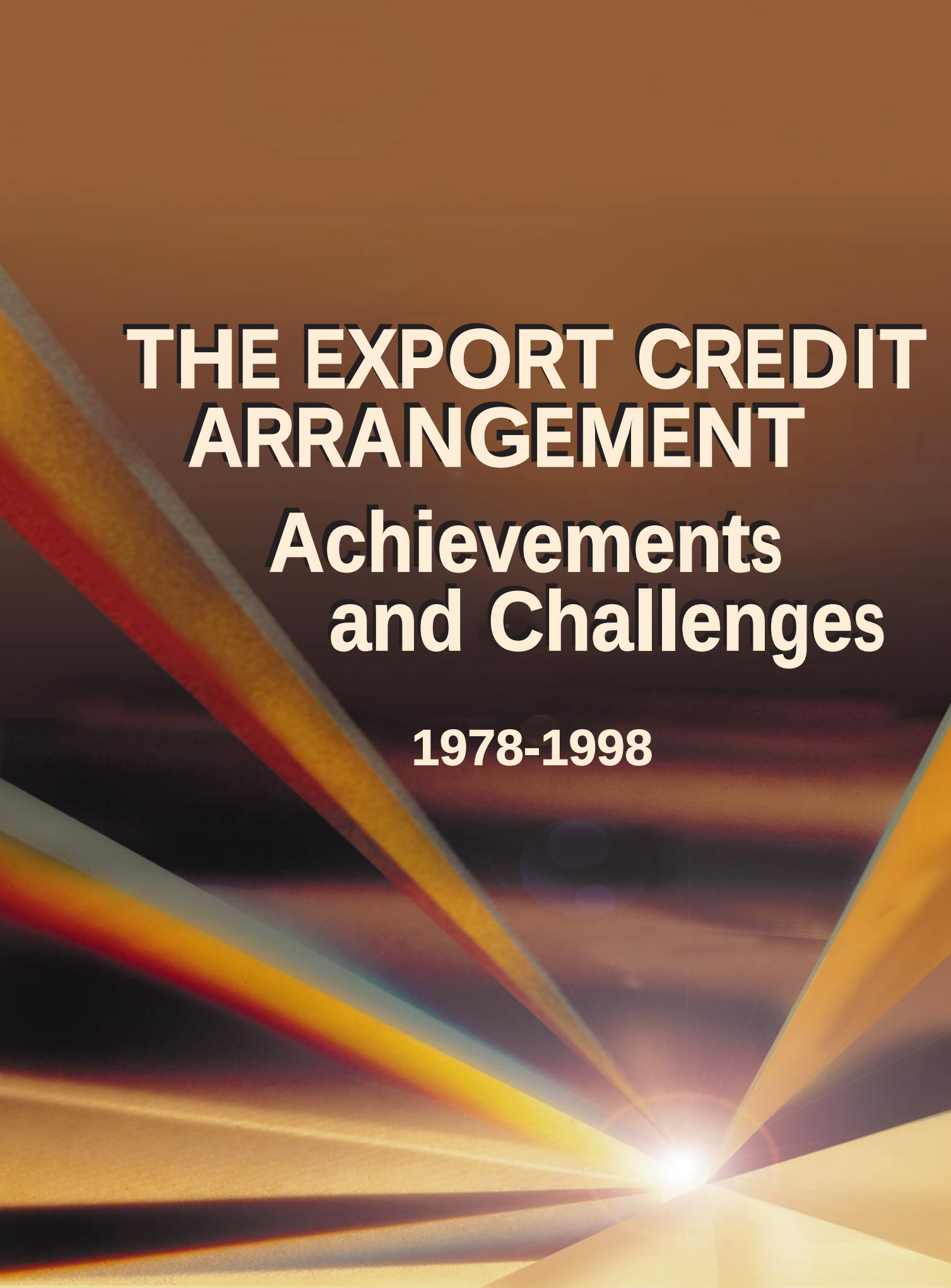


The background of the cover is an abstract composition of warm, golden-brown and orange tones. Several broad, diagonal bands of lighter and darker shades of these colors sweep across the frame from the bottom towards the top. At the bottom center, there is a bright, glowing light source, possibly representing a sun or a star, which creates a lens flare effect with concentric circles and radiating beams of light that illuminate the surrounding abstract shapes.

THE EXPORT CREDIT ARRANGEMENT

Achievements and Challenges

1978-1998

PERSPECTIVES DE LA SCIENCE,
DE LA TECHNOLOGIE
ET DE L'INDUSTRIE

1998

THE EXPORT CREDIT
ARRANGEMENT
Achievements and Challenges
1978-1998

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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Foreword

Donald J. Johnston,
Secretary-General of the OECD

I am delighted to contribute the foreword to this publication, which commemorates 20 years of the Arrangement on Guidelines for Officially Supported Export Credits. The Arrangement plays an important role in the multilateral trading system and shows the strength of the OECD approach of consensus-building, based on transparency and peer pressure.

Although the Arrangement is a “Gentleman’s Agreement”, with no formal procedures for settling disputes, its success is remarkable in terms both of the adherence of its Participants to its guidelines and its adaptability to reflect the globalisation of trade. I applaud the remarkable achievements of its Participants, over those two decades, in phasing-out subsidies and trade distortions. These achievements include the agreements last year on the Knaepen Package on premium fees and on the new version of the text of the Arrangement, as well as earlier agreements, such as the 1992 Helsinki Package on tied aid and the 1994 Schaerer Package implementing a market-related regime of interest rates.

Current negotiations, aimed at developing the Arrangement into new areas, such as Project Financing and Agricultural Exports, demonstrate the dynamism of the Participants in reflecting market developments and the determination to provide a level playing field so that exporters compete on the price and quality of their goods and services, not on the support they receive from their governments.

I look forward to the next twenty years of the Arrangement being as active and successful. Happy twentieth birthday to the Arrangement and its Participants!



A handwritten signature in black ink, which appears to read "Donald Johnston". The signature is stylized and fluid, written over a light background.

Contents

Chapter 1: An Introduction to the Export Credit Arrangement

Introduction	
<i>Janet West</i>	9
Flexibility in a Changing World	
<i>Kurt Schaerer</i>	13
The Multilateral Trade System, the Export Credit Arrangement and the WTO	
<i>Gerhard Abel</i>	15
The Arrangement: What It Is All About	17

Chapter 2: Past Achievements

Milestones of the Arrangement	24
The Genesis of the Consensus	
<i>Rolf Geberth</i>	27
The Arrangement from the Inside	
<i>John Ray</i>	33
The Arrangement from a Spanish Perspective	
<i>Soledad Abad Rico, Luis Marti Espluga and Rafael Manzanares</i>	39
Wallén, Helsinki, Schaerer <i>et al</i> :	
Some Major Achievements, Some Challenges to Meet	
<i>David Stafford</i>	45
The Birth of the “Helsinki Package”	
<i>Eero Timonen</i>	51
Mission Impossible: Enhancing Discipline in Tied Aid Credits	
<i>Birgitta Nygren</i>	55
Mission Accomplished: <i>Ex Ante</i> Guidance for Tied Aid	
<i>Frans Lammersen</i>	59
Mission Assessed: What Grounds for Commercial Viability?	
<i>Tony Owen</i>	67
A Development Co-operation Perspective on the Helsinki Tied Aid Disciplines	
<i>Bill Nicol and Gerry Duffy</i>	71
The “Knaepen Package”: Towards Convergence in Pricing Risk	
<i>Pierre Knaepen</i>	75
The Ragged Arrangement – or – From RAG to Riches	
<i>Bob Crick</i>	81

Chapter 3: Future Challenges

The Economic Policy Benefits of International Co-operation <i>Timothy F. Geithner</i>	87
From Simple to Sophisticated <i>Hidehiro Konno</i>	95
A National Perspective: The View from Germany <i>Michael Kruse and Eckhardt Moltrecht</i>	99
The Export Credit Agency in a Market Environment <i>Vivian Brown</i>	103
Soft Law, Hard Results <i>Jacques de Lajugie</i>	107
A New World for the Export Credit Agencies <i>A. Ian Gillespie</i>	111
New Challenges <i>Allan G. Dalvin</i>	117

Chapter 4: International Institutions' Perspectives

Export Credit Agencies and the World Bank: A Partnership <i>Hiroo Fukui</i>	123
A Consensus for Change <i>Noreen Doyle</i>	127
The Balance Between Discipline and Effectiveness <i>Malcolm Stephens</i>	133

Chapter 5: Private Sector Perspectives

A View from the Export Market <i>Julien de Wilde</i>	141
An International Banker's View: Important Developments and the Challenges and Opportunities They Bring <i>Jan Kalff</i>	143
Export Credit in Context <i>Paul Melly</i>	151
The Advance of the Private Sector in Short-Term Export Credit Insurance <i>Ted Watson</i>	159

Chapter 6: And Finally

Postscript <i>Janet West</i>	167
Chairmen of the Participants to the Arrangement on Guidelines for Officially Supported Export Credits	169

Chapter 1

An Introduction to the Export Credit Arrangement

Introduction

Janet West

We could not let the 20th anniversary of the Arrangement on Guidelines for Officially Supported Export Credits go by without marking the occasion. The evolution over two decades of this “gentlemen’s agreement”, from a relatively simple to a more market-reflective instrument, seemed to be a tale worth telling, especially in the light of its many distinguished players.

