exposure, 1987-93 1/

(In billions of U.S. dollars)



Sources: Berne Union; and Fund staff estimates.

Arrears and unrecovered claims | Medium- and long-term commitments outstanding | Short-term commitments outstanding

1/ This chart, as well as Charts 4 and 7 to 22, are based on the Berne Union's quarterly survey covering some 40 developing countries and transition economies. Exposure in the form of unrecovered claims arises from non-payment by a debtor which results in an export credit agency having to pay claims to an insured creditor. The non-payment can result either from default by the debtor or from a rescheduling agreement between the debtor country and the creditor country; claims arising from both events are unrecovered claims until repaid. Exposure in the form of arrears arises where the debtor has failed to meet its obligations to the original creditor, but a claim has not yet been paid by the agency (usually because the claims waiting period has not yet expired). In contrast to unrecovered claims, arrears still represent a contingent liability for the agency, rather than a liability that has already been realized.

Exposure in the form of commitments outstanding arises from insurance, guarantees, or direct loans provided by the agency, in cases where repayment of the loan has not yet fallen due. In the case of insurance and guarantees, this exposure represents a contingent liability. It should be noted that the exposure reported by agencies in this category includes insured interest falling due, so that the agency's total exposure can be larger than the face value of the loan insured. In contrast, reported exposure in the form of unrecovered claims does not include an estimate of interest that will fall due on such claims before they are repaid. Therefore, this category understates the likely obligations of the debtor to the agency, and the amount at risk for the agency. Where unrecovered claims are substantial this understatement can be significant.

The distinction between medium- and long-term commitments outstanding and short-term commitments outstanding made here corresponds to the exposure figures reported to the Berne Union by individual agencies. Agencies have different definitions of short-term commitments, generally ranging from up to one year to up to two years. Thus, some debt in the one to two-year maturity range may be reported in each of the categories. In practice, however, commitments in this maturity range are generally limited, so that anomalies resulting from the different definitions used by agencies are of limited significance.

were often reluctant to extend new commitments because of doubts about countries' ability to service new debt and often poor performance under rescheduling agreements. It also became evident that nonconcessional export credits were generally an inappropriate form of financing for many of the low-income rescheduling countries (as discussed in Section III.4.a.).

b. Re-examination of agencies' role

The continued low levels of export credit activity combined with persistent cash-flow losses led to calls for a re-examination of agencies' approaches to export promotion and to closer scrutiny of the budgetary costs of their operations. These pressures intensified as the Paris Club moved toward concessions in reschedulings for the low-income countries, and agreed comprehensive debt restructurings in 1991 for Egypt and Poland (which involved a reduction by 50 percent in present value terms). While seen as exceptional, these agreements led to doubts about the ultimate recovery of rescheduled claims on sovereign debt. At the same time, budgetary strains in most industrial countries led to a declining willingness to subsidize exports, and this reduced the role of agencies as a channel for financial subsidies. Agencies, particularly in Europe, also faced increasing competition from private insurers on short-term business in the OECD markets, which accounted for a large part of their premium income.

In response to these pressures, agencies and their government authorities implemented a wide variety of measures--including restructurings and other institutional changes--aimed at increasing the effectiveness of agencies as instruments of export promotion while reducing costs and bringing greater transparency to their operations. Most agencies strengthened their approaches to assessing and managing risk, through improved country risk assessment procedures, the use of more market-related pricing, and other innovative approaches to export promotion (see Chapter III and Box 2). With new procedures and systems in place or in the process of implementation, many governments, which for a number of years had taken a restrictive stance on export credits, began to pursue export promotion more aggressively, often seeing export promotion as a tool to stimulate economic growth in the recession of the early-1990s. 1/

c. Rebound in the volume of export credits

The more aggressive approach to export promotion coincided with and reinforced the recovery in demand for imports of capital goods by many developing countries. A number of governments also saw export credits as an important instrument in supporting the economies in transition, and significant amounts of export credits were extended to several countries in Eastern Europe and to the former Soviet Union. This led to a decisive

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1/ The idea that export promotion can be a powerful tool to combat domestic recession is not new: many agencies were founded in the 1930s for just this reason.

Box 2. Changing Approaches to Export Promotion

Agencies differ considerably in the way they approach their general mandate to promote exports, and this is reflected in institutional arrangements.

Some governments see their agencies essentially as insurance agencies which decide, within an overall ceiling on the volume of their business, whether or not to underwrite export credit transactions presented by exporters or their banks. For these agencies, export credit activity is essentially demand-driven, and their government authorities have at times found it difficult to impose effective limits on the provision of export credit cover and thus effective budget constraints on the activities of agencies. Other governments have given their agencies a broader mandate and often a wider range of instruments to promote exports, but typically more tightly defined overall financial objectives.

The recent restructurings and re-organizations of agencies have generally aimed at placing agencies on a more commercial and independent footing. Governments have not abandoned the pursuit of other, essentially political, objectives through use of export credits, but they have adopted clearer definitions and separations of such "national interest business".

An example of this general approach is the Export Development Corporation of Canada (EDC). Recent revisions of its mandate provide EDC with broad authority to engage in a wide range of transactions, including leases, equity investments, domestic financing and insurance activities, and borrowing operations in international capital markets. EDC has made profits in recent years on its operations. Transactions which EDC considers too risky to take on its own corporate account can be supported under the Government's "Canada Account" but only after the transaction has been rejected by EDC's Board and under strict limits and review of various government agencies. Subsidies for exports are limited to transactions on the account of the government and are funded not from the general aid budget but an account explicitly devoted to export promotion.

Agencies have also adopted a wider range of strategies to facilitate exports and deal with risk. These include:

- Development of more effective instruments of export promotion, including more complex and sophisticated insurance and financing techniques, including escrow accounts.
- More open information policies regarding country risks and cover opportunities.
- Efforts to facilitate exports of enterprises that have little or no experience with foreign buyers, and assist established exporters in shifting business toward lower-risk markets.
- Discussions with borrowing countries for which cover opportunities are limited on their investment priorities and the most effective use of financing rather than providing cover on a first-come first-served basis.
- Strengthened capacity for in-house project appraisals and project financing packages (involving coverage for commercial risk).

These approaches have in common a focus on the <u>quality</u> of export credits. They hold out the promise of improved repayment prospects together with the provision of support that is better tailored to the needs of both exporters and borrowing countries.

reversal of the long decline in export credit activity. New commitments by export credit agencies began to rise sharply, and this upswing is now well established. Thus, for example, Berne Union data show that new commitments of the twelve largest export credit agencies to 40 developing countries increased to US$53 billion in 1990 and further to US$69 billion in 1993. Within this overall increase in new commitments, there was also a marked increase in new commitments to low-income countries, although this mostly reflected very substantial new commitments to some of the largest low-income countries, in particular China, India, and Indonesia. New export credit commitments in the period 1990-93 for some of the largest markets are shown in Chart 4. More generally, the overall increase in new commitments masks substantial variations among countries. Some countries attracted little new finance; others received very substantial new flows.

3. *The financial position of export credit agencies*

a. Net cash-flow

The financial performance of most export credit agencies has remained weak, as measured by net cash-flow, the indicator of financial performance most commonly used by the agencies themselves. 1/ Chart 5 shows the effect of income from premia and recoveries of previous claims and of new claims payments on the cash-flow of the export credit agencies covered in this study during the years 1990-92. The picture that emerges differs little from the experience of the 1980s: new claims payments, averaging over US$10 billion a year, have continued to exceed premium income and recoveries by a wide margin. While the experience of agencies has varied markedly, reflecting the different composition of their portfolios across recipient countries, most, though not all, agencies have continued to incur very substantial cash-flow losses. Information currently available from agencies indicates a broadly similar outcome for 1993, and further large cash-flow losses are projected for 1994.

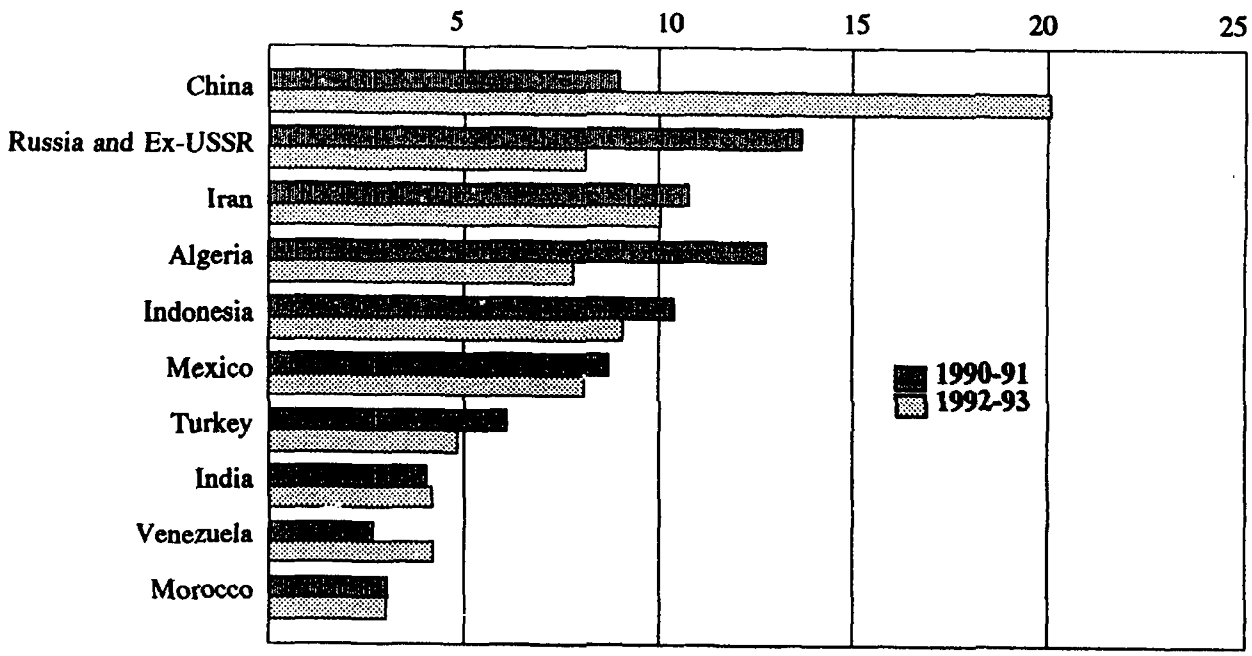
Two divergent trends underlie these figures. On the positive side, a number of major debtor countries have begun to emerge from the Paris Club rescheduling process 2/ and many others are making payments on previously rescheduled debts while continuing to require reschedulings. As a result, recoveries on rescheduled debts have become the dominant source of income

1/ The accounting systems and practices of agencies vary widely, reflecting in large part differences in institutional arrangements. While an increasing number of agencies have been moving to accounting systems that establish provisions and include measures of the expected recovery of claims, and in particular of arrears and restructured claims, other systems are kept on a cash basis and thus do not allow assessments of financial positions on an accrual basis. Net cash-flow remains therefore the only indicator for which data are available on a reasonably consistent basis.

2/ See companion background paper on official financing for developing countries, Chapter II.

Chart 4. New Export Credit Commitments in Selected Major Markets, 1990-93

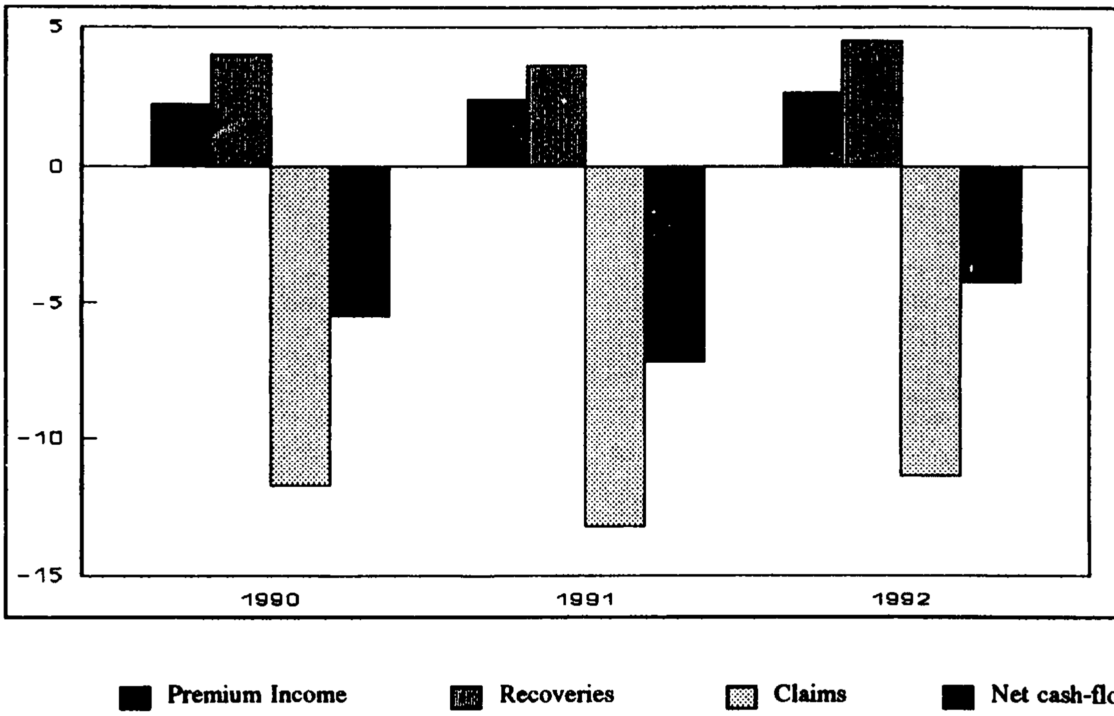
(In billions of U.S. dollars)



Sources: Berne Union; and Fund staff estimates.

Chart 5: Export Credit Agencies 1/: Premium Income, Recoveries, Claims, and Net Cash-Flow, 1990-92

(In billions of U.S. dollars)



Sources: Export Credit Agencies visited, OECD, Annual Reports of Export Credit Agencies; and Fund staff estimates.

1/ Agencies covered in study.
2/ These cash-flow losses are included, either ex ante or ex post--in some cases with some delay--in government expenditure.

for most agencies. Agencies have also seen significant increases in their direct revenues in the form of premium income on new business.

These positive effects on cash-flow have been more than offset, however, by continued claims payments on export credits to other debtor countries. To some extent these reflect continuing claims resulting from cover decisions taken several years ago. But they also reflect the emergence of payments problems in some major debtor countries which had previously been considered good risks by export credit agencies. The very substantial claims on credits extended to the former Soviet Union have dominated the cash-flow position of agencies during the past two years, and claims payments have increased further during 1994 as the result of the Paris Club rescheduling agreement with Algeria. Most agencies have also experienced large claims on credits extended to Iran. All agencies have significant exposure in at least two of these three markets; some agencies noted that their recent claims payments had exceeded by a substantial margin the claims experienced at the height of the debt crisis.

b. Provisioning

Governments have responded to agencies' continued cash-flow losses in a variety of ways. In several countries an attempt has been made to draw a clear line between old and new business of the agency. Such approaches usually involved recognizing that the agency's cash-flow losses on old business were unlikely to be fully recouped, and making financial provision for these losses to be covered by the Government, while putting in place more ambitious financial targets for the agency's new business, and more rigorous risk assessment procedures. 1/

Some agencies use their risk assessment procedures as a guide to what should be the level of provisioning against potential future losses. For example, the risk assessment process is directly linked to provisioning in the systems of Canada, Sweden, the United Kingdom, and the United States.

1/ An example of this approach is the decision by the U.K. Export Credit Guarantee Department (ECGD) to divide its trading accounts into two, to enable a clear distinction to be made between new and old business. According to ECGD's Annual Report for 1992/93, ECGD's financial objective for Account Number 1, which comprises mostly guarantees issued prior to April 1991, is to "manage the portfolio of assets and liabilities so as to minimize the cost to the taxpayer". The financial objective for Account Number 2, which includes only guarantees issued from April 1991 onwards, is "to build up and maintain sufficient reserves on new business to give the level of assurance of break even required by ministers".

Other examples of the approach include a similar separation of old and new business by EKN of Sweden and the new system of risk assessment and provisioning put in place for U.S. Eximbank under the Credit Reform Act of 1990.

However, most agencies are opposed to linking country risk assessments to provisions for specific countries. Moreover, it should be noted that agencies that are making provisions do so largely to provide their parliamentary and guardian authorities with a transparent picture of the quality of their total portfolio of lending and insurance. Agencies have not written down the face value of their claims, except in cases where debt concessions were agreed in the Paris Club. Finally, some agencies reject the need to make provisions for sovereign loans altogether (though they may hold reserves against commercial risk in their portfolio). The position of these agencies remains that all of their sovereign credits will ultimately be recovered (though some will be serviced at much lower interest rates in cases where they have participated in Paris Club debt and debt-service reduction operations), and they therefore see no justification for drawing a line between old and new business to evaluate financial performance. However, even those agencies that have not formally separated old and new business have, in many cases, overhauled their system of risk assessment, tightened their approach to cover policies, and developed new approaches to facilitate exports and deal with risk (see Box 2).

III. Current Issues and Prospects

1. The new emphasis on risk assessment

Export credit agencies are in the business of export promotion through the provision or coverage of export credits, often on terms better than those available in the market. But this involves taking risks. 1/ This means that financial results hinge crucially on two factors: realistic pricing and diversification of risks. Agencies thus face a dilemma between assuming risks which threaten their financial positions and eschewing such risks at the cost of a loss of business for exporters. Their experiences over the past decade and, in particular, their continued weak financial performance, have heightened this dilemma.

