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A Study on the Activities of IFIs in the Area of Export Credit Insurance and Export Finance

Malcolm Stephens
Diana Smallridge

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C O N T E N T S

Contents

A STUDY ON THE ACTIVITIES OF IFIs IN THE AREA OF EXPORT CREDIT INSURANCE AND EXPORT FINANCE *

Malcolm Stephens **
Diana Smallridge **

Export Credit Agencies (ECAs) play a role of central importance in international trade and investment flows. ECAs are a vital part of the infrastructure supporting trade and have often been considered to be a critical component in a nation's export-led growth strategy. The basic role of an ECA is to support and encourage exports and outward investment by insuring international trade and investment transactions and, in some cases, providing finance directly.

One of the most common and most challenging problems that ECAs face is what to do about small exporters. Small exporters are a significant and politically sensitive subject in most countries for various reasons and not necessarily because they make a substantial or potentially substantial contribution to total exports. Facilities tailored to small exporters may be costly to operate largely because of diseconomies of scale: administrative costs per contract may be as high as those for larger exporters, yet income per contract is likely to be lower.

The International Financial Institutions (IFIs) have played an increasingly active role in the area of export credit insurance and finance, but the extent and nature has varied significantly between individual IFIs. Helping to establish and support an ECA in the difficult early days has been recognized as an important role for IFIs. Moreover, IFIs can play a part in helping to address gaps in the availability of trade finance and working capital -especially for Small and Medium-Sized Enterprises (SMEs)- which can exist and which can be helped by trade facilitation arrangements of various kinds.

IFIs have been active in developing programs to assist in national and regional trade development and facilitation efforts. Access to and availability of appropriate financial tools, including export credit facilities, have been components of some of these efforts.

IFIs, even with their relatively modest involvement in supporting the export credit field, have taken a variety of different approaches. With trade a key agenda item for IFIs, it seems inevitable that there will be a continuing and even growing focus on trade finance systems, including export credit schemes.

Looking at the experience of other IFIs, it seems that the most successful facilities and initiatives were designed to meet specific rather than general objectives problems; and worked with existing market practices and documentation and did not seek to reinvent mechanisms or to apply unduly complicated documentation or practices.

* This paper was commissioned by the IDB Integration and Regional Programs Department.

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Contents

I. INTRODUCTION

Exporting presents a range of risks, many of which do not exist in domestic sales. These risks exist whether goods and services are sold for cash or on credit. In other words, as soon as a company begins to produce for export, there is the risk the events may arise which either prevent the export of the goods or services or their import into the buying country, or the buyer may cancel the order. Then there is the range of risks which can occur after the goods have been shipped or accepted by the buyer meaning that the exporter does not receive timely payment.

Thus, even though the bulk (over 90%) of world trade may take place on the basis of cash or very short credit terms, this does not mean that exporters are not faced with risks which could threaten not only their ability to make future exports but also their very existence. A single bad debt is very frequently the cause of a company becoming insolvent.

And companies must be able to access finance for both the production for export and for any credit while they wait to be paid. In other words, it is very rare for exporters to be paid in cash with the order.

Against this background, a very important factor in both OECD and emerging markets is the availability of insurance against many of these risks -called export credit insurance. Not only does this enable exporters to concentrate on producing and selling with the confidence that they have protection against many of the risks mentioned above, but the existence of such insurance provides useful security for banks providing working capital and financing exports.

Traditionally, these risks were divided into two categories, namely commercial risks and political risks. Political risks are the risk of non-payment on an export contract or project due to action by an importer's host government. Such action may include intervention to prevent the transfer of payments, cancellation of a license or acts of war or civil war. Commercial risks arise primarily as a result of non-payment by a private buyer, commercial bank or a public buyer, due to default, insolvency or bankruptcy or failure or willingness to take delivery of the goods (i.e., repudiation).

However, the trading world is now rather more complicated than it was historically, especially with the impact of more and more countries having floating exchange rates or being vulnerable to significant increases in interest rates. Thus, there has been a blurring between commercial and political risks. The key point therefore for exporters (both large and well established and, especially SMEs) and banks is first to recognize the existence of the risks and then to get them covered by insurance.

Government involvement often through Export Credit Agencies (ECAs) in this area varies between different countries but in few countries is there no involvement at all.

The IFIs have played an increasingly active role in this area but the extent and nature has varied significantly between individual IFIs. Helping to establish and support an ECA in the difficult early days has been recognized as an important role for the IFIs to play. Moreover, gaps in the availability of trade finance and working capital -especially for SMEs- which can exist, can be helped by IFI trade facilitation arrangements of various kinds.

This report tries to address some of these issues and, after reviewing what some IFIs have done or are doing, makes some recommendations about where IFIs can most usefully be involved, usually as a catalyst.

Contents

II. EXPORT CREDIT AGENCIES

A. Background

Export Credit Agencies (ECAs) play a role of central importance in international trade and investment flows. ECAs are a vital part of the infrastructure supporting trade and have often been considered to be a critical component in a nation's export-led growth strategy.

The basic role of an ECA is to support and encourage exports and outward investment by insuring international trade and investment transactions and, in some cases, providing finance directly. However, there is no such thing as a typical ECA. Their business models, status, objectives and institutional arrangements are different, reflecting their own unique national circumstances. Moreover, the status and facilities of a particular ECA may be subject to change over time, reflecting changing national and international circumstances.

Over the years, a number of governments had found that ECA support was an effective and apparently low-cost method of carrying out some of their policy objectives, whether in the context of trade and foreign policy or as a substitute for aid or for industrial and commercial reasons (such as through the provision of support for industries or sectors or individual firms short of orders and, especially, for small companies/SMEs).

ECAs provide a range of insurance and finance products to facilitate export sales, the bulk of which is export credit insurance. Not all export credit insurance is provided by "official" ECAs and the growth of private sector activity has been very significant, especially in the area of short-term credit.

The Berne Union (known formally as the International Union of Credit and Investment Insurers) has as members all of the Organization for Economic Cooperation and Development (OECD) ECAs and many of the new and emerging ECAs. In 2000, the Berne Union members insured or financed more than half a trillion dollars and had total outstanding commitments of nearly US $600 billion.

There are some 50 Berne Union members from 40 countries of which the majority are the official ECAs of their respective countries or have some link to their national government. Of the 50 members, only three are from Latin America and the Caribbean. Of these, two are official ECAs (National Eximbank of Jamaica and Bancomext of Mexico), while the third member, CASC of Argentina, is a privately owned credit insurer. SBC of Brazil (a private company) was recently granted observer status, en route to becoming a member. BNDES-EXIM, the "official" Brazilian ECA is not a member.

The first ECA, Export Credit Guarantee Department (ECGD) of the United Kingdom (UK), was established in 1919. By the 1970s, most of the major OECD countries had ECA and, during the past 25 years or so, developing countries too have been actively setting up ECAs as an important tool for export development.

1910s	1920s	1930s	1940s	1950s
UK	Netherlands	US	Canada	Japan
Germany	Norway	Mexico	Austria	Finland
		Switzerland	France	Belgium
		Sweden	Italy	India
				Israel
				South Africa

1960s	1970s	1980s	1990s	2000s
Hong Kong	Australia	Egypt	Nigeria	New Zealand
	Denmark	Jamaica	Colombia	Pakistan
	Korea	Turkey	Romania	Africa
	Taiwan	China	Thailand	Yugoslavia (future)
	Portugal	Indonesia	Philippines	Macedonia (future)
	Spain		Malaysia	Vietnam (future)
	Sri Lanka		Hungary	Bangladesh (future)
			Bosnia	
			Slovenia	
			Slovakia	
			Bulgaria	
			Czech Republic	
			Poland	
			Singapore	
			Brazil	

Some ECAs only provide insurance or guarantees,[1] while others are also lenders, sometimes referred to as Eximbanks. Some provide both export credit insurance and investment insurance, while in other cases these functions are in separate institutions. Some are government departments and others are private companies acting as agent for the government or taking reinsurance from the government. In some countries, there is both an export credit insurer and an Eximbank. In some countries export credit facilities are provided by the development bank or by the Central Bank.

Although there is no single model for an ECA, it is possible to group ECAs into categories of business models and discuss the basic characteristics of each group. This is done in Section D of this chapter.

B. Reasons for Establishing an ECA

There are a number of reasons for a government to consider establishing an ECA. Naturally, there are some good reasons and some bad reasons. The best reason to establish an ECA is in relation to an unmet need or the existence of certain "market gaps" that exists within a country's or region's trade finance arrangements and thus acting as a catalyst to the private sector. While ECAs cannot solve all the problems facing exporters and banks, they can play an important role in filling certain gaps and acting as a catalyst to the private sector.

[1] The term "guarantee" can mean different things. In Europe, a conditional insurance policy is sometimes referred to as a guarantee. In the North American context, a guarantee is typically unconditional.

Good Reasons

- Protection Against Risks -

The main reasons for having an ECA are to provide exporters with both the confidence to export and the protection against possible losses. An ECA can help an exporter by mitigating or removing some of the most important risks, i.e. political and commercial risks.

- Access to Bank Finance -

Export credit insurance policies can provide useful collateral against which banks can provide finance to exporters, particularly for working capital. In addition, policies can be issued directly to the financing bank.

- Access to Information, Expertise and Training -

An ECA can serve as a single point for information on overseas buyers and countries. Moreover, ECAs have (or gain) expertise in the technical aspects of international trade and trade finance. ECAs can help train exporters and banks in these areas and demonstrate that both commercial and political risks are involved in exporting.

- International Cooperation -

As an instrument of government policy, ECAs can be effective in offering facilities that are internationally competitive with those being offered by exporters in other countries. It can also help encourage cooperation with exporters in other countries and participation in multisourcing (e.g., obtaining subcontracts from main contractors in other countries).

Bad Reasons

- Encouraging Exports to Bad Credit Risks -

It is not helpful to either exporters or banks for an ECA to be encouraging exports to countries/ buyers which have no intention or ability to pay for them. ECAs should be involved in commercial credit, not in the "business" of providing foreign aid. Neither should ECAs provide soft terms on its credit as this is an expensive and, ultimately, self-defeating policy as other ECAs can match the softer terms. A buyer should have to choose which supplier on the basis of price and quality and not on the cost of the credit.

- ECAs as Providers of Subsidized Working Capital -

Providing working capital to exporters is -or should be- a normal commercial bank function. Exporters at the manufacturing or pre-shipment stage sometimes need such finance. ECAs can play a useful role in facilitating the provision of working capital, and can offer partial security (but not subsidies) to commercial banks to encourage them to provide working capital. Subsidizing working capital, particularly to prop up inefficient domestic companies, is expensive and normally ends up with the ECA holding bad debts.

- ECAs as Providers of Subsidized Medium and Long-term Credit -

The beneficiary of subsidizing interest rates for medium/long-term credit is the overseas buyer and not the exporter (or bank). OECD countries have recognized this fact and have more or less eliminated the interest rate subsidy, which was originally allowed by the OECD Arrangement on Officially Supported Export Credits (see Section F of this Chapter).

- ECAs as a Guarantor of Exporters and Banks -

Introducing governments as the guarantor of performance and financial strength of domestic companies and banks can be the worst of all worlds, as it means taking risks without the benefit of sharing profits and, as a government entity, being potentially in the uncomfortable position of having to collect debt from domestic firms, possibly pushing them into bankruptcy.

C. Major Market Segments

It will be helpful to consider what are the basic businesses in which ECAs are typically engaged. As noted earlier, the basic role of an ECA is to support and encourage *exports* and *outward investment* by insuring international trade and investment transactions and, in some cases, providing finance directly.

The market in which ECAs operate is made up of different sectors, which are subject to different pressures and dynamics. These pressures may vary by country, particularly as between developing and OECD countries, but some general trends exist.

The basic risks that ECAs cover are political and commercial risks. For export transactions, political risks are the risk of non-payment on an export contract or project due to action by an importer's host government. Such action may include intervention to prevent the transfer of payments, cancellation of a license or acts of war or civil war. Commercial risks arise primarily as a result of non-payment by a private buyer, commercial bank or a public buyer, due to default, insolvency or bankruptcy or failure or willingness to take delivery of the goods (i.e., repudiation).

Many ECAs insure outward foreign direct investment by their national companies or banks, insuring against the political risks. Traditionally, investment insurance has been applied to three risks: expropriation/confiscation/nationalization without compensation; inability to convert and transfer profits and dividends; and the effects of war and civil war.

The three major categories/segments of ECAs' business are:

- short-term export credit insurance;
- medium- and long-term export credit insurance; and
- investment insurance

Working capital facilities are also provided by certain ECAs, as are bonding facilities, and these are dealt with separately.

Short-Term Business

There is no universally accepted definition for short-term business. In practice, most short-term credit business involves not more than six months/180 days' post-shipment credit. The Berne Union uses a cut-off point of one year's credit between short-term and medium-term credit, while the OECD uses a dividing line of two years' credit. For the purposes of this report, short-term business will be regarded as business involving up to 2 years' credit. It should be noted that, in practice, little business is done on credit terms between 180 days and 2 years.