But simply reflecting on past experiences and achievements was not enough: we wanted also to look forward to the new challenges facing the Participants to the export credit Arrangement. The Participants are, after all, a dynamic group of negotiators ever keen to hone and tease the Arrangement to reflect market realities. Some would even view their aim as to negotiate themselves out of the export credit market entirely – although recent events in South-East Asia will, for others, re-inforce the continuing desirability of official support.

Contributors to this commemorative publication, including Chairmen and Vice-chairmen of the Participants, past and present negotiators and representatives of the international institutions and the private sector, have expressed their recognition of the vital role that the Arrangement has played in eliminating trade distortions. Timothy Geithner, for example, refers to the evolution of the Arrangement from a simple creditors’ cartel to a powerful force for improved international and domestic economic policies world-wide; and Hidehiro Konno refers to export credits as being the fuel that powers the trade engine that drives the increasingly integrated global economy.

The genesis of the Arrangement, as Rolf Geberth writes, was the desire on the part of some OECD governments in the early 1970s to have a “gentlemen’s agreement” to bring order to official export financing, with the focus on interest rate subsidies. In 1976 the G7 summit at Rambouillet provided the backdrop for a “Consensus” on official export credits among a limited number of OECD countries. Two years later, in April 1978, the Arrangement was established at the OECD in Paris with twenty participating countries.

The Arrangement has grown over the years and we now have a refined and reformatted text which has been welcomed by all the Participants. As Bob Crick remarks, the definition of official support is not yet cemented but the quest continues. Jacques de Lajugie notes in his article that although the Arrangement is soft law it produces hard results; and although it is not a legal act of the OECD, the degree of adherence by its Participants is extremely high – indeed, it is quite



Janet West has been Head of the Export Credits' Division of the OECD Trade Directorate since 1993.

remarkable in the absence of any formal dispute settlement process. As my predecessor, John Ray, explains in his article, this success is attributable to modesty, pragmatism and transparency, all of which the Participants have displayed in abundance over the last two decades.

There have been a number of notable successes in the life of the Arrangement, in particular, the phasing-out of interest-rate subsidies, the implementation of tied aid disciplines and, more recently, the establishment of risk-based premium fees which should also satisfy the WTO obligation to charge premiums that are not inadequate to cover long-term operating costs and losses.

The reflections by many of the contributors on these past successes illustrate well both the sense of the Participants' objective to eliminate trade distortion and the process by which their aim is achieved: the former driven by economic, competitive and developmental motivations, the latter dictated by the need to reach practical and pragmatic consensus. David Stafford recalls the concerns that led to each of the major set of reforms to the Arrangement: the Wallén, Helsinki, Schaerer and Knaepen Packages. And in their articles Eero Timonen, Pierre Knaepen and our Spanish colleagues – Soledad Abad Rico, Luis Marti Espluga and Rafael Manzanares – reflect the reality that consensus inevitably means compromise to some degree or other and that the benefits and the burdens have to be shared as equally as possible among all parties.

Export credits is a practical business, and the implementation of negotiated compromises is always a priority. The codification of experience with the Helsinki tied aid disciplines into *Ex Ante* Guidance for Tied Aid is an example of this often difficult process. Birgitta Nygren and Frans Lammersen write on this apparent “mission impossible” turned “mission accomplished” with the analytical assistance of Professor Tony Owen. Although it is concerns about trade distortion that have steered the Participants' debate about tied aid, it is the quality of aid that remains uppermost in the minds of our colleagues in development assistance, as Bill Nicol and Gerry Duffy note.

Of course, the Participants have neither the export credit insurance and guarantee field to themselves nor a monopoly on export financing. Paul Melly and Ted Watson note that the private market, over the lifetime of the Arrangement, has developed enormously. Today the market not only complements the facilities available from official Export Credit Agencies (ECAs) but also competes with them, especially for business in the more creditworthy markets. Indeed, some contributors suggest that official ECAs may in the future be left with the rump of lesser-quality risk while the market takes the lion's share of the best business (not a happy thought for the taxpayer) unless more commercially orientated approaches are adopted. The development of the market, of course, poses challenges for ECAs, and a range of responses is offered here, including Ian Gillespie's view that a market philosophy should be maintained and that ECAs should re-think the role of the Arrangement and how they do business, and Malcolm Stephens' warning against over-gilding the Arrangement lily.

All this calls for the ECAs to be innovative and open to bilateral and multilateral opportunities such as co-financing with the international financial institutions, as Hiroo Fukui and Noreen Doyle describe, and with the private sector, as noted by Vivian Brown and others, who consider that ECAs have a future which by necessity must be one of change and continuing adaptation to the business

environment. The Arrangement should therefore be constantly under review to ensure that market developments and the Participants' innovative and dynamic spirit are translated into appropriate disciplines backed by transparency. In this context, many have written about the importance of accommodating the structure of project finance transactions: international companies such as Alcatel (Julien de Wilde) and ABN AMRO (Jan Kalff) emphasise how desirable this flexibility is, and their views are underlined by our German colleagues Michael Kruse and Eckhardt Moltrecht and others.

The Participants' acknowledgement of market developments has led to the present negotiations on project finance, the examination of interest-rate practices under the CIRR system and the peer review of so-called "market window" operations. And in the forum of the Working Group on Premia the Participants are looking at private market indicators as one of the three tools to evaluate the ongoing validity of the minimum premium benchmarks.

There are also a number of challenges lined up before the Participants, if they are to protect and build upon their achievements while ensuring that market realities are not ignored. The continued monitoring and review of the extant Arrangement guidelines, the regular reports and the codification of experience remain vital activities. Looking to the future, the priorities are the negotiations on complementary guidelines for agricultural products, agreement on flexibility under the Arrangement for project finance and the emerging issues of export credits and the environment (a G8 priority), the impact of the OECD Convention on Bribery on official export credit support and the further untying of aid. Other dimensions that the Participants will have to bear in mind as the next millennium approaches include the preparation for the European Monetary Union: a euro-CIRR will have to be developed, as Allan Dalvin notes. And there will be implications for the Participants from a wider membership of the OECD and an enlarged European Community. Of course, there are other issues—such as market windows and the updating of the interest rate regime—that await resolution. But even here movement is visible and the Participants continue to discuss and examine possibilities.

Against the background of all these issues, the OECD pillar of transparency through the exchange of information remains the fundamental cornerstone, one which is essential for the effectiveness of the disciplines that rely on peer review.

My thanks to the authors for the efforts which made this book possible. The result is a unique document and analysis of a remarkable piece of international "law"; it also contains some surprising insights into the world of international negotiation.

Flexibility in a Changing World

Kurt Schaerer

Looking back on the five years during which I have had the privilege of sitting in the Chair of the Participants to the Arrangement on Guidelines for Officially Supported Export Credits, I can see a number of remarkable achievements. If I were to judge the achievements of the last few years from the perspective of my early experience as a junior member of the Swiss Delegation to the Participants' meetings, I would simply not have believed it possible to negotiate, within five years, discipline on tied aid, to abolish interest rate subsidies, introduce automatic reclassification of importing countries, establish a market-related system of discount rates and agree on guiding principles for premium fees and related conditions. The Participants can fairly claim that their efforts have allowed the export credit Arrangement to follow the fast cycles of change in the global economic environment.

Yet there is little likelihood of leaning back to enjoy the scenery. The protected hunting grounds of national politicians are becoming the victims of globalisation. Such territories, which were once at the core of national economic policy making, are being suborned more and more by outside influences. Companies that operate globally can swiftly shift their production to countries where they obtain the most competitive advantages. Particularly for larger projects such advantages may include financing and official support.

