

# The Role of Export Credit Insurance

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## The Job of the Export Credit Insurer

In selling overseas, an exporter will require his buyer to pay for the goods or services supplied either when the order is placed or at some date or dates thereafter. The longer the exporter extends such (export) credit, the greater the risk he runs that his buyer will not be able to pay when the due dates arrive. Exports of raw materials, consumer goods, spare parts, small items of equipment, etc. would normally be paid for on delivery or not later than 180 days from delivery. Exports of machinery and equipment and larger items would normally require the exporter to extend credit over a period of years from delivery probably ranging from two years to five years depending upon the value of the order concerned. Under such arrangements the buyer would be expected to pay a percentage with order, a percentage on delivery with the balance (usually 85 per cent) spread over the agreed credit period with payments being made at six-monthly intervals. For major exports of capital goods and for projects, even longer credit terms would be required often extending up to 10 years or more from date of delivery or date of completion of the project. Most exporters would not regard themselves as being in the business of financing the credit advanced to their buyers and would therefore look to their banks to fund the credit period either by making advances to the exporter against the security of the amounts receivable from the buyer (Supplier Credit) or by the bank themselves advancing sums directly to the buyer in order that the latter might pay off the credit as goods are delivered with the banks then being repaid their financing loan over the contractually agreed period (Buyer Credit).

In extending credit in this way both the exporter and the bank are exposed to the risk that when the time comes to effect payment, the buyer himself may be either unable to pay because of lack of funds (Buyer Default) or the buyer's country may have insufficient foreign exchange at its disposal to enable it to remit to the exporter's country the sterling or whatever equivalent of the local currency that the buyer wishes to transfer over (Transfer Delays). Other events outside the control of the exporter or his buyer, etc. import restrictions, war, etc. may also intervene to frustrate payment or contract performance. Most

exporting countries now possess organisations such as the ECGD (Export Credits Guarantee Department) in the UK whose function is to insure the exporter and his bank against these non-payment risks. In most countries there is a mix of private sector and Government sector organisations fulfilling this function, with the private market concentrating its activities at the short term end of the business (i.e. up to 180 days) and the Government sector concerning itself with the medium and long term credits where the horizons of risk would normally prove unacceptable to the private sector.

In the UK, these functions are carried out mainly through the Government sector by ECGD (a separate Government Department responsible to the Secretary of State for Trade and Industry) both for short term and medium/long term credits, although the private sector does provide a measure of support mainly for short term business. The way in which official export credit support is organised can however vary from country to country. For example Eximbank in the USA is an organ of Government but acts both as an insurance operation and as a lending operation. Hermes in Germany is a private sector company but operates on behalf of the German Government in this area. EID/MITI in Japan is a Government operation coming within the Ministry of International Trade and Industry. What they all have in common, however, is that either as Government or on behalf of Government they provide insurance and financial support for their national export programmes. Not only do they come in at the beginning of the particular export transaction in this way, but also when things go wrong and transfer delays occur because of foreign exchange difficulties faced by particular debtor countries, they will then come together in concert with the Government of the debtor country to arrive at a programme for the rescheduling of their officially-supported debts. The forum for this coming together is the Paris Club.

Within the United Kingdom, ECGD operates both in the short term credit area (the Cardiff-based Insurance Services) and in the medium/long term project area handling exports of capital goods for projects (the London-based Project Group). It is the Government's intention that from April 1 1991 these two different types of business will be run as separate organisations,

with Insurance Services being converted into a company that will progressively be privatised. This is expected to help customers operate in the expanding and increasingly competitive European market that will exist after 1992. The facilities of the Project Group will remain within Government, a decision which recognises that such business often involves very large contract values, has repayment terms spread over a very long horizon and will normally be seen as being particularly exposed to the transfer risk. For example, much of the ECGD's current unrecovered claims are the result of the foreign exchange shortages being experienced by many developing countries around the world. As at March 1989, some £4.4 bn of unrecovered claims were recorded of which some £3.8 bn were the subject of Paris Club rescheduling agreements. Normally the title to such debts will remain with the exporter but he will give authority to the ECGD to act for him in recovering that debt through the Paris Club arrangements. In the meantime the exporter will have had his claim paid by the ECGD provided it is covered under the terms of his insurance policy.