The reaction of agencies has been to refine and to systematize their country risk assessment, and to reinforce links between the risk assessment process and cover policies. All agencies have now moved toward more realistic pricing of political risk. Risk diversification has proved to be more difficult, however, because of the strong links to particular markets for historical and geographic reasons and because of adverse selection: official support for export credits is only sought for exports for which private sector insurance is either not available or is more costly and self-insurance is seen as too risky by the exporter. All agencies have therefore

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1/ Agencies cover a wide variety of risks, as described in Box 1, but they see political risk (often referred to by agencies as "country risk") as the most important risk in medium- and long-term financing to developing countries.

strengthened and refined risk-sharing and risk-reducing techniques to improve the quality of the portfolios. 1/

a. Approaches to risk assessment

While agencies approach country risk assessment in different ways, one common feature of the systems now in use is that they place countries into risk categories. The number of categories and the implications for cover policy vary, but all agencies attempt to order and give numerical rank to countries in terms of the risk attached to new business.

Some agencies go much further in attempting to quantify risks and attach specific credit scores to countries. For example, the portfolio management system of ECGD (United Kingdom) assigns to each new credit a probability of default and an expected loss coefficient. A similar quantitative approach to risk assessment is taken by COFACE (France) and OND (Belgium). These three agencies are also collaborating on the design of a country risk assessment system which could be used by all agencies in the European Union in the context of the ongoing discussions on harmonization of export credit policies. U.S. Eximbank also employs a quantitative system of risk assessment. 2/

Other agencies use a more qualitative approach and place less reliance on credit scores resulting from quantitative models, believing that highly standardized models fail to deal adequately with the individual characteristics of countries, making it difficult to give an appropriate weight to inherently subjective judgements on, for example, the political sustainability of economic policies. However, even those agencies which favor a more eclectic approach have evolved a set of criteria, including quantitative indicators, as the basis for their country risk assessments. Several of these agencies pointed out that the outcome of their assessments usually differ little from those produced by more elaborate quantitative systems.

b. Criteria used in evaluating risk

All agencies covered in this study considered payments performance the single most important factor in their assessment of country risk. Countries that have established a solid track record of servicing their debts according to agreed schedules are regarded as good risks. Erratic payments performance, such as recurrent delays, even on small amounts, is seen as a clear indication of a bad or deteriorating risk. A lack of attention to payments can thus have strong effects on a country's access to export credits and the cost of such credits.

1/ For further details on risk-sharing techniques see Box 3.

2/ This system is shared by U.S. agencies and government departments, and used to determine budgetary allocations required under the provisions of the Credit Reform Act of 1991 for all new credits and contingent liabilities.

Box 3. Sharing Risks

Collaboration among agencies

Export credit agencies collaborate with each other in a number of ways. Most agencies require that a certain proportion of the value of an insured export be produced in their own country, so that it is generally not possible for an agency to finance exports from other countries. Therefore, when a project requires exports from exporters in more than one country, agencies usually get together to provide support for the project as a whole, with each agency insuring exporters from its own country.

Agencies have also developed a number of channels for exchanging information and opinions on both individual countries and on more general issues. Recent experience has led them to seek ways to strengthen further the effectiveness of information exchanges. Most of the main agencies hold regular bilateral consultations covering issues, countries, and projects of common interest. Government authorities and many agencies have also access to reports from the multilateral institutions, including the Fund, reports from embassies, and also make extensive use of commercial sources of information.

The Berne Union holds regular meetings at which the stance of cover policies and a wide range of technical issues are discussed. In addition, the Berne Union provides information to members on the level of activity, the stance of cover policy and payments experience of member agencies for some 40 countries covered in its quarterly survey. Membership in the Union is limited to agencies and does not include representatives of guardian authorities, and discussions on some policy issues are therefore limited.

The process of consultation in the OECD Export Credit Group and the Participants in the OECD Consensus (which includes representatives from the guardian authorities) has intensified in recent years with regular exchanges of information, and discussions on a wide range of policy issues, including premium structures as well as discussions on a project-specific basis on the modification of the Consensus regarding mixed credits.

Cofinancing with multilateral institutions

Agencies have increasingly sought cofinancing arrangements with multilateral financial institutions and consider cofinancing an important technique to reduce and share risk. Under these arrangements, agencies provide support for part of the finance for projects selected and developed by the multilateral institution, and thus provide additional resources for development. Agencies see direct involvement of the multilateral institution as an important means to ensure that the projects have been appraised carefully and fit within the overall development strategy of the country. They also see participation by multilateral institutions as an effective means to reduce, if not eliminate entirely, the risk of payment delays on such credits. Furthermore, cofinancing allows participation in a wider range of projects than would otherwise be possible.

The World Bank remains the by far most important multilateral partner of agencies for cofinancing. During the past two fiscal years, the Bank approved some 250 projects for cofinancing with an average total value per year of US$12 billion, a sharp increase over the US$9 billion during the 1991 fiscal year. This reflected the surge in World Bank operations in sectors such as power and water, which lend themselves to cofinancing by agencies. However, cofinancing with the World Bank was seen by many agencies as very complex, reflecting in part the nature of projects in infrastructure as well as the Bank's rules on bidding for contracts which favored lowest-cost sources. In contrast, agencies were particularly keen on cofinancing with the IFC of private sector projects in sectors that earn foreign exchange (and which often incorporate explicit security arrangements). The European Bank for Reconstruction and Development (EBRD) has recently introduced a new cofinancing program (Export Credit Loan Arrangement Technique--ECLAT). This program, which seeks to streamline the often complex procedures of conventional cofinancing techniques, was seen by many agencies as a promising and flexible vehicle to provide export support to economies in transition.

Agencies also give significant weight to economic performance. Most agencies emphasized that they attached considerable importance to borrowing countries' relations with the Fund and the World Bank and countries' track records under Fund arrangements, and many observed that they made extensive use of Fund staff reports in assessing countries' economic and financial situations and medium-term prospects. 1/ Agencies also use a wide range of financial indicators, and look particularly carefully at external debt and debt-service ratios and the adequacy of and developments in countries' reserve positions. 2/

Criteria less easily quantified, but of increasing importance in risk assessment, are the policies and attitudes of the borrowing country government towards the private sector, a liberal trade and payments system and the development of a sound and well-functioning banking system. Finally, agencies attach considerable importance to political developments in the borrowing country, and make judgements about the sustainability of policies being followed. These judgements are typically applied in a one-sided manner: the perception of political instability lowers country-risk ratings, but improvements in the political climate do not translate into higher ratings unless accompanied by improvements in economic and financial factors.

2. Limitations of export credit finance

The nature of export credits, and trade financing more generally, imposes a number of limitations on the role such financing can be expected to play. In particular, export credits are not well suited as a substitute for general balance of payments support. For the financing of investment projects, the main domain of long-term export credit finance, there is generally a lag between commitment and disbursement of several years which makes such credits an ineffective vehicle for balance of payments financing. Moreover, the volume of medium-term export credits is directly linked to the volume of imports, and more specifically capital goods imports. 3/ This means that additional net financing can only be provided in support of an increase in the demand for such imports. Short-term financing is quick-disbursing and more readily available for countries in need of balance of payments support, but extensive recourse to short-term export credits can

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1/ Agencies generally consider Fund staff medium-term scenarios as useful benchmarks, but also observed that they typically made downward adjustments in their own medium-term projections to correct for what they saw as an optimistic bias resulting from the assumption of full implementation of adjustment programs.

2/ Some agencies also observe closely ratings of bond issues and secondary market prices of commercial bank debt of borrowing countries.

3/ Furthermore, most agencies will only provide cover for exports from their own countries. An important exception is The Export-Import Bank of Japan (J-EXIM), which has moved increasingly towards untied financing in recent years.

rapidly lead to severe debt-servicing difficulties, as illustrated by the recent experience of Algeria and Iran (see Chapter IV, below). The distinctive features of short-term credits are discussed further in Box 4.

The fact that export credits are expected to be repaid quickly also suggests that such credits should not be relied on as a major source of net financing for prolonged periods. Countries that need large transfers of resources, such as the low-income countries and many transition economies, require, instead, financing on long maturities or, preferably, non-debt creating flows in the form of foreign direct investment, or grants from official sources. Countries that continue to rely largely on export credit financing without diversification towards other sources of financing are likely to run into debt-servicing difficulties over time. An unsustainable build-up of debt obligations on export credits can usually not be addressed through access to additional export credits. It requires, instead, recourse to exceptional financing through Paris Club reschedulings, which transform contingent insurance claims of the export credit agencies into direct (and untied) credits with much longer maturities, but at a considerable cost in terms of creditworthiness and hence in terms of future access to financing.

This is brought out in Chart 6, which shows the share of export credits in total debt of the twenty largest recipients of export credits. Of these twenty countries, only six have avoided recourse to either substantial payments arrears or recent debt reschedulings (China, India, Indonesia, South Africa, Turkey, and Venezuela). For these six cases, the share of export credits in total debt is significantly lower than for most of the other fourteen countries.

The nature of export credit financing thus circumscribes the potential of export credit agencies in the overall financing of developing countries, and particularly in the financing for economies that require significant net financial flows for prolonged periods. More specifically, export credits cannot serve as an instrument of large-scale support for the poorest countries, though a cautious use of export credits to help finance carefully selected projects might well be appropriate in some cases. A cautious use of export credits is also indicated for many of the economies in transition and other countries in situations that require financing closely targeted to their near-term circumstances and medium-term prospects.

3. Low-risk markets and competition among agencies

In countries considered creditworthy borrowers, competition for business among exporters and among agencies is intense. Such competition can result in financing on terms that might not otherwise have been available, even to developing countries that have demonstrated their creditworthiness. But agencies' reactions to competitive pressures can also lead to outcomes that are not in the collective interest of creditors or borrowing countries. Two issues are of particular interest.

Box 4. Short-Term Credits

Agencies draw a clear distinction between short-term credits on the one hand, and medium-and long-term credits on the other. First, unlike in the case of medium- and long-term credits, there is significant involvement by private insurers in the provision of short-term export credits. Second, there are a number of features which distinguish short-term export credits.

- Most short-term business is conducted on a routine basis with established commercial banks and buyers. Therefore it does not involve the complexities that arise in covering medium- or long-term transactions related to capital goods or projects.

- The risk periods are short. Risks are therefore more predictable, and generally much lower, as even countries that have lost access to other forms of financing have continued to service short-term debts to preserve the flow of essential imports.

- The size of transactions is typically small which makes it easier to control exposure.

- The Paris Club has not rescheduled short-term debts except for a very few difficult cases.

As a result, agencies tend to remain on cover for short-term credits in all but the most risky markets even in cases where they are off cover for medium- and long-term business.

Agencies also have a greater variety of techniques at their disposal to limit or share risks for short-term credits, as banks are generally willing to take part of the risk, and in particular, cover commercial risk. Additional securities that agencies might require include:

- irrevocable letters of credit from domestic banks in the buyers' country, particularly ones with secure access to foreign exchange;

- guarantees from the Government or Central Bank; and

- letters of credit confirmed (and therefore guaranteed) by a bank in another country.

While most agencies consider credits up to one year as short-term credits (and some go up to two years), Berne Union guidelines require that certain types of exports, such as consumer goods and certain raw materials, be financed with short-term credits not exceeding 180 days. It should be noted that these guidelines are not binding, however, and that they do not cover agencies and institutions that are not members of the Union, such as, for example, the Commodity Credit Corporation of the United States and the Canadian Wheat Board.

<u>Relations to private sector insurers</u>

One aspect where agencies differ widely is in their relations to private sector credit insurers. This is complicated by the fact that a number of agencies are private organizations that act on behalf of the government but also on their own account.

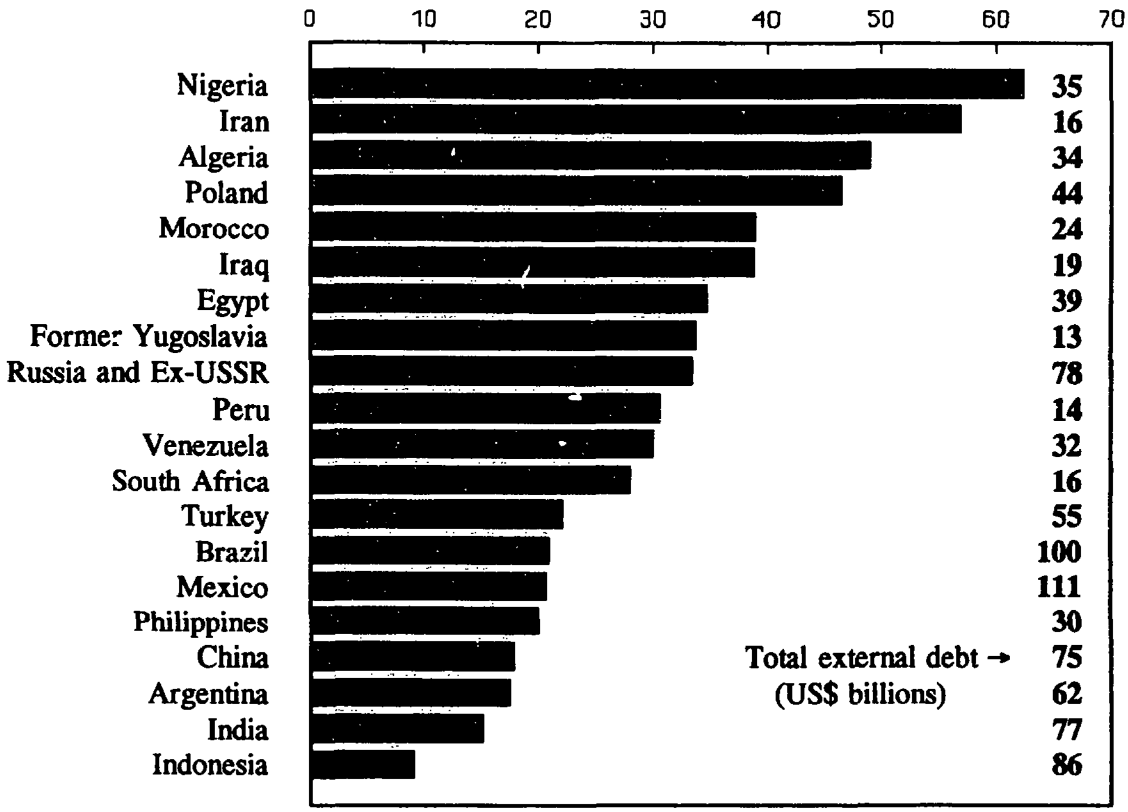
Increasing attention has recently focused on the role of officially supported agencies in short-term insurance and the relation between official and private insurers, in particular in the European Union in the context of harmonization. At issue is what official agencies can reasonably do in the areas of insurance and re-insurance without inhibiting or distorting competition.

Governments have taken different approaches. For example, the United Kingdom has privatized ECGD's short-term business (which was taken over by NCM of the Netherlands, itself a private insurer). However, the United Kingdom continues to provide some re-insurance for short-term business.

Many other agencies in the European Union have made a distinction between, on the one hand, short-term commercial credit risk (up to two years) to countries within the OECD (excluding Turkey), for which private credit insurance is generally available and which they see as an area where official support might lead to distortion and should therefore be avoided and, on the other hand, political risk within the OECD and all short-term risks in other countries.

Chart 6. Twenty Main Recipients of Export Credits: Share of Export Credits in Total External Debt, 1992

(In percent)



Sources: OECD; and Fund staff estimates.

First, agencies are often slow in reacting appropriately to deteriorations in the policy environment. Under competitive pressures, agencies tend to continue to provide or even expand cover to countries that do not have apparent debt-servicing difficulties, but are pursuing policies that could lead to future problems. Similarly, agencies are under often intense pressures to help exporters gain an early foothold in countries seen as future growth markets, and have provided cover to countries where policy performance and agencies' own country-risk assessments indicated a more restrictive stance.

Second, the desire to support exporters in competitive markets has led agencies and their governments to make use of export subsidies in ways that distort trade, divert scarce aid resources, and prevent a more commercially based approach to export credit financing for large projects.

a. Agencies' reactions to changes in the policy environment

For countries seen as good risks, agencies tend to be relatively unconcerned about large increases in new commitments or even breaches in their internal guidelines on the maximum share of risk to a single country. In some cases, the result of agencies acting collectively in this fashion has been a very rapid buildup of debt by the borrowing countries which, on a number of occasions, has been followed by payments difficulties. This is not a new problem, and the first Fund study on export credits in 1985 had pointed to this tendency as a major contributing factor to debt difficulties. Attempts by agencies to address this problem in recent years have not been entirely successful, as illustrated by the recent emergence of serious payments difficulties in three markets which had been seen as good credit risks, Algeria, Iran, and the former Soviet Union. These cases illustrate a number of features of agencies' policies in newly competitive or emerging markets and in particular the difficulty agencies can experience when they do not act on the conclusions of their own risk assessments. All are discussed in more detail in Chapter IV.

Agencies acknowledged that continued export credit support had often helped countries to postpone adjustment measures, and thus made eventual adjustment more difficult. They commented that achieving greater discipline on their side was complicated by a number of systemic and agency-specific factors. First, it was difficult for any agency to tighten cover in an intensely competitive environment ahead of others. Second, the effect of a tightening by an individual agency would be marginal to the overall outcome. Third, warning signals were often not fully conclusive, and an abrupt move by agencies as a group could well precipitate a liquidity crisis, especially since increased demand for export credits was often a reflection of changed sentiment of private creditors. As official agencies, it was their responsibility to help their exporters in maintaining trade flows to fundamentally creditworthy debtors in temporary difficulties. This would also assist the importing country. Finally, agencies contended that it was the responsibility of the borrowing country to ensure that debt obligations remained within sustainable bounds and to implement appropriate adjustment measures in response to external shocks.

Those points have some validity. It is certainly true that agencies face difficult decisions on whether to continue providing cover for countries where policy slippages are becoming evident. However, it is also undeniable that the choices that agencies have made have sometimes been inconsistent with their own risk assessment; have resulted in delays in adjustment, with considerable costs for the borrowing countries; and have lead to substantial claims and cash-flow losses for the agencies themselves.

b. Mixed credits

Export subsidies in the form of "mixed" or "tied-aid" credits remain a powerful and often-used instrument of competition in loans to certain countries considered good risks. These credits generally involve projects funded in part by export credits and in part by aid resources which are used either as a grant or applied toward reducing interest rates on the export credit. As with export credits on commercial terms, the export credit elements of mixed credits can take the form of direct lending or insurance or guarantee of a loan made by a private creditor. (For further details see Annex II.)