A number of major changes are transforming the world of official export credit supporters. Private insurers are stepping into areas so far reserved to public institutions. For those who believe in the long-term benefits of restricting government activity in the economy to a subsidiary role, this trend raises the politically difficult question of whether to watch the economic and political influence of governments being reduced by a private market which more and more writes its own quasi-sovereign rules. Governments are informed about important corporate decisions with wide-ranging social and international consequences on the eve of press announcements, and after the share market has reacted to the news.

Yet, in my opinion, the authorities watching guard over official export credit support should observe and follow closely what is happening in the market. Over time, and in most instances, market forces will be the winner. But reasonable innovative financing and risk-mitigation techniques introduced in the market should, where necessary, be accompanied by official support. The Participants to the Arrangement should continue to be alert to such developments, endeavouring



Kurt Schaerer is Head of the Export Risk Guarantee and Export Promotion Service of the Federal Office for Foreign Economic Affairs, Berne; since 1992 he has been Chairman of the Participants to the Arrangement on Guidelines for Officially Supported Export Credits and of the Group on Export Credits and Credit Guarantees.

to strike a fair balance between consolidating past results and modernising outdated rules.

To safeguard the integrity of the Arrangement while simultaneously acknowledging market realities, I favour as little rigidity as necessary combined with as much flexibility as possible. Fortunately or unfortunately, there is no textbook which reveals how to achieve this end. That leaves an eternal challenge for our enlightened negotiators in their meetings at the OECD in Paris. If the excellent personal and professional spirit which has accompanied the meetings of the Participants over the last five years continues to reign over future negotiations, our common cause should prevail.

The Multilateral Trading System, the Export Credit Arrangement and the WTO

Gerhard Abel

The success of the Arrangement on Guidelines for Officially Supported Export Credits demonstrates the effectiveness of the OECD as a forum for the development of rules-based disciplines within the multilateral system and complementary to those of the WTO. Such disciplines are achieved through consensus and peer review, demonstrating the pragmatic and practical approach governments can take to levelling the playing-field in international trade.

The Arrangement, is something special in the work programme of the OECD Trade Directorate: it goes beyond analyses, policy advice and recommendations, and sets out genuine disciplines which are adhered to by its Participants. Although dissimilar in character from the rest of the work of the Directorate, the Arrangement is an integral part of our agenda and warrants recognition as a priority in the activities of the Organisation.



Gerhard Abel has been Director of the OECD Trade Directorate, Paris, since 1988.

A Direct Link with the WTO

The disciplines of the Export Credit Arrangement have found recognition under the WTO framework. Article 3 of the WTO Agreement on Subsidies and Countervailing Measures (the “SCM Agreement”) prohibits many kinds of export subsidisation. However, item (k) of the Illustrative List of Export Subsidies annexed to that Agreement gives an exemption for export credits in conformity with the interest rate provisions of the Arrangement, whether provided by a Participant or by a non-Participant. Thus a level playing-field should prevail in the provision by governments of financing support for exports of capital goods and services.

A further link between the Arrangement and the WTO is through item (j) of the Illustrative List which provides that export credit facilities provided by governments or on their behalf should be at premium rates not inadequate to cover long-term operating costs and losses. This international obligation has been well recognised by the Participants through their momentous agreement last summer on guiding principles for setting premium fees – the so-called “Knaepen Package”.

And the current negotiations of the Participants to the Arrangement to arrive at an Understanding on disciplines for official export credit support for agricultural products clearly demonstrates their desire to honour the commitments in the Final Act embodying the results of the Uruguay Round of multilateral trade negotiations. Under Article 10.2 of the WTO Agreement on Agriculture, which relates to the prevention of circumvention of the special export subsidy disciplines

for this sector, Members undertake to work towards the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees or insurance programmes. The WTO Members are looking to the Participants' efforts to this end, and at an appropriate stage the WTO Committee on Agriculture will be able to consider how an Understanding amongst the Participants could be made multilateral within the framework of their Agreement on Agriculture. This is indeed an important activity of the Participants to the Arrangement, a conclusion to which has been urged by OECD Ministers.

Steps Ahead

The recent reforms to the Arrangement, and the challenges of those which are currently being worked upon, reflect the importance of flexibility to accommodate market and political developments with a view to the further elimination of subsidies and trade distortions.

I am sure that the Participants to the Arrangement, under the guidance of their experienced and skilful Chairman, Kurt Schaerer, will meet these challenges with their usual combination of pragmatic realism and determination. In my long professional career as a free trader and multilateralist, I have seen few international groups acting so constructively on economically and politically important and often sensitive issues.

To assist such successful international co-operation is a honour for the Secretariat and a reward for the hard-working export credit team, headed by the tireless and enthusiastic Janet West, in the OECD Trade Directorate.

The list of contributors to this publication reads like a Gotha of the key players, former and present, in the export financing story. They all deserve congratulations for a job well done. But the story goes on and expectations of further success remain high.

The Arrangement: What It Is All About

This note offers information about the Arrangement on Guidelines for Officially Supported Export Credits,¹ explains some of the terms used, and details some of the major agreements made during the 20 years of the Arrangement.

The Purpose of the Arrangement

The main purpose of the Arrangement is to provide a framework for the orderly use of officially supported export credits. The Arrangement seeks to encourage competition among exporters based on the price and quality of the goods and services being exported rather than on the most favourable officially supported terms.

The Application of the Arrangement

The Arrangement applies to officially supported export credits with repayment terms of two years and more. It also includes guidelines on the circumstances in which official support in the form of trade-related tied and partially untied aid may be given and/or mixed with officially supported export credits. Military equipment and agricultural commodities are excluded from the application of the Arrangement, and special guidelines (Sector Understandings) apply to nuclear power plant and civil aircraft; a separate Agreement exists for ships.

The Guidelines of the Arrangement

The Arrangement places limitations on the terms and conditions of export credits that benefit from official support. Such limitations include minimum premium benchmarks, the minimum cash payments to be made at or before the starting point of credit, maximum repayment terms and minimum interest rates which benefit from official financing support. There are also restrictions on the provision of tied aid.

The Participants to the Arrangement

There are nine Participants to the Arrangement: Australia, Canada, the European Community (which includes the following Member States: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden and the United Kingdom), Japan, Korea, Norway, New Zealand, Switzerland and the United States.

Export Credit

An export credit is an insurance, guarantee or financing arrangement which allows a foreign buyer of exported goods and/or services to defer payment over a period of time.

1. Cf. OECD Document "Arrangement on Guidelines for Officially Supported Export Credits".

Official Support

Although there is no agreed definition of official support, it is generally understood that it involves government-backed support for an export credit. Official support can take the form of direct credits/financing, refinancing, interest-rate support (where the government supports a fixed interest rate for the life of the credit), aid financing (credits and grants), export-credit insurance and guarantees. Direct credits/financing (where the loan is extended by the government of the exporter), refinancing and interest-rate support are referred to as “official financing support”. The provision of insurance and guarantees with no official financing support is termed “pure cover”.

Export Credit Agencies (ECAs)

The institutions which undertake these official activities for or on behalf of governments are Export Credit Agencies (ECAs). There are many different types of ECA: they can, for instance, be government departments, or government or commercial institutions administering an account for or on behalf of government, separate from the commercial business of the institution.

ECA Programmes

ECAs provide a range of different services,² including guaranteeing repayment of a loan by a financial institution to an overseas buyer (for example, a Buyer Credit facility), insuring against non-repayment of a credit extended by an exporter to an overseas buyer (for example, a Supplier Credit facility), and providing direct loans or credits to overseas buyers.

Commercial Interest Reference Rates

The Arrangement stipulates that Participants providing official financing support shall apply minimum interest rates, i.e., not below the relevant Commercial Interest Reference Rate (CIRR). There is a CIRR for the respective currency of most OECD countries. CIRRs are adjusted on a monthly basis and are intended to reflect market rates of interest in the domestic market of the currency concerned, closely corresponding to the rate for first-class domestic borrowers. In most cases, they are based on treasury bond yields, plus a margin. The prevailing CIRRs are available on the OECD Internet page (http://www.oecd.org/news_and_events/new-numbers/cirr/cirrlist.htm)

Tied, Partially Tied and Untied Aid

Tied aid (including partially untied aid) is aid which is in effect tied to the procurement of goods and/or services from the donor country and to a limited number of other countries. “Untied aid” is aid whose proceeds are fully and freely available for procurement of goods and/or services in all OECD countries and in substantially all other countries.