Short-term business is the traditional and main product of export credit insurance. This is not surprising since at least 90% of world trade is conducted on the basis of cash or short- term credit. Normally, both political and commercial risks are covered. The basic insurance will apply to risks which can arise after shipment/delivery of the goods and services but most insurers also will consider providing cover against risks which can arise in the period between signing of contracts and shipment/delivery; these risks are normally called pre-credit risks. The traditional product has been a framework or umbrella policy which will embrace all or an agreed part of the exports of the insured party over an agreed period (normally one year). Individual transactions are handled under separate credit limits on individual buyers which can either be set by the insurer or agreed by policyholders under arrangements for discretion given by the insurer. This makes the administration of the insurance slightly easier than would otherwise be the case if separate policies were to be issued for each and every export order or shipment.

It is in this short-term area that the activities of the private sector have grown most substantially and where there is now very significant capacity within the private reinsurance market. Indeed, the bulk of short-term credit insurance in OECD countries (with the exception of Japan and Canada) is now provided by the private sector and is supported by private sector reinsurance. In addition, and partly as a result of this, it is in this area that there is the greatest competition for business, both between private companies and also between private insurers and public insurers. The European Union has reacted to this by setting guidelines on the activities of public insurers: public insurers are only allowed to underwrite "non-marketable risks" whereas private insurers and reinsurers within the European Union can underwrite any risks which they are willing to cover.

For most insurers, both private and public (other than specialist Medium and Long-term and/or Investment Insurance, including countries where the government may have largely withdrawn from short-term business), short-term business represents the bulk of the insurer's activities. While this is certainly true of the volume of business insured, the position may be different in respect of premium income since premium rates for the other categories of business described below would normally be much higher than the premium rates for short-term business.

In developing countries, short-term business is the mainstay of their ECAs. Demand for medium and long-term credit for export sales of capital goods is generally limited given the export composition, therefore medium and long-term credit insurance is similarly limited.

Medium and Long-Term Business

Special export credit facilities for medium- and long-term business were not introduced until the 1960s. Before that date, capital goods were either sold for cash or other means of providing/ accessing credit such as bonds or bank loans were used.

There are two main kinds of medium- and long-term credit for exports. *Supplier credit* refers to cases where the length and terms of credit are set out in the exporter's contract (e.g., payment will normally be made by means of Bills of Exchange or Promissory Notes over five years from delivery/ completion). Financing may be provided by a bank, but the export credit insurance facility will be given to the exporter who may, if he wishes, then assign it to a bank as part of the arrangements for securing finance.

However, the most common form of medium- and long-term credit in use today is *buyer credit*. This involves not only a contract between an exporter and a buyer, but also a parallel loan agreement between a bank in the exporting country and a borrower in the buying country. The export credit facility then either takes the form of a policy or guarantee given to the lender or, in some countries such as Canada, the export credit insurance institution itself also provides the financing loan.

Export credit cover in this area embraces both political and commercial risks and lenders will press to get as close as possible to a full guarantee of repayment of the loan from the insurer, rather than a conditional insurance policy.

Traditionally and especially in exports to non-OECD countries, most of this business involved sales to Governments or public sector organizations in other countries where commercial risks were thus of less significance than political risks. However, this has now been substantially complicated by two developments. Firstly, the change from centrally planned economies in many countries and consequent privatizations mean that the buyers of capital goods may be private or quasi-private companies where commercial risks are real and difficult to assess. Secondly, there is growing disenchantment with sovereign guarantees both amongst the Governments who gave them and amongst those who received them but found that they were often of little practical value.

As a result, many capital goods projects -even infrastructure projects- are now handled on a project finance basis where the risks underwritten concern the viability and cash flows of the project itself rather than the financial strength of the buyer/borrower/guarantor. One result of these developments has been that handling, processing and underwriting medium- and long-term business has become considerably more difficult and labor intensive than may have been the case in the past. In addition, the assessment of project risks and commercial risks is now more relevant and, sometimes, is more important than the traditional assessment of political risks. Both of these factors are producing challenges for ECAs, many of whom have not been staffed or structured to deal with and underwrite project viability risks or medium- to long-term commercial risks.

Some ECAs reacted to these developments by looking to share risks with private insurers on the basis that the political risks would be underwritten by the ECA and the commercial risks would be taken by the private insurer or by the banks, or even possibly by the project sponsor. In general, these efforts have not been totally successful, mostly because it is increasingly difficult to draw a clear distinction between commercial risks and political risks while project lenders/sponsors naturally seek to turn all problems resulting in delays or defaults in payment into political risks, i.e., into insured risks.

There is now some competition from the private sector on the insurance of medium- and long-term credit. Where support is coming from an official export credit agency, its terms are set under the terms of the OECD Arrangement (see Section F of this Chapter). Private sector insurers have in the past not been particularly interested in underwriting commercial and political risks on large projects, apart from some limited risks such as contract frustration.

Investment Insurance

Investment insurance traditionally has covered only political risks. Since commercial risks have not been covered, in some quarter's investment insurance has become known as political risk insurance. This, however, is a misleading name because, in practice, most political risk business has been underwritten as part of export credit insurance and not for investment insurance.

Most official insurers have enjoyed much better results from investment insurance than from export credit insurance (partly because investment insurance cases have been exempt from reschedulings under the Paris Club, and partly because claims have been fewer and smaller and more have been recovered). This has led to great interest from the private sector in underwriting this class of business and thus considerable potential for competition and cooperation between private and public insurers. In fact there has been so far more co-operation between private and public insurers in terms of co-insuring and reinsuring and risk sharing in this area than in medium- and long-term export credit insurance. Some major private insurers (e.g., AIG, Zurich, Sovereign and Lloyd's) operate in this area and are substantial underwriters with large capacity.

In the last few years, there has been a significant change in that demand for investment insurance has been applied less to equity investments than to loans. Banks in particular have shown a greater interest in using investment insurance to cover the political risks involved in lending into project finance structures. This has led to a potentially uncomfortable gray area and overlap between export credit insurance and investment insurance where the investment insurance is attached to a loan into a project financing. In fact, banks and others have not been slow to arbitrage between export credit insurance and investment insurance, especially where there are differential premium rates and where an ECA may be on cover for investment insurance but not on cover for export credit insurance. For instance, export credit insurance when provided from official sources is subject to the full rigors of the OECD Arrangement, while investment insurance is not subject to these restrictions/conditions. This means, *inter alia*, that there are no maximum lengths of credit or minimum premium rates for investment insurance.

Against this background, there has been some tendency for institutions which write both export credit insurance and investment insurance to bring the underwriting of these facilities together into the same unit. This is not an option, which is currently open to those countries who have separate institutions for underwriting these facilities.

Another result of these trends has been that more insured parties are seeking investment insurance to cover risks beyond the original three risks referred to above. In particular, they are looking for cover against the risk of host Governments violating undertakings of various kinds with respect to projects as well as other political events which could lead to non-payment of an insured project loan. Such undertakings from host Governments play an increasingly important part in the security packages for many project financings, especially infrastructure projects. The initial response of some official insurers was to look at this in the context of creeping expropriation but, more and more, insured parties are looking for specific cover against breach of contract or breach of undertaking by host Governments. It is difficult to generalize about the response of official insurers to this although most of them are making moves in the direction of meeting the requirements of insured parties. *Inter alia*, this deepens and widens the gray area of overlap between investment insurance and export credit insurance.

Working Capital

Working capital is the financing required by an exporter to start or to continue to operate and to produce goods and services to be exported. Normally, ECAs are not directly involved in providing working capital although exporters often are able to obtain working capital from their banks because the exporter can provide as security the ECA insurance policy (which may include cover of pre-credit risks) sometimes through the assignment of the policy to the bank.

A few ECAs are directly involved in the provision of working capital, offering facilities directly to the banks. In certain instances, working capital loans are provided by the ECA directly. However, this is a difficult and high-risk area, especially if the exporter fails to perform its contractual duties and, as a result, is not paid by the importer.

In most OECD countries, government involvement in working capital for exporters is usually only directed at the SME sector whose access to finance may be limited by the size of their balance sheet (see Chapter III on SMEs). In most instances, the provision of working capital to exporters or working capital facilities to financing banks would be done in respect of a specific export transaction: the exporter has an export contract and needs working capital in order to meet the order, or the exporter has already shipped goods and has an outstanding export receivable.

In developing countries, working capital facilities can be an important part of the product offerings of the ECA depending on the state of the commercial banking sector and, in particular, the ability of banks to assess commercial and performance risks and so to provide working capital or general financing facilities to exporters.

Bonding and Guarantees

Most ECAs provide cover to a commercial bank that issues a facility to a buyer on behalf of an exporter. The bonds or letters of guarantee can be tender, advance payment, bid, performance or retention. A performance bond, for example, is a guarantee of the bank that the exporter will meet the terms of its contract with the buyer.

A call on the bond will result in a claim paid by the ECA and, if the call on the bond is rightful, the ECA will seek indemnification from the exporter. Alternatively or additionally, ECAs will provide insurance to the exporter against *unfair or wrongful calling* for political reasons of these bonds.

D. Major ECA Models and Government Involvement

Although credit insurance was developed in the private sector, in virtually every country where export credit insurance has been provided, the government has been involved in some way. The precise reasons for government involvement and why this should have lasted for so long are less clear-cut. They generally are centered on the government's perception of a market gap resulting from a general reluctance by private insurers to take on what were perceived to be unacceptably high and unpredictable risks in developing countries, and the desire to protect and promote exports. There were no doubt other reasons related to industrial and foreign policy.

One of the reasons for the continuing involvement of governments in this area has perhaps been the view among exporters and banks that government organizations will be more persuadable and open to pressure than private companies and more susceptible to the argument that, if support is not provided, then exports will be lost. It is almost certainly the case that some governments have provided support in response to these kinds of arguments. An official ECA was believed to provide a rather flexible instrument for governments in exporting countries to be used for a range of trade, financial, industrial, commercial and foreign policy and aid contexts.

No Single or Perfect Model

As discussed earlier in this chapter, there is no single or perfect model or status or organization or, for that matter, structure for government involvement in an official export credit scheme. Nor is there such a thing as a typical ECA.

- Some export credit insurers are government departments, some are public corporations and some are private companies. Some of the latter may write most of their business on their own account but, under an arrangement/agreement with their government, may also write business on the government's account.
- Some do only short-term business, some do only medium- and long-term business and some do both.
- Some only insure or issue guarantees, some lend and some do both.
- Some are called insurers and some export/import banks. The role of Eximbanks varies considerably in that some, such as India, give the greatest emphasis to import finance.
- Some provide working capital facilities to exporters where the commercial banks are -for whatever reason- unwilling or unable to do so.
- Some only write export credit insurance and some only investment insurance but most (at least of the larger agencies) do both.
- Some are very large, with premium income running into US $100M+ whereas others are considerably smaller.
- Some primarily underwrite political risks and some write primarily commercial risks, but most now cover both categories.

In most countries, the emphasis for medium- and long-term credit increasingly has been on providing insurance/guarantees rather than on direct lending. Most of the institutions who underwrite both medium- and long-term export credit insurance and investment insurance have now brought these activities either into the same unit or at least much closer together. Indeed, there is some growing tendency towards dispensing with the two categories and referring to the whole activity as political risk insurance although this potentially could cause problems in relation to the OECD Arrangement, which governs credit insurance but not investment insurance.

All of these points demonstrate that not only is it very unwise to try directly to copy or transfer export credit schemes or institutions from one country to another country but also that it is essential to keep these schemes and organizations under constant review. What may be entirely suitable for a country at one point in time may not be relevant or may, indeed, be positively unhelpful even two or three years later.

Major International Models for ECAs and for Government Involvement

As has been noted, there is no single or perfect model for an ECA or its status or relations with its government. Moreover, it is very dangerous to try to transplant a model from one country to another country. It is vital to design a model in the specific context of the country concerned. In addition, it is very important to keep this model under constant review, since what may well be a good and relevant structure and status at one point of time may well need adjustment even a couple of years later.

While no ECA is alike, most institutions fall into one of four broad categories. ECAs from both OECD and non-OECD countries can be categorized into these main models, although it is important to note that there may be significant differences in some contexts between the institutions which fall into the same category or model.

- Private Company Acting as Agent -

This is the model which applies in France, Germany and the Netherlands. It also used to apply in South Africa, before the government decided in 2000 to set up its own institution to underwrite and issue policies directly. In these countries the Government has an exclusive arrangement with the private company concerned (COFACE in France, Hermes in Germany, and NCM in the Netherlands) and the company issues policies as agent for the government. When acting as agent for the government, all risks are taken by the government, even the documentation risk in the case of the Netherlands. Most of the key decisions will be taken by the government but it usually is open to the company to make recommendations and to provide not only services for the issue of policies but also for the initial analysis of the risks involved.

Since the arrangement is an exclusive/monopoly one, it can be regarded as a "sweetheart deal" and, for this reason, such arrangements increasingly give rise to complaints from other insurers who are not able to access them.

One potential problem with these arrangements is that the private company will normally also have the ability to underwrite business on its own account and so there may be some tension or conflict of interest in the context of which business goes into which category, either own/corporate account or government account.

- Government Department/Facility -

Within the OECD countries, the UK and Switzerland operate their export credit agencies as government departments. In the UK, the Export Credit Guarantee Department is a separate Department responsible to the Secretary of State for Trade and Industry. In Switzerland, Export Risk Guarantees is part of the Secretariat for Economic Co-operation. In the case of New Zealand, the Export Credit Office comes under the authority of Treasury.