According to agencies, the motives behind mixed credits vary. Sometimes they are used as a means of stretching aid resources and encouraging worthwhile development projects. On other occasions, however, an initial request for cover on commercial terms is supplemented by aid resources to enable the agency and the exporter to compete with terms offered by another agency. As agencies routinely consider matching the terms of export credits for the same export contract, mixed credits are a significant instrument of competition. This has raised concerns about the diversion of increasingly scarce aid resources from the poorest countries without access to financing on commercial terms to countries that already have access to export credit financing, and often also to financing from private markets.

To limit the subsidization of exports through export finance, the agencies in OECD countries have agreed to be bound by the provisions of the OECD Consensus on officially supported export credits. The Consensus establishes guidelines concerning financial terms and sets minimum concessionality requirements for mixed credits. The required levels of concessionality are 50 percent for the poorest (Category III) and 35 percent for intermediate (Category II) countries; mixed credits are not allowed for relatively rich (Category I) countries. 1/

A significant step towards further reducing the use of aid in export credit finance was the 1992 modification of the OECD Consensus ("Helsinki

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1/ The OECD Consensus is described in more detail in Annex III.

accord"). 1/ The major element of this modification was to prohibit the use of mixed credits for projects that are commercially viable (except for the Least Developed Countries). The rules for implementation are currently the subject of intense discussion in the OECD Export Credit Group. 2/ Most agencies believe that the "Helsinki accord" has succeeded in eliminating the worst abuses of mixed credits. However, almost all noted instances where the spirit, if not the letter, of the accord had been breached. There was also a widespread view that for some major debtor countries, the pressures of competition would continue to make mixed credits an important factor in obtaining export contracts. Indeed, according to several agencies, a number of their largest borrowers had indicated that exporters that did not offer mixed credits could not expect to receive export contracts; mixed credits thus remained a virtual necessity for doing business in several countries, mostly in Asia.

In this context, many agencies and their government authorities deplored the insistence of a few of the larger recipient countries on contract interest rates below a specified threshold, and noted that this use of "cosmetic interest rates" had been made virtually unavoidable in some countries by making all imports financed with loans carrying higher interest rates subject to substantially higher import tariffs. Such rates were seen as leading to distortions by making export credit transactions less transparent both within the recipient country and vis-à-vis other creditors. 3/

As strains on aid budgets have been increasing, agencies and their government authorities have taken various approaches to limit or at least make more transparent the use of aid for export subsidies. A number of donor governments eschew the use of mixed credits altogether. Others have made more explicit the use of aid for export credits, or have strictly limited and separated budgetary accounts for export promotion in this form. Some creditors channel tied-aid credits through separate institutions rather than providing subsidies on export credits. The extent to which more limited use of aid as an instrument of export competition could free resources for direct development assistance to the poorest countries is therefore not easy to assess, but there appears to be considerable scope for re-allocation.

1/ Agreement on this modification had been reached at the 1991 Helsinki Ministerial Meeting of the OECD.

2/ The discussions center around the conformity with the guidelines of individual projects. The standards and definitions on, inter alia, "commercial viability" and "projects" are currently being worked out on the basis of "case law" and precedent, and while the body of experience is growing, specific guidelines are not yet firmly established.

3/ Exporters typically agree to the lower interest rate but compensate by raising the invoiced price of exported goods, so that the importing country is unlikely to gain much.

Further restrictions on tied-aid credits would also help eliminate trade distortions and free exporters to compete on the basis of the price and quality of their product rather than on the basis of the associated financing. Many agencies see the creation of such a "level playing field" as a precondition for considering changes to the Consensus rules on overall maturities. A more commercially based approach to export credit finance combined with a lengthening of maturities would be highly desirable in the financing of large-scale projects to ensure that repayment periods are more in line with the cash-flow profile of the project. The increased demand for large projects, particularly in infrastructure, by many developing countries lends urgency to modifications of the Consensus in this direction, as was noted in the communique of the Development Committee in the fall of 1993.

4. Cover policy in countries perceived as high risk

It is in countries perceived as high-risk markets that the increased emphasis on risk assessment discussed above has had the most impact. In general, the use of risk assessment techniques has served agencies well in those countries. It has enabled agencies to distinguish, for example, between the situations of countries like Mexico and Morocco, which have required recourse to Paris Club reschedulings in the past but are now emerging from their debt-servicing difficulties, and those of other countries where the commitment to strong adjustment policies and sound debt management is not as strong, and problems of creditworthiness remain.

There are cases, however, where it may be that agencies' policies are too conservative. In particular, the emphasis which agencies place on payments performance has led them to regard countries that have recently rescheduled their debts as of potentially higher risk than others. Agencies have extended substantial credits to rescheduling countries that have established a solid track record of performance under their Paris Club rescheduling agreements, but they remain very cautious in extending cover to rescheduling countries with mixed records of performance. This strong emphasis on payments records means that most agencies are slow to re-open cover for countries that have had poor records in the past, but that have recently strengthened their policies in the context of Fund-supported adjustment programs. Some government authorities commented that they considered this tendency of agencies to remain off cover perverse, as a country's prospects were improved with a Fund-supported program in place and a regularization of relations with creditors. There appear to be particular issues in two groups of countries.

a. Low-income rescheduling countries 1/ 2/

Low-income countries are among the most important markets for export credit agencies. The level of income is therefore not seen as an indicator of creditworthiness for export credits. However, agencies regard low-income countries with great caution, both in terms of their payments performance and prospects to service nonconcessional debt. Debt reschedulings (which also cover concessional loans from bilateral sources) are seen as an unambiguous sign of an inability to service export credits. Agencies, nearly without exception, reported that for the low-income rescheduling countries (largely in sub-Saharan Africa) they were only prepared to give cover for short-term lending and for offshore operations. Most agencies believed that long-term financing for these countries should come exclusively in the form of aid and concessional loans.

At the same time, however, a few agencies and some government authorities recognized that this very cautious approach could lead them to miss opportunities to promote exports where export credits on commercial terms were an appropriate form of financing for low-income rescheduling countries. In particular, these agencies agreed that export credits on commercial terms should generally be used to support private or privatized enterprises. Use of aid or tied-aid credits in such cases would perpetuate the idea that projects need not have commercial rates of return in low-income countries, whereas in fact more--rather than less--reliance on market criteria was needed. Some agencies also noted that export credit agencies remain for many of the low-income countries the only source of short-term trade financing at reasonable cost, and that establishing a solid record of payments performance on these credits was a first step toward regaining creditworthiness. Thus while there remains a consensus that for low-income rescheduling countries large-scale support in the form of nonconcessional export credits is neither appropriate nor feasible, equally there are cases where export credits on commercial terms are justified, and could be beneficial.

b. Responses to debt and debt-service reduction

Agencies' attitudes towards countries that had reached agreements involving debt and debt-service reduction in the Paris Club were mixed. 3/ Some agencies thought that debt reduction generally improved a country's prospects of servicing its remaining debt, and that cover policy should reflect this. At the same time, most of these agencies also commented that the debt reduction granted so far for most of the low-income rescheduling

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1/ Agencies' policies toward rescheduling countries more generally are discussed in Annex IV.

2/ For countries covered, see companion background paper on official financing, Annex II.

3/ For details of such agreements, see companion background paper on official financing for developing countries, Chapter II.

countries had not been sufficient to permit a return to creditworthiness. Other agencies thought that once countries had obtained debt and debt-service reduction from bilateral creditors they would tend to look for it again, and that a very cautious attitude to new cover for these countries was called for. Two major agencies emphasized that it would be extremely difficult for them to provide or insure new money for a country that had reached an agreement with official bilateral creditors incorporating elements of debt and debt-service reduction.

5. Export Credits to the private sector

a. Issues

Although public sector borrowers continue to be the main recipients of export credits in developing countries, agencies have been placing increasing emphasis in recent years on providing cover for exports to the private sector. This trend has intensified as an increasing number of countries have adopted development strategies that call for a much larger role for the private sector in investment and production, including an expanded role in areas that were previously considered the sole responsibility of the public sector, such as telecommunications and power generation. The reluctance of many debtor country governments to provide guarantees has further accelerated this move towards greater direct involvement with private sector buyers.

To some extent this represents a reversal of traditional practice. In the mid-1980s, agencies tended to react to debt-servicing difficulties on the part of a country by using public sector guarantees more frequently, reflecting their experience of a better record of servicing of the debt owed or guaranteed by the public sector than that owed by the private sector. This in part reflected the priority accorded to the public sector in foreign exchange allocations in some countries, and in part the fact that the poor economic situation in some borrowing countries had worsened the commercial risks for the private sector borrowers. 1/ Many agencies still charge higher premia for private sector borrowers than they do for public sector borrowers.

In countries where experience with public sector debt servicing has been poor, a number of agencies are now pursuing an approach that clearly favors credits to the private sector and agencies have adopted a more open stance on cover towards loans to private sector enterprises, or guaranteed by private commercial banks, than to loans to or guaranteed by public sector

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1/ Assessments of commercial risk generally focus on the creditworthiness of the buyer, or of a guaranteeing commercial bank. However, commercial risk can also be affected by economic developments in the country concerned. For example, a substantial devaluation of the currency that greatly increased the domestic currency cost of external debt service might reduce the creditworthiness of a borrower.

institutions. 1/ In Brazil, in particular, several agencies reported that they were on cover for private sector borrowers but not to the public sector, or gave more favorable terms to private sector borrowers, because they have established a better payments record. One agency also reported that it preferred guarantees from commercial banks to sovereign guarantees in lending to public sector borrowers. 2/

Many of the agencies surveyed stressed that policy actions in two areas could greatly facilitate the provision of cover to private buyers in their countries. The first was a well-functioning local banking system. Although a few agencies that already did substantial business with private buyers had credit records and could conduct credit assessments on a large number of private firms in developing countries, other agencies considered that they did not have the capacity to conduct independent assessments of the creditworthiness of any but the largest private buyers. In such circumstances, the provision of cover to private buyers could be greatly facilitated by a relationship with a local bank in which the agency had confidence, since this could substantially reduce the costs of credit assessment and documentation. Several agencies already make substantial efforts to find reliable commercial banks in developing countries.

The second area cited by most export credit agencies as important in enabling them to provide cover to private sector buyers in developing countries was the existence of a legal system which was stable, consistent, and fair to foreign investors and creditors. Most agencies stressed that they would still require either commercial bank or public sector guarantees for all transactions, but the legal system nevertheless remains an important focus of concern.

b. Prospects

Agencies generally considered credits for the private sector as an area where growth in their activities could be expected. Two aspects of cover for the private sector which were seen as particularly promising were buyers' credits and project finance. In the case of buyers' credits, a bank in a developing country acts as an intermediary, responsible for assessing the creditworthiness of buyers and the viability of projects and assuming the commercial risks involved in the lending operations. Agencies cover the risk associated with the possible failure of the borrowing bank and the transfer and other political risks. Agencies saw such credit lines as particularly effective instruments to improve the quality of investments, because the demand for finance would originate with buyers rather than

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1/ For some agencies this is not a new practice. Among the countries for which some agencies have had better terms on credits to the private sector are Argentina, Côte d'Ivoire, and Kenya (see Tables 2 and 3).

2/ The same agency also commented that it differentiated its cover policy for specific Brazilian public buyers according to the payments record of the buyers.

exporters keen to expand their business, while, at the same time, exports from small businesses that would otherwise not have ventured into this market might be encouraged.

Project finance, defined in this context as the provision of credit with only limited recourse by the lender to the owner of the project or the host government, has taken on an increased importance as developing countries have privatized large utilities with heavy demands for finance, and as demand for infrastructure investment has picked up in a number of large developing countries. The advantage for the developing country is that the risks associated with such finance can be limited; the advantage for the lender is that security can be obtained for the loan, either in the form of an ownership stake in the project or through the placing of some of the borrower's assets in escrow accounts, usually held offshore. However, the absence of a formal government guarantee on the loan does not mean that it frees the government from all responsibility or the loan from political risk. Governments are generally required to give letters of comfort promising not to interfere with the operations of the enterprise or the service of its debts. Moreover, experience has shown that project financing can involve complex transactions that strain the capacity of agencies. For this reason, as much as any other, the volume of project financing undertaken by agencies has so far remained limited.

6. Economies in transition

a. Overall views

Export credit agencies see the fundamental restructuring of the economies of most of the countries of the former Soviet Union and of eastern and central Europe as presenting them with tremendous opportunities but also tremendous challenges. The economies in transition have been undergoing a period of rapidly changing economic and legal environments, sharp declines in output and major strains on the budget and balance of payments. At the same time, many of these countries have educated work forces, some have excellent resource endowments and all have huge pent up demand for consumer and capital goods. Central and eastern European transition economies are also geographically natural markets for exporters in the western Europe. Finally, there has been considerable political support for assistance, largely through export credits, to countries undergoing a difficult transition to democracy and a free market economy. While these factors together have resulted in considerable interest in transition economies on the part of agencies, the rapidity and extent of the changes in these countries have also given them and their government authorities an acute sense of the risks involved in such finance.

Agencies emphasized the particular difficulties they face in assessing the creditworthiness of borrowers in transition economies. Both public institutions and private companies in borrowing countries are often new and unfamiliar. In cases where the country itself is new, and especially in the case of the FSU countries other than Russia, there may be little external debt and therefore no payments record. The scope of sovereign guarantees has been the subject of intense negotiations with some countries, and may or may not prove to be reliable; and in some cases it is not clear which government agencies have the right to commit government resources for the contingency of nonpayment by the borrower. The regulatory environment is evolving rapidly and accounting standards vary widely from country to country. The distinction between public and private enterprises and banks in these economies is also often uncertain. In this situation, traditional criteria for assessing political risk or the commercial viability of enterprises or projects--such as debt-service indicators, past payments records and borrower or project evaluation--are often not readily applicable.

Agencies have responded to these problems in a variety of ways. They have tried to supplement the limited information that is available by using other sources, including Fund staff reports. Agencies look particularly for evidence of the authorities' commitment to a stable macroeconomic framework. Other policy issues of importance to agencies are the extent to which the authorities are encouraging the emergence of a private sector through privatization; the development of an efficient and reliable banking system; and a clear legal framework, especially with respect to creditors' recourse in the event of default. Finally, agencies scrutinize with more than usual care whatever evidence of a payments record there is. Diligence in meeting debt-service payments, even those that are small, is regarded as an indication of a responsible attitude towards debt generally. On the other hand, if the authorities appear inattentive to the need to service debts on time when debt-service payments are limited, then export credit agencies are reluctant to make commitments that will lead to more substantial obligations in the future.

Agencies have generally taken a very gradual and cautious approach to cover. They have tended to begin with short-term cover at relatively low levels, and follow this with more substantial medium- and long-term cover upon establishment of a good payments record. Similarly, in extending credits to emerging private sectors in economies in transition, agencies have looked for a few reliable commercial banks as guarantors in the borrowing country, leaving open the option of extending credits on a broader basis once business relationships have been established. It was in this context that the establishment of a sound banking system was seen as absolutely essential for further easing the existing restrictions on cover.

b. Securitization techniques--escrow accounts

In some countries export credit agencies seek more direct securities than guarantees by governments or creditworthy commercial banks. Securitization and collateralization is not new: commercial lenders often seek security in the form of an irrevocable lien established over assets or export earnings of private buyers, and export credit agencies have also made use of, or participated in, such arrangements in transactions involving private sector importers. However, in markets considered high risk, where creditors' risk assessments indicate that no cover should be extended, and where sovereign guarantees are seen as of little value, security arrangements have been sought on a broader basis. These arrangements typically involve escrow accounts in offshore banks through which export proceeds of the debtor are channelled and which give the creditor priority for debt service. To ensure timely debt servicing, even in the face of possible variations in cash-flow, the debtor is typically required to keep a minimum balance in these accounts.

A substantial group of agencies saw no possibility of their providing more cover for most FSU states, including Russia, without establishing security arrangements, including offshore escrow accounts. In the case of Russia, agencies have been influenced in this stance by the substantial payments difficulties on outstanding debt. This group of agencies preferred escrow accounts--in conjunction with project financing, including in transactions involving the public sector--to sovereign guarantees, which they considered of lesser value. Most escrow accounts that have been set up so far relate to credits to private sector entities. However, following the World Bank's recent waiver of the negative pledge clause (see Box 5) for Russia, the U.S. Eximbank, EID/MITI (Japan), and SACE (Italy) have all reached agreements with Russia involving escrow accounts for financing of public investments in the oil and gas sectors. 1/

However, the possibility of escrow-secured lending has not yet led to major additional inflows to transition economies. One reason is that while escrow accounts can serve to reduce substantially transfer risk, creditors remain largely exposed to commercial risk. Further possible reasons include the bias introduced by escrow accounts towards projects that can earn convertible export proceeds, which reduces the set of potential borrowing

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1/ The U.S. Eximbank and Russia have signed a framework agreement under which loans or guarantees would be provided to Russia's 24 oil production associations and to Gazprom, the state-owned gas producer, for the rehabilitation of oil and gas production operations. Escrow accounts will be established to collateralize the loans, containing funds equivalent to 150 percent of annual debt-service payments. U.S. Eximbank estimates that total lending under the agreement might be US$2 billion, though this is not a limit.

EID/MITI has committed a US$2.9 billion line of credit to Russia for loans secured by escrow accounts. As with U.S. Eximbank, the focus is on oil and gas, and Gazprom has so far been the major recipient of loans (commitments of US$700 million up to November 1993). Both U.S. Eximbank and EID/MITI agreements include a letter of undertaking from the Russian government to the effect that export licenses will be issued, so that the export credit agencies can deal directly with producer organizations.

SACE has reached an agreement whereby Italian exports with a contract value of US$1.9 billion will be supplied to Gazprom. Repayment will be made through an escrow account, with the additional security that the extra supplies of gas engendered by the new equipment will be exported to Italy.