The Wallén Package, 1987

This set of reforms, adopted in March 1987, was an important step in the process of phasing out subsidised “matrix rates”: in the first stage the matrix interest

2. Cf. the OECD publication, *Export Credit Financing Systems in OECD Member and non-Member Countries*.

rate was abolished for exports to Category 1 (Relatively rich) countries. In addition, the method for calculating the grant element of tied aid, henceforth labelled the “concessionality level”, was changed to reflect more accurately market rates of interest for each currency through the introduction of the Differential Discount Rate (DDR) rather than a uniform 10% discount rate. Additionally, the minimum concessionality level of such aid was raised in stages from 25% to 35%.

Axel Wallén of the Ministry of Finance, Sweden, was Chairman of the Participants to the Arrangement from 1980 to 1987.

The Helsinki Package, 1991

This package of measures, agreed in December 1991, prohibited tied and partially untied aid for richer developing countries as well as for projects which should be financed commercially. The intention of these disciplines was to redirect such aid away from richer developing countries (those whose per capita GNP makes them ineligible for 17-year loans from the World Bank) which are generally creditworthy and thus able to attract commercial credits, towards poorer developing countries. Furthermore, tied aid to the latter group (except for grants and very concessional loans) was henceforth limited to so-called commercially non-viable projects, i.e., for which commercial funding would not normally be available.

The Participants agreed to two key tests for evaluating whether projects are commercially non-viable and therefore eligible for aid financing:

- whether the project lacks capacity, with appropriate pricing determined on market principles, to generate cash flow sufficient to cover the operating costs of the project and to service the capital employed; or
- whether it is reasonable to conclude, based on communication with other Participants, that it is unlikely that the project can be financed on market or Arrangement terms.

These disciplines resulted in the establishment of the Consultations Group on Tied Aid to determine whether individual projects satisfied the two key tests. Projects in Least Developed Countries (LLDCs), grants and very soft credits with a concessionality level of 80% or more and, in order to limit the administrative burden, projects with a value of less than 2 million SDRs are exempted from the commercial viability tests.

The Helsinki Package also included:

- the phasing out (second stage) of subsidised matrix interest rates for Category (Intermediate) countries
- further refinement of the DDR in order to reflect more accurately the real cost of aid to governments
- adjustments to the CIRRR system
- discussion with the DAC, to agree on targets for the further untying of aid.

These reforms were named the Helsinki Package after the Finnish capital where, at a key stage in the negotiations, the Package was drafted under the then Chairman of the Participants, Eero Timonen from the ECA of Finland, the Finnish Guarantee Board (FGB).

The Schaerer Package, 1994

This agreement, concluded in September 1994, abolished SDR-based interest rates (i.e., the remaining element of the matrix rate system) for financing support so that the CIRR system, intended to reflect market rates more closely, would apply for all countries from September 1995. It also streamlined the classification of countries for maximum repayment terms, reduced the number of country categories from three to two, and refined further the DDR system. Finally, the Schaerer Package included an agreed work programme:

- Agriculture:* The Participants firmly undertook to start negotiations on complementary guidelines on export credits for agricultural products.
- Steel:* The Participants agreed that the requirement for further or complementary guidelines in the Arrangement for Steel Plant and Equipment would be considered when the outcome of the negotiations in the Multilateral Steel Agreement were known.
- Premium and related conditions:* The Participants recognised that premium and guarantee fees were an important and a priority issue and agreed to investigate guiding principles with a view to produce convergence among premium fees. In accordance with their international obligations (item j of the GATT/WTO Illustrative List of Export Subsidies), the Participants agreed that premium fees should not be inadequate to cover long-term operating costs and losses. The Participants endorsed the notion of risk-based premium fees, and the necessity of eliminating trade distortions whether caused by premiums or related conditions.
- Market windows:* The Participants undertook to investigate further both the issue of transparency and definition of “market window” operations with a view to preventing distortion of competition.
- Global untying of aid:* The Participants confirmed their resolve to co-operate with the OECD’s Development Assistance Committee to develop targets for the untying of aid and a more precise definition of untied aid, and improved transparency.

This reform package was called the “Schaerer Package” after the present Chairman of the Participants, Kurt Schaerer of the Federal Office for Foreign Economic Affairs, Switzerland, who chaired the negotiations.

Ex Ante Guidance for Tied Aid, 1996

After four years’ experience of the Helsinki tied aid disciplines, the Participants agreed, in December 1996, to guidelines to assist aid donors and recipients, export credit and aid agencies and project planners to determine at an early stage whether or not projects would be eligible for tied aid. The guidance followed the principle underpinning the Helsinki disciplines that official aid should be avoided for exports which would be commercially viable without concessional financing.

This guidance was based on a body of experience of tied aid notifications and the evaluation by the Participants’ Consultations Group of some 100 individual export projects over the period 1992-1996.

The Meetings of the Consultations Group were chaired by Birgitta Nygren (1992-1995) and Frans Lammersen (1996-1997) of the Permanent Delegations of Sweden and the Netherlands respectively to the OECD.

The Knaepen Package, 1997

The Knaepen Package sets out guiding principles for setting premium fees for official export credit support through minimum premium benchmarks for country and sovereign risks; it was concluded by the Participants in June 1997. The guidelines reflect two basic principles:

- pricing should be risk-based so that the premium fees charged are not inadequate to cover long-term operating costs and losses (in accordance with the WTO obligation); and
- pricing should converge and, from the exporter's perspective, reflect the differing quality of officially supported export credit products.

The agreement was concluded after two years' of technical development in the Working Group of Experts on Premia and Related Conditions chaired by Pierre Knaepen of the Belgium ECA, Office Nationale du Ducroire (OND), and after whom it is named. The guidelines encompass:

- an econometric model to assess country risk;
- initial minimum premium benchmarks assigned to seven country risk categories;
- differences in the minimum rates to be applied according to the quality and percentage of cover being provided;
- provisions for the regular review of the minimum premium benchmarks to ensure that, over time, the rates remain commensurate to risk and not inadequate to cover long-term operating costs and losses;
- a comprehensive Electronic Exchange of Information, developed for the Participants to the agreement to ensure maximum transparency.

These rules will come into effect on 1 April 1999 and will apply to all officially supported export credits, whether provided by direct financing, refinancing, insurance or guarantees.

A New Arrangement Text, 1997

A revised text reflecting a complete overhaul of the Arrangement was agreed in November 1997 following two years' preparation by the Redrafting of the Arrangement Group (RAG) under the chairmanship of Bob Crick from the Export Credits Guarantee Department (ECGD), the ECA of the United Kingdom.

The new text incorporates, in a more user-friendly style and format, the decisions and interpretations and the numerous reforms and enhancements to the Arrangement which had been agreed by the Participants since 1992, including the premium guidelines of the Knaepen Package.

Chapter 2

Past Achievements

● MILESTONES

1978

Arrangement on Guidelines for Officially Supported Export Credits becomes effective

- Participants are Australia, Austria, Canada, Member States of the European Economic Community, Finland, Greece, Japan, New Zealand, Norway, Portugal, Switzerland and the United States.
- Applies to officially supported export credits with a repayment term of two years and more.
- Military equipment, agricultural products, nuclear plant and civil aircraft are not covered.

1983

Agreement to Uniform Moving Matrix

- Minimum matrix interest rates raised.
- CIRR for low interest rate currencies introduced.

1987

Wallén Package

- Minimum concessionality level for tied aid raised to 35%.
- Minimum concessionality level for tied aid raised to 35%.

1991

Helsinki Package

- Tied aid for richer countries and commercially viable projects prohibited.
- Notification requirements for tied aid strengthened.
- The Participants' Consultation Group on Tied Aid formed to determine commercial viability of projects.
- DDR system refined.
- Commitment made to work with the DAC towards untying of aid.

1994

Schaerer Package

- Application of CIRRs made universal.
- Classification of markets streamlined to two categories.
- Work programme agreed on agriculture, steel plant and equipment, premium fees, market windows and global untying.
- Mandate agreed for Working Group of Experts on Premium and Related Conditions.
- Agreement to redraft Arrangement text.

1978

1981

- Matrix minimum interest rates increased sharply.

1984

- Sector Understanding on Export Credits for Nuclear Power Plant agreed.

1985

- Minimum grant element for tied aid raised from 20% to 25%.
- Notification procedures for tied aid strengthened.

1986

- Standard formula for setting CIRRs agreed.
- Sector Understanding on Export Credits for Civil Aircraft incorporated into the Arrangement.

1995

- The Redrafting of the Arrangement Group (RAG) begins work.
- Working Group on Agriculture established, with a mandate to develop an outline Understanding to cover export credits for agricultural products.