The sums involved can be huge. Over the two years ending March 31 1989 the ECGD insured £28 bn of UK export business and paid out more than £1.5 bn in claims arising from political events which in the Department's language are defined to include currency transfer delays as well as such events as war, etc. Altogether the amount at risk which ECGD carries is in excess of £21 bn and claims paid out in recent years have averaged over £800 mn per year. This much exceeds the ECGD's income from premiums of around £180 mn per year and even when recoveries of earlier claims and interest on Paris Club rescheduled debt are taken into account at around £325 mn is a vivid illustration of the serious problems which the international debt crisis continues to pose for all export credit agencies. Experience suggests that a major part of gross unrecovered claims will eventually be recovered under the Paris Club arrangements but only after a considerable delay. When the total of unrecovered claims is in excess of £4 bn, as it is for ECGD, the accumulated borrowing by the Department from the Consolidated Fund to finance the negative cash flow until recoveries are received (£1.6 bn at March 31 1989) is a substantial figure. One way of looking at that figure, which some people favour, is to say that it represents an *ex post facto* and unintended subsidy to the exporters of capital equipment to projects in countries which subsequently ran into grave balance of payments problems. However, this ignores the fact that ECGD continues to pay interest on its borrowings at a commercial rate and that most of the debt is the subject of inter-governmental Paris Club agreements and is thus sovereign debt, the greater part of which will eventually be recovered.

When transfer delays prevent exporters being paid in foreign currency for their goods on the project side, a country may be placed 'off cover' for certain types of business. In this context it is important for us to distinguish between 'non-performing' risks which arise when the buyer is in default and transfer delays which are the result of the balance of payments problems and policies of the country itself. We also need to distinguish between cover for medium term business and cover for short term business. By turnover some 80 per cent of exports insured by ECGD are short term, i.e. sold on credit terms of up to 180 days, but the preponderant part of the risk is from the medium and long term business. It is often the case that short term debt is serviced according to contract while medium and long term debt is not. In such circumstances a country may be 'off cover' for medium and long term finance thus making it difficult for British exporters to participate in new projects in that country while at the same time remaining on cover for short term credit. Therefore at any one time the countries hit by debt problems may be off cover. It is, however, seen as an important part of ECGD's role to continually monitor such situations and to seek to restore medium term cover as steps are taken by the host government to resolve its economic problems. It is here that the role of the Paris Club assumes a particular significance.

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### **The Role of the Paris Club**

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A significant part of the LDC debt problem can be seen as a mutual problem shared between the debtor countries on the one hand and the export credit agencies as creditors on the other. In this approach, the exposure of Export Credit Agencies (ECAs) in the LDC countries, a large part of which can be described as debt in the sense that maturity dates have come and gone with no payment being made, can be regarded as an investment of mutual benefit to both parties and the question arises as how best to protect and optimise their investment by encouraging economic growth in the debtor country.

The approach taken, a mix of debt rescheduling and a controlled flow of new credits, seeks to preserve ECA interests in a way that continues to benefit both parties. The main thrust of the argument therefore is the function of the Paris Club on the rescheduling front and on the reopening of officially-supported credit to rescheduling countries.

As explained, ECAs will normally continue to provide support for the classes of debt not taken into debt rescheduling. If, as is usually the case, short term debt is excluded from any rescheduling, agencies are likely to go on providing cover for such credits reasonably secure in the knowledge that this class of business at least will be serviced and turned over freely. The same considerations would apply if, for example, public

sector debts only were rescheduled leaving private sector debts to be serviced on due date.

More often than not the agreement will relate to all classes of medium term credits which will be further broken down into arrears on recent maturities, new maturities over an agreed forward period and, all too sadly these days, arrears on previously rescheduled debt.

The communique following the Toronto Summit meeting represented something of a breakthrough. First it recognised that Paris Club creditors had already introduced a policy of extended grace and repayment periods for the poorest debtor countries. The key development was the willingness to offer a menu of concessional rescheduling interest rates, longer repayment periods at commercial interest rates, partial write-off of debt servicing obligations during the consolidation period or a combination of these options. The intention is to allow official creditors to choose options consistent with their legal or budgetary constraints.