Box 5. Special Security Arrangements and the World Bank's Negative Pledge Clause

The basic purpose of the World Bank's negative pledge clause is to protect the Bank against the use of governmental resources, or the use of governmental authority to mobilize other resources, to enable other foreign creditors to obtain foreign exchange in preference to the Bank through the creation of liens or priorities on public assets. The Bank's negative pledge clause provides that if any such liens or priority interests are created, they shall equally and ratably secure the Bank, unless the Bank agrees otherwise.

Escrow accounts established by borrowing enterprises to ensure availability of foreign exchange to service specific debt or other contractual obligations are seen by foreign investors as one important element of protection against noncommercial risks. Commercial risks faced by lenders are, or course, unaffected by such accounts.

In March and November 1993, the World Bank adopted changes in its general negative pledge clause policy to provide for country specific waivers under certain conditions. Country eligibility is assessed on the following basis:

- At least 75 percent of income producing assets are in the public sector.
- Macroeconomic policies are satisfactory. In cases where no Fund-supported program is in place, the Bank staff would make an independent assessment of the macroeconomic framework.
- A program of structural change is being implemented involving two key elements: (i) diversification from the public to the private sector including an appropriate privatization program; and (ii) a shift from an administered system to a market economy.

Eligible countries are granted a waiver for an initial period of 2 years. Subject to review by the Bank's Executive Board by the end of the second year, the waiver can be extended for a further period of 2 years. All eligible transactions signed during the waiver period are covered for the full maturity of the liens established. The Bank requires that project financing be supported by a feasibility study prepared by competent independent experts which demonstrates that the project would generate foreign exchange in excess of the amount necessary to service the debt incurred. Finally, the Bank reserves the right to withdraw the waiver for projects not yet approved if an event of default occurs under a Bank loan or guarantee with the country.

The waiver is granted with respect to any lien to secure repayments of external debt under a loan made to finance a specific investment project, provided that the initial maturity of the loan is not less than 5 years, and that the lien does not permit the accumulation of more than 12 months' projected debt service obligations in any related escrow accounts. The lenders may also require reserve accounts to be established to sequester appropriate amounts of project revenues as provision for future operating expenditures, and other project contingencies, limited to the equivalent of an additional 6 months' projected debt service obligations.

Other conditions are that:

- the lender does not have alternative recourse for repayments of the loan such as guarantees of public authorities in the borrowing country or insurance or any form of third party indemnity with the exception of that provided by a private source or by an official agency which requires the establishment of the lien as a condition of its support;

- the lender is private in character. Liens created in favor of official bilateral aid and export credit agencies and multilateral development institutions are therefore excluded from the scope of the waiver, except that (i) the waiver can extend to loans made by multilateral development finance institutions which are unable to obtain a government guarantee due to legal restrictions; (ii) an official agency which has guaranteed a loan by private lenders can benefit under a lien in favor of the latter by subrogation of rights (e.g. after payment to the lender under a guarantee issued by an ECA); and (iii) an official agency's direct lending comprises less than 50 percent of the loan;

- the Bank is not a cofinancier of the investment project concerned. Where the Bank is cofinancing an investment project it is generally its practice to share, equally and ratably, in an escrow or other security arrangements.

[1] Assets of a joint venture between a government or public entity on the one hand and a foreign private enterprise on the other will not fall under the scope of the Bank's negative pledge clause unless the joint venture is controlled by, or operates mainly for the account, or benefit of, the government or public entity.

sectors. Putting escrow accounts in place has also proved to be a complicated and time-consuming process, involving technical work with which agencies have had limited experience in the past. As a result, a number of agencies have not pursued escrow accounts and some of the agencies that have used them have commented that they would prefer a sovereign guarantee to an escrow account, if they had more confidence that the guarantee would be honored. Finally, there are some countries for which export credit agencies would not provide any cover, with or without escrow accounts.

Agencies also reported that governments in transition economies tended to be cautious in approving requests to establish escrow accounts for public sector projects. They agreed that there are some features of escrow-secured lending operations which could make them unattractive to borrowing country governments. Escrow accounts reduce the authorities' flexibility in mobilizing and managing foreign exchange; monitoring of external debt operations is also complicated by offshore escrow accounts. Escrow accounts reduce the supply of foreign exchange and lead to a segmentation of foreign exchange reserves. They may also divert foreign credits to companies that can offer the best security package, rather than to companies that can put credit to the most economically efficient use. Finally, there is a danger of proliferation: governments that agree to frequent use of escrow accounts may see creditors insist on them in cases where they would not otherwise have done so, which would effectively reduce a country's ability to obtain credit. In this context, agencies noted that they had difficulties in justifying non-secured lending in cases where governments had agreed to provide other creditors with security packages.

c. Limitations of export credit <u>financing for transition economies</u>

The concerns of borrowing countries about escrow accounts may also in some cases reflect ambivalence about export credits generally. At their best, export credits can be an essential instrument in financing the restructuring of the economy, relieving pressure on reserves, and as a stepping stone towards access to longer-term, more flexible forms, and more diversified sources of foreign financing. But some of the limitations of export credits discussed above (see Chapter III.2.) are particularly relevant to transition economies. Even when escrow accounts are not involved, credits may be allocated to sectors where foreign exporters are pursuing contracts most aggressively rather than to those where in the view of the borrowing country government the need is greatest. At worst, extensive recourse to export credits without careful consideration of the economic benefits to be gained from them can result in unproductive projects and future debt-servicing problems. The risks of this may be particularly acute in transition economies because the rapid economic change in these countries makes sound financial evaluation more difficult.

IV. Cover Policies

1. The links between risk assessment and cover policy 1/

Agencies observed that their most important decision resulting from the risk assessment process was whether to provide export credit cover to a country or not. Every agency was off cover altogether for some countries where the stance of policies, the track record, and the external environment appeared to offer little prospect that the country would be in a position to service new loans on commercial terms. However, almost every agency covered in this study was on cover for political reasons for some countries for which cover would not be available if the outcome of the risk assessment process had been the only determinant of cover policy.

Most agencies attempt to provide cover, even if very limited, for as large a number of countries as possible, and the trend towards more differentiated and nuanced cover policies has become more pronounced in recent years. If cover is made available, risk assessment is used by agencies to determine the type of cover (short-term or medium- and long-term) and the pricing of cover. Recent years have also seen an evolution in the thinking of agencies on the effectiveness of their cover policy instruments. In the late 1980s, differentiation of premia charged had been seen as a way to make cover available to most borrowing countries, provided that the price accurately reflected the risk entailed. More recently, however, almost all agencies have come to the view that demand for export credits in high-risk markets is insufficiently price-sensitive and the risks resulting from asymmetric information about creditworthiness too large for premia to be the main means of allocating cover. While the trend towards differentiated premia for borrowers has continued, not least because of the continued weak financial performance of most agencies, the use of other cover policy instruments is generally also regarded as necessary in managing risk portfolios. These include quantitative ceilings on the total annual level of commitments to countries and/or on the size of individual transactions that can be covered, and security requirements, such as the guarantee of banks in the form of irrevocable letters of credits. 2/ Instruments of cover policy are discussed in more detail in Box 6. An example of how one major agency (HERMES of Germany) sets its premia is given in Box 7.

1/ Cover policy refers to the terms and conditions under which export credit agencies are prepared to offer insurance or guarantees for export credits, or, in some cases, to provide the financing themselves.

2/ This approach is consistent with the theory of asymmetric information. Agencies face the problems of adverse selection and moral hazard in assuming the risk of nonpayment by borrowers about whose creditworthiness they have limited information. To screen borrowers and thus mitigate the information problem, they employ quantitative rationing instruments in combination with variable premia.

Box 6. Instruments of Cover Policy

Premium rates

Realistic pricing of risks is seen by all agencies as an important objective, and all agencies have now established premium structures for export credits that provide a direct link between the rate of premium and the perceived degree of country risk. Most agencies have been devoting considerable resources to analyses of both the degree of differentiation and the overall level of premia. Premia have an obvious direct impact on the financial positions of agencies. Many agencies had raised their premia, in some cases for the first time in 30 years, in the wake of the first series of reschedulings and cashflow losses in the early 1980s, but then made no further general adjustments to their rates. However, as cashflow losses persisted during the late 1980s, many agencies raised premia again. The unexpected severity of more recent losses has led most agencies to adjust overall premium rates still further, while increasing the degree of differentiation. Premia vary with the maturity of the export credit, the type of borrower and the borrowing country (Box 7).

Agencies also saw differentiated premium rates as a way to help dampen demand in riskier markets, thus rationing cover in an economically efficient manner, and to encourage a shift in the direction of trade toward stronger markets. However, agencies observed that premium differentiation had clear practical limits. Some believed that even the highest levels of premia that they charge fail to compensate them adequately for some risks that they take. [1] Moreover, almost all agencies were skeptical about the adequacy of premia as an instrument for limiting demand and thus for managing their risk portfolios. They thought that demand for cover was highly inelastic with respect to premium levels in the more risky countries. Almost all found it therefore necessary to supplement high premia with other instruments, particularly quantitative ceilings, for countries seen as high risks.

Discussions on premium policy among agencies have intensified in recent years. One reason for this increased focus on premia is their significance as an instrument of competition among agencies, and between agencies and private sector insurers. Though some agencies believe that different premium levels have little impact on the competitiveness of export transactions except in markets with the lowest risk, the levels and structure of premia on medium- and long-term export credits have recently become the subject of intense debate both in the context of moves towards harmonization in the European Union, and in the OECD export credit group. [2]

The increased attention being given to premia may also reflect the diminished relative importance of interest rate subsidies as an instrument of competition among agencies, as the result of the decline in international interest rates from the higher levels of the 1980s and the strengthening of the provisions of the OECD Consensus on the use of interest subsidies. The issue of premium rates has thus become more closely connected with the questions on export subsidization (see also Annex III).

Quantitative limits and other instruments

Limits on total exposure continue to be a feature of most agencies' cover policies towards at least some developing countries. Such ceilings are also seen as an important means of ensuring portfolio diversification. Most agencies reported that they used these ceilings flexibly, and when exposure reached the ceiling, a thorough review would be conducted. Typically, the ceiling would be raised but this would normally be accompanied by other measures, such as increases in premium rates or other restrictions.

Other instruments, such as reducing the percentage of cover or extending the period the exporter must wait before filing a claim, continue to be used, but less so than in the past. A number of agencies reported that limiting the percentage of cover was a very effective device for curbing demand in cases where they had reached the upper limit of what they considered reasonable premia. Others thought that it was precisely in high-risk cases where demand was inelastic that exporters would increase contract prices to offset their participation in the risk, and this would have a perverse effect of increasing the total amount of the export credit. It is for this reason that one agency covers typically 100 percent of the export credit, and most others have increased the share covered to between 90 and 95 percent. However, most agencies consider it an important principle that the exporter or financier should continue to bear a part of the risk against the failure of an export transaction or project as a safeguard against badly designed or unviable transactions.

Similarly, most agencies do not use the claims-waiting period as an active instrument of cover policy but rather in cases where payments tend to be late, but can be counted on to arrive eventually. A longer waiting period in these cases prevents a proliferation of claims payments that are quickly followed by recovery. Other agencies commented that in their experience extensions only served to lengthen delays still further as debtor countries became aware of changes in agencies' policies, and that the lengthening of claims waiting periods could well lead agencies to remain on cover longer than warranted by underlying conditions, as shown by their recent experience with Iran.

[1] Several agencies commented that there was a maximum rate of premium that could reasonably be charged, and that premia above this level would only be paid by countries which intended to default. Some agencies also noted that in some cases where they were on cover for national interest reasons, premia were kept at levels below those that would have been implied by their risk assessment systems because the latter would be prohibitive.

[2] Discussions have centered on the level of premia that would allow agencies to "break even" and thus prevent indirect export subsidies. The criterion of "break-even points" is, of course, crucially dependent not just on premium levels but also on the time-frame over which agencies would be expected to break even. In this context, most agencies argue that premium levels cannot (and should not) be set at rates that would cover cash-flow losses on old business but rather at levels that compensate for expected losses on more recent business activity only.

Box 7. Determination of Premium Levels

All agencies visited employ highly structured premium systems. However, the average level and steepness of the premium curve varies substantially across agencies, as do the degree of differentiation among recipient countries and the methods of calculating premia. These differences reflect the variety of views on the relative importance of various forms of risks and on the appropriate method of pricing each of them, as well as the fact that premium levels are used in conjunction with varying constellations of other cover policy instruments, and that the terms of the cover agreements vary widely. Having said this, useful details emerge from the example of how one agency sets premium levels, given below.

The premium system [1] used by Hermes, the German export credit insurance agency, utilizes five country risk categories, namely:

Category 1: OECD countries;
Category 2: Countries with long favorable payment record and no expected payment difficulties;
Category 3: Developing countries with the typical level of developing country risk;
Category 4: Rescheduling countries and those with imminent payment problems;
Category 5: Countries with very high risk for which medium- and long-term cover would entail unacceptable risk, and countries where HERMES is off cover.

A country where HERMES has a very high concentration of risk may be assigned to the next higher country category. Premium charges are due at the time the risk begins, with very limited exceptions. The new system differentiates between public and private buyers both for supplier's and buyer's credits. In the case of public buyers the basic premium is determined only by the country risk. For category 3 countries--the category taken as the basis for determining premia--1 percent of the covered amount is charged. Premium levels for other categories are adjusted by a factor reflecting the difference in country risk relative to category 3. Thus for category 1 the basic premium is 0.33 percent, for category 2: 0.67 percent, for categories 4 and 5: 1.5 percent and 2 percent, respectively. In addition, a further, time dependent premium component is also charged. The annual level of this component is 0.72 percent of the outstanding covered amount for category 3, and this level is adjusted by the factors described above for each other category.

In the case of private buyers an additional flat premium component is added, amounting to 35 basis points for the basic premium portion and an additional 25 basis points per annum. This surcharge is reduced if a commercial bank guarantee is available, or an international financial institution is involved, and in the case of co-financing with bilateral aid.

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1 Described in AGA Report #49, April 1994, a newsletter issued by HERMES.

2 From a bank acceptable to HERMES as the sole debtor for the amount involved.

2. The general stance of agencies' cover policies

Tables 2 and 3 summarize the stance of cover policies at end-1993 for 21 developing countries, distinguishing between short-term cover and medium- and long-term cover. 1/ The tables show clearly that most agencies impose some restrictions on their cover, with a requirement that security devices be associated with cover being the most frequently used restriction on short-term cover, and with ceilings on the size of transactions or the total volume of new cover being the most frequently used restriction on medium-and long-term cover. 2/

Chart 7 presents the evolution of agencies' cover policy stance in their main markets over the period 1989 to 1993 in the form of country-specific indices. The indices reflect the ease and cost of obtaining cover, with a decline in the indices representing a tightening of cover policy. It is notable that for most of the countries shown, agencies have tightened their cover policy over the period studied. This is consistent with the increased focus on risk assessment. However, as noted above, it has not prevented an increase in the volume of export credits over the same period. Rather, the trend can be seen as evidence of the strength of demand for export credits: as agencies have tightened cover policy and raised the price of cover, exporters and borrowing countries have been able and willing to meet the new conditions and pay higher premia.

3. Cover policy for major export credit markets

The recent experience with the five markets where export credit exposure was highest at end-1993 (Russia and the ex-USSR taken together, China, Brazil, Mexico, and Indonesia) illustrates how agencies' policies have shaped export credit developments in recent years. Chart 8 compares the developments in total exposure (including arrears and unrecovered claims) in these top five markets. Agencies' experience with Russia is discussed further below, in the section on cover policy for the economies in transition.

a. China

The rise in export credit agencies' exposure to China, as shown in Chart 9, is striking. It has been driven in large part by increases in demand associated with China's high growth rate and increases in the investment ratio. The increase in exposure is entirely a reflection of new commitments. China was by far the most important market for export credit agencies in 1993, receiving more than twice as much in new commitments as

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1/ The stance of cover policies towards economies in transition is discussed in more detail below.

2/ Some of these restrictions are more important than others, so that the number of agencies imposing restrictions does not in itself fully capture the overall tightness of cover policies.

Table 2. Summary of Short-Term Cover Policies of Export Credit Agencies Toward Selected Developing Countries, end-1993

	Number of agencies			Number of Agencies Imposing Each Type of Restriction 1/					
	Open without restrictions	Open with restrictions 2/	Off cover 3/	Security devices 4/	Ceilings 5/	Reduced percent of cover	Case by case	Maturity limit	Extended claims waiting period
Algeria	–	11	1	9	6	3	2	1	5
Argentina	2	10	–	4	3	3	4	1	–
Brazil	2	10	–	5	2	3	2	2	1
Chile	9	3	–	1	2	1	–	–	–
China	4	8	–	5	3	1	1	–	–
Côte d'Ivoire 6/	1	9	2	6	3	4	4	2	–
Egypt	–	12	–	8	3	2	3	1	1
Hong Kong	8	3	1	–	2	1	–	–	–
India	5	7	–	3	2	1	2	–	–
Indonesia	4	8	–	4	3	1	1	–	–
Iran	–	8	4	6	3	1	5	1	3
Iraq	–	–	12	–	–	–	–	–	–
Kenya 6/	–	8	4	3	3	2	1	1	1
Mexico	7	5	–	2	3	3	1	1	–
Morocco	3	9	–	4	4	4	3	1	2
Nigeria	–	5	7	5	3	1	1	–	1
Pakistan	3	9	–	6	3	2	2	1	–
Philippines	4	7	1	3	3	2	3	1	1
South Africa	5	6	1	2	3	1	–	–	–
Turkey	4	7	1	2	3	1	1	1	–

Sources: The Export Credit Agencies of the countries visited; Berne Union; and Fund staff estimates.

1/ One agency can have several types of restrictions.
2/ Including cases where restriction is only on private sector. Agencies whose stance is not yet determined but are open on a case-by-case basis are included here.
3/ Including agencies reporting an undetermined stance.
4/ Including guarantees of payment or transfer, commercial bank guarantees.
5/ Including limits on individual transactions, on total commitments, and on annual new business.
6/ In Côte d'Ivoire one agency offered unrestricted cover for the private sector, but was off cover for the public sector; in Kenya, two agencies adopted this stance.