OF THE ARRANGEMENT

Future challenges

1997

Knaepen Package (effective 1999)

- Guiding Principles for setting minimum risk-based premium fees for country and sovereign risks introduced.

1996

Ex Ante Guidance for Tied Aid

- Guidance for project planners and aid agencies to rationalise decisions on whether projects would be eligible for tied aid under the Helsinki disciplines agreed.

1997

- The New Arrangement text, incorporating all agreements and amendments since 1992 agreed.

- Official Support: definition agreed?
- Understanding of Agricultural Products: agreement reached?
- Project Finance: flexibility in Arrangement Guidelines agreed?

- Market Windows: next steps in the investigation of transparency and definition of these operations agreed?
- Untied Aid: progress made, in co-operation with the DAC, towards further untying of aid?

- Official financing support: reviewed and developed?
- A Euro-CIRR established?
- New Participants to the Arrangement?

1998

1997

- Korea becomes a Participant.

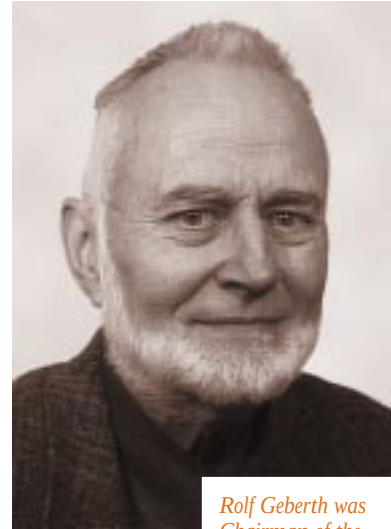
1997

- Negotiations on an export credit Understanding for Agricultural Products begin.

The Genesis of the Consensus

Rolf Geberth

In the beginning of the 1970s there was increasing competition in export financing, mainly between the Member States of the European Community, the United States and Japan. For the exporting countries, the situation deteriorated seriously after the beginning of the first oil crisis in 1973. Because of world-wide economic depression and the necessity of obtaining more hard currency to be able to pay the steeply increased charges for oil, these countries made substantial efforts to increase exports by offering better export credit terms than their competitors. As a consequence of basic differences in the structure of the export-finance systems in Europe and in the United States and Japan, these efforts were related to different parameters.



Rolf Geberth was Chairman of the Group on Export Credits and Credit Guarantees from 1973 to 1976.

The US system was based on a powerful Eximbank which was rather strongly bound to market interest rates and which had to refinance by long-term emissions on the capital market. But this fact enabled Eximbank to lengthen its repayment terms from eight to ten, to fifteen and up to twenty years and to lower its down payments from 20% to 15%, to 10% or to even less.

The Europeans had systems relying on export credit insurance and refinancing by commercial banks. In principle, these banks were unable to refinance on terms longer than five years and had considerable difficulties in extending this period to eight or to a real maximum of ten years. In order to compete with Eximbank in the United States, some of the major exporting countries in Europe maintained the low interest rates of the pre-1973 years by giving interest-rate subsidies to commercial banks for officially guaranteed export credits; in one way or the other these subsidies came from national budgets.

The Japanese were in a better competitive position because of their mixed system, which relied both on their Eximbank and on a well-developed export-guarantee system with refinancing by commercial banks.

First Steps

In 1973, during the Nairobi conference of the International Monetary Fund, the ministers of finance of France, Germany, Italy, Japan, the United Kingdom and the United States agreed to consider concerted action by the exporting countries so as to limit the excessive bargaining power of the buyer countries. At the

Rome conference which followed in January 1974, the German Finance Minister, Helmut Schmidt, took the initiative by inviting high-level experts to a meeting in Bonn on 7-8 February. It was there that the German chairman proposed consideration of a kind of “gentlemen’s agreement” with a minimum interest rate of 7% for subsidised parts of export credits and a maximum repayment period based on European practice.

At the beginning of 1974, different exporting countries had somewhat increased their interest rates for officially supported export credits. At that time, exporters receiving official support could refinance their export credits at 6% in United Kingdom, 6.5% in Italy, 6.75% in France and Japan, 8-9% in United States (7% for the 50% of the credit financed by Eximbank) and about 8.5-9% in Germany. The prevailing market rates were clearly higher: 9.5-11%.

At the Bonn meeting, the French Delegation declared that they were ready for a further increase: from 6.75 to 7% if the United Kingdom, Italy and Japan would follow and if the United States would limit the length of credit to five years for industrialised and to eight-and-a-half for eastern countries. The United States asked for a minimum interest rate of 8% and refused to take any geographical considerations into their repayment philosophy, which was related exclusively to the nature of the projects being financed. The other countries were unable to give any commitments for further increases in interest rates. Furthermore, they argued that export credit conditions (interest rates, repayment period and down payments) should take into account not only the nature of the project but also the financing capacity of the importing country.

Advances on Minimum Interest Rates

In March and April 1974 the European Community (EC) Co-ordination Group on Export Credits (the Policy Co-ordination Group for Credit Insurance, Guarantees and Financial Credits) developed the first detailed proposition for an agreement with a uniform minimum interest rate for refinancing of the officially supported part of export credits (not the contracted rate and exempt of charges and fees): 7% for all credits longer than two years and with three maximum repayment periods of five, eight-and-a-half and ten years for industrialised, for eastern (“intermediate”) and for developing countries.

After two meetings of the nine EC Member States and the European Commission with the United States, there was a first meeting of these countries and Japan in Washington on 10-11 July and a second one in Brussels on 10-11 September 1974. But it proved impossible to reach an agreement. On the one side, the United States continued to be reluctant to include the length of credit if the other countries would not agree both to exclude very large projects and to extend such an arrangement to the grant element of aid credits. On the other side, the French requested an interest-rate exception for credits to Russia, and the Japanese wanted general exceptions for export contracts linked to imports of specific raw materials. Nevertheless, these meetings had an important beneficial outcome by leading to general support of a minimum interest rate of 7.5% (with only the United States continuing to push for 8%) and of an average effective cost (including fees and charges) of 8.5%.

At that stage a degree of disagreement showed up between some EC Member States, which wanted to use the momentum for concluding an agreement at least

on interest rates (the United Kingdom and smaller countries), and others which insisted that both chapters should be linked. A compromise was found with the Agreed Minutes on Export Credit Support signed in Washington on 2 October 1974 by France, Germany, Italy, the United Kingdom and the United States, joined by Japan on 24 October. These six countries agreed, that “as a measure related to, but distinct from, the negotiation on a gentlemen’s agreement on rates and other credit conditions”, a minimum interest rate of 7.5% for export credits longer than five years “should prevail”. This wording covered a secret waiver that allowed the French to undercut the agreed rate somewhat in their negotiations with the Soviet Union on a new five-year credit arrangement. In fact, the Washington Agreement helped the French to agree to 7.5% as a general rule and to 7.2% for very large projects, with a clause that there should be a review after two-and-a-half years. (The second chapter of the common undertaking was reached by agreeing on a maximum length of credit of three years among the signing countries and with wealthy oil-countries.)

Enduring Obstacles

Immediately after this first agreement, the parties continued their discussion on a broader arrangement. In December 1974, the United States accepted for the first time the position of the EC countries: to split geographically not only the maximum repayment period (ten, eight-and-a-half and five years) but also the minimum interest rate (proposition of the United States: 10% for industrialised and 8% for all other countries). The Japanese were reluctant in general (the position it had generally adopted) but always prepared to agree if they were going to find themselves isolated.

In the spring of 1975, a year after the beginning of the negotiations, the four main problems were:

- minimum rate: 7.5% (France, Japan, United Kingdom) or 8% (United States, other EC members);
- special rule for large projects (more than SDR 100 million);
- minimum down-payments (United States: 10%, EC: 15%, Japan against any rule);
- delimitation (“cordon sanitaire”) between export credits and aid credits (Japan and the United States: grant element of at least 25%, France: 15%, other EC members: 20%).

The fifth high-level meeting, on 12-13 May 1975 in Brussels, was to be decisive. Jack Bennett, Under-Secretary in the US Treasury, came with the firm intention of concluding an agreement; the export credit agency of the United States (US Eximbank) seemed to be ready for real concessions by accepting binding maturity terms (with exceptions for projects of national interest). But soon the US Eximbank revealed itself to be a second US delegation acting in clear opposition to the Treasury. So the French were not isolated with their struggle for a minimum rate of not more than 7.5%, and the Japanese were able to continue their general opposition. The disappointment was considerable. The results were rather poor. The US Eximbank – although still rejecting binding repayment terms – accepted for the first time prior consultations (30 days’ advance notice) on credits longer than five years (for countries with GNP of more than \$3 000 per capita), eight-and-a-half years (\$3000-\$1000) or ten years (less than \$1000). And a general understanding on down-payments was reached: a minimum of 20% for rich countries and 15% for all others.