For certain developing countries, special export credit facilities are offered either via the Central Bank (e.g., Chile, Barbados) or the Commerce/Industry ministries (Cyprus).

- State-Owned Agencies -

The most common form of delivery for export credit facilities is via an autonomous institution which is owned by the government. However, there are many different versions of this institutional arrangement, not least of which is the product line. Some of these agencies provide only insurance (e.g., SACE in Italy) while others provide only lending (e.g., Czech Export Bank). Many more combine both insurance and lending under one roof (e.g., EDC in Canada, US Eximbank, Thai Eximbank). However, not all Eximbanks combine both insurance and lending. Meanwhile, only in the US and Germany is export and investment support in separate institutions (i.e., US Eximbank and OPIC; Hermes and PWC).

A few important distinctions between these government-owned agencies can be made. These distinctions reflect the different operating philosophies and mandates given by their government guardian authorities.

- Government Provider of Reinsurance -

This is, perhaps, a growing trend as more governments review not only the extent and nature of their involvement in export credit insurance but also whether they want to be involved at all. Thus in some areas (e.g., in the UK and soon in Australia) the government will not issue facilities for short-term business to exporters and banks but will provide reinsurance (100% or less) to one or more approved insurers.

- Government Provider of Working Capital Facilities -

Some ECAs, particularly in developing countries, focus primarily on the provision of working capital, offering guarantee facilities to the banks, and in certain instances and in certain countries, direct loans to the exporters or financing banks.

There are typically two types of facilities offered: general financing facilities and specific financing which is related to an export transaction. The type of facilities usually depends on the strength of the banking sector and, in particular, the ability of banks to assess commercial and performance risks of an exporting company.

For specific working capital facilities, the provision of working capital to exporters or working capital facilities to financing banks would require that the exporter has an export contract and needs working capital in order to meet the order, or the exporter has already shipped goods and has an outstanding export receivable.

Other Issues

- Competition or Last Resort? -

The two ends of the spectrum are those state institutions, which compete with the private sector, and those state institutions, which act as lenders or insurers of last resort. Almost all OECD governments have required their ECAs to break-even over time, so as not to operate as export subsidy mechanisms. Some governments have also insisted that their ECAs function as a last resort institution, only filling the markets gaps in the facilities offered by the private insurers and banks.

The best and perhaps only real example of a last resort agency is in the United States. US EximBank is *not* supposed to compete at all with the private sector and, indeed, also has the objective of offering the lowest possible cost facilities to SMEs. It can be a direct lender for fixed rate finance but generally issues guarantees to lending banks in the medium- and long-term area rather than lending itself. The main reasons for this approach seem to be a wish not to compete with, or inhibit the growth of, the private sector in either the short-term or medium- and long-term areas and also to provide low-cost facilities for SMEs.

However, it is very important to note that it is extremely difficult to operate as a last resort insurer while at the same time not operate at a loss and achieve break-even. The challenge for those last-resort institutions to operate at no net cost to the public is particularly difficult, if not impossible, if they are only able to pick up business that the private sector does not want because it is either too risky or too big. This puts the ECA in a real and perhaps unsustainable dilemma.

The difficulty of meeting these dual objectives did not really matter as long as the ECAs had what were almost monopoly products and so there was no real competition for the business. However, official ECAs now face competition in virtually every area of their operation making this balancing act extremely challenging. And so, US EximBank increasingly runs up against the problem of trying to offer a competitive and efficient service when it does a little short-term business. There also are particular question marks over its ability to analyze and so underwrite prudently medium- and long-term commercial risks.

One key point in this area which applied to both private and public export credit insurers -especially of short term business- is the very high cost of obtaining and accessing credit information on buyers worldwide and being able to offer competitive facilities electronically to exporters. This means that very large insurers operating in and out of a number of countries, so generating large premium income and being able to spread their overheads, have a great advantage. It is very hard for small insurers to compete or to offer a competitive and effective service.

There are a few countries in which the ECAs compete head-on with private insurers and, even banks. Typically, these institutions enjoy significant advantages over private insurers such as tax and dividend exemptions, costless government guarantee of capital, etc.

In Canada, Export Development Corporation (EDC) competes vigorously with the private insurers for all areas of business. It is also a lender for medium- and long-term business and so, rather than providing a guarantee to funding banks as is done in most countries, it lends directly, competing with the banks.

Japan's NEXI also competes with the private insurers which have an important and growing presence in Japan. In addition to some of the large multinational credit insurers operating in Japan (AIG, COFACE, etc.), there are some Japanese multi-line insurance companies which have also set up credit insurance operations.

In Turkey, there are also private credit insurers (e.g., COFACE) competing with the government-owned ECA. Turk Eximbank not only provides credit insurance to Turkish exporters, it also offers subsidized working capital loans to banks and exporters, which are even cheaper for the exporter if credit insurance is also purchased.

Unsurprisingly, private insurers are concerned about what they see as "unfair" competition from state institutions.

- Two institutions -

As noted above, in some countries there are two institutions providing export credit support, one the insurer and the other the lender. This is particularly true in Asia where in Japan, Korea, Malaysia, India and China insurance and lending institutions exist separate from one another. This is also the case in the Czech Republic.

The reasons for a two-institution system are various. In some countries, it stems from legal requirements that some institutions cannot be involved in both banking and insurance and there may, in addition, be different supervisory authorities for insurance and banking. In some cases such as the Czech Republic for example, while there are two separate organizations, they work closely together and in fact share certain common resources. However, in most cases it is very difficult to avoid some competition developing between the two institutions.

- Contingent Reinsurance -

In some countries, as suggested earlier, there are separate and different arrangements for short-term business and for medium- and long-term business, e.g. in the UK, Denmark and New Zealand.

In the case of the UK and Denmark, the Government has largely withdrawn from short-term business other than providing reinsurance, usually on a contingent basis, to all eligible reinsurers. In other words, there is no special arrangement with one company as is the case in France, Germany and the Netherlands.

In New Zealand, some 15 years after the Government privatized its export credit agency, a new export credit scheme was established in 2000 in which the Danish ECA acts as agent for the New Zealand Government. Effectively, a "virtual" ECA was set up whereby the Government provides the capital and carries the risk but the underwriting is done by the Danes.

In all three countries, medium- and long-term and investment insurance business is operated on a direct insurance business.

The main "drivers" for these arrangements has been the wish of the Governments to withdraw to the maximum extent from short-term business but to keep in place some safety net arrangements contingently available in the form of a national interest capability. Operating on a reinsurance basis removes the need for the Government institution to have the whole panoply of information and underwriting expertise on a general or across-the-board basis.

- Multinational Groups -

One very important development of the last ten years have been a move away from the tradition of having one "national" export credit insurer, private or public, in each country. There are now three very large groups (Euler/Hermes, Gerling/NCM and COFACE) which operate in and out of a growing number of countries, proving largely short-term insurance against both commercial and political risks using private market reinsurance. They now dominate the market and compete vigorously between themselves and with others and it is very difficult for small insurers to match their speed of service and their electronic systems and products.

E. Key Challenges for Official Schemes

ECAs from both OECD and non-OECD countries face a range of financial, competitive, operational and policy challenges. Some of these are common to all providers of export credit insurance while others are particular to official ECAs.

Financial Challenges

Pressure on ECAs -especially from their own government- to cover the costs of their operation has been mounting in recent years, not least of all due to the losses from the 1980s debt crisis and the World Trade Organization (WTO) obligation that export credit schemes break-even (see Section below for more details). However, as noted earlier, the dilemma of not competing with the private sector while at the same time earning sufficient premium to cover the losses and costs of operation is a formidable challenge.

Competitive Challenges

A review of competitive challenges is particularly relevant in the context of discussions on the role of ECAs, and whether they should operate only or mainly in market gaps. If official operations are to be restricted to market gaps, then it is vital to review in considerable detail what constitutes a market gap, and also to bear in mind that the gaps may change significantly in a relatively short period, partly as perceived risks change, but also as available capacity in the private insurance and reinsurance markets fluctuates. A significant reduction in business volume in an official scheme could mean that a reliance on last resort business will lead not only to losses and an unbalanced portfolio, but also that the level of business underwritten and so premium income may fall below the critical mass which is necessary to maintain a credible and effective infrastructure of experience, expertise, and information (including spending on IT development).

Again it is useful to deal separately with the different categories of business. This is partly because the involvement of private sector insurers is different in the three business areas. In addition, competition in some areas does not come only from insurers as such, but from other sources and other products.

Overall, the one inescapable conclusion is that official ECAs no longer have monopoly products in *any* of the three business areas.

In the short-term area, competition is probably the greatest. Most exporting companies continue to self-insure (i.e., not buy export credit insurance -some from deliberate choice some from unfamiliarity with the risks and/or with credit insurance products), while in many countries, official involvement has been significantly reduced over the last few years as private insurers have become more active and as governments have decided to "cut back". Other products such as letters of credit (L/Cs), forfaiting and factoring can also be seen as alternatives to export credit insurance, although it is also possible to use these products in combination with export credit insurance.

In the area of medium- and long-term business, the willingness of the private insurance market to undertake some aspects of this business on any scale is still open to doubt, although there have been some developments. There is competition from other sources and other products such as commercial banks, investment banks/capital markets and forfaiters, although as in the case of short-term business, there are also opportunities for cooperation between them and ECAs. And medium/long-term business is not a homogeneous area. It can include not only large projects but also aircraft, shops, defence goods and machinery, plants and vehicles of many kinds (trucks, buses, tractors, etc.).

Investment insurance is already available from official, private and IFI sources. Co-operation between ECAs and private insurers has been active in this area but this is almost certain to turn to more active competition over the next few years and it is likely that capacity in the whole market (including the official insurers) will be greater than demand for this kind of cover. A key issue is the extent to which this insurance is used for loans as well as equity and how active investment insurers will be in extending the risks covered beyond the traditional three of nationalization/ confiscation, convertibility/transfer and war/civil war into wider areas of breach of contract by host governments or host government actions adversely impacting on the viability of insured projects.

Operational Challenges

The operational challenges facing ECAs are ones being faced by all suppliers of export credit insurance and finance, challenges arising from the increasing complexity of a globalized international economy and of the transactions arising from it.

Privatization has lead to a shift away from the traditional sovereign buyer risk or sovereign-guaranteed risk to commercial and project risk. This is true not only in projects but, more widely as import/export business and banking are privatized and reshaped in most emerging markets. There has been increasing reliance on project finance structures and most ECAs (both in OECD countries, and especially in developing countries) simply do not have staff with the skills necessary to deal with and underwrite large numbers of medium- to long-term project viability risks involving sophisticated security packages. Project finance also poses other challenges to ECAs, not only in the need for greater flexibility in national content requirements, but for the ability to commit support in advance of procurement decisions, counter to the normal reactive mode of most ECA operations.

Furthermore, and associated with this, ECAs are having to develop ways to meet the needs of multi-sourcing. In order not to disadvantage their national exporters, ECAs are having to find ways to streamline their sometimes cumbersome bureaucracies. A network of bilateral reinsurance agreements between ECAs are being developed which allow one ECA to lead in a multi-source contract, using only one financing document backed by reinsurance agreements with the ECAs of other suppliers covered under the contract. From the buyer's perspective, this lessens the burden since it is not necessary to accommodate the individual documentation of each ECA.

Credit insurance is no more immune to the problems and opportunities of e-commerce than any other industrial or commercial or financial services sector. Meeting the challenge of e-commerce requires the development of new products, implying radical changes from the past. An important aspect of this is storing, accessing and manipulating a vast amount of data on literally millions of buyers in a large number of countries and developing and using correlated statistics on a range of sectors/trades both of sellers and buyers. The very high cost of producing these new products and of developing the IT mechanisms required to support and to deliver them is huge. This is yet another reason for the continuing concentration of insurers in the credit insurance market and carries real implications for the survival of smaller institutions with limited resources, whether these are official or private insurers.

Policy Challenges

For a variety of reasons, over the last few years there has been much greater public, parliamentary, press and NGO interest in ECAs. This, in turn, has given rise to demands that there should be a clearer link between decisions on ECA facilities and other aspects of government and international policy. Official schemes are especially vulnerable to these demands for corporate social responsibility, encompassing a range of policy issues. The common theme in all of the areas and issues is the pressure for greater openness and transparency, not only in relation to the procedures and practices of ECAs but also in relation to specific transactions. Obviously, the second area opens up very sensitive and difficult questions of commercial confidentiality and the competitive position of exporters vis-à-vis particular transactions. And in the context of competition between private and public insurers referred to earlier, private insurers are obviously subject less to these pressures.

Some of this debate and policy development is being done on a national basis, but given the preference of most governments to move on a multilateral basis, under procedures and arrangements which have been agreed with other governments, much is being done in the context of the OECD.

One of the current key issues is that of the environment, and demands, especially from the non governmental organizations (NGOs), that ECA support be contingent on proof that the project or transaction being supported meet certain environmental standards. ECAs and their governments have been generally reluctant to take steps which would put their own exporters at a competitive disadvantage and so the debate was taken up within the OECD Arrangement to apply common environmental standards for capital goods exports benefiting from official export credit support. A common approach to environmental impacts and mitigating strategies has been agreed by OECD Participants, with the exception of the US.