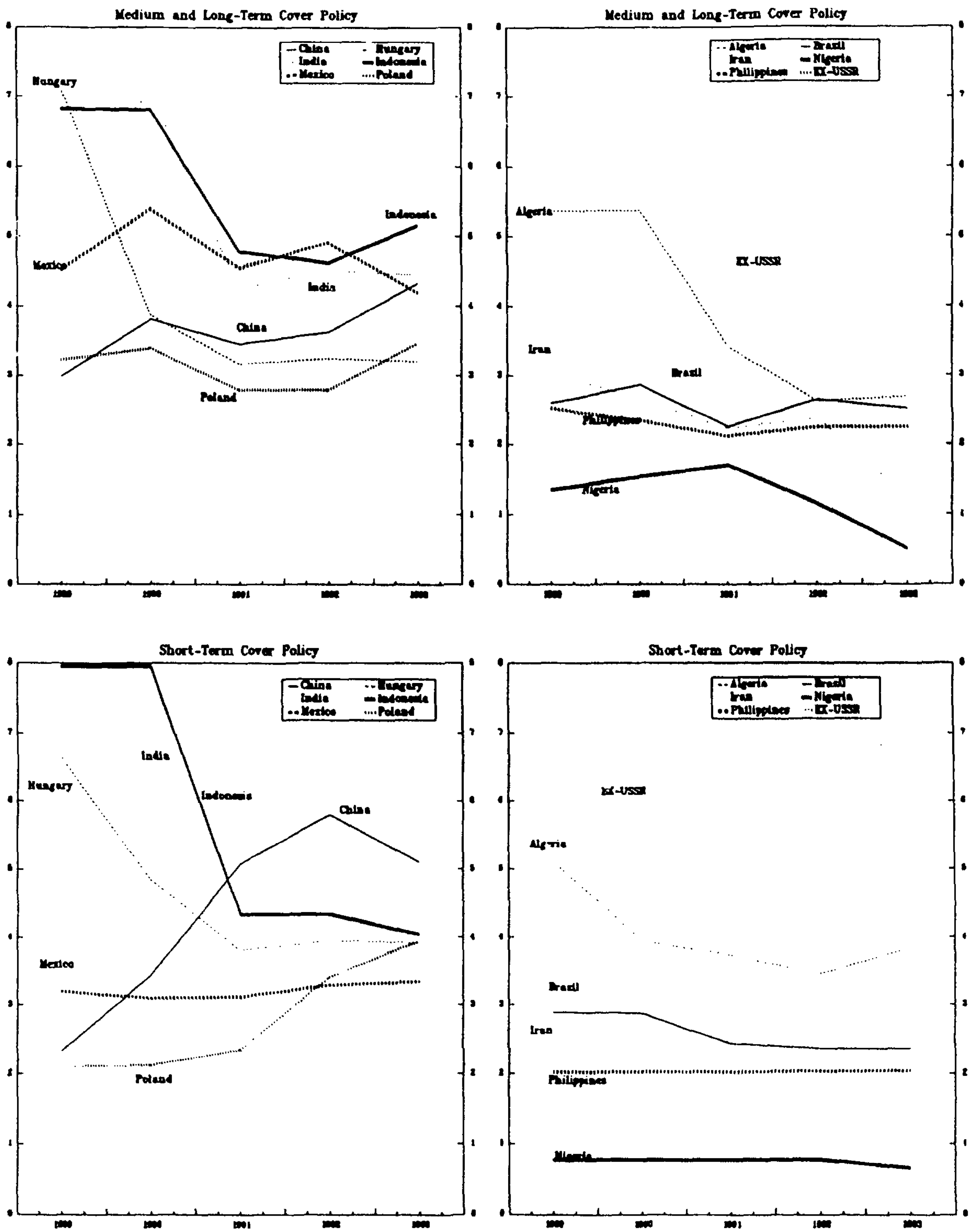
Table 3. Summary of Medium- and Long-Term Cover Policies of Export Credit Agencies Toward Selected Developing Countries, end-1993

	Number of Agencies			Number of Agencies Imposing Each Type of Restriction 1/					
	Open without restrictions	Open with restrictions 2/	Off cover 3/	Security devices 4/	Ceilings 5/	Reduced percent of cover	Case by case	Maturity limit	Extended claims waiting period
Algeria	--	5	7	--	5	1	1	--	1
Argentina 6/	1	11	--	3	9	2	3	--	--
Brazil	--	8	4	3	5	1	5	--	1
Chile	8	4	--	1	3	1	1	--	--
China	2	10	--	7	4	1	2	--	--
Côte d'Ivoire	--	3	9	2	2	1	1	--	--
Egypt	--	8	4	2	5	--	5	1	1
Hong Kong	4	7	1	1	2	1	4	--	--
India	1	11	--	3	9	1	4	--	--
Indonesia	4	8	--	4	4	1	3	--	--
Iran	--	4	8	2	2	1	2	--	1
Iraq	--	--	12	--	--	--	--	--	--
Kenya	--	1	11	1	--	--	1	--	--
Mexico	2	10	--	2	6	2	4	--	--
Morocco	2	10	--	2	9	3	3	--	1
Nigeria	--	1	11	1	--	--	1	--	--
Pakistan	--	12	--	2	9	2	5	--	--
Philippines	--	11	1	3	8	1	6	--	--
South Africa	2	9	1	2	8	1	3	--	--
Turkey	1	10	1	4	7	1	3	--	--

Sources: The Export Credit Agencies of the countries visited; Berne Union; and Fund staff estimates.

1/ One agency can have several types of restrictions.
2/ Including cases where restriction is only on business with private sector; or where agency is open for medium- but not for long-term cover; agencies whose stance is not yet determined but are open on a case-by-case basis are included here.
3/ Including agencies off cover for new business and those reporting an undetermined stance.
4/ Including guarantees of payment or transfer, commercial bank guarantees.
5/ Including limits on individual transactions, on total commitments or on annual new business.
6/ Two agencies offered restricted cover for the private sector but were off cover for the public sector.

Chart 7: Cover Policy Indices, 1989-93 1/



Sources: Export credit agencies, Berne Union; and Fund staff estimates.

1/ The index of cover policy is based on reports from twelve major agencies to the Berne Union in the final quarter of each year. If an agency is off cover for a country, a value of zero is assigned for that agency; less restrictive cover stances are given higher values, up to a value of eight for an agency that is open for cover without restrictions. The value assigned for each agency is weighted to reflect the relative importance of that agency for the country concerned.

Export Credit Exposure, 1987-93 1/

(In billions of U.S. dollars)

Arrears and uncovered claims | Medium- and long-term commitments outstanding | Short-term commitments outstanding

Chart 8: Total exposure in top five markets

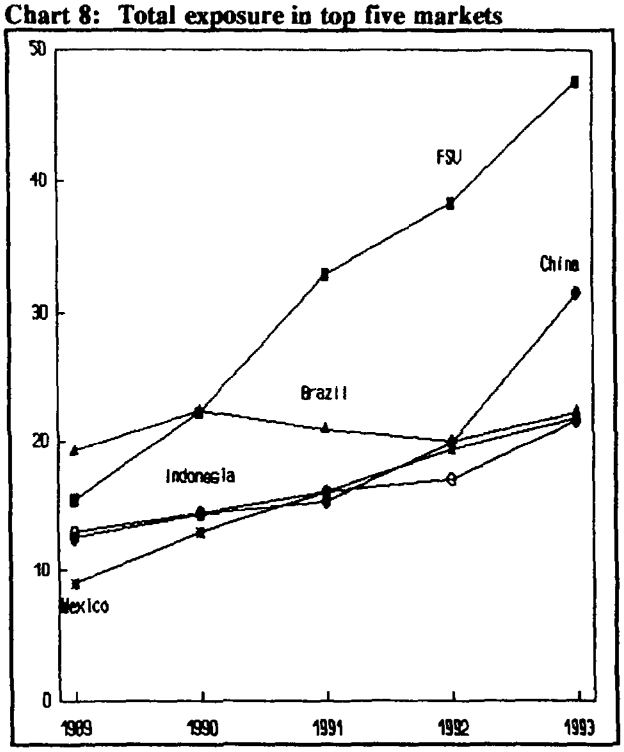


Chart 9: China

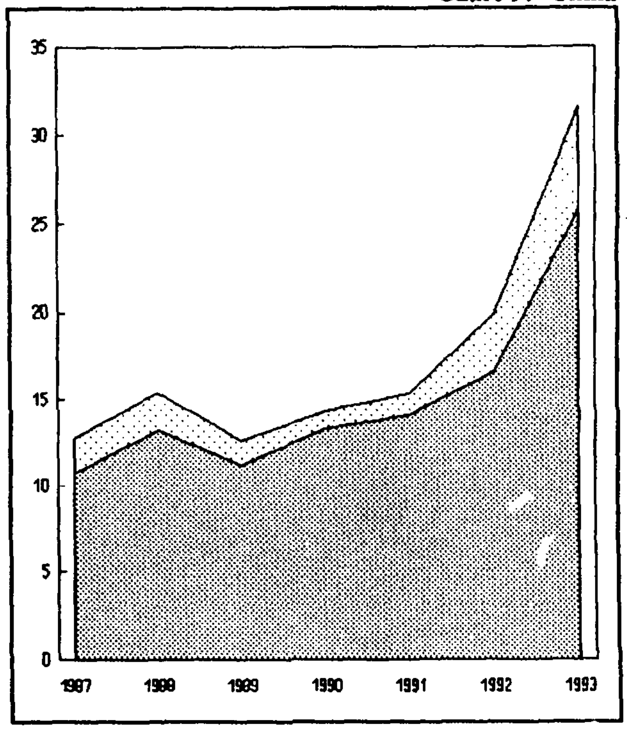


Chart 10: Brazil

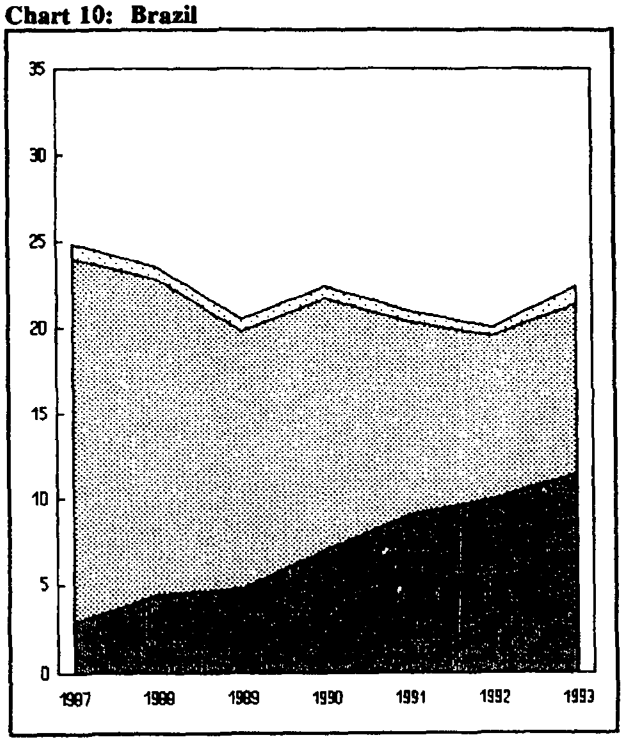
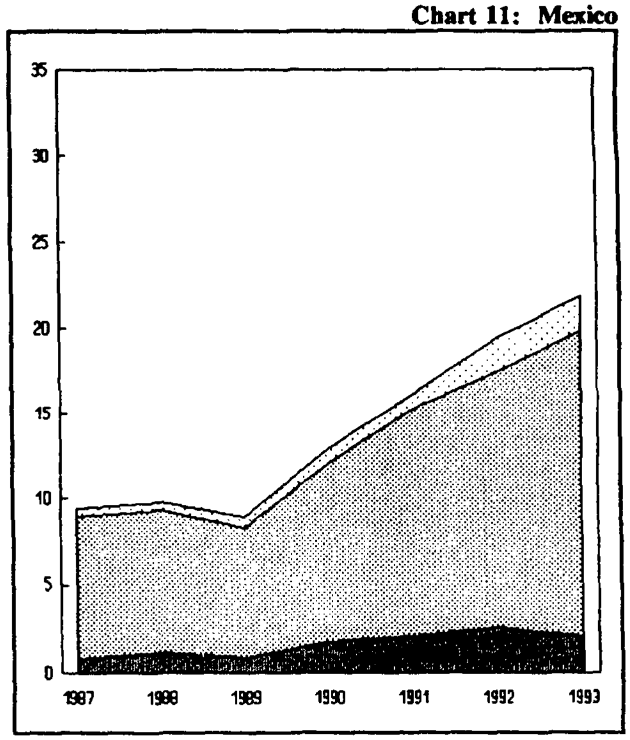


Chart 11: Mexico



Sources: Berne Union; and Fund staff estimates.
1/ For data definitions see Chart 3.

any other single country, and agencies reported that their outstanding offers for further business exceeded commitments made in 1993. Competition remains intense among agencies for business with China, and subsidization of exports in the form of tied-aid credits remains an important factor.

b. Brazil

Experience with Brazil has been very different (Chart 10). While some export credit agencies have continued to make new commitments, these have remained modest. Agencies' total exposure to Brazil has, however, fallen only marginally from the levels of the late 1980s, because of Brazil's continued recourse to Paris Club reschedulings (through August 1993) which is clearly reflected in the rising proportion of agencies' portfolios in the form of arrears and unrecovered claims. Given the close relationship between agencies' cover policies, and hence new commitments, and borrowing countries' payments performance, the relatively low level of new commitments to Brazil can be seen as a direct consequence of Brazil's inconsistent payments record under reschedulings and on post-cutoff date credits over the last several years. Moreover, commitments that were made were increasingly channelled to Brazil's private sector.

c. Mexico

Mexico's experience provides a sharp contrast, and clearly illustrates the success of the country's adjustment efforts and of creditors' debt subordination strategy. Export credit agencies provided early and substantial financing for Mexico's adjustment programs and thus helped accelerate access to capital markets following the debt and debt-service reduction agreement with commercial banks (Chart 11). 1/ New commitments have remained at high levels since then. The result has been a steady increase in the exposure of export credit agencies with a declining share of unrecovered claims, as Mexico graduated from the Paris Club and is now making substantial repayments on rescheduled claims.

d. Iran

Starting in 1989, Iran was seen as a major new market. Exporters competed intensely for new business but were reluctant to extend credit without official support. Most, but not all, agencies quite readily provided export credit cover, first on a short-term basis and then with longer maturities, and this was reflected in a very rapid rise in export credit commitments. This was followed by an abrupt decline in export credit cover in 1993 as doubts arose about Iran's ability to continue debt servicing and arrears began to emerge on a large scale. Despite the sharp reduction in new commitments, agencies' exposure to Iran remained broadly

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1/ The figures understate support by agencies because the Berne Union data do not cover J-EXIM and other lending in the form of untied financing.

unchanged through end-1993, but with a striking increase in the share of arrears and unrecovered claims (Chart 12). 1/

Most agencies agreed that their cover policies had led to a rapid build-up of debt and contributed to the emergence of difficulties, particularly through a rapid increase in the share of export credits on relatively short maturities in the period before payments difficulties became acute. This reflected to some extent demand factors, in particular demand for consumer goods and a strong bias in Iran's external debt management towards short-term credits even for investment goods.

e. Algeria

Algeria, by contrast, had long been a major market for export credit agencies for both consumer goods and large-scale investments in the hydrocarbon sector. Algeria's centralized import allocation system facilitated a heavy dependence on export credits, and it managed to remain current despite comparatively high debt-service ratios, largely arising from heavy amortization payments on export credits. However, the debt-service situation, together with increasing doubts about the sustainability of Algeria's policy stance, led agencies to shift to progressively shorter maturities. 2/ New commitments declined after 1991, though some large agencies continued to make new commitments to Algeria notwithstanding the mounting economic and financial difficulties (Chart 13). Algeria's debt-service obligations reached over 70 percent of exports of goods and services in 1992 and then rose still further with the fall in the oil price in 1993. 3/

f. Other major markets

Charts 14, 15, and 16 show developments in export credit agencies' exposure to Indonesia, Turkey, and Venezuela. All have experienced increases in commitments, and, within this trend, an increase in short-term commitments. Based on the experience of export credit agencies with Iran, it might appear that a trend of rapidly rising export credit commitments together with a rising share of commitments on relatively short maturities is a strong leading indicator of future payments difficulties. However,

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1/ Most agencies have recently concluded refinancing agreements with Iran on a purely bilateral basis, with overall maturities ranging up to five years.

2/ The data presented here do not bring out the extent of this shift for Algeria, where many agencies extended credits classified as medium term, but with a very short average maturity.

3/ Algeria agreed a rescheduling with the Paris Club in June 1994 which provided for repayments over 16 years with a graduated repayment schedule. For details, see companion background paper on official financing, Chapter II.