All that could be agreed was that the deliberations should continue some months later. At that point I was head of the German delegation and also the Chairman of the OECD Group on Export Credits and Credit Guarantees, and so, in order not to lose momentum, I presented (on a personal basis) a compromise which I circulated and explained without any discussion. The main items were:

- minimum rates for credits of two to five years: 8% for rich countries (a maximum of five years) and 7.5% for all others;
- minimum rates for credits over five years: 7.75% for intermediate countries (maximum eight-and-a-half years) and for developing countries (maximum ten years);
- for large-scale projects (more than SDR 100 million with exported value of more than SDR 80 million): maturity could reach ten years for intermediate and twelve years for developing countries or, if normal maximum length were respected, minimum rates could be reduced by 0.25% (to 7.5%);
- aid credits: prior consultation if less than 25% grant element;
- down payments: minimum of 20% for rich countries and 15% for all other countries (consensus already reached);
- prior consultations for credits longer than five years to rich countries, longer than eight-and-a-half years for those to intermediate countries, and longer than ten years for poorer countries (consensus already reached).

The decisive breakthrough was reached on 23 July 1975 with a letter from William Simon, the US Secretary of the Treasury, to Dr Friedrichs, German Minister for Economics, agreeing with what he called “the Geberth compromise”, now enlarged by longer maturities for some sectors like thermal power plants (ten years) and steel mills (ten to twelve years). Now the French were isolated in their persistent resistance to increasing their minimum rates from 7.5 to 7.75%. French agreement was finally given after discussion of this obviously marginal point at the Economic Summit Meeting of Rambouillet in November 1975.

A last obstacle arose in the same month of November when the European Court confirmed the view of the European Commission that the agreement must be concluded by the Commission for all European Countries and not by individual Member States – an opinion which had been categorically refused by France.

An Emerging Consensus

During the first three months of 1976, France, Germany, Italy and the United Kingdom continued to discuss with United States, Japan and – a newcomer after Rambouillet – Canada in secret meetings without the European Commission. They reached a consensus on all elements and promised, without any formal agreement, to implement identical rules on a purely national basis during June 1976 for an experimental period of one year, up to mid-1977.

The main differences between this “Consensus” and the compromise proposition of 13 May 1975 were:

- lower rates for developing countries (7.5 instead of 7.75%) and for credits from two to five years (7.75 and 7.25% instead of 8 and 7.5%);
- shorter delays for consultation (seven plus nine days for discussion instead of 30 days);
- exemption for exports falling under OECD sector agreements (concluded or under negotiation) instead of special rules for all kinds of large projects;

- information only instead of prior consultation for aid credits with a grant element of 15-25%.

The implementation by US Eximbank was published first (on 9 June 1976), followed by Germany (15 June) and the other five partners. Largely because of legal problems internal to the European Community, this “Consensus” on export credits had no binding character at all. From mid-1977, every partner could retire with 60 days’ notice to the other participants. But, because of the interest which all exporting countries had in it, the arrangement showed a solid life. Less than two years later (on 1 April 1978) the number of partners had already increased to 20; more exactly, they were twelve Participants: one of them – the dispute between France and the European Commission having been settled – was now the European Community with nine Member States.

The Arrangement from the Inside

John Ray

The Arrangement on Guidelines for Officially Supported Export Credits has been a success: it gets the job done, and with a minimum of fuss. To what can this success be attributed?

The first quality that comes to mind is modesty. From its conception, the export credit Arrangement has kept a low profile and sought to deal with real problems as they came up. Indeed, its very title – the “Arrangement” – was carefully chosen to avoid any implication of a formal agreement, to say nothing of a treaty. No one really seems to be sure exactly what “arrangement” signifies in international jurisprudence. The Participants in the Arrangement have been careful to keep it that way.

Pragmatism is also important. The Arrangement gradually developed on a purely *ad hoc* basis from meetings at the margins of annual International Monetary Fund and World Bank meetings. There was no secretariat. Dr Rolf Geberth from the German Ministry of Economics – and who was also the Chairman of the OECD Group on Export Credits and Credit Guarantees – provided a degree of continuity. The result was a few pages of general guidelines for interest rates and for the durations of officially supported export credits. Not only did this first paper have no formal status; it was not even made public. It was known informally as a “gentlemen’s agreement”.

Even when the Arrangement was brought into the ambit of the OECD in 1977, modesty and pragmatism continued to be basic attributes. Building on the work already done, progress was made by dealing with problems as they arose. Here the flexibility of the OECD played an important role. The status of the Arrangement has always been one of useful ambiguity. It is obviously “in” the OECD, and yet it has never been officially part “of” the OECD. Thus, although the Secretariat of the Organisation provides a small staff and services and although the Arrangement is widely known as the “OECD Arrangement”, it does not exist officially within the OECD. It is not an “act of the Organisation”. Rather, it is an arrangement between certain countries which are all Members of the OECD. It does not report to the Council of the OECD, and yet the Council provides its budget and gives the Participants in the Arrangement political guidance from time to time. It reports to the Council of Ministers and receives instructions from them as necessary. Sometimes, too, it receives instructions from G7 summit meetings. Although the Arrangement seems to have all of the characteristics of a “dog’s breakfast” – even of a bureaucratic nightmare – it gets its work done and keeps moving ahead. *Eppur, si muove!*



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The Pros and Cons of Hurrying Slowly

At an early stage, the Participants in the Arrangement learned to think small and to avoid biting off more than they could chew. Here again, modesty is important. The Arrangement moves ahead in small incremental steps – as Gep Ledebøer, for many years the Dutch representative to the Arrangement, liked to say, “Little mouse steps, one at a time”.

The Participants in the Arrangement have thus been willing to leave difficult and intractable problems to the side while they made progress where they could. The result has been a rather lopsided and clumsy structure. For many years, for instance, large sectors – agriculture is one – were left out. Only when time had done its work and problems seemed ripe for progress, did the Participants re-open negotiations in these areas.

Another example can be found in premium fees, that is, the pricing of official export credit support – an important area if there ever was one – where guidelines weren’t even attempted until the Arrangement had been in existence for over fifteen years. In the intervening period, competition between export credit agencies (ECAs) through more and more unrealistic premium fees became progressively more acute and wasteful. Even then, progress was slow and deliberate, and the 1997 agreement on premium fees (the “Knaepen Package”) will not go into effect until April 1999.

One of the most important decisions of the Participants was not to seek detailed rules for exactly which projects and sectors tied aid credits would be allowed under the Helsinki Package in 1991. As it was obvious that opinions within the Participants were so divided that any attempt “to nail things down” would have led to stalemate and thus put the whole package into jeopardy, only very general guidelines were laid down. The implementation was left to a special forum of the Participants – the Consultations Group – with the expectation that, over time, a “body of experience” would evolve that would give the guidance required. At the time, this caution was seen as very risky. In the event, it worked, and this “body of experience” was embodied in the “*Ex Ante* Guidance for Tied Aid” agreed at the end of 1996. The results seem to have been more satisfactory than any of the original developers of the Helsinki Package could have expected.

Another lesson is the utility, if not the necessity, of negotiating in small, informal groups. Attempts to reach agreement on contentious issues are practically impossible in plenary meetings, as was amply demonstrated by the failure to reach consensus on an ambitious package at Brussels in 1975. Progress was possible only in a small group, limited at first to representatives from Germany, Japan and the United States – and then extended to the other members of the G7. Later, this “Consensus” was adopted by other OECD countries. It is difficult, if not impossible, to imagine the 24 countries that eventually adhered to the Consensus would have ever agreed to it in a plenary meeting; only after a few key countries had showed the way by adopting it unilaterally did the others follow along for fear of being left out.

A variant on this theme was the agreement on the “Wallén Report” in 1983 which led to the system of the Uniform Moving Matrix and which proved vital to the survival of the Arrangement when it was faced with the high interest rates of the late 1970s and early 1980s. In this instance the late Axel Wallén of Sweden was appointed as what was in truth a committee of one (assisted by an outside

consultant and by the OECD Secretariat). After wide consultation with the most important participants, he produced a lengthy report. But more important than the Report itself, which – as Wallén himself later admitted – was largely a device for gaining time and for allowing one-on-one consultations, were its recommendations, which became the basis of agreement by the Participants. This agreement was possible because Wallén had, in effect, pre negotiated the parameters of the recommendations with the major countries and could reasonably count on their support or, at least, their benevolent neutrality before the plenary meeting of the Participants.