Another area where there has been a growing link between export credit facilities and wider policy considerations is in respect of good governance and corruption. As a general rule, ECA facilities would be invalid if it were to be shown that an insured contract had been obtained by corrupt means and so fell into the category of an illegal contract, but a number of NGOs and countries wish to go further than this. This is another area where the OECD is at work. The work has partly been of a general nature to try to get an agreement or understanding between OECD countries in relation to good governance but this is now being carried into the specific area of medium- and long-term export credits.

Some governments (and of course some NGOs) would like new export credit facilities to be made conditional on the Governments of the buying countries meeting some specified standards on human rights or child labor or workers' recognition. Others would like to see officially supported export credits denied for some countries or across the board for arms sales. The desire is that new export credit facilities should be used as leverage to pressure governments of buying countries to improve their performance and raise their standards in various areas. The United States has already taken some unilateral action in this context and is probably off cover for more countries for "political reasons" than any other major exporting country. These areas are also now the subject of discussions within the OECD since few governments would wish to move unilaterally in this area and so put their own exporters at a competitive disadvantage with exporters from countries which have not implemented or introduced such requirements or conditions or exclusions.

International Legal and Regulatory Challenges

Two main sets of rules exist for ECAs, one for medium- and long-term business and the other for short-term business. The OECD Arrangement on Guidelines for Officially Supported Export Credits provides guidelines for credits with repayment periods of two years or more. Berne Union guidelines set out credit terms for different types of goods, normally but not exclusively, sold on short terms.

In addition, until 1995 there was also a GATT requirement for official export credit schemes to break even. Since then, with the advent of the WTO and a number of important panel rulings on export finance cases, the relevance of the WTO to export credit has become even more important. This is discussed more in Section G.

F. The OECD Arrangement

General

The OECD Arrangement on Officially Supported Export Credits, now almost 25 years old, was put in place to prevent a "subsidy war" among official ECAs which were -at the time- using credit to "buy" export sales/deals. The Arrangement was intended to established a level playing field so that exports would be won on the basis of price, quality and service and not on the costs and conditions of financing. There is a tremendous amount of information available on the OECD's website in regard to premium rates, country ratings, common environmental approaches, etc. (See *http://www.oecd.org*).

Status

The Arrangement (known also as the "Consensus") covers credit with repayment terms of 2 years and more. It sets limits on the repayment terms which are generally 10 years for most countries and sectors, but are shorter for higher income countries and can be as long as 12 years for power plants and 15 years for nuclear power plants.

The Arrangement also sets a strict limit on the length of the grace period (i.e., the period between the completion or delivery date and the date of the first repayment) of six months. Principal must be repaid in equal semi-annual instalments and so annuity structures or bullet payments are generally not allowed. Special provision for Project Finance structures were put in place in 1998 which allow for a limited degree of flexibility to reflect better the cash flow of limited recourse project financings.

Interest Rate Provisions

A system of minimum interest rates applies where official financing at fixed interest rates is provided (i.e., the ECA lends, or provides an interest make-up to the bank to lend). The interest rate is called the CIRR (commercial interest reference rate) and there is at least one CIRR rate for each major currency (and up to three different rates to reflect different maturities) all based on the government treasuries for that currency. When cover is provided by the ECA only for the credit risk and no interest rate support is given, this is called "pure cover", allowing the bank to charge whatever spread/margin it deems appropriate on the underlying loan.

Tied and Untied Aid

The Arrangement also outlines the conditions for providing mixed credits (a French invention representing a blend of export credit and bilateral aid) so as to restrict the use of these and to make them more expensive in terms of the amount of bilateral aid required to make the cases compliant with the Arrangement.

Aid (in the form of either grants or concessional loans) can be provided under certain, restricted circumstances. The minimum level of concessionality (i.e., either the percentage of the loan in the form of a grant or the NPV of the difference between the concessional interest rates and the CIRR) must be 35%. The project receiving the concessional support must be shown to be commercially non-viable, e.g., in the social sector, housing and education, etc. Some loopholes exist for *de minimis* contracts which are below a threshold of 2 million SDRs.

Premium Rates

In 1997, the OECD Participants to the Arrangement adopted the "Knaepen Package" which was a comprehensive agreement on minimum premium benchmarks for political risks. It is the premium minimum rate that can be charged for political risk and it applies to *all* transactions. Therefore, it is the basic building block to which an increment for commercial risk can and should be added.

The OECD premium system is underpinned by a country classification system which categories countries in one of 7 categories. A "country experts" group meets regularly to discuss country classifications. An econometric model first categories a country and then the experts discuss whether the model has rated the country too high or low and needs to be adjusted for "non-quantified" factors, such as recent signing of an International Monetary Fund (IMF) agreement.

Civil Society Issues

In recent years, the OECD Participants to the Arrangement have shifted their attention into other areas, such as the environment. In January 2002, all Participants (with the exception of the US) implemented a common environmental screening process/standard which essentially requires ECAs to review ex ante the environmental impacts and to apply World Bank standards, if possible, or at a minimum, ensure host-country standards are met. The US, feeling that the agreement was not strong enough, made the decision not to sign on to it. These guidelines are also available on the OECD's export credit website.

The OECD ECAs also have a common procedure with respect to trying to eliminate bribery, requiring their exporters/clients to sign a form saying that no bribes were given. In addition, there has been recent agreement not to provide export credits to be used for "unproductive expenditures" in Highly Indebted Poor Countries (HIPCs). OECD ECAs have agreed to report all their new business with these HIPC countries and this data is then aggregated and put up on the OECD website.

G. The WTO and Export Credit

General

This is an area of increasing relevance, importance and concern for official OECD ECAs and their governments.

Historically, capital goods exporters and ECA providers of medium and long term export credit were generally in OECD countries and so any disputes or disagreements between countries could be settled in the OECD forum. Moreover, the rules of the Arrangement are fairly clear so only on rare occasions in the past 25 years had there been disagreements of any importance. Therefore, matters arising in the area of export credit were dealt with in this forum.

The WTO is the global international organization dealing with the rules of trade between nations. The WTO came into force on January 1, 1995 as a successor agreement to the GATT and is an agreement between some 144 nations.

The WTO Agreement on Subsidies and Countervailing Measures (SCM) was put in place following the Uruguay Round of negotiations. Therefore the adoption of the WTO had important and new implications for developing countries, which had previously not been GATT members. Developing countries were given an 8-year phase-in period (to expire at the end of 2002) to give them time to reduce their level of subsidies. According to the WTO Secretariat, there has been a request by over 30 developing countries to extend this transition period for an additional 2 years. (The full text of the WTO SCM agreement is available on the WTO's website: *http://www.wto.org*).

The fact that the WTO membership now includes developing countries has important implications for the OECD Arrangement, which until 1995 had been solely the concern of OECD countries as providers of export credit and export finance. In 1995, with the accession of many developing countries, some of which were also export credit providers (e.g., Brazil and India), as well as recipients, there was a need for the OECD Arrangement to be better understood more generally by the rest of the world and to open up its membership and participation.

The objective of the WTO is to ensure that trade is able to flow as smoothly, predictably and freely as possible, by imposing multilateral disciplines on those subsidies which distort international trade.

There are two types of subsidies which have the potential to distort trade: export subsidies and the use of domestic products over imports. The first type of subsidy gives an opportunity for price reductions of country's exports, while the second type favors domestic products over imports from another country. Either type of subsidy has the potential to distort trade.

Unlike the OECD Arrangement, the WTO is not simply a "gentlemen's agreement", but is legal text ratified by the Parliaments of all Member countries. Most of the WTO members are not OECD Participants and some, such as Brazil, India and China, export capital goods and whose governments/ECAs provide medium and long term export credit support. Therefore, while a dispute between OECD countries on export credit transactions can be handled in the OECD, any dispute between an OECD and non-OECD country has only the WTO forum upon which to rely.

Export Credits

The issue of export credits was put firmly at the centre of the WTO's interests because of the recent (and ongoing) cases of Canada against Brazil and Brazil against Canada in the area of export finance programs for Regional Jet aircraft. These cases brought to the attention of the WTO the fact that a certain portion of their rules were in the hands of a "subsection" of their members, namely the OECD Participants, and it was incumbent upon the WTO Secretariat to be more informed about these disciplines. The OECD Participants were reluctant to have the WTO Secretariat as an observer at their meetings, fearing that they would be ceding their right to interpret the Arrangement to another body. However, the right to interpret the Arrangement does not in fact fully belong to OECD Participants, as the Arrangement itself is a subtext of the WTO SCM Agreement and is legally therefore in the hands of the WTO, a body with some 144 members, all of whom "own" this text.

The dispute between Brazil and Canada on Regional Jet aircraft dates back to late 1996. As Brazil is not a Participant in the OECD Arrangement, Canada challenged Brazil's export finance subsidy PROEX at the WTO.

Brazil subsequently launched a counter-request for consultations on certain Canadian programs which affect the export of aircraft. The two cases evolved in parallel throughout the entire process, with both parties appealing certain aspects of their rulings by the WTO panels in respect of their cases which were brought before the Appellate Body. Both parties launched the second round of panel hearings about the specific meaning of the implementation of the first rulings. More recently, a new case against Canada has been heard (Details of the Brazil-Canada cases are available on the WTO's website - *http://www.wto.org*).

The consequences of the decisions coming from the WTO on the meaning of the OECD Arrangement have been profound.

Definition of Subsidy

The WTO SCM Agreement defines a prohibited subsidy as having met both the conditions of: (1) a financial contribution by government in the form of loans, grants or guarantees/insurance; and (2) conferring a benefit beyond that available in the market to the recipient. Where this subsidy is tied to exports, or more precisely contingent on export performance, it is a prohibited export subsidy.

Typically, ECA support meets these two conditions, i.e., being government support and doing business and taking risks where the "market" may be unwilling. While not making a legal interpretation of the WTO text, it is fairly safe to say that export credit support provided by a Government agency, department or private entity on behalf of Government, would be captured by the definitions of financial contribution.

It might also seem logical that export credit support, which does *not* confer a benefit, would not be a subsidy. This point has apparently been confirmed by the most recent panel rulings.

Definition of Prohibited Export Subsidies

Having defined therefore what is a prohibited export subsidy, the SCM provides in an Annex an illustrative list of export subsidies, i.e., not an exhaustive list of what might constitute such a subsidy, but rather a number of items which could be expected to be a subsidy.

There are two relevant items in the list:

- Premiums which are not adequate to cover long-term operating costs and losses; and
- Lending below cost of funds.

In the first case, this had traditionally been interpreted to mean that ECAs has to break-even on the export credit schemes. In the second case, a certain carve-out or "safe haven" was allowed which under certain circumstances would mean that the prohibited export subsidy would be allowed.

Safe Haven

The "safe haven" is available in certain cases, which allows governments to provide such support without it being deemed an illegal or prohibited export subsidy. Generally speaking, this "safe haven" is referred to as the "interest rate provisions" of the Arrangement. Notably, it is only the *interest rate* provisions and not the other provisions which apply. This could mean that "pure cover" operations are not covered by the "safe haven" and thus subject to the full rigors of the SCM agreement.

However, there is an argument being developed by developing country members (notably Brazil and India) that the "safe haven" should be defined differently for these countries and, more specifically, that the minimum interest rates be lower for them than for OECD countries.

At this stage, it is difficult to imagine that OECD ECAs' pure cover business is under threat, not least because some country would need to take a case against them and would need to be able to prove injury. However, it does suggest that export credit rules are no longer the sole domain of the 25 OECD countries.

III. SPECIAL CHALLENGE OF SMEs

A. General

One of the most common and most challenging problems that governments can face is what to do about small exporters. Small exporters are a significant and politically sensitive subject in most countries for various reasons and not necessarily because they make a substantial or potentially substantial contribution to total exports. It is important to distinguish between small exporters and new exporters.

Small business owners often wield considerable political power through their sheer numbers. Some of the disadvantages they face in exporting, relative to their larger competitors, are real. However, this does not translate into a general imperative for ECAs to apply different underwriting approaches or to charge lower premiums to small exporters than they do in other areas. Special facilities may indeed be appropriate for small exporters, but special facilities need not mean cheaper facilities; on the contrary, it may mean more expensive ones.

Facilities tailored to small exporters may be costly to operate largely because of diseconomies of scale: administrative costs per contract may be as high as those for larger exporters (or higher, because small exporters may need more agency assistance), yet premium income per contract is likely to be lower. Lower-than-normal premium rates would not cover these costs. It is one thing to develop special facilities and products for smaller exporters (or, more precisely, small companies that export), but it is quite a different thing consciously and deliberately to operate these facilities on a money-losing basis. The first objective is good, but the second is undesirable and unnecessary. Moreover, it is vital never to overlook the importance of large exporters and the need not to impede or discourage them or to discriminate against them.

Export Credit Insurance for SMEs

Export credit insurance is a difficult and technical subject, and for this reason the policy documents tend to be both complicated and lengthy. This is not normally a problem for large and experienced exporters, but small companies typically lack both experience and expertise in international trade and finance. Smaller exporters will normally find the ECA's traditional products difficult to understand, complicated and expensive to operate. They will also usually find it unattractive to try to fill these knowledge and resource gaps by buying external expertise. Smaller exporters will, in addition, often face shortages of finance, including working capital.

Thus, smaller exporters need not only simplicity of concept, approach and documentation but also clear and easy administrative procedures. In addition, they may need greater help from the ECA, both in setting up and operating the facilities and in exporting and obtaining finance generally.