Export Credit Exposure, 1987-93 1/

(In billions of U.S. dollars)

Arrears and uncovered claims | Medium- and long-term commitments outstanding | Short-term commitments outstanding

Chart 12: Iran

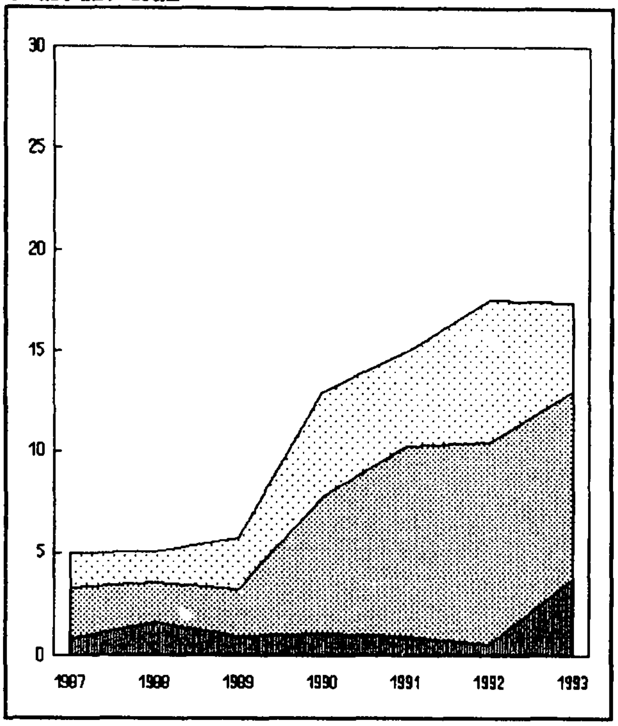


Chart 13: Algeria

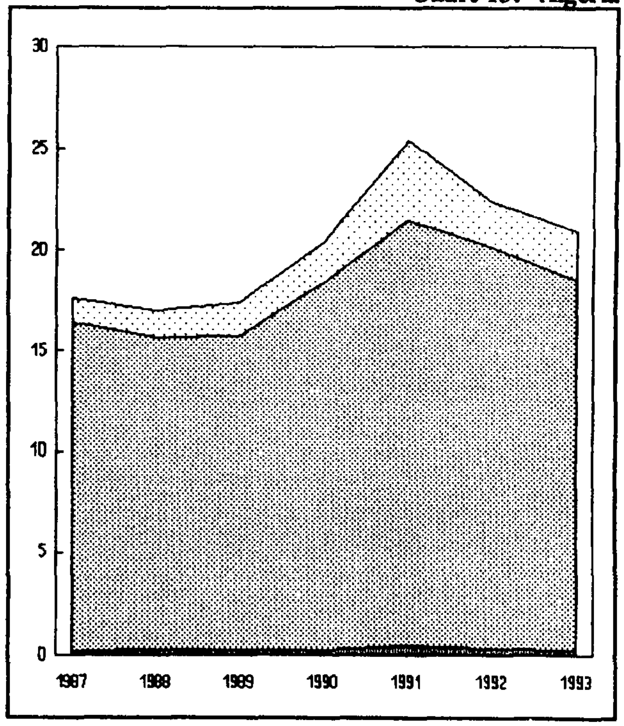


Chart 14: Indonesia

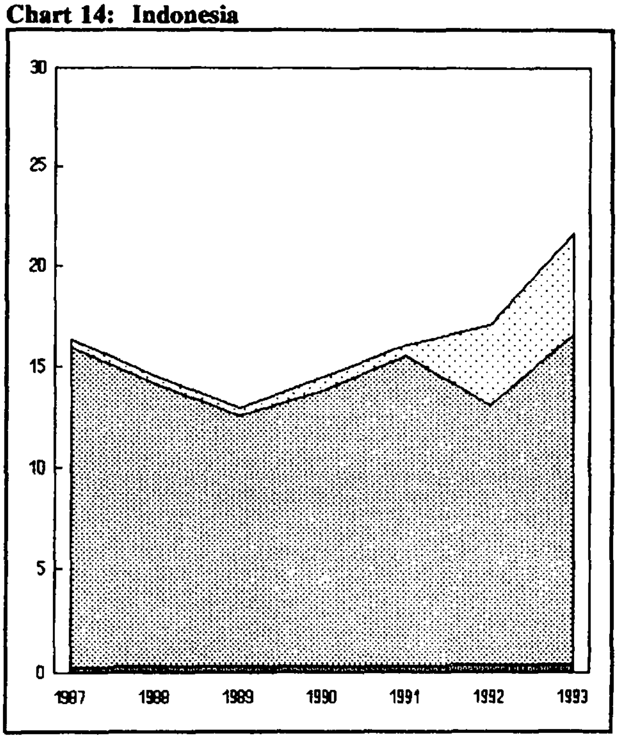
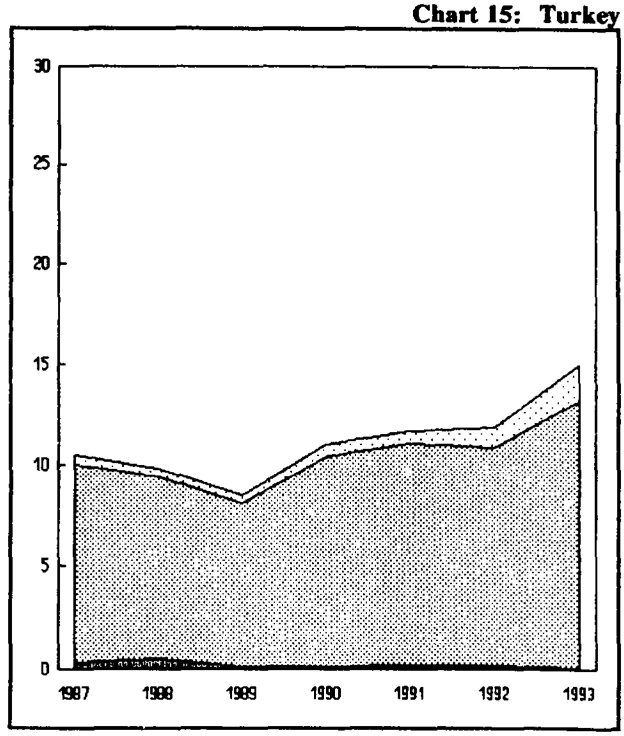


Chart 15: Turkey



Sources: Berne Union; and Fund staff estimates.
1/ For data definitions see Chart 3.

Export Credit Exposure, 1987-93 1/

(In billions of U.S. dollars)

Arrears and uncovered claims | Medium- and long-term commitments outstanding | Short-term commitments outstanding

Chart 16: Venezuela

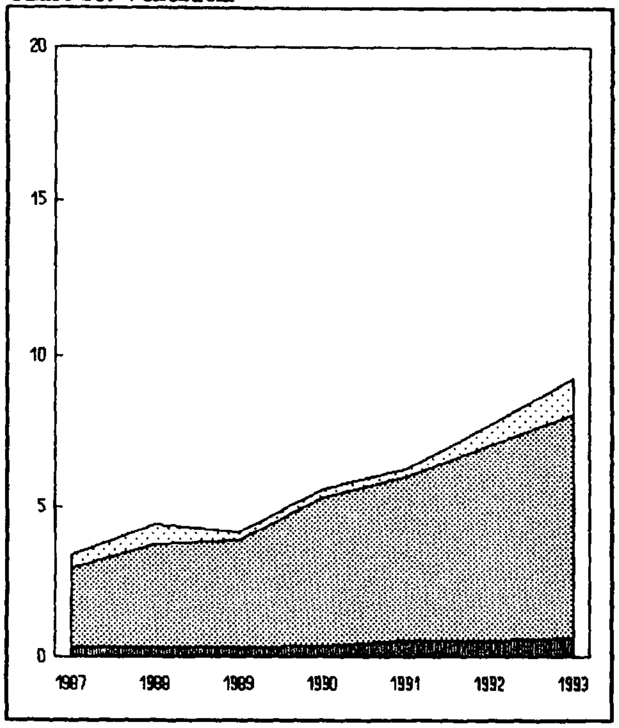


Chart 17: India

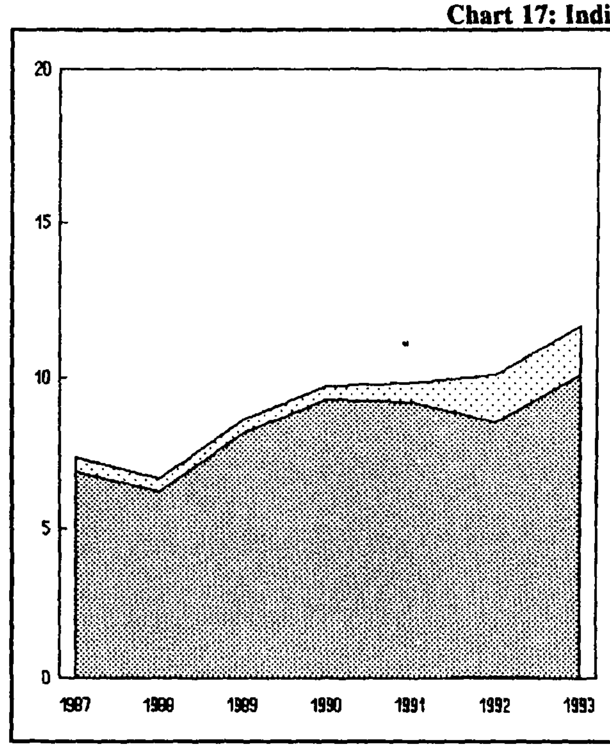


Chart 18: Philippines

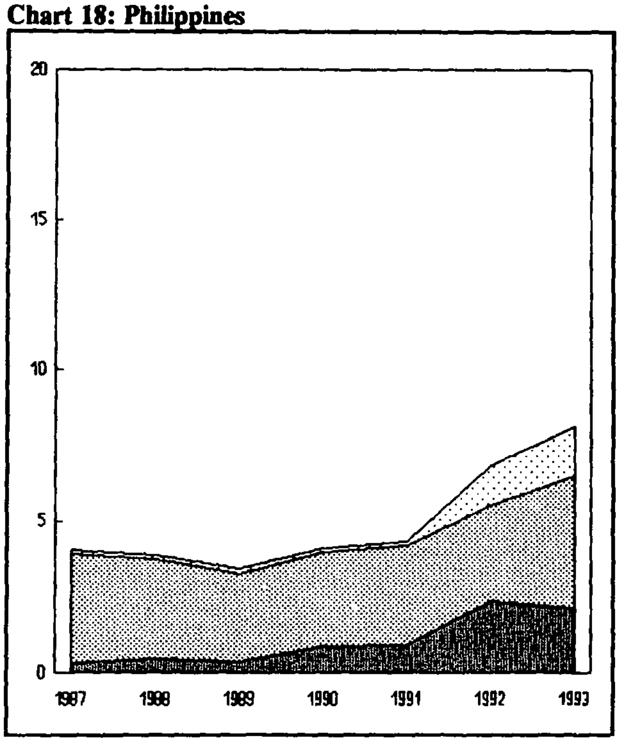
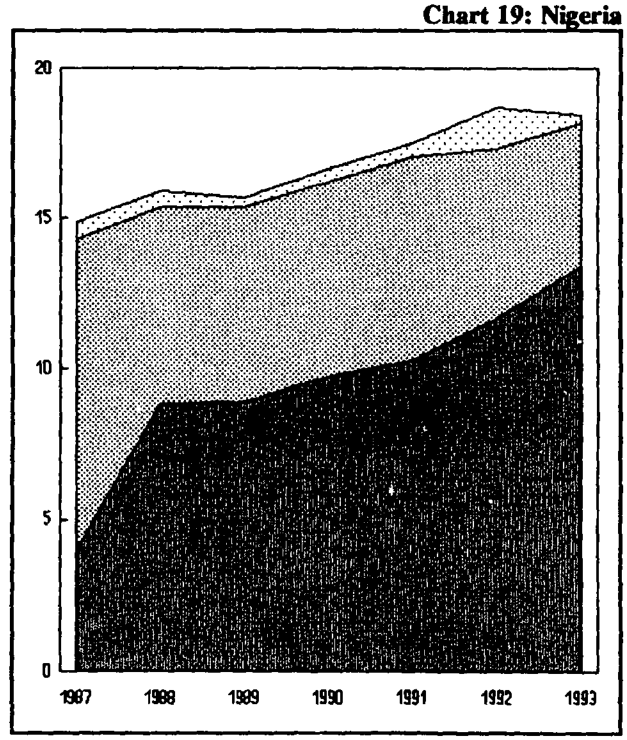


Chart 19: Nigeria



Sources: Berne Union; and Fund staff estimates.

1/ For data definitions see Chart 3.

these cases illustrate that this is not always the case, particularly for countries that have access to diversified sources of financing. 1/ Indonesia, Turkey, and Venezuela also all had similar profiles to that of Algeria in the early 1990s, but the economic situations of these three countries vary considerably. An increase in the proportion of short-term exposure can sometimes be a sign of improvement, as in the case of India (Chart 17) where the increase in short-term exposure of export credit agencies in 1992 reflected renewed commitments to India following the successful implementation of an adjustment program. Similarly, the recent increase in short-term commitments to the Philippines (Chart 18) took place in the context of a broadly satisfactory macroeconomic framework and also represents a shift of credits to the private sector. However, uncertainties about whether the Philippines would return to the Paris Club after a period of full debt-service payments may also have played a role in making agencies more cautious on the maturity profile. 2/

More generally and as illustrated by all of these cases, developments in overall export credit agency exposure and data on new commitments need to be interpreted with caution. Shifts in the volume of overall new commitments, or in the proportion of short-term exposure, may reflect shifts in the demand for export credits because of shifts in import demand in the borrowing country, shifts by exporters toward official support, or policy decisions by export credit agencies. Moreover, there may be changes in policies by export credit agencies that do not directly affect the level of new commitments but are nevertheless important, for example, increases in premia charged on new commitments. Finally, it should be noted that exposure of export credit agencies reflects actions taken in the past as well as actions taken in the present. A good example is a case of Nigeria, which is the eighth largest country in terms of export credit agency exposure, but for which new commitments recently have been minimal because of its poor performance (Chart 19).

4. Cover policies for Eastern Europe and the FSU

Tables 4 and 5 summarize the stance of cover policies on short-term and on medium- and long-term credits towards central and eastern European and selected FSU countries at end-1993. As noted above, agencies have found it difficult to assess the creditworthiness of economies in transition. However, with the experience gained over the past few years, and in comparing transition economies, a hierarchy of creditworthiness as perceived by agencies has clearly emerged.

1/ It should also be noted that the share of short-term commitments in total exposure is much larger in the case of Iran than in the other countries discussed here.

2/ The Philippines concluded a Paris Club agreement in July 1994 which was an exit rescheduling. For a fuller explanation, see the companion background paper on official financing.

Table 4. Summary of Short-Term Cover Policies of Export Credit Agencies Toward Selected Economies in Transition, end-1993

	Number of Agencies			Number of Agencies Imposing Each Type of Restriction 1/				
	Open without restrictions	Open with restrictions 2/	Off cover 3/	Security devices 4/	Ceilings 5/	Reduced percent of cover	Case by case	Maturity limit
Central and eastern European countries								
Bosnia-Herzegovina	--	1	11	1	--	--	--	--
Bulgaria	2	4	6	3	2	1	1	--
Croatia	--	3	9	2	2	--	1	--
Czech Republic	3	9	--	5	1	3	2	--
Hungary	3	9	--	7	2	1	2	--
Macedonia, FYR of	1	1	10	1	--	--	--	--
Poland	1	10	1	7	4	3	4	1
Romania	--	11	1	10	4	3	4	1
Slovakia	--	12	--	9	3	2	2	--
Slovenia	1	8	3	7	3	3	2	--
Selected FSU countries								
Kazakhstan	--	3	9	2	3	1	--	--
Russia	--	10	2	6	7	2	3	--
Ukraine	--	4	8	3	3	--	1	--
Uzbekistan	--	--	12	--	--	--	--	--

Sources: Agencies visited, Berne Union; and Fund staff estimates.

1/ One agency can have several types of restrictions.
2/ Including cases when restriction is only on private sector; agencies whose stance is not yet determined but are open on a case by case basis are included here.
3/ Including agencies off cover for new business.
4/ Including guarantees of payment or transfer, commercial bank guarantees or irrevocable letters of credit.
5/ Including limits on individual transactions, total commitments or annual new business.

Table 5: Summary of Medum- and Long-Term Cover Policies of Export Credit Agencies Toward Selected Economies in Transition, end-1993

	Number of Agencies			Number of Agencies Imposing Each Type of Restriction 1/				
	Open without restrictions	Open with restrictions 2/	Off cover 3/	Security devices 4/	Ceilings 5/	Reduced percent of cover	Case by case	Maturity limit
Central and eastern European countries								
Bosnia-Herzegovina	–	–	12	–	–	–	–	–
Bulgaria	–	4	8	3	3	–	1	–
Croatia	–	1	11	1	1	–	–	–
Czech Republic	2	10	–	5	2	1	4	–
Hungary	1	11	–	8	5	1	4	–
Macedonia, FYR of	1	–	11	–	–	–	–	–
Poland	–	9	3	4	7	1	5	–
Romania	–	11	1	5	9	1	6	–
Slovakia	–	10	2	4	5	1	4	–
Slovenia	–	8	4	4	6	1	2	–
Selected FSU countries								
Kazakhstan	–	2	10	1	1	1	–	–
Russia	–	9	3	4	6	1	4	–
Ukraine	–	2	10	2	1	–	1	–
Uzbekistan	–	–	12	–	–	–	–	–

Sources: Agencies visited, Berne Union; and Fund staff estimates.

1/ One agency can have several types of restrictions.

2/ Including cases when restriction is only on private sector; or when agency is open for medium but not for long-term cover. Agencies whose stance is not yet determined but are open on a case-by-case basis are included here.

3/ Including agencies off cover for new business.

4/ Including guarantees of payment or transfer, commercial bank guarantees or irrevocable letters of credit.

5/ Including limits on individual transactions, total commitments or annual new business.

Agencies view the Czech Republic and Hungary as better risks than most other countries: cover to these countries is basically demand-determined. Most agencies are on cover for all maturities without significant restrictions in Poland as well, although certain agencies' approach toward Poland is significantly more restrictive because of the debt and debt-service reduction agreement with the Paris Club in 1991. Slovenia is also considered as a good credit risk because of its good payments record and its rapid conclusion of bilateral agreements on its share of the debt of the former Yugoslavia.

The second tier of countries includes the Slovak Republic, the Baltic states, and Romania. In these countries, agencies have typically extended only relatively shorter-term credits and monitor payments records closely, but have a basically positive attitude towards providing new cover. Cover policy of most agencies towards Bulgaria is more restrictive due to its past delays in servicing post-cutoff date debt and in reaching bilateral agreements under Paris Club reschedulings. Croatia has been affected by war risk and uncertainties about its share of Yugoslav debt. Albania and the Former Yugoslav Republic of Macedonia are considered to require mostly concessional financing rather than export credits on commercial terms.