The menu approach heralded a departure from the normal Paris Club requirement for rescheduling terms designed to ensure equal burden sharing. However it was still intended that the range of options should be available within a framework of comparability or equal effort.

After the Toronto Summit attention switched to the Paris Club which represents a somewhat greater number of creditor countries. There was sensitivity that the smaller countries not represented at Toronto would not wish to be told what to do by the major creditors. In fact most of the smaller creditors adopted a positive attitude and ironically some of the difficulties which emerged when trying to work out the technical details came from some of the larger.

Creditors will indicate which particular option they will apply as part of the multilaterally Agreed Minute which records the outcome of individual negotiations. They will be able to choose different options on a case by case basis and they can provide a combination of measures, perhaps differentiating between different types of debt.

There has been some discussion of the precise eligibility criteria to be used to determine which countries should benefit. However, the Paris Club, whilst laying down guidelines such as:

- i) high debt service compared with export income;
  - ii) sufficiently poor to qualify for IDA credits;
  - iii) adequate efforts being made to service debts;
  - iv) adherence to an IMF adjustment programme;
- will not provide special terms automatically to any debtor. The countries of sub-Saharan Africa are prime candidates for consideration but the decision will continue to be taken in the Paris Club on a case by case

basis.

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## The Resumption of Cover

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Turning to the question of new ECA credit flows in respect of LDC countries which have had recourse to debt rescheduling: the effect of rescheduling on the agencies is normally to bring about a suspension of further cover for the country in question at least so far as the class of debts being rescheduled is concerned. By definition such cover would probably already have been reduced to a minimum if not withdrawn altogether as the economic situation in the country in question was seen to be deteriorating and moving towards the need for a rescheduling of ECAs' existing exposure.

Most ECAs, however they may be structured, follow a fairly common pattern of country risk assessment and controls which are a mixture of premium rates, ceilings on exposure, restrictions on the type of business or size of contracts that will be covered and ultimately the phasing out of cover altogether. By the time of an approach to the Paris Club, therefore, an ECA would already have run down its ability to accept new exposure to a minimal level.

The rescheduling arrangements associated with the putting into place by the debtor country of an economic recovery programme on the back of an IMF Standby Agreement or similar arrangement, the parallel commercial bank debt relief arrangements and the possible World Bank lending programme, will then create an environment which will lead the ECA to address the question of a resumption of cover for the country in question.

This compares with the previous approach whereby resumption of cover would be considered only after the debtor's creditworthiness had been re-established and a good debt repayment record built up which could often mean a gap of several years before cover could be restored. This policy came under scrutiny in 1984 due to the scale and severity of the debt crisis and the need to offer debtors an incentive to enter into policy adjustment programmes in concert with the IMF etc.

In the case of ECGB, this meant that towards the end of 1984 a decision was taken to allow cover to be resumed much earlier than before for selected countries which had rescheduled their officially guaranteed debt and who were adopting vigorous adjustment policies in conjunction with an IMF programme. The approach was intended both to help UK exporters maintain a stake in overseas markets which were in the process of recovering from debt service difficulties and to assist such countries' recovery efforts by providing export credit support for essential imports.

The criteria normally employed by ECGB when

considering a rescheduling country as a candidate for this resumption of cover are that the debtor country must be committed to a readjustment programme supported by the IMF, that the Paris Club rescheduling negotiations must have been completed and a bilateral agreement signed with the UK and that the recovery programme embarked upon provides a reasonable prospect of current payments and debt servicing commitments being honoured given the relief afforded through the Paris Club and other associated rescheduling agreements. In applying the cover it would be expected that the credit support be related to exports of UK goods and services showing an early contribution to the foreign exchange earning capacity of the debtor country and its economic rehabilitation.

Large capital goods projects requiring lengthy lead times and pay back periods so far as the foreign exchange earning benefits were concerned would be the subject of one off consideration and we would expect such projects to be endorsed and preferably supported financially by the World Bank as relevant to the recovery programme.

This combination of Paris Club relief, on more favourable terms than in the past for the poorest debtors, and support for new flows of growth related credits against the criteria outlined will constitute the main plank of agencies such as ECGD in their contribution towards the management of the LDC debt problem.