It is very important to bear in mind that export credit insurers need the business of large exporters to generate the overall income to pay for the substantial infrastructure (credit information, specialized expertise and, especially, IT systems) they need if they are to give rapid, internationally competitive, comprehensive and efficient service to all their exporting customers, large and small. The resources and money to buy and maintain this kind of infrastructure cannot be derived from the premium income of small exporters alone.

Moreover, it costs export credit insurers money and resources to develop and operate special facilities where the level of insured business per policy or policyholder will be small. ECAs face the delicate task of trying to balance the emphasis, priority, and resources they devote to smaller exporters with the relatively meagre premium income they will receive from this business.

If the facilities extended to smaller exporters are deliberately treated as inevitable money losers (even if no claims are paid), these facilities will always be vulnerable to change, reduction or withdrawal. They will be assigned a lower priority and less skilled staff, and as a result they will provide less customer care. Apart from everything else, this ends up being very much to the disadvantage of the small exporters.

Thus, the guiding objective for export credit insurers and their governments should be to give priority to developing special products and facilities which meet the particular needs and special problems of SMEs and to administer them effectively and not simply to offer low or subsidized prices.

Working Capital Facilities for SMEs

As noted, SMEs typically face additional hurdles above and beyond those faced by larger companies. These challenges are reflected in limited financial and management resources, and difficulty in obtaining financial support. Lack of access to commercial bank financing is due to a number of related factors, such as a weak balance sheet, the lack of useful collateral, insufficient information for the banks to do a proper credit assessment, lack of a track record, etc. This is often exacerbated by a lack of expertise in international business and finance.

Both IFIs and ECAs have recognized the important gap in this area and have thus introduced certain programs and facilities to address the special needs of these companies, working together with government, business and financial sector partners. Those initiatives by ECAs and IFIs which have been most successful have also recognized the fact that working capital is invariably most effectively provided by commercial banks who have day-to-day dealings with the companies and are thus very familiar with them. If, with that experience and knowledge, banks are not happy to provide working capital for *risk* (as opposed to *cost*) reasons, then it is very difficult for an IFI, an ECA or any other government organization to make the finance available or take the risks, without suffering losses or having problems in recovering the funds from SMEs.

The major and most significant role of an ECA is the provision of export credit insurance and not the provision of working capital. In addition, another vital point is the important distinction between the *availability* of working capital and the *cost* of working capital. It is always politically attractive to make subsidized working capital available but invariably this produces early problems for meeting the costs of such a subsidy. The ECA cannot do so from its own resources and, once introduced, governments find this a difficult subsidy to withdraw.

The next chapter examines the role of IFIs in this area.

B. ECA Initiatives

The following section outlines various approaches to the SME sector taken by some of the key ECAs.

Australia - Export Finance and Insurance Corporation (EFIC)

Like many other ECAs, EFIC has been the subject of a recent government review. One of the results of this has been the outsourcing of aspects of its operations, including some most relevant to its SMEs customers such as short-term credit insurance and working capital support.

While the full range of EFIC products (including also direct loans, export finance guarantees, documentary credit finance and guarantees, political risk insurance, medium-term payment insurance, bonding facilities) is theoretically available to SMEs, many of these are not suitable to them, or require a minimum contract size which is greater than most SMEs could handle.

- Delivery -

Although EFIC had established a small, dedicated team in its Export Finance Group to deliver working capital support (see below), the team was disbanded several years ago and part of the work has been outsourced.

However, there is a new EFIC Assist unit on the credit insurance side which was created specifically to service SMEs, defined as companies with an annual revenue base of A $10 million (US $5mn). Similar to SME units in other ECAs, it has developed streamlined products and processes to address the needs of this market segment.

EFIC offers access by either internet or toll-free telephone, but does not offer e-business delivery as such.

- Products -

Export Payment Protection Insurance: Designed especially for exporters with an annual turnover of less than A $10 million, selling on payment terms of up to 180 days, the streamlined policy provides cover in the event of non-payment by an overseas buyer as a result of specified commercial or political events. The policy provides up to 100% indemnity for various country/political risks including currency convertibility and transfer, war/insurrection, change in law (e.g., cancellation of import license) or shipment diversion. Up to 90% indemnity is provided for commercial risks including wrongful failure to accept goods or to pay after acceptance, buyer insolvency or issuing bank's failure to honour an irrevocable L/C. The SME exporter has the option of paying a single annual premium, or split monthly premiums, based on an estimate of its annual insurable export volume.

Working Capital Guarantee Facility (WCGF): This facility is being phased out by the government and is only provided on the "National Interest" account of the government, which means that the government, not EFIC bears the losses. Under the WCGF, the exporter's bank provides additional financing or an extension of the exporter's credit line for designated export transactions. The WCGF provides support for up to 30% of the value of the export transaction (or up to 50% exceptionally), with a minimum guarantee amount of A$50,000. As currently structured, EFIC retains responsibility for business initiation and portfolio management, but the credit evaluation aspect has been outsourced to a private venture capital firm.

Bonding and Guarantees: While EFIC can either issue bonds directly or provide guarantees to the bank issuing the bond, provided that the export contract is valued at a minimum of A$500,000. Bond insurance against wrongful call is also available.

Canada - Export Development Corporation (EDC)

EDC is acknowledged as one of the first ECAs to develop special initiatives to meet the needs of the SME community. This is not surprising given the critical importance exports play in the Canadian economy, representing some 45% of GDP. However, with five exporters accounting for 20% of total Canadian exports (and the top one hundred accounting for over 50% of total Canadian exports) diversifying the export base by developing and supporting SMEs, so that they too can compete successfully in the international arena, has become a key government objective.

For the past decade, EDC has been building and refining its approach to SMEs and today while SMEs represent just under 90% of EDC's customer base, they provide only just over 16% of its business volume.

EDC is relatively unique as an ECA in that it offers a full range of credit insurance, loans and bonding, openly competing with the private sector in many of its products. However, in more recent years EDC has also been working to develop products in association with private insurers and banks, as evidenced in some of the special facilities established for SMEs as described above. These partnerships are based on risk sharing in one form or another, and are designed to leverage support for this riskier market segment. Other partnerships, directed at all EDC customers, are focused on providing credit, payment and settlement solutions on-line over the Internet, or combining the receivables management expertise of a private sector firm with the export receivables insurance services of EDC.

In a more general way, EDC is also an active partner with both the government and private sector in outreach activities aimed at educating SMEs on international opportunities and risks and the export finance and credit tools which can be put to their service.

Given the labor intensive nature of servicing SMEs (viz the specialized teams established to look after them), and the higher risk nature and relatively small premia/interest income to be derived from their small-scale transactions, EDC's experience echoes that of other ECAs: generally SME business is not profitable.

Certainly, an institution could not focus only on SMEs and pay for the technology and other investment needed to operate. In EDC's case, its SME export credit insurance business operates at a loss (and this represents over 90% of its SME business volume), while its SME financing operates at best on a break-even basis and the SME bonding program is profitable.

- Delivery -

At a very early stage EDC decided that it would dedicate specific resources to serving SMEs. It created the SME Services Group with two specialized teams:

- Emerging Exporters Team: This team provides short-term credit insurance to SMEs with annual export sales of under Cdn $1 million (US $0.62 million). In order to be more accessible, customers can choose between a toll-free number to speak directly with a decision-making underwriter, a free Internet access or a streamlined paper application.
- SME Financial Services Team: This team provides medium-term financing (either lines of credit, loans or guarantees) for SMEs with export sales of between Cdn $5-25 million annually. (US $ 3.1-15.5 million)

- Products -

EDC offers the full range of its standard products (credit insurance, lending and bonding facilities) to its SME customers and, in addition, has developed some facilities especially geared to them.

EDC's basic principle has been to recognize that while the risk of loss is greater with SME business, the severity (amount) of the loss is lower. This principle has thus has allowed the Corporation to offer streamlined products, with less documentation and speedier decision-making.

Export Credit Insurance: Not surprisingly, this is the product most used by EDC's SME customers, accounting for over 90% of its SME business volume. The policy terms for credit sales of under one year are the standard ones (90% of loss due to buyer non-payment) but delivery for SMEs is simplified (i.e., the insurance can be purchased over the phone or via Internet) and the policy and administrative guide are simplified and written in plain language. EDC has also entered into partnership with a private insurance company to deliver both domestic and export credit insurance.

Financing: EDC can provide financing either directly to an eligible foreign buyer, or through an existing line of credit (of which EDC has about 50, primarily with banks in foreign countries). The latter is the most frequent route, since financing terms are pre-arranged and the approval process and documentation can be kept to a minimum. Given the small transaction sizes of SME contracts, the offer and loan agreement are the same, thus eliminating the need for legal opinions. Medium-term financing of up to Cdn $3 million (US $ 1.86 million) is also offered through an EDC private sector partner, Northstar Trade Finance; EDC provides insurance to Northstar on its loans, as it does with several other private sector partnerships.

Note Purchase/Factoring: The exporter can either sell to EDC a promissory note issued by the buyer (essentially a form of simplified lending), or sell part or all of its accounts receivables protected under an EDC insurance policy to a bank or factoring company. Either way, the exporter benefits from immediate cash payment, minus the discount.

Working Capital Risk-Sharing Guarantees: For SME exporters in knowledge based industries, EDC has established a 50/50 risk sharing facility with one of the Canadian commercial banks to provide the working capital needed to deliver on export contracts. Similar facilities are under negotiation with other banks. It should be noted that this finance is at commercial/market rates of interest and no subsidy is involved.

Scotia Americas Capital Equipment Purchase Program: Under the program, smaller export sales of capital equipment can be financed through the Canadian bank in Canada and its subsidiaries in selected Latin American and Caribbean markets, with EDC providing re-financing.

Master Accounts Receivable Guarantee: This product was designed specifically to help SMEs increase their commercial bank operating lines of credit by providing the bank with an EDC guarantee for the SME's foreign accounts receivable (which are normally disregarded by the banks) as security. In actual fact, the facility is little used.

Bonding: EDC offers to SMEs its normal bonding support in the form of either Bid or Performance Security Insurance (covering up to 95% of loss on wrongful call on letter of guarantee) or Bid or Performance Security Guarantee (issued to the bank providing a letter of guarantee to the exporter thereby freeing its working capital from being used as collateral).

United Kingdom - Export Credit Guarantee Department (ECGD)

In 1991 ECGD, following a review of its operations, privatized its short-term credit insurance business; this was purchased by NCM, a large Netherlands based private credit insurer. The UK market for credit insurance has changed drastically in the subsequent decade with more than 20 credit insurers now operating in the market and UK exporters enjoying more choice and competitive premium rates. NCM, which also acts as agent for the Dutch government's official export credit scheme, has developed an important SME program, which will be discussed in the next section.

ECGD now has only a role as contingent reinsurer to the private market for short-term credit insurance and not as a direct insurer. Thus, short-term programs for SMEs are not relevant. However, ECGD provides direct insurance and guarantee facilities for medium- and long-term capital goods but, in reality, these are of limited relevance to SMEs.

Recently, ECGD was the subject of a full review of its mission and status. The review, published in July 2000, called on ECGD to widen its customer base, *inter alia*, and specifically to attract more medium-size exporters and investors, as well as to offer a package of products geared to light capital goods and services and to the smaller exporter/investor. In this connection, ECGD has noted that in the past its support to SMEs usually came as a result of their sub-contractor status to larger UK firms acting as prime contractors on turnkey projects, but that with changes in international procurement practices, many clients are managing projects themselves, meaning that SMEs are being called on to tender and contract directly.

- Delivery -

Unlike EDC, ECGD does not have dedicated resources to look after its SME clients, instead working through established teams which are organized on a sectoral basis. However, ECGD has introduced a fast-track process for exporters with smaller contracts.

- Products -

In November 2000, ECGD announced a new Small Firms Package, designed for SMEs targeting export markets outside Western Europe and North America. Not so much new products *per se*, this package consisted primarily of enhancements to and streamlining of existing products (export credit insurance, loans and overseas investment insurance). Its announcement coincided with an outreach program of seminars directed to exporters of light capital goods and services, with the objective of increasing awareness of ECGD services.

Global Sourcing: ECGD, in line with a number of other ECAs, has increased the amount of foreign content on smaller value transactions (defined as up to £10 million) from 15-30% up to a maximum of 40%.

Export Credit Insurance: Although its short-term credit insurance business was privatized in 1991, ECGD can provide single-contract policies for political and/or commercial risks where the payment terms are less than two years.

Supplier Credit Financing: Targeted at exports of capital or semi-capital goods to developing countries, supplier financing on terms of two years or more can be provided by ECGD through unconditional guarantees to the exporter's bank against non-payment by the buyer or the buyer's bank, with the exporter benefiting from immediate cash payment.

Recourse Indemnity: While ECGD would not normally require recourse for smaller export transactions, for larger sized projects where a SME may have difficulties in providing the necessary recourse support to ECGD in order to obtain financing, a recourse indemnity policy has been developed with Lloyd's of London whereby ECGD would be compensated in the event that either the exporter or the buyer defaults.

Margins on Fixed Rate Export Financing: Commercial banks earn a margin from ECGD over and above the value of the fixed rate financing they provide to UK exporters. The higher margins which were once available only for larger loans are now available also for smaller loans, thus potentially benefiting SMEs.