The impact of these varying perceptions of creditworthiness on the part of export credit agencies can be seen in Charts 20 and 21 which show export credit agencies' exposure and new commitments to Hungary and Bulgaria. In the case of Hungary, which, as indicated above, has established a very good payments record, both total exposure and new commitments have risen steadily from 1988 to 1991; since then they have been broadly stable. In the case of Bulgaria, on the other hand, new commitments have declined since the late 1980s, exposure has also fallen, and the share of exposure in the form of arrears and unrecovered claims has increased sharply.

As noted earlier, Russia was viewed by most agencies as a unique case. Having assumed responsibility for the debt of the former Soviet Union, it already has substantial obligations to export credit agencies and its payments record has been inconsistent. This has made export credit agencies reluctant to extend new cover without security arrangements. On the other hand, governments have been conscious of the need to support Russia's reform efforts and support through agencies has been their most important instrument for meeting this need. As a result, the largest agencies in particular have extended substantial new credits to Russia; such credits are sometimes treated explicitly in agencies' accounts as national interest lending by governments (where such distinctions are made).

Chart 22 shows developments in the exposure of export credit agencies to Russia and the former Soviet Union. As Russia has taken on

Export Credit Exposure, 1987-93 1/

(In billions of U.S. dollars)

Arrears and uncovered claims — Medium- and long-term commitments outstanding — Short-term commitments outstanding

Chart 20: Hungary

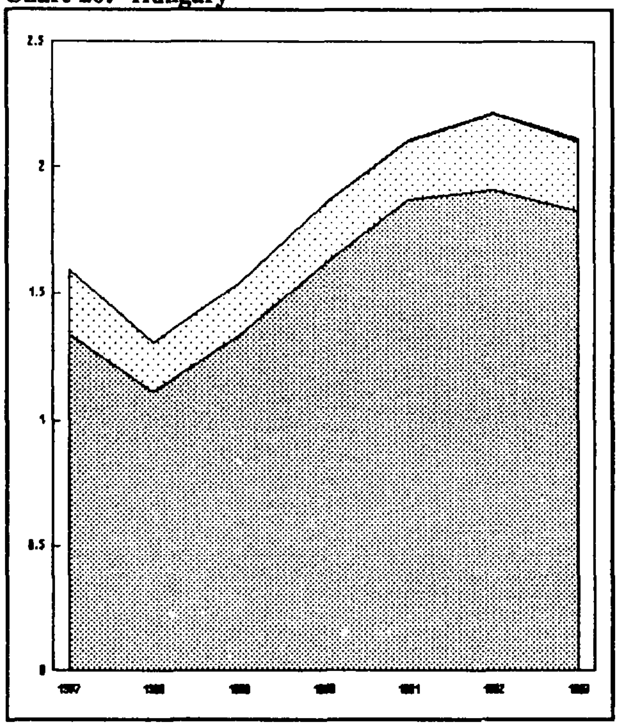


Chart 21: Bulgaria

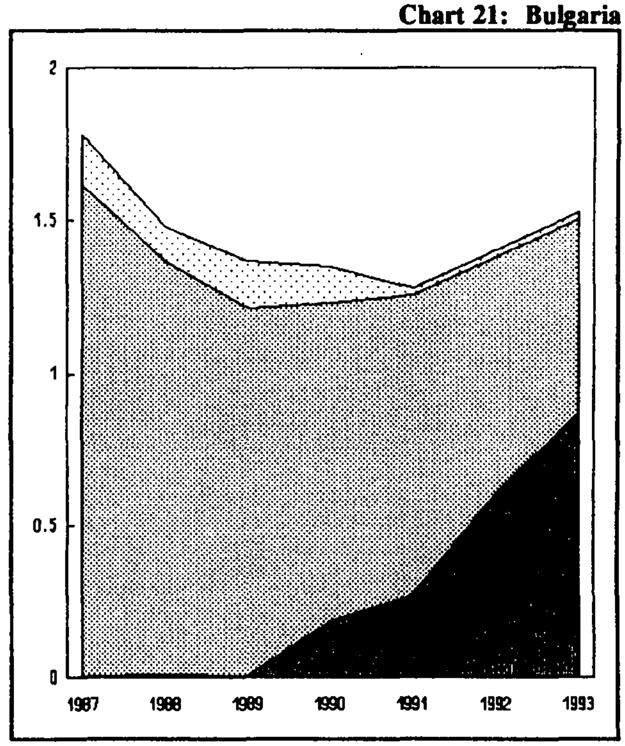
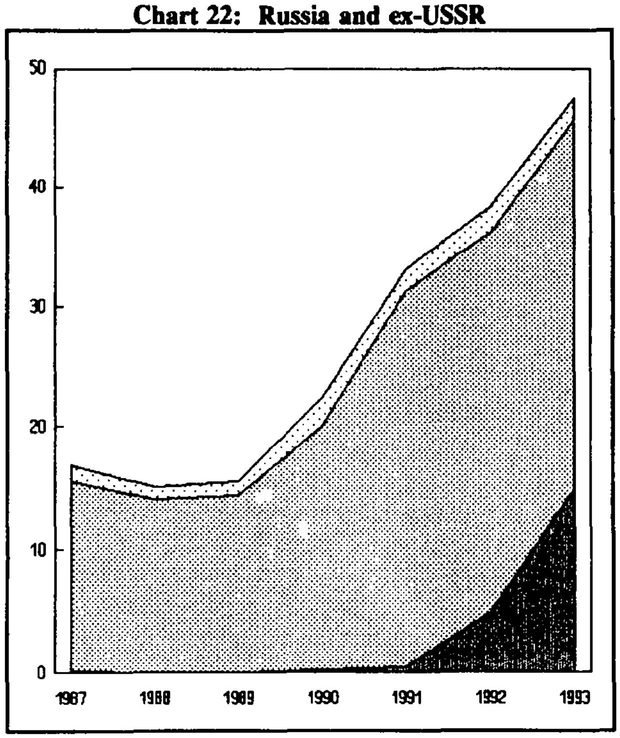


Chart 22: Russia and ex-USSR



Sources: Berne Union; and Fund staff estimates.
1/ For data definitions see Chart 3.

responsibility for the debt of the ex-U.S.S.R., the chart shows the combined exposure. 1/ From 1992 onwards, new export credit commitments were made to the Russian Federation, though disbursements continued to be made from commitments made prior to 1992 to the former Soviet Union. The overall exposure of export credit agencies has increased sharply since 1989, reflecting in large part the strong political support for financing. Since 1991 when arrears started to accumulate, followed by comprehensive reschedulings in 1993 and 1994, exposure in the form of unrecovered claims and arrears has also increased significantly, though only on commitments originally made to the former Soviet Union; commitments to the Russian Federation have not been rescheduled. While new commitments have declined somewhat during the last two years, they remain substantial. The extent of export credit agencies' support for Russia can also be seen in the change in the relative exposure to Russia compared to exposure to other countries. At the end of 1987, the former Soviet Union ranked fourth in terms of export credit agency exposure, behind Brazil, Algeria, and Poland. By the end of 1993, export credit agency exposure to Russia was 50 percent higher than that to any other country, and amounted to over 13 percent of the total exposure of export credit agencies to non-OECD countries (Chart 2).

In the FSU countries other than the Baltic states and Russia, agencies have adopted varied approaches. Some were open for cover in the three larger economies (Belarus, Kazakhstan, and Ukraine); some were closed for all except the Baltic states. Most agencies are cautiously opening cover for the resource rich Asian states, Kazakhstan, Uzbekistan, and Turkmenistan, or are contemplating such a move. Ukraine, Belarus, and Moldova were considered more risky markets, and despite their potential, most agencies were not on cover for them in the absence of a decisive improvement in the policy environment. The remaining FSU states are either considered by most agencies to be too poor to receive export credits on commercial terms (e.g., Kyrgyz Republic), or have war risk, precluding cover altogether (e.g., Armenia, Azerbaijan, Georgia, and Tajikistan).

1/ The Berne Union data cover only export credits extended through member agencies but not other government agencies involved in export credit finance for specific products (such as the Commodity Credit Corporation in the United States or the Canadian Wheat Board). In most cases, this imparts only a small bias to the aggregate data. The differences are more substantial in the case of Russia and the FSU, but do not affect the basic analysis.

Export Credit Agencies Visited in the Review

The agencies visited in the course of the present review were: Österreichische Kontrollbank Aktiengesellschaft (OeKB), Austria; Office National du Ducroire (OND), Belgium; Export Development Corporation (EDC), Canada; Compagnie Française d'Assurance pour le Commerce Extérieur (COFACE), France; Hermes Kreditversicherungs A.G. (Hermes), Germany; Sezione Speciale per l'Assicurazione del Credito all'Esportazione (SACE), Italy; Export-Import Insurance Division, International Trade Policy Bureau, Ministry of International Trade and Industry (EID/MITI), Japan; The Export-Import Bank of Japan (J-EXIM), Japan; Nederlandsche Credietverzekering Maatschappij, N.V. (NCM), the Netherlands; Exportkreditnamnden (EKN), Sweden; Export Credits Guarantee Department (ECGD), United Kingdom; and the Export-Import Bank of the United States (Eximbank), USA.

The staff also had discussions with the Secretariat of the International Union of Credit and Investment Insurers (Berne Union) in London, with the staff of the Organization for Economic Cooperation and Development (OECD) in Paris, with the staff of the Commission of the European Union in Brussels, and with World Bank staff.

II. Technical Note on Export Credit Statistics

In this and past Fund staff papers on officially supported export credits, the quantitative analysis of developments has been based on three statistical sources: the Berne Union, the OECD, and agencies' Annual Reports. All of those sources contain useful information, and both the Berne Union and the OECD have made considerable efforts to improve the quality of their data in recent years. However, both rely ultimately on the individual agencies for data, and each agency uses definitions and concepts which differ in important ways. Given this, and given the different methodologies used by the Berne Union and OECD themselves, it is extremely difficult to reconcile data from different sources and to relate data on officially supported export credits to financing flows and debt stocks.

Difficulties also arise from the increasingly complex interlinkages among various channels of official bilateral financing. Such financing can take the form of direct credits or of insurance for credits funded by the private sector; in the latter case, a wide variety of instruments and institutional arrangements is used. Reschedulings and refinancings further complicate the picture, particularly in cases of concessional reschedulings, as do other forms of budgetary support, such as mixed credits. More fundamentally, there are few incentives for agencies to collect and compile detailed data in a form which in most cases is quite different from the way in which they keep their own books.

1. Berne Union

The Berne Union quarterly survey of agencies includes data for some 40 developing countries and economies in transition on outstanding commitments, arrears, unrecovered claims, outstanding offers, and new commitments during the last quarter from each member agency. Those data have been provided to the Fund staff on a confidential basis for its use in analyzing various aggregates for individual debtor countries.

The most attractive feature of the Berne Union series is that data are collected in the way most agencies actually keep their books; that is, the concept "commitments" encompasses insured principal and, in most cases, interest on undisbursed as well as disbursed credits. This facilitates consistency in reporting and avoids errors that can occur when agencies are asked to make estimates of statistical concepts for which they have no hard numbers. The Berne Union data have the advantage of being a leading indicator, in the sense that they include agencies' commitments on undisbursed credits and they are available with a substantially shorter time lag than data from other sources. The data also provide a breakdown of total exposure into commitments on outstanding credits (representing a risk of future claims) and arrears and unrecovered claims (resulting from nonpayment, and in the latter case, claims payments by agencies).

Among the limitations of the Berne Union data are that they are not readily comparable with other types of debt statistics and they do not accurately reflect trends in new disbursements. Some agencies do not report export credit activity on account of the government. On the other hand, the data include the insurance of certain transactions that are not exports, for example, insurance against exchange rate movements or insurance of pre-shipment risks, which do not involve export credits. 1/ Finally, the Berne Union only covers member agencies. 2/

2. OECD

The OECD compiles two types of data on export credits. The first are published in "Statistics on External Indebtedness: Bank and Trade-Related Non-Bank External Claims on Individual Borrowing Countries and Territories", which the OECD prepares jointly with the BIS. The series was published for the first time in April 1984, and revised data are now available from December 1983 through December 1991. The series reports stocks of export credits on a basis broadly comparable with other external debt data, that is, covering outstanding amounts of disbursed principal only, and brings together the information available to the BIS on banking credits and to the OECD on export credits. 3/ However, since the concepts used do not reflect the way most export credit agencies keep their accounts, for certain creditor countries estimation by either the reporting country or the staff of the OECD is required. Moreover, the BIS-OECD data provide a breakdown of outstanding amounts among nonguaranteed bank claims, guaranteed bank claims, and non-bank officially supported export credits. However, official export credits can fall into either the second or third categories, both of which also contain other items.

The second set of data from the OECD is compiled by the Secretariat of the Export Credit Group. This records the flow of new commitments of export credits with initial maturities of over one year, and initial maturities of over five years, as well as the stock of officially supported short-term credits. These data, which are prepared for the OECD Export Credit Group, from the basis of the data shown in Annex II, Table 1.

1/ Pre-shipment risk cover is prevalent in the case of military exports which are generally characterized by long pre-shipment risk periods followed by cash payment.

2/ Excluding notably The Export-Import Bank of Japan (J-EXIM), though all but a small part of export credits financed by J-EXIM are covered by insurance from EID/MITI and thus included in the Berne Union Data. It should be noted that most J-EXIM lending in recent years has not been related to exports. Commodity and other credits extended by U.S. agencies, such as the Commodity Credit Corporation or the Department of Defense; and, for example, the Canadian Wheat Board are also not covered.

3/ The BIS-OECD data covers the U.S. Commodity Credit Corporation, and direct lending by institutions such as The Export-Import Bank of Japan, but the coverage is not exhaustive; for example, credits from the Canadian Wheat Board are not included. The two institutions, together with the Fund and the World Bank, are engaged in the International Working Group on External Debt Statistics, whose work is focused on concepts and measurement issues in this area.

Table 1. Flow of New Commitments of Officially Supported Medium- and Long-Term Export Credits, 1981-92 1/

(In millions of U.S. dollars)

	Total of Category I (Largely Industrial) Countries	Category II (Middle-income Developing) Countries	Category III (Low-income Developing) Countries	Categories II and III (Developing countries)	Total 2/
	(Medium- and long-term credits with an initial term of over one year) 3/				
1981	...	...	...	...	82.8
1982	...	...	...	...	85.6
1983	...	...	...	...	67.5
1984	...	...	...	...	58.2
1985	12.0	24.5	10.7	35.1	47.8
1986	11.7	22.3	11.4	33.7	46.1
1987	16.0	20.9	9.4	30.4	47.1
1988	9.7	21.2	12.7	33.9	45.0
1989	12.2	27.3	13.6	40.9	54.1
1990	9.9	28.9	9.4	38.3	48.2
1991	20.7	26.3	9.3	43.4	64.0
1992	21.7	38.9	12.4	51.1	72.8
	(Long-term credits with an initial term of over five years) 3/				
1981	...	...	...	...	21.5
1982	...	...	...	...	20.4
1983	...	...	...	...	13.9
1984	1.8	7.0	2.6	9.5	11.4
1985	1.0	4.9	2.5	7.4	8.4
1986	0.9	5.2	3.2	8.3	9.4
1987	2.3	3.7	2.2	5.9	8.3
1988	1.9	4.7	6.3	10.9	12.8
1989	3.6	5.3	2.9	8.2	11.8
1990	1.1	5.2	3.8	9.0	10.2
1991	2.9	8.5	5.2	13.5	16.4
1992	6.3	11.3	7.2	18.4	24.8

Sources: OECD, Secretariat of the Export Credit Group; and Fund staff estimates.

1/ The value of commitments includes principal and insured interest. The country cases correspond to the classification used by the OECD Consensus on Export Credits.

2/ Includes unallocated credits, so total exceeds the sum of the categories.

3/ Includes undisbursed lines of credit.

The following general caveats need to be kept in mind in interpreting both the Berne Union and the OECD Export Credit Group data. First, since agencies typically provide insurance for both repayments of principal and payments of interest, data provided to the Berne Union, and to the OECD export credit group, are based on agencies' exposure, including future interest payments. 1/ Second, agencies typically report at the time contracts are concluded the full value of the contract, including undisbursed amounts. Thus, it is difficult to relate commitment data to actual disbursements. Finally, data in agencies' own annual reports should also be used with caution, since they often refer to the total value of exports supported, which includes downpayments by the buyer as well as self-participation of the exporter in the credit.

3. Arrears and reschedulings

In the event of nonpayment by the debtor, the agencies record the unpaid amounts of principal and interest first as arrears, and then, after the claims-waiting period and following claims payments, as "unrecovered claims". However, interest accrued on arrears is generally not recorded as an increase in claims. Similarly, when unrecovered claims are regularized through a Paris Club rescheduling, agencies do not record an increase in exposure in their reports to either the OECD or the Berne Union, despite the fact that since repayment periods under Paris Club reschedulings are in most cases significantly longer than for export credits, the amount of future interest at risk is a correspondingly larger fraction. By contrast, if arrears or unrecovered claims are refinanced rather than rescheduled, the refinancing results in an increase in recorded exposure.

The series on the stock of commitments and the stock of disbursed credits prepared by both the OECD and the Berne Union are affected by variations among agencies in their treatments of arrears and restructured credits. Most agencies include arrears and rescheduled or otherwise restructured export credits (including capitalized interest) in their reports to the Berne Union and the OECD. However, some agencies exclude credits that are no longer the responsibility of the agencies in their reports. The treatment of debts rescheduled on concessional terms also varies across agencies. These variations make the reported numbers for countries which have experienced debt-servicing difficulties particularly difficult to interpret and generate a downward bias in the estimated stock of disbursed credits.