A last example of this practice is the negotiation of the “Helsinki Package”, with which I was personally connected. There the Chairman of the Participants – Eero Timonen of Finland – set the pattern early on at a meeting of the Bureau (made up of the Chairman and Vice-Chairmen of the Participants) that took place at Helsinki in 1989. I have always thought that part of the success of this meeting can be ascribed to the wisdom of the Chairman in inviting all those attending to a sauna on the first evening of our arrival, followed by a ramble under the midnight sun through the various eating, drinking and music establishments on Helsinki’s Esplanade. The result was a spirit of camaraderie that stood us all in good stead during the long negotiations that followed.

By using the Bureau as a steering group, Timonen avoided the difficult process of getting agreement on a select negotiating group. As the Bureau included members from Canada (and later Australia), Finland, the Netherlands and Switzerland, all the Participants to the Arrangement – except for Japan and the United States, who could well look out for themselves – felt that their ideas and interests were in some way represented and did not object when the Bureau took unto itself the functions of an inner group that guided the negotiations. At the time of the plenary sessions, the inner group was supplemented by representatives from the European Commission, Japan and the United States for negotiating sessions, generally conducted on the basis of a Bureau draft. (This procedure left a number of delegates sitting in the lobby drinking coffee, but they did so in good spirit – largely, I believe, because of their confidence in the good faith of the Chairman.)

There was also a feeling that the presence of Bureau members from a number of smaller countries would help to keep the major negotiators “honest”. In the evenings after the end of the plenary sessions or during the next day – and a few times at dates between these sessions – the Bureau met in order to consider the results of the plenary and negotiating sessions and to plan for the next round. That usually involved a complete or partial redraft of the negotiating document, which evolved considerably as the months went by.

In the end, a large area of agreement was reached. Yet there were some sticking points to which not all delegations subscribed – particularly since the negotiation had gone beyond export credits themselves into the area of aid credits. Many delegations were two-headed, with representatives from both the export credit and aid communities. Delegations were consequently exposed to violent and disabling attacks of schizophrenia.

When Should a Political Decision be Invoked?

Another facet of the Arrangement is that recourse to the OECD Council of Ministers – for a political decision when national delegations are blocked –

happens very rarely, and then only under rather special circumstances: when the Chairman is convinced that an agreement is possible and yet sees that it requires changes in national positions that are beyond the competence of delegations.

For example, Axel Wallén, the Chairman of the Participants in 1985, was sure that, after over a year of intensive work among the Participants, an agreement was possible to increase the minimum grant element in tied aid credits. Although there was general agreement on the advisability of such a measure, the Participants were not ready to commit themselves. And so, after careful informal consultations, Wallén proposed to the Ministers at their 1985 meeting that this step be taken as a first one on the path towards a comprehensive package of measures to strengthen further the rules of the Arrangement. This proposal was discussed extensively by Ministers' deputies during the course of the Ministerial meeting. They finally agreed and recommended adoption of a revised text to their Ministers. The decision was incorporated into the Ministerial Communiqué and immediately put into effect.

In the case of the Helsinki Package in 1991, Eero Timonen, the Chairman of the Participants, had been co-operating closely with Barry Ireton (of the United Kingdom), the Chairman of the Working Party of the OECD Development Assistance Committee that dealt with aid financing. Together, the two Chairmen agreed on a package that they felt should meet the concerns of their respective members. Knowing that they could never get agreement from all of the members of both committees on each and every detail of this package, they sent parallel messages on their own responsibility to the 1991 meeting of OECD Ministers, with recommendations that the package be adopted. Here again, the question was extensively discussed by Ministers' deputies in drafting the Communiqué. The central question was how the Ministers should deal with the very specific co-ordinated recommendations that the two Chairmen had presented to them.

Both Chairmen were at the OECD during the Ministerial Meeting, as were many key negotiators from their groups. Plenary and restricted meetings and consultation took place during the night between the two days of the Ministerial Meeting. After much effort, it was agreed that the Ministers should "welcome" both the reports and "the progress made on the main elements of a future agreement" and should express "their commitment to overcome the remaining obstacles in order to come to an agreement" not later than the end of that year. The problem then became: "Should these reports and recommendations be the basis for the future agreement?" This proposition was strongly disputed. Finally, in the small hours of the second day of the Ministerial Meeting, the Deputies agreed that they should recommend that any agreement should be neither "on the basis on" nor "in the light of" but rather "against the background" of the reports.

The profound significance of this distinction may escape readers unversed in the delicacies of international negotiation, just as it then escaped me, although I was in the room at the time (exhaustion may have been a contributing factor). But its practical importance cannot be denied. It enabled the parties involved to agree on a text that they could recommend to their Ministers in the morning. The last thing that the deputies wanted was for their Ministers to become directly involved in the arcane ramifications of export credits, which was a swamp from which they might never emerge. For their part, Ministers were only too happy to accept their deputies' recommendation and to move on to more congenial subjects. Thus the Participants finally had a Ministerial mandate, armed with

which they were able to continue the negotiations and to finish by the end of the year.

Transparency and Discipline

It is said that the Arrangement is built on the two pillars of transparency and discipline. Discipline is, of course, the cornerstone of the Arrangement and is obviously essential. But the importance of transparency should never be underestimated. The Arrangement's legal status is deliberately ambiguous. There is, moreover, no real way of enforcing its guidelines – at best, other participants can match the actions of a violator, which simply is to compound the original fault.

What is important is that governments do not like to be seen to be in violation of their obligations. My experience, both in the United States administration and in the Secretariat of the OECD, is that governments will go to enormous lengths to avoid being exposed in this way; caught in an international assembly with one's "hand in the till", so to speak, representatives will blandly deny the most glaring evidence. They can do nothing else. Yet, once returned to their capital, they will move heaven and earth to avoid ever again being placed in such a situation.

Such is the strength of transparency. And it depends on the unheralded donkey work of the OECD Secretariat in gathering and in publishing timely data and statistics, which is absolutely essential to the proper working of the Arrangement.

The Arrangement from a Spanish Perspective

Soledad Abad Rico,
Luis Marti Espluga
and Rafael Manzanares

To obtain a clearer idea of the importance for Spain of the Arrangement on Guidelines for Officially Supported Export Credits, some historical background is necessary. The Spanish Decree-Law on Regulation of the Economy of 21 July 1959 introduced a new economic policy that involved transition from a self-sufficient interventionist economy to an open-market one and the entry of Spain to the OEEC (the predecessor of the OECD) and other international trade and financial organisations. The encouragement of exports was subsequently to be placed on indirect stimulus and promotion, and controls and direct intervention in exports were to be progressively abandoned.

Moreover, as a result of the new economic system established by the Stabilisation Plan, early 1960 saw the beginning of a new credit policy involving promotion of the funding of specific activities or sectors of key economic interest to be achieved by the special rediscounting by the Bank of Spain of loans from private banks.

For export credits, the new economic policy meant the creation, as from 10 February 1960, of various export credit instruments and facilities. This did not involve a new line of action on export credits but rather continuation and reinforcement of an ambitious financial promotion policy initiated thirty years earlier, although now somewhat in the background. The Royal Decree of 25 July 1928 had in fact set up the Banco Exterior de España and introduced export-credit insurance through the CECC (the forerunner of the present-day Spanish export credit agency, CESCE). Spain was, soon after, to be one of the small number of founding countries of the International Union of Credit and Investment Insurers (the “Berne Union”).

In the initial years, 1960-62, Spanish legislation was sensible and gave official medium- and long-term financial support only to vital exports of capital goods. Nevertheless, from 1963 onwards, pressure from exporters, invoking the bad examples of some of our neighbours, led unfortunately to legislative “matching”. Although subsequent changes were made, the basic Spanish export credit system was in place by 1963-65 and official support was given to all “promising” exports.



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The first recorded business figure dates from 1960 and amounts to Ptas 1,027 million (credits for the year) which, with fluctuations, rose to Ptas 5,760 million in 1965, only half of which were for capital goods, with the rest used for other purposes (working capital, construction of export warehouses, sales networks abroad). In the face of the reluctance of private banks to provide financing support, the go-ahead was given, with little success, to the official Banco de Crédito Industrial (BCI) which obtained the funds it required from the Instituto de Crédito a Medio y Largo Plazo (Institute for Medium- and Long-Term Credit), the predecessor of the Instituto de Crédito Oficial (ICO). In 1965, the BCI provided 73% of all loans for capital goods.