United States - US Eximbank

US Eximbank has always been particularly sensitive to its public policy mandate not to compete with the private market and operate in the market gap, so SMEs have been a longstanding marketing focus. However, it would seem that this has been less reflected in specific service differentiation and it has been accepted by US Eximbank that the necessary investment in technology to enable special streamlined service to SMEs has not been made, not least because US Eximbank for various reasons does not have many large exporters as short-term policy holders.

According to US Eximbank statistics, in the past several years SMEs have accounted for over 80% of the total number of approved transactions, representing roughly 15-20% of total business volume.

- Delivery -

US Eximbank has developed comprehensive marketing tools directed at SMEs, including a dedicated section on its web-site, as well as access through toll-free numbers, regional offices and various local partnerships. However, it does not have staff specifically dedicated to looking after SME customers and few shortcuts are taken when evaluating SME requests for support (i.e., financial statements are still reviewed, unlike EDC, for example, where policies can actually be issued over the telephone).

- Products -

Working Capital Guarantee: This facility is designed to address the difficulty SMEs often encounter in financing pre-export activities, the program guarantees 90% of the principal and interest on working capital loans extended by commercial lenders to eligible US exporters. The guarantee may be provided for a single loan, or for a revolving line of credit, and must be secured.

Export Credit Insurance: US Eximbank provides a range of policies, amongst them some designed especially for SMEs. Under the Small Business Insurance Policy, eligible companies (which have average annual export credit sales of less than US $3 million for the two years prior to application and which meet the Small Business Administration's definition of small business based on size standards for different types of economic activity or industry) can obtain a short-term policy (up to 180 days) covering 95% of the commercial and 100% of the political risk. Under this policy the SME must insure all of its export credit sales through US Eximbank; a SME may request an intermediary such as a state agency, export trading and management company or insurance broker to act as an intermediary with US Eximbank in obtaining the coverage. There is also a Short-Term Single Buyer Policy to cover single or repetitive sales to the same buyer, covering 90% to 100% of both political and commercial risks; there is a special reduced premium for SMEs. SMEs are also eligible for other US Eximbank policies such as Medium-Term Insurance for contract up to US $10 million and repayment terms of up to five years (100% commercial and political risk coverage on 85% of the US export value).

Loans and Guarantees: US Eximbank provides both loans and guarantees of commercial financing to foreign buyers of US capital goods and related services, covering up to 85% of the US export value with repayment terms of two years or more. Guarantees generally cover political and commercial risks on 100% of the financed amount, either as a single transaction or under one of its guaranteed lines of credit to foreign banks. Again, the latter is the most common route for SMEs given their smaller transaction sizes.

Netherlands - Nederlandsche Credietvezkering Maatchappij NV (NCM)

The shareholding structure and scope of operations of NCM are somewhat different from those of the other official ECAs reviewed, and as such requires a brief explanation. NCM was established in 1925 primarily as a private sector reinsurer and its ownership has continued to reflect a complex shareholding structure including banks and insurance companies. NCM became active in the credit insurance business after WWII. Its international expansion began in 1991 when it took over the short-term credit insurance business of ECGD of the UK and although still headquartered in the Netherlands, it now has branches in 14 countries. In 1998, Swiss Re became the majority shareholder and in 2001, NCM took over Gerling's credit insurance operation.

NCM has been repositioning itself as a global leader in receivables management rather than as simply a provider of credit insurance. It advertises its ability to service companies of all sizes, ranging from multinationals with complex world-wide trading patterns to small enterprises requiring straightforward low-cost credit insurance.

- Delivery -

NCM makes extensive use of the Internet and offers on-line credit management services, as well as access to its extensive database on buyers, countries and trade sectors.

- Products -

While credit insurance (both domestic and export) remains its core product, in the Netherlands NCM also offers medium-term cover acting on the account of the Dutch Government.

NCM has developed a number of credit insurance policies directed at the needs of different business customers, amongst which is the Compact Policy designed for smaller companies (with annual business volume up to Euros 7 million). Like the EDC approach, the policies are written in straightforward language in order to keep paperwork and administration to a minimum.

In addition to a range of credit insurance products, NCM also offers debt recovery, guarantees, factoring, and tender exchange rate indemnity.

C. Best Practices

ECAs play a central role in helping small companies to export profitably. The combination of smaller but generally riskier transactions, and special servicing requirements (read more hand-holding) has meant that ECAs have had to consider a combination of product and delivery adaptations if they are to successfully meet the challenge. The key has been to define the most effective and relevant nature and scope of facilities for smaller exporters, rather than simply seeking to provide such facilities at the lowest cost.

Indeed, the objective of lowest costs seems to lead to poorer service. The question which cannot be avoided if below cost facilities are provided is "who finances the loss?" And, there are no easy answers to this. The solutions are individual to each situation, reflecting the scope and mandate of the ECA, private sector involvement in export finance, and the needs of SMEs themselves.

Predicated on the understanding that official support through an ECA should be considered only when private sector options for support are unavailable, experience in a number of countries has suggested some of the most helpful and relevant ideas for serving smaller exporters.

The first step has been to recognize that SMEs represent a distinct customer segment which needs to be addressed on its unique terms. Coming to terms with their limited financial resources and export finance sophistication has meant that ECAs have had to refine their understanding of this market segment and to determine what SMEs are exporting and what export finance tools can best serve them.

Arriving at this precise knowledge of what SMEs needs implies having staff dedicated to SMEs, otherwise small exporters might tend to be viewed as a "nuisance", eating up resources which could otherwise be devoted to larger scale, more remunerative transactions and customers. This has worked well in a number of ECAs which have devoted teams to this market segment.

The "easy" or obvious answer to many SME problems is to subsidize but this always produces difficulties. Subsidies are always easier to introduce than to withdraw. And SMEs are used to paying more for finance and raw materials, etc. than large companies. So the basic question is: why should export credit insurance be any different? Experience suggests that cost is not the major issue. Rather what has worked well is to develop simple and easy/cheap to administer facilities which operate to the benefit of the SME and the ECA and to charge what this costs as premium. Apart from all else, this should be a sustainable policy not vulnerable to cancellation, etc.

An important component of the successfully implemented SME strategies has been simplification of product. Policy documents which are made shorter and written in plain language have helped to bridge the gap in export finance sophistication. While perhaps not suitable for larger individual transactions where the potential loss would be greater, for small, short-term transactions such simplified documentation could be sufficient to protect the ECA.

Similarly, the administration, especially of business declarations and premium collection arrangements, has been successfully streamlined for SMEs. For example, small exporters could be charged a single premium when a policy or facility is issued. Then, at the end of the year, a reconciliation could be made against export business actually done. This avoids the labor of monthly declarations for both the SME and the ECA.

In addition to adapting existing products, analysis of SME needs might point out the need for new products specifically geared to them. Given their limited resources, access to working capital support for pre-export needs is often a real problem for SMEs; it has been possible for insurers to develop facilities or products that somehow associate credit insurance and working capital and can cooperate with any existing government schemes in this area. But, sooner rather than later, it has become vital to involve commercial banks who should be the providers of working capital and the risk takers, perhaps using the basic ECA insurance as part of their security package.

Depending on the relationship with other business and government partners, service to SMEs can be delivered directly through the ECA, or through other institutions. In the case of indirect delivery, two approaches are possible. Special facilities can be designed for the benefit of smaller exporters but issued to other, specialized institutions, which would then act as policy managers for these customers. Wholesale policies or other facilities can be issued directly to banks (or to specialist policy management companies) which would then retail them to the small exporters among their existing customers. This approach would also help link export credit insurance with other forms of financing.

In the case of direct delivery, many "best practice" ECAs in this area have turned to technology to facilitate access and cut ongoing transaction processing costs as much as possible (although the initial cost of developing this technology will be high). This has meant providing access over the Internet, or toll-free telephone lines to reach a dedicated SME team or department.

As is often the case in most countries, SMEs are in need of assistance and training, not only with the export finance needs, but also with international business in general. The idea is to leverage resources, and partner with other government and private groups where possible, benefiting from their greater local presence. It has been successful in certain countries to link up insurance products with export support facilities and mechanisms available from the government of the exporting country. It has also worked well where ECAs have also cooperated more closely with national and local chambers of commerce, which in turn have acted on behalf of smaller exporters in various ways.

Governments and ECAs often provide a range of help and advisory facilities such as help desks, in addition to credit insurance. Although not common, it is an option to consider charging a fee if the advice verges into consultancy or is otherwise labor intensive.

Similarly, governments or ECAs provide training either directly to smaller exporters, or to brokers who would then cater to such exporters. ECAs also train banks and brokers on the export insurance needs of smaller exporters and on the facilities that they provide, to increase cooperation in these and associated areas.

Small exporters are an important group. Handling their export business effectively is also important, and not only to ECAs. Blanket subsidies or low-cost facilities are unlikely to be effective. The business is best operated in the context of an ECA's total business, not least so as to take advantage of the infrastructure and information generated (and paid for) by the business of larger exporters. It needs to be remembered that at least some small exporters will someday become large exporters, and that viable approaches of the kind suggested here can help to increase the expertise and experience of the ECA's own staff.

It follows from all of this that ECAs play a varied and important role in helping SMEs in a range of ways. But, before this can be done, the basic question must be addressed of who meets the costs?

1. Should SMEs themselves pay?
2. Should the government do so (e.g., part of its Export Promotion budget)? or
3. Should the ECA try to so do by charging higher premium rates to big exporters.

The last is a very dangerous option for all kinds of reasons, not least of which is that the large customer may simply decide not to insure with the ECA, either finding a private insurer to offer a better price, or self-insuring. The second option of the government paying the costs raises the possibility of running afoul of the WTO subsidy rules if the premium charged is not adequate to cover the long-term losses and operating costs, or the interest rate is less than the entity's cost of funds.

IV. INTERNATIONAL FINANCIAL INSTITUTIONS

A. General

Empirical studies confirm the strong relationship between international trade and economic growth. Those countries which have strengthened their ties with the global economy through trade and investment have tended to grow more rapidly over a sustained period. They have also tended to experience larger reductions in poverty. In recognition of these linkages between trade and economic growth, IFIs have been active in developing programs to assist in national and regional trade development and facilitation efforts. Access to and availability of appropriate financial tools, including export credit facilities, have been components of some of these efforts.

IFIs are not intended to be providers of credit insurance or to compete with ECAs. And, for various reasons, their involvement in trade finance and export credit has been limited, but there is a general recognition that for borrowing member countries, the existence of a healthy trade finance system is an important and integral part of their trade regimes.

However, it is very important, from the outset, to distinguish between a number of areas in which IFIs could take an interest. For example:

(a) Developing an effective export credit insurance scheme within a country concerned so as to develop and increase profitable exports;

(b) Improving and increasing credit facilities for trade for *imports* into a country;

(c) Increasing working capital available to exporters into countries;

(d) Helping new or small exporters; and

(e) Improving the performance and increasing the involvement of local banks in trade finance, both import and export.

There have, perhaps, been three main approaches taken by IFIs in these areas. These are:

(a) Technical assistance to a national or regional scheme in borrowing countries either for the establishment of a facility or institution, or the further development of an existing facility or institution;

(b) Direct support to an export credit agency, e.g., to on-lend to exporters for pre-shipment working capital; and

(c) Counter guarantees or confirmation of letters of credit opened by local banks.

It is important to note that (a) and (b) relate to exports, while (c) relates primarily to imports.

This section provides a general overview of how the Asian Development Bank (ADB), the European Bank for Reconstruction and Development (EBRD) and the World Bank view involvement in the area of export credit and trade finance. It then briefly examines a sample of recent illustrative projects supported by each, the approaches taken and why, as well as lessons learned.

B. Programs o International Financial Institutions

European Bank for Reconstruction and Development (EBRD)

The EBRD is focused on private sector development and on SMEs in particular. While its facilities generally involve the provision of equity and debt into enterprises and their projects, it is permitted to have up to 40% of its assets with public borrowers, provided the end beneficiary will be the private sector. The EBRD now does 75% of its new business with the private sector in the form of purely commercial private transactions without sovereign guarantees.

The EBRD has developed a range of products aimed at facilitating intra-regional and international trade in its countries of operation. These include EBRD guarantees to support trade instruments issued by banks in its countries of operation, direct financing of banks in the region in the form of pre-export finance advances, and direct financing of selected large private sector companies in the form of pre-export finance and/or working capital loans.

The EBRD has also implemented a few programs, albeit most of them modest in scale, which have supported the establishment, development and activities of ECAs in the region. The EBRD views ECAs as an important strategic partner, particularly those from OECD countries with whom the EBRD can co-finance as part of its overall risk sharing agenda, but also those from borrowing member countries who might require assistance in order to maximize their support to exporting enterprises.

- Regional Technical Assistance -

The ECAs of Central and Eastern Europe (CEE) for the most part came into being in the early and mid-1990s. The EBRD played an important and active role in nurturing their development.

The key activity of the EBRD in this regard has been the funding of what became known as the "Prague Club" or the "mini-Berne Union". In 1994, using Dutch trust funds, the EBRD as sponsor provided technical assistance to the Berne Union Secretariat (under Malcolm Stephens at the time) to form a group of the newly established ECAs from the region for the purpose of mentoring and training. This learning organization was an extension of the Berne Union's regular mandate and helped these new ECAs to gain the necessary experience and level of sophistication needed to become official members of the Berne Union.