1/ Future interest payments typically account for some 25 percent of total commitments. This is, for example, consistent with an interest rate of 7 percent, an average maturity of 5 years and repayment in equal installments as required under the OECD Consensus rules. However, long-term commitments may involve a stream of interest payments that account for a much greater share of total commitments.

4. Mixed credits

A further complication in the interpretation of the OECD and the Berne Union data concerns the treatment of mixed credits. All agencies report the commercial component of mixed credits in their returns. However, the institutional arrangements for providing mixed credits vary between creditor countries. Some arrange the financing by mixing concessional loans provided by the national aid agency with commercial export credits to achieve the desired level of concessionality; for these countries the data on export credits covers only the commercial loans. In contrast, other countries provide the whole of the financing in the form of commercial credits supported by cover from the export credit agency, but arrange for some part of the interest to be paid directly to the lender by the aid agency. For these countries the whole of the mixed credit will be reported as an export credit.

5. Exchange rate effects

The BIS/OECD also publishes estimates of the impact of exchange rate changes on flows of export credits. In principle these estimates allow the net effect of transactions on the change in reported stock to be identified. However, the methodology used is such that in practice other factors, such as the treatment of arrears and debt reorganizations, also affect the stock.

The OECD Consensus on Export Credits 1/

The Arrangement on Guidelines for Officially Supported Export Credits, commonly called the "Consensus", was established in 1978. The most recent modification was in June 1992. 2/ The Consensus defines a set of limits relating to the terms of officially supported export credits and requires prior notification to other participant countries of "derogations" or "deviations", that is, of credits extended by any one participant on terms and conditions not conforming with the guidelines. The Consensus gives the right to any participant to match the terms of export credits deviating from these guidelines (derogating credits). It also sets out in detail the procedures to be followed in prior notifications and in matching derogating credits. Finally, it provides guidelines for the conditions under which mixed credits (combining aid resources and commercial credits) can be granted.

Although the Arrangement places limits on the ability of agencies to subsidize exports with submarket interest rates, it does not set the terms and conditions of the insurance or guarantees issued in support of export credits. The Consensus is complemented by more limited "Sector Understandings" on export credits for ships, for civil aircraft, and for conventional and nuclear power plants. The Arrangement does also not apply to export credits relating to exports of military equipment and agricultural commodities.

a. Income groups

The terms of export credits are differentiated by groups of recipient countries. The Arrangement classifies as Category I (relatively rich) all countries with a GDP per capita income of over US$4,000 per annum according to the final 1979 data published in the 1981 World Bank Atlas; as Category II (intermediate) all countries not classified in Categories I or III; and as Category III (relatively poor) all countries eligible for IDA credits plus any low-income countries or territories whose GNP per capita would not exceed the IDA eligibility level.

b. Main features

The four main elements concerning the terms under which agencies in participating countries provide cover are the following:

1/ This section is based on the "Arrangement on Guidelines for Officially Supported Export Credits", OECD, Paris, June 1992; and discussions with the staff of the OECD.

2/ A description of developments in the Consensus during the 1980s can be found in Appendix IV of "Officially Supported Export Credits", World Economic and Financial Surveys, May 1990.

(i) a minimum cash down payment of 15 percent of the export contract value payable by the importer at or before the date of taking physical possession of the goods;

(ii) a maximum repayment period of five years for Category I countries 1/; eight and a half years for Category II countries; 2/ and of ten years for Category III countries, with principal repayments in equal semiannual installments beginning no later than six months after the starting point;

(iii) a set of currency-specific minimum interest rates applicable for conforming credits; 3/ and

(iv) a minimum concessionality level for conforming tied and partially tied-aid credits, including mixed credits, of 35 percent. 4/

The Consensus prohibits participants from offering export credits that do not conform to the main conditions of the Arrangement concerning repayment terms, the minimum interest rates, or the minimum level of concessionality ("No-derogation engagement").

c. Minimum interest rates

The elimination of interest rate subsidies has been one of the major aims of participants in the Consensus. The original arrangement had established a matrix of minimum interest rates which could only be adjusted by unanimous decision after negotiation--there was no provision for automatic adjustment to maintain the relation to market rates. This problem was addressed in October 1983 when the participants adopted the Uniform Moving Matrix (UMM) (after sharply increasing the fixed matrix rates in November 1981). 5/ To avoid placing credits denominated in low-interest rate currencies at a competitive disadvantage, the participants also agreed

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1/ Though not technically a derogation, the provision of support for export credits to Category I countries with a repayment period of more than five years up to eight and one-half years is subject to prior notification.

2/ In July 1982 certain countries which had previously been classified in Category III were reclassified to Category II. For these countries the maximum repayment term is ten years.

3/ These interest rates are the relevant Commercial Interest Reference Rates (CIRRs) shown in Annex III, Table 1. In the case of Category III countries, participants have the option of choosing the SDR-based interest rate computed by the OECD, irrespective of the currency of the export credit.

4/ The minimum concessionality level is 50 percent if the beneficiary country is defined as a Least Developed Country (LLDC) by the United Nations.

5/ The Uniform Moving Matrix established a single matrix of minimum interest rates which move automatically as market rates fluctuate, and apply to all currencies used for extending export credits.

Table 1. Arrangement on Officially Supported Export Credits
Commercial Interest Reference Rates

	Jan-83	Jan-84	Jan-85	Jan-86	Jan-87	Jan-88	Jan-89	Jan-90	Jan-91	Jan-92	Jan-93	Jan-94	Jul-94
SDR 1/	10.00	9.50	9.85	8.80	7.40	8.00	8.30	8.30	9.20	9.20	7.55	5.95	7.35
DM 2/	...	9.65	8.55	8.03	6.73	6.55	7.18	8.68	10.12	9.51	7.97	6.17	7.54
Yen	...	8.10	7.50	7.10	6.00	5.50	5.50	6.60	7.60	6.40	5.30	3.30	4.20
£ Sterling	...	12.29	12.38	12.47	12.09	10.07	11.67	12.22	11.96	10.89	8.30	6.71	9.44
US$<5yr 3/	...	13.20	12.72	10.38	7.57	9.35	9.99	8.65	8.63	7.09	6.21	5.54	7.27
US$5-8.5yr	...	13.20	12.72	10.38	7.97	9.75	10.39	9.05	9.03	7.49	7.08	6.15	7.70
US$>8.5yr	...	13.20	12.72	10.38	7.97	9.75	10.39	9.05	9.03	7.49	7.46	6.48	7.91
Australian $ 4/	...	...	...	...	14.85	13.00	14.50	14.45	12.99	9.22	9.24	7.17	10.04
Austrian Shilling	...	9.13	9.13	9.13	7.50	7.89	7.53	8.70	9.80	9.65	8.56	6.91	7.89
Belgian Franc	...	...	...	...	8.70	9.04	9.05	10.67	10.99	10.04	8.71	7.42	8.72
Canadian $ 5/	...	12.09	12.15	10.35	9.12	11.00	11.20	10.90	11.25	8.90	8.20	6.05	9.41
Danish Krone	...	...	...	...	12.10	13.70	9.90	11.80	11.80	10.50	11.20	7.20	8.20
Finnish Markka 6/	...	11.45	11.45	11.55	9.16	9.31	9.67	12.05	12.90	11.50	10.70	7.25	10.15
French Franc	...	...	...	...	10.08	11.08	9.64	10.76	11.43	10.31	9.44	6.50	8.13
Irish Punt	...	...	...	...	...	...	...	...	11.43	10.51	11.75	6.95	9.18
Italian Lire	...	...	...	...	...	11.50	11.74	13.30	12.96	12.25	13.31	8.58	9.92
Dutch Guilder 7/	...	10.20	9.20	8.55	7.35	7.30	7.35	9.00	10.15	9.75	8.05	6.10	7.55
New Zealand $	...	...	...	...	...	16.30	14.75	13.47	13.22	9.54	8.40	6.65	7.68
Norwegian Krone	...	...	...	...	14.82	14.55	13.03	11.92	11.66	10.65	10.11	6.27	8.70
Spanish Peseta	...	...	...	...	11.36	14.14	13.82	15.49	15.54	12.87	13.99	9.08	10.82
Swedish Krone	...	...	...	...	11.54	12.44	12.02	13.93	13.73	11.41	10.60	7.73	10.32
Swiss Franc 8/	...	6.80	7.05	6.80	6.55	6.55	6.55	8.30	8.30	8.30	6.78	5.25	6.28
ECU	...	...	...	10.07	8.67	8.87	8.42	9.83	10.46	9.56	9.00	6.56	7.99

Source: OECD.

1/ DR-based interest rates are the same for all currencies, set semiannually, and apply to Category III countries only.

2/ Up to Aug-83 a lower DM rate applied to maturities up to 5 years and a higher one to maturities up to 10 years, from Sept-83 to May-86 the lower rate /applied to facilities under SDR 40 million in value, the higher rate to all others, thereafter the same CIRR applies to facilities of all maturities and values.

3/ Up to May-86 one CIRR applied to all maturities, from May-86 until Jan-92 a lower CIRR was applied to maturities of less than five years; from Jan-92 there are three CIRRs applied to maturities of less than 5 years, 5-8.5 years, and more than 8.5 years, respectively.

4/ There were three separate CIRR rates for different maturities until May 1987, after which one rate applies to all maturities.

5/ Three separate CIRR rates apply to different maturities from February 1992, previously one rate applied to all maturities.

6/ Two separate CIRR rates applied to different maturities until December 1986, thereafter one rate applies to all maturities.

7/ Three separate CIRR rates apply to different maturities from January 1992, previously one rate applied to all maturities.

8/ Two separate CIRR rates applied to different maturities until February 1992, thereafter one rate applies to all maturities.

to establish market-based "commercial interest reference rates" (CIRRs). The minimum interest rates at which participants could provide export credits was the lower of the matrix rate and the CIRR of the currency in which the credit was denominated. 1/

In July 1987, the participants agreed to replace the matrix minimum interest rate for export credits to relatively rich (Category I) countries with the appropriate CIRRs and to raise the minimum matrix for intermediate (Category II) and poor (Category III) countries by 30 basis points in order to reduce the subsidy element. Minimum matrix rates were later abolished altogether even though participants retained the SDR interest rate for credits to Category III countries.

d. Tied-aid credits

The original Arrangement followed the DAC criterion for determining the concessionality of tied or partially tied-aid credits, using a flat 10 percent discount rate. This gave countries with low-interest rate currencies a competitive advantage over countries with high-interest rate currencies: with low nominal interest rates, only small interest subsidies were required for ODA loans to yield a high level of concessionality when discounted at the flat rate of 10 percent. Similarly, in the case of mixed credits, comparatively small amounts of pure grants had to be combined with a commercial loan to meet the required level of concessionality. To redress this situation, the participants in the Consensus decided to adopt a currency-specific formula for the discount rate to be used in calculating the concessionality level of aid credits: the differential discount rate (DDR). The formula gives 75 percent weight to a market-related interest rate for each currency; 2/ the remaining 25 percent weight is assigned to the flat discount rate of 10 percent. The resulting discount rate thus more closely reflects market interest rates. In addition, the minimum concessionality level for Category III countries was raised to 50 percent, and for Category II countries to 30 percent on July 15, 1987, and to 35 percent a year later. 3/

1/ The CIRR is set for each currency at a fixed margin of 100 basis points above a base rate defined as the yield on the secondary market for government bonds with a residual maturity of five years, except where the participants agree otherwise. Participants notify the OECD Secretariat of changes in the CIRRs monthly, and changes in the CIRRs are implemented as necessary on the fifteenth day after the end of each month.

2/ The average of monthly CIRRs for the currency during the six months preceding the fixing of the DDRs, which are set for one year on each January 15.

3/ If the tied or partially tied credit is in the form of a financing package, combining concessional loans or grants or other official flows with a purely commercial credit, the overall concessionality level is calculated as a weighted average of the concessionality levels of each component.

e. "Helsinki package"

In March 1992, participants agreed on a major modification to the Consensus, often referred to as the "Helsinki" package. 1/ This modification covered export credits involving tied or partially tied aid to low-income countries. The aim was to increase transparency and to improve the quality of tied aid credits. The relevant modification to the OECD Consensus specifies:

"Tied and partially untied concessional or aid credits, except for credits to LLDCs, shall not be extended to public and private projects that normally should be commercially viable if financed on Arrangement terms".

The key tests for such aid eligibility are (i) whether the project is commercially non-viable; and (ii) whether it seems unlikely that the project can be financed on market or Arrangement terms.

The modification also established procedures on the implementation of the Helsinki package through consultation. Projects involving tied aid over SDR 50 million are automatically placed on the agenda of monthly consultations; participants may also request consultations on any other project involving tied aid. Discussions have focused on the definition of commercial viability, which requires, in particular, judgements on appropriate pricing and project definition. Agencies found this case-by-case approach time-consuming, but saw it as generally working well in helping to establish guidelines for implementation and in weeding out projects that should not be financed through the use of aid. Agencies generally agreed that this process should in due course lead to a substantial reduction in the use of tied-aid credits in the financing of commercially viable projects. However, they differed on whether the net result would be to free aid resources for the least developed countries, or merely result in a re-allocation of aid within the current recipient countries to projects that do not fall under the strengthened guidelines.

1/ Agreement on the package had been reached by the OECD Ministerial Meeting in Helsinki.

Export Credit Agencies' Policies Toward Rescheduling Countries

The role of export credit agencies in the debt strategy and in particular the policy reactions of agencies to countries that required reschedulings in the Paris Club have been the primary focus of previous Fund studies on export credits. 1/ Since 1976, official bilateral creditors have concluded well over 200 rescheduling agreements with 61 countries covering debt service obligations of some US$250 billion. 2/ Since the recent evolution of Paris Club reschedulings is described in detail in the companion background paper on Official Financing for Developing Countries, this Annex focuses on more general issues arising from reschedulings and their links to cover policies, and in particular on agencies' policies with regard to middle-income countries that have graduated or are well on their way toward graduation from the rescheduling process. Agencies' policies on low-income rescheduling countries requiring debt reduction from official bilateral creditors are discussed in Chapter III.

a. Debt subordination

Until the mid-1980s, the normal practice of export credit agencies had been to go off cover for countries that sought a Paris Club rescheduling, and to wait for a return to full creditworthiness and establishment of normal relations before resuming cover on new credits. As it became evident that debt servicing difficulties would not be resolved quickly by most rescheduling countries, official bilateral creditors needed to find ways to not only fill short-term financing gaps, but also provide new credits for countries implementing adjustment programs.

The strategy of debt subordination developed by export credit agencies and their governments has realized these twin objectives. The cornerstone of this strategy was the policy of the Paris Club to maintain the cutoff date (set at the first rescheduling) in subsequent reschedulings, and to give clear priority to the servicing of post-cutoff date debts, even where that necessitated very comprehensive reschedulings of interest payments and debt-service obligations arising from previous reschedulings. This strategy has been implemented consistently for ten years: since mid-1984 cutoff dates fixed at the first Paris Club rescheduling have not been changed in subsequent reschedulings. Two other aspects of the debt subordination strategy have been the exclusion of short-term debt, and of credits extended to the private sector without the guarantee of the borrowing country government, from coverage under reschedulings.

1/ See in particular Chapter III of "Officially Supported Export Credits," World Economic and Financial Surveys, May 1990.

2/ These figures overstate the impact of reschedulings on the exposure of export credit agencies, because part of the debts rescheduled were obligations on ODA loans by bilateral aid agencies. The figures also include reschedulings of obligations arising from previous reschedulings in cases where countries experienced persistent payments difficulties.

This provided a framework in which export credit agencies could go ahead with new credits in confidence that these would not be caught up in future reschedulings but would be serviced on a timely basis. As most countries required repeat reschedulings, this has meant that, after the first rescheduling, there have not been significant interruptions in cover by export credit agencies provided that countries established a record of timely servicing of post-cutoff date debt and implementation of the rescheduling agreements. Continued, and often large-scale, support in the form of export credits has indeed been a crucial factor in assisting many middle-income countries in resolving their debt difficulties (such as Mexico and Morocco) and in making progress toward graduation from the rescheduling process.

b. Requests for bilateral reschedulings

Agencies noted that countries in evident debt servicing difficulties that attempt to work out their problems without a Paris Club rescheduling posed particular difficulties. Nearly without exception, agencies refuse requests for reschedulings on a bilateral basis. Many agencies require a multilateral approach for legal reasons and also because of burden-sharing considerations. Moreover, obligations arising from reschedulings on a bilateral basis would be considered pre-cutoff date debt in the Paris Club and would thus be caught up again if a Paris Club rescheduling were eventually needed. Finally, there is the danger that cash-flow relief is wasted in support of unsustainable policies: countries that request debt reschedulings on a bilateral basis do so often in order to avoid the adjustment measures required for the Fund programs which provide the basis for Paris Club reschedulings.

At the same time, however, agencies also fear that going off cover could cause the country to cease payments to them. They therefore tend to remain on cover, but on a more restricted basis, and typically for shorter maturities, as long as payments do not fall into arrears. This policy can have the perverse effect of dragging out a process where both adjustment and financing are insufficient. In such circumstances, the interests of both debtors and creditors would be served better if the borrowing country embarked on early and determined policy reforms supported by a Fund program and combined with appropriate cash-flow relief in the Paris Club.

c. Repeat reschedulings

Agencies also noted that there were cases of countries returning time and again to the Paris Club, while available cover for new credits remained unused. In some cases, this may reflect a reappraisal and restructuring of countries' investment programs and could be expected to be temporary. In others, however, debtors continue to seek general budget and balance of payments support, including through reschedulings, to maintain levels of private and public consumption, while sources of finance for sound investment projects remain untapped. This tendency, some agencies thought, was reinforced by two factors. First, there remained the perception on the part of debtors that the Paris Club might provide concessions for a wider range of countries. Second, recent changes in budgetary and accounting procedures had for some agencies made reschedulings less expensive, from a budgetary perspective, than the extension of new credits. While agencies agreed that concessions were required for many low-income rescheduling cases (as discussed in Chapter III), they also thought that clearer signals were required on the part of the Paris Club that countries with access to new financing should graduate from the rescheduling process.