A number of CEE ECAs have now progressed significantly (but not perhaps consistently) and many are now full members of the Berne Union (e.g., Poland, Hungary, Czech Republic, Slovenia).

What started as a forum of 4-5 participants from CEE has now grown to over 30 participants, with newly established ECAs from Asia, Africa and the Islamic countries also participating. The EBRD, of course, is not financing the involvement of non-CEE participants, who are typically paying their own way. Meetings are held semi-annually and the EBRD attends, providing presentations on countries in the region.

- Country-Specific Technical Assistance -

The EBRD has also provided technical assistance in support of a specific country's export credit system. In 1996 the EBRD funded a study to analyze Bulgaria's export finance needs and to prepare a plan for the establishment of an ECA. In 1998 the Bulgarian Export Insurance Agency was set up.

- Country-Specific Support -

In 2000, the EBRD made a loan to the Croatian Bank for Reconstruction and Development (HBOR), which functions both as an ECA and as a development bank providing financing support, but not export credit insurance. This was a term loan for on-lending to exporters for working capital and pre-shipment finance.

- Trade Facilitation/Guarantees -

Although not directly related to export credit systems in the EBRD's countries of operation, a particular focus for the EBRD has been its trade facilitation program for local banks introduced in 1999. Essentially, the program issues guarantees in favour of international confirming banks to guarantee all or part of the obligations of local issuing banks (which are acceptable to the EBRD) arising from eligible trade finance transactions, both import and export. The EBRD guarantee covers commercial and political risk of non-payment by the issuing bank only; there is no assumption of any risk of the exporter or the importer.

Asian Development Bank (ADB)

With sustainable economic growth as one of its three core areas of intervention, the ADB has identified private sector development and trade and investment expansion as key strategies. In the context of its trade agenda, the ADB looks to support mechanisms in borrowing member countries which can help a country develop its higher value-added exports. The ADB, however, also appears to put emphasis on the need to ensure that any mechanisms developed (and supported by the Bank) must be consistent with international developments in the export credit market worldwide and that the Bank's role be restricted to one of facilitator and gap-filler. As such, in considering any project involving export support, the ADB considers first a country's trade operations in order to target the Bank's intervention on those areas which would have the greatest impact, while respecting the important role of the local banks and other private sector financial institutions in helping to finance imports and exports.

In view of the above, it seems that the ADB would generally not encourage a member country to set up an ECA in order to deliver short-term credit insurance on a stand-alone basis, recognizing that this is now a globalized business, with three or four major international players.

- Regional Technical Assistance -

The ADB has been a regular participant in an annual Asian Eximbank forum (referred to as the Asian Export Finance Institutions initiative), started in 1996 by the agencies themselves for the purpose of enhancing financial and technical cooperation. This has offered an opportunity for the ADB to better understand the needs and issues faced by these Eximbanks (focusing particularly on their role as providers of export finance), as well as to be available to offer advice.

- Country-Specific Technical Assistance and Support -

The ADB has undertaken country-specific trade facilitation programs in Thailand, Pakistan and Indonesia, with varying degrees of success. These activities have included the design, funding and implementation of certain programs, as well as the more traditional technical assistance support.

THAILAND

During the Asian crisis and in the face of a severe credit crunch, the ADB put in place a US $1 billion loan to Thai Eximbank for on-lending to local banks who would in turn use it to provide working capital to SMEs in order to enable them to continue exporting. The program wound up early and only partially drawn (20%). It is understood that the margins charged by the banks to companies were felt to be too expensive and there was no real mechanism in place to ensure that the funds actually reached the end users for whom it had been designed.

More recently, the focus and ongoing work of the ADB has been in the area of corporate governance for Thai Eximbank, one of four specialized financial institutions under review. The technical assistance has included the development of a performance management and measurement system for Thai Eximbank.

PAKISTAN

The ADB has taken a slightly different approach for Pakistan where it has designed a program to help improve the trade finance system more broadly, with focus on a few key areas. In December 2000, the ADB Board approved the SME Trade Enhancement Facility. The facility had two major components:

1. A US $150 million political risk guarantee facility for international banks confirming letters of credit (L/Cs) issued by Pakistani banks to finance imports of intermediate goods which are used as inputs into production for eventual exports. Similar to the EBRD's trade facilitation program, the ADB will guarantee 100% of the obligation under each eligible L/C, provided that the failure to pay by the issuing bank is caused by currency inconvertibility or transferability blockage.
2. The establishment and capitalization of a working capital guarantee program under a new agency, Pakistan Export Finance Guarantee Agency (PEFG), which is owned by 13 Pakistani banks and the ADB. The ADB invested up to US $2mn. The PEFG issues guarantees on behalf of SMEs to Pakistani banks providing trade finance.

INDONESIA

A program similar to the US $1 billion ADB loan to Thailand to be used for on-lending for working capital needs was also put in place in Indonesia during the Asian crisis, but was never used. As with its Thai counterpart project, the project suffered from design problems resulting in margins were that were too high (in part due to the large number of intermediaries involved) and difficulty in ensuring delivery to the desired end-users.

World Bank

In the mid-1990's the World Bank shifted its focus to a broader reform agenda and decreased its emphasis on trade, but more recently the pendulum has again swung back to viewing trade as a priority. With noted improvements in "border" issues relating to trade (e.g., decreasing tariffs and more efficient customs administrations), the Bank is now looking increasingly to "behind the border" issues, including, in some instances, financial sectors that service foreign trade.

However, as with the other IFIs, there are few trade finance specialists at the Bank. While certain Bank officials do recognize that an official ECA can provide useful functions, the focus of the Bank has tended to remain at a macro, policy level rather than the implementation of projects to support an individual specialized government-owned financial institution. One of the results has been that although the Bank has undertaken a number of trade facilitation and export promotion projects, export financing/credit schemes have been central to only a few of these. Indeed, the impetus to put in place a trade finance or export credit related project has usually come from outside the Bank.

- Regional Technical Assistance and Support -

AFRICA

In 2000, the World Bank, at the request of the Secretariat of COMESA (Common Market for Eastern and Southern Africa), provided technical assistance for the design and implementation of ATI (Africa Trade Insurance Agency). In order to begin to realize African's potential for trade and investment, it was recognized that perceptions of political risk needed to be addressed. ATI was designed as a regional insurance facility (focused on short- and medium-term trade transactions in order not to compete with MIGA's longer-term investment related activities) with the objective of contributing to private sector led growth by improving access to financing for productive transactions and cross-border trade.

The World Bank has provided start-up IDA credits of US $105 million to set up the new multilateral insurance agency based in Nairobi. To date seven countries have joined (Burundi, Kenya, Malawi, Rwanda, Tanzania, Uganda and Zambia), with membership open to all members of the Organization of African Unity. The ATI's main function is to provide insurance against a range of non-commercial risks with the prime objective of facilitating trade and investment into Africa. What is unique about the export credit and political risk facility is that each member country assumes ultimate financial liability for political risks affecting trade within its respective jurisdiction.

The World Bank IDA credits, together with counterpart donor funds from each participating country, are placed in escrow to be used as a first loss security against any claims to be paid on a political risk facility underwritten by ATI. These funds serve as financial back-up to each insurance policy and may be used only to pay valid claims, as decided by the private insurers participating in the scheme. For any claims resulting from government actions (i.e., all covered political risks with the exception of war and civil disturbance) the respective country is required to replenish its trust account.

- Country-Specific Technical Assistance and Support -

TURKEY

At the time of its establishment in the late 1980s, Turk Eximbank, Turkey's official export credit bank/export credit agency benefited from technical assistance from several sources including NCM, the Dutch ECA (on export credit insurance and guarantee operations) and Citibank (on banking risk monitoring). To build on this initial support and to address specific challenges facing Turkish exporters (especially a shortage of working capital), in 1999 the World Bank provided a US $252.5 million Export Finance Intermediation Loan, the major component of which was the wholesaling of World Bank loan funds through Turk Eximbank's existing wholesale lending function.

Complementing this has been a technical assistance project aimed at upgrading the Turk Eximbank's organizational structure, operational policies and procedures, and staffing.

YUGOSLAVIA

With single country schemes already implemented or under implementation in other Central and Eastern European countries (including Bosnia and Herzegovina, Moldova, Albania), in 2001 the World Bank turned its attention to the delivery of an export finance facilitation project for Yugoslavia, comprising four main components. Currently in the design phase, this project is directed at Yugoslav private sector enterprises, or enterprises which have started the process of privatization.

There are four facilities being developed:

1. *Political Risk Insurance Facility*: The scheme is very similar to that of ATI, as described above, except that it is single country rather than regional in scope.

2. *Working Capital Facility*: The purpose of the facility is to provide working capital to Yugoslav exporters, either through loans or guarantees of loans provided by banks. Where possible, these will be tied to specific export orders and secured by proceeds of the exports.

3. *Export Performance Insurance Facility*: Similar to a facility introduced in Bosnia and Herzegovina, this is designed to address the difficulty Yugoslav exporters have had in providing contract bonds to overseas buyers. The insurance functions as an indemnity in favour of a bank guaranteeing an overseas buyer that the Yugoslav exporter will perform according to contract obligations. Like the political risk insurance facility, is to be offered in partnership with private insurers.

4. *Credit Insurance Facility*: The facility comprises both export and import components. In the case of export credit insurance, the Yugoslav exporter may obtain insurance against the failure of overseas buyers to pay for goods and services as contracted for. In the case of import credit

insurance, the facility will guarantee or insure foreign trade credit insurance companies or financial institutions covering the supply of essential inputs to Yugoslav companies; this would be done on a maximum 50% risk share basis.

A last component of the project is the development of high quality credit reports on Yugoslav corporations and banks, most likely in association with a major international credit information company.

C. Export Credit Schemes - Lessons Learned

While the issue of government involvement in providing export credit finance or insurance continues to be an issue for debate, including in development circles, the fact remains that virtually every developed country has an official ECA. Each has been tailored and adjusted over time to its own particular national circumstances. Few now occupy the dominant place in their national trade finance schemes, but all have been deemed to play a legitimate and necessary role as facilitators of international trade. It is noteworthy that even New Zealand which had done away with its scheme, very recently has found it necessary to re-institute a government trade support mechanism; it has succeeded in doing so without building a bricks and mortar institution, but instead has arranged for an existing agency (in this case another country's ECA) to deliver its product.

As highlighted at the beginning of this report, the key factor in the success of an ECA is that it works with the grain of a country's trade and finance system which can vary from country to country. There are no perfect models to be followed. Indeed, in the face of ongoing and seemingly accelerating changes to the global economic and trade system, constant review and testing is necessary if an ECA is to operate essentially in the gap (not competing head-on with the private sector) but still retain enough business volume to maintain a level of technical expertise and achieve at least a financial break-even.

Defining the gap is key. This implies a comprehensive understanding of a country's whole trade cycle, and all those who play in it whether private or public sector and whether potential user or partner/counterpart/competitor. Appropriate roles for each player (local banks and other private sector financial institutions, host government, IFIs, etc.) need to be considered. Successful schemes are built from the bottom up; they have tended to be the result of an internal momentum to address a specific gap in support or a specific problem. A survey of potential users of the schemes (exporters) is necessary to clearly understand their needs and to develop a strong database of prospective clients for future marketing once the scheme is up and running.

In some cases the gap/problem will be a short-term one (as might occur in the aftermath of a financial crisis such as that which hit Asia in the late 1990's), or it might be a longer-term, endemic one. For example, a specific gap or market failure may exist with respect to the SME sector's access to financing, but which otherwise does not exist for larger firms.

Unfortunately, experience has suggested that some of the short-term solutions have been more difficult to implement successfully, e.g. some efforts to provide for working capital on-lending in some countries where the existing institutional framework did not allow for efficient and economic delivery of the support as designed and where margins charged by banks and others were a problem.

The challenge therefore is not only to diagnose accurately the problem (the reason for the gap), but also to target the solution (product) and its delivery mechanism so that it hits its mark. And it is only by having a very clear objective that success of the scheme can be assessed. Not properly diagnosing the problem behind the gap can result in wasted efforts, e.g. in a country facing problems in importing where the perceived problem was that international banks were not willing to confirm L/Cs where the real problem was that banks were not willing to open L/Cs because the importers were not prepared to deposit the cash required as collateral, not least since this removed the rationale and benefit of the credit being extended by the sellers.

Understanding possible alternative methods/products to address the problem may suggest potential for partnering with the private sector. If so, consulting with them throughout project design and preparation is needed in order to develop a structure that will maximize their involvement and best leverage official resources, as well as meet exporter needs. This was done in the case of the World Bank's ATI, with the result that two of the Lloyd's syndicates are partnering in delivery of political risk insurance under the scheme. Questions of moral hazard may loom when considering partnership, especially if the partner does not have a substantial stake or risk share; if merely acting as agent on behalf of the Government, or with a modest share of the risk, the private partner may tend of take higher than acceptable risks with the comfort that losses will have minimal or no impact on them.

What special implications do these lessons have for IFI involvement in the export credit field? Beyond the broad issues of project design and implementation alluded to above, there are product-specific concerns to be accounted for.

Given the nature of the Latin American economies, commodity exports are key and these are sold on short terms. As noted earlier, short-term credit insurance (and investment insurance) is now very competitive, with strong global capability in the private sector, suggesting a decreasing role for ECA involvement, except in the margins as contingent reinsurance capacity. Although short-term credit insurance has been the mainstay of many developing country ECAs this can be expected to change as private insurers continue their expansion.

The ADB approach suggests a possible role for an IFI as catalyst to draw in private sector capacity through workshops and even technical assistance. Furthermore, in light of Latin America's history of political volatility, program to provide capacity when the private sector withdraws in the face of unacceptably high risks may be required, although whether this should take the form of the ATI and Yugoslavia projects or whether a government-backed contingent reinsurance capability would be sufficient is open to debate. The EBRD's trade facilitation guarantee program for trade instruments may also offer a possible solution when the domestic banking system is weakened.

There is less private sector appetite for medium- and long-term credit and thus, to the extent that there is unmet demand for this type of support, an official ECA may be relevant, although there may be alternatives to actually establishing an institution for delivery (e.g., the New Zealand approach via outsourcing delivery).

Lastly, there is working capital support, likely a key issue for Latin American companies. Various approaches to this are possible not all of which need or should involve ECAs. The ECA could be involved by providing support either directly in the form of full or partial guarantees to the bank extending the working capital loan, or indirectly by having its export credit insurance policy used as collateral for the bank's loan. In the event of a severe credit crunch, an IFI may wish to consider adding capacity to the system. In working capital areas, the question of interest rates/margins to be paid by borrowers and if there are to be "subsidies" is a vital one.

D. Case Studies of Successful IFI - Supported Schemes

"Success" in this context is not a single or straightforward concept. It needs to be applied and judged against particular objectives. It is believed that, in a number of cases, the objectives of the IFI-supported scheme may not have been fully articulated or that those which were articulated did not necessarily fit with the prevailing problem that the scheme was meant to address. Thus under these circumstances the ability to judge performance of a scheme against its objectives can be a challenge.

The review of existing IFI activities has focused on three main areas: (a) the establishment of new institutions; (b) technical assistance for existing institutions; and (c) trade facilitation in the form of lending to or guaranteeing of local institutions (either ECAs or banks). It would be expected that each area would have a different set of objectives.

For example, criteria for judging success for establishing a new institution could include:

- the extent of new business which would not otherwise have taken place that has been facilitated by having IFI involvement;
- the extent to which the IFI scheme is up and running and working with the existing, local institutions;
- the extent to which the IFI scheme works with existing techniques and practices and so is likely to last beyond IFI involvement; and
- the extent to which the IFI scheme generates private sector participation which would not otherwise have happened.

Against this criteria, it was felt that it would be difficult to come up with two different and successful schemes in Asia. Therefore, and as agreed with the IADB, the following sections look in more detail at the World Bank's African Trade Insurance Agency and the ADB's Pakistan scheme, noting the particular criteria for success.

Africa Trade Insurance (ATI)

It has been recognized that in order to begin to realize African's potential for trade and investment, perceptions of political risk need to be addressed. ATI has been designed by the World Bank as a regional facility with the objective of contributing to private sector led growth by improving access to financing for productive transactions and cross-border trade.

The ATI's main function is to provide insurance against a range of non-commercial risks with the prime objective of facilitating trade and investment into Africa. Eligible transactions include exports from one participating country to another, exports from a participating country to a third country, and imports of goods or capital from anywhere to a participating country (provided that the import is related to a productive activity). Political risk cover from ATI is available to any risk-taker, whether supplier, financial institution or other party financing, insuring or guaranteeing an eligible transaction. The insurance covers a range of political risks including: war or civil disturbance, inconvertibility, inability to transfer currency, expropriation, embargo, and government interference such as arbitrary removal of import/export licenses, imposition or increase in import/export taxes, seizure of goods or interference with the carriage of goods. Insurance is offered for a maximum five-year term, plus one year of pre-shipment cover. The maximum amount of cover per insured varies from country to country.

ATI operates in partnership with private political risk insurers, led by two syndicates at Lloyd's of London, thereby leveraging funds provided by the World Bank and participating/donor countries. While ATI does not offer commercial risk insurance, it has been designed to encourage others, whether official or private insurance providers, to provide commercial cover, with the comfort of ATI provided political risk cover. Indeed, comprehensive cover (political and commercial risk) is available in partnership with private credit insurance.

The World Bank funds have been put towards setting up political risk insurance facilities for each of the seven participating countries, and to pay for ATI's start-up operational costs for the first two years. Initially at least, each participating country will continue to have separate trust funds in which their IDA credit and donor funds are deposited, and thus separate political risk insurance facilities.

The World Bank IDA credits, together with counterpart donor funds from each participating country, are placed in escrow to serve as financial back-up to each insurance policy and may be used only to pay valid claims, as decided by the private insurers. For any claims resulting from government actions (i.e., all covered political risks with the exception of war and civil disturbance) the respective country is required to replenish its trust account. The leverage ratio for each political risk insurance facility is determined with the private syndicate to determine the maximum amount of insurance available to cover transactions involving that country, whether import or export. In the event that private insurers are not willing to extend cover, funds in the IDA/donor trust fund cannot be leveraged and each policy must be fully backed by cash in the trust.

In addition to involvement through funding, the World Bank will continue to play a supervisory role during implementation of the project, and monitor ATI's operations.

ATI has a number of features which suggest that it is and will become a "successful" initiative. Although it has not been in operation long, there are good reasons to believe that it will meet certain objectives.

ATI has been successful in that a concept has been developed into an institution which is now in existence with paid-up capital.

It has also been successful in that it has sought to use techniques and practices which already exist and which would have, for example, enabled it to set in place co-operation arrangements with major private sector credit insurance companies.

It has, in addition, been successful as a catalyst in that it has put in place reinsurance arrangements with the private market and so has been able to look at gearing up its operations beyond what would have been possible had it been solely dependent on its own capital.

Some of these factors and the fact that not all staff are "foreign experts" from outside the region mean that an objective of transferring expertise is also being achieved.

Finally, to the extent that business has already been done, success can be gauged by the amount of international trade which has been insured, recognizing that a proportion of this would not have taken place had ATI not existed.

A point however should made about the ATI scheme which is also relevant for certain other initiatives (e.g., Yugoslavia) put in place by the World Bank. The basic essence of the initiative is that premiums are paid to a scheme backed by these African governments against the risk that a political risk event arises. In other (slightly more straightforward) words, premiums are paid to induce these governments not to behave badly.

Pakistan

The first component of the Pakistan program is the Political Risk Guarantee facility which guarantees payment to international banks confirming letters of credit issued by Pakistani banks to finance imports of intermediate goods for eventual export.

The basic problem is that offshore suppliers that sell much-needed imports to Pakistan can encounter problems in obtaining confirmation of L/Cs issued by Pakistani banks, or have done so in the past at a high cost. This may result in Pakistani exporters paying more for inputs used for export production than their international competitors.

The objective of the facility is to ensure continued and improved access to finance for imports that are directly or indirectly used for export production. By effectively transferring to ADB certain non-bank country risks such as currency convertibility and transfer blockage, which are of particular concern to some international banks, the facility seeks to reduce financing cost, increase tenor and keep Pakistan country limits for international banks confirming eligible import L/Cs.

The ADB guarantees 100 percent of the obligation under each eligible L/C, provided that the failure to pay by the issuing bank is caused by currency inconvertibility or transferability blockage or other agreed political risk events directly affecting payment. L/Cs may have a term if up to 360 days and may, on a case-by-case basis have a term of up to 3 years.

The facility is available for companies in Pakistan who wish to import for export production. It is designed specifically for companies which are unable to obtain bank credit partly due to lack of security to meet banks' collateral requirements.

In order to qualify, the issuing banks in Pakistan must meet minimum paid-up capital requirements and other regulations of the State Bank of Pakistan (the Executing Agency); have a correspondent banking relationship with the confirming bank that is willing to take the commercial risks of the issuing bank which are not covered by this guarantee; and are willing and able to issue the L/C and take all risks of the Pakistani importer for whom the L/C has been opened.

In June 2001, Standard Chartered Bank was appointed as the ADB's agent to manage the operational aspects of this facility out of its Dubai office.

The second component of the program is the ADB's equity investment in the Pakistan Export Finance Guarantee Agency. The ADB's US $2mn investment in the PEFG is 20% of the issued and paid-up capital of the PEFG. The remainder of the equity comes from thirteen Pakistani commercial banks. The total capital is expected to be able to leverage US $100mn per year in guarantee volume within the first three years of operation. IT is too early to tell whether this will happen.

A technical assistance grant of US $800,000 was also provided.

Though not a typical ECA, the PEFG will issue guarantees on behalf of small exporters to Pakistan banks providing pre-shipment working capital facility.

The ADB's Pakistan program is still too new to judge the results, but there are some indications that it should successfully meet certain objectives.

It is successful in that it has worked with existing trade finance mechanisms (L/Cs) and players in the market. The Political Risk Guarantee program works with an internationally reputable bank (Standard Chartered as agent) and top Pakistani banks.

PEFG is not a government institution but owned by the ADB and a consortium of Pakistan's top commercial banks, thus it has encouraged the participation of the private sector. Again, it is still too early to tell what the results will be, but the involvement of the banks is an important and positive aspect of the program.

E. Possible Future IFI Activity in this Area

IFIs, even with their relatively modest involvement in supporting the export credit field, have taken a variety of different approaches. With trade and its role in poverty alleviation and sustainable development a key agenda item for IFIs, it seems inevitable that there will be a continuing and even growing focus on trade finance systems, including export credit schemes.

In considering whether any IFI involvement of assistance is desirable or necessary, two key points should be:

1. An evaluation of the main factors inhibiting:
   - Exports
   - Imports
   - Inward FDI
   - Outward FDI (if appropriate)

2. For the country concerned, detailed analysis and assessment of the problem to be solved of the gap to be filled and of the policy objective and mechanism which will be applied to each problem

and each gap. It is also important that account is taken of normal and current commercial mechanisms already existing, e.g. for letters of credit and other trade finance products.

Both of them may seem obvious, but as is clear from this section, they seem not always to have been applied by IFIs in the past.

For example:

(a) An ECA is not normally a good mechanism for tackling problems associated with the concerns of potential providers of FDI to the country;

(b) There are well-established and widely used trade finance mechanisms. These need to be simple and capable of easy administration (e.g., letters of credit). They are not suited to an "investment banking" approach with large and complicated documentation and associated high costs; and

(c) As noted earlier, there are good and bad reasons for having an ECA and whether one should be established, what form it takes and what it should do and with whom it should co-operate, should not be assumed or simply copied from other countries.

Using various measures, export credit does currently seem to play a lesser role in the IADB's countries of operation than is true in other parts of the world.

It is not immediately clear or obvious why this is the case or, importantly, how significant a factor this is in inhibiting the growth of cross-border trade and investment flows.

For individual countries, it is helpful to consider:

(a) Is there an ECA of any kind in existence. Does any institution, public or private, currently offer credit insurance to exporters and trade finance banks?

(b) If not, why not?

(c) If so, what does the ECA/institution do (e.g., scale of business, range of facilities, nature of co-operation -including reinsurance- with others)?

(d) Would IFI assistance of any kind (financial and/or technical assistance) be helpful/relevant and what "gearing" effect would this have on others (both public and private)?

(e) Would any kind of "regional" scheme help? What would be involved and what, in detail, would the objective be?

(f) Would "regional" technical assistance help in any way? If so, how?

(g) Are there already "centers of expertise" within the region which could help others or be used as some kind of base on which to build?

Looking at the experience of other IFIs described in this report, it seems that the most successful facilities and initiatives were tended to have two key characteristics:

(a) they were designed to meet specific rather than general objectives/problems; and

(b) they worked with existing market practices and documentation and did not seek to reinvent mechanisms or to apply unduly complicated documentation or practices in areas like short-term trade finance where this would have been unrealistic.

The second point -especially in regard to trade finance- essentially reflects the fact that in this area the IFI's will always be minor players whose role is best that of catalyst rather than as an "inventor" of new techniques.

V. SUMMARY AND CONCLUSIONS

While competition is normally favored and to be encouraged, in the areas covered by this report, it almost certainly not desirable that IFIs should themselves provide the competition. In other words, it is not desirable for an IFI to compete either with the ECA in the country concerned (or with ECAs in other countries providing support for imports into the country concerned) or with commercial banks on trade finance in or out of the country concerned.

This partly reflects the basic point about the role of the IFIs. This role can be considered in the context of encouraging, helping and supporting the development and operation of ECAs in emerging markets, as well as in the provision of finance (both trade finance and, if appropriate, working capital) in respect of trade and investment flows into the country (and, importantly, trade flows out of the country).

This role should be that of catalyst. The IFIs should help to fill gaps not only of finance but also of experience and expertise. It is very desirable for this role to be a bridging and catalytic one for it to be done via local institutions (e.g., via credit enhancement of various forms) and in partnership with commercial and international banks (e.g., by utilizing existing well established trade finance mechanisms like the opening and confirmation of letters of credit rather than seeing to invent new mechanisms specific to the operational methods of the IFIs themselves.

In other words, the operations of the IFIs in this area should be judged successful by reference to two main criteria. The first criteria must be whether the initiative is a solution of the immediate problem. The second criteria is the extent to which the gap remains closed and the problem remains solved by the activities of the institutions which have been the partners of the IFI and those who have reacted positively to the IFIs lead as a catalyst.

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