A fatal case of fraud in 1968-69 put an end to export funding by the BCI. The passivity of the private banks made it imperative to give effect to a new law of 1970, which abolished rediscounting by the Bank of Spain and created a special export credit instrument (the COE). The COE was managed exclusively by the Banco Exterior de España, the capital of which was mainly in the hands of the state, with funds being provided by the ICO.

To adapt to the export credit Arrangement and its interest rate regime, the Commercial Interest Reference Rate (CIRR) system, the COE was replaced in 1983 by official financing support (CARI) not involving subsidies but with reciprocal adjustment, as in recent years, providing revenue for the Spanish Treasury. This system enabled private banks to participate on a large scale in medium- and long-term financing. The COE ceased to exist in 1995 and the Banco Exterior is today on exactly the same footing for credits as other Spanish and foreign banks.

Apart from official credit policy, numerous mandatory investment-ratios were also applied to deposits of financial institutions. Credit was controlled in a highly interventionist fashion, as is still found today in some developing countries. In the case of exports this regime came to mean that, in addition to medium- and long-term loans, credit was available also for the other purposes mentioned (working capital) and for financing in the short term as well as for pre-financing, at rates of interest below those of the market. To make the system flexible the Bank of Spain created an unusual secondary market among financial institutions bound by the ratios.

For exports this tangle of short-term credit facilities finally disappeared in 1987, leaving only official financing support for exports involving repayment terms of two or more years (normally for capital goods). The investment ratios were eliminated somewhat later although – strangely enough, in view of the development of the Spanish economy – some of the Spanish autonomous regions are trying to reintroduce them.

Discipline in the Face of Domestic Opposition

In November 1975, the first G7 Meeting (at that time the G5) in Rambouillet appropriated existing work, as it was to continue to do subsequently, and launched the initiative of harmonising medium- and long-term (two years or more) export credit lines amongst its members. In 1976, various OECD countries made unilateral declarations supporting the spirit of Rambouillet. In 1977, an interesting discussion started among the same countries with a view to adopting a “gentlemen’s agreement” on export credit and consolidating it.

Spain took an interest in the matter on its own initiative, following intense domestic discussion of advantages and drawbacks. With much persistence, the authors of this article finally obtained the participation of three Ministries (Economics, Finance and Trade) and eventually managed to obtain the necessary ministerial signatures.

The difficulties encountered in those early days are understandable once it is realised that in Spain twenty years ago mentalities were still much affected by the isolationism of the past. Today it may be difficult to understand why “intense domestic discussion” was necessary before the government decided to include Spain in the “gentlemen’s agreement” (the Arrangement of Guidelines for Officially Supported Export Credits) and why we had to employ such persistence, rather than simply conducting a routine administrative enquiry and submitting a proposal for action.

The fact is that, at that time, fresh air from outside was still seen as likely to cause pneumonia, or at least was presented in that way by the interests concerned. Many people could see little advantage in the country joining – of its own accord, moreover – an international agreement restricting credit facilities for Spanish exports, still less accepting an information system for breaches of the agreement. Exports of capital goods and more particularly of entire plant and factories were already starting to materialise and, although it now seems difficult to understand, both the exporting and financial sectors, with (of course) some prominent exceptions, supported the view that “Spain should keep its hands free” and that important successes could be achieved with the discretionary use of export support. Even minor sectoral accords of the “Berne Union”, affecting exports of buses and other products, were severely criticised every time the CESCE marked a proposal “not to exceed x years in view of the Berne Union agreement”.

It is easy to forget that at that time many supported the working hypothesis that Spanish exporters could obtain orders for capital goods by offering extravagant terms for credit repayment. The Arrangement was seen as a brilliant idea since it meant that competitors had their hands tied. But action had to be secret and pressures both from abroad (governments, the European Commission) and at home (some unhelpful officials) had to be ignored if Spain were to keep out of an agreement among “gentlemen”, obviously an undesirable category for a clever and clear-minded country.

Exporters sometimes accompanied the submissions for support of their projects with curt verbal observations to the effect that “we have got the order provided we can offer fifteen years”. These words, apparently originating in an obscure ministry of the importing country (and even if they were true), were underpinned by the equally heroic understanding that Spanish exporters could operate alone, without being seen or heard by others, and could offer a unique, high-quality and essential product. But Spain was not, of course, the sole producer of any capital good and within hours the wily purchaser had informed French, Italian or other competitors of the financial terms offered by the Spanish exporter. Even if those terms were exceptional, no competing country had the slightest difficulty in matching them, so that the comparative advantage was lost and one was back to square one, with the buyer accepting the best terms obtained or looking for something even better from the same supplier or some other unwary competitor.

This is an accurate description of what happened at the time and explains the desire to limit such financial anarchy through agreement on repayment terms

and the disclosure of violations. In Spain it was difficult to understand first, that there are no secrets among competitors (since such openness is in the buyer's interest) and second, that any European country or the United States or Japan could equal any terms offered by Spanish exporters, or even improve on them. This reluctance to understand plain fact can be explained only by ideas inherited from the recent past and which, by the early 1970s, had already lost all contact with reality, both in Spain and throughout the world.

It is only proper to recognise that within the administration Spain's narrow room for manœuvre was well appreciated, as was the advantage of the country joining an agreement such as the Arrangement. The problem was fully understood: Spain was quite unable to win the export credit race, and could at the same time avoid the high financial cost of operating outside the rules. Pressure from sectors that still believed in a kind of "export isolationism" (a contradiction in terms if ever there was one) led to Spain's participation in the Arrangement being deferred on several occasions; nonetheless, after further debate the three Ministries finally decided to join.

Nor did the rearguard action stop with the declaration of Spanish participation in the Arrangement. The implementation of the exchange of information procedures of the Arrangement, in the hands of the CESCE, was a critical confidence factor – vital when another insurer approached the CESCE having heard that the CESCE was prepared to guarantee repayment terms of fifteen years for an order which, according to the Arrangement, could not exceed ten years, and particularly if the allegation was true. Even what was obvious could be denied – and there was no lack of those who were prepared to suggest that it would be sensible to conceal the truth. But this concern should not be misinterpreted: everyone involved, both inside and outside Spain, had to learn how to behave and what was at stake. Others were subject to similar pressures, and some puzzling behaviour – rather than outright disinformation – was commonplace for a time among credit insurers: for instance, systematic delays in giving responses, feeble excuses that adequate information was lacking or a response to the extent that "we have not been approached yet". It took a while until open collaboration became the rule in all ECAs, but ultimately it did prevail for the benefit of all.

Progress by Stages

The Spanish Delegation arrived in Paris in good time in September 1977 and with Sweden (represented by Axel Wallén) and Gilbert Morleghem (Belgium) as Chairman, became a member of the restricted Working Group together with the United States, the European Economic Community, Japan and the Secretariat. This Group sometimes worked into the early hours of the morning to prepare and draft the original Arrangement text of April 1978. Thus harmonisation and co-ordination of global (not sectoral) export credits was finally achieved – fourteen years after the first efforts were initiated in the OECD Group on Export Credits and Credit Guarantees. At those winter, night-time meetings, Japan was represented by a single delegate who, at the stroke of midnight, wisely wrapped himself in a luxurious Japanese shawl.

The most interesting phase in the Arrangement history was in the early 1980s, with Axel Wallén as Chairman of the Participants, when various aspects of the disciplines were in their early stages. Wallen had been one of the "founding fathers"

of the Arrangement, had enormous professional experience, was balanced, patient and a good listener. His chairmanship was marked by, *inter alia*, the perfecting of the then interest rate system under the Arrangement, with the aim of trying to eliminate direct subsidies. This entailed moving from fixed interest rates by country of destination and repayment period, but with no differentiation for currencies, to a flexible and uniform system (UMM) and then via the Differentiated Discount Rate (DDR) system towards the revolutionary Commercial Interest Reference Rate (CIRR) regime. During this time, Spain also played a very active role as a Vice-Chairman of the Participants in support of Chairman Wallén.

The Arrangement has been a successful example of international co-ordination in a difficult area where the inclination is to beat competing countries through an uncontrolled credit race. The decisive argument at the time of Spain's entry was our limited financial weight, which could not compare with that of the leading countries. The Arrangement was informal, giving it flexibility to adapt and change. Strangely enough, that remained the case for Spain until 1986 when we joined the European Community, for which the Arrangement is adopted into EC law. The informal character of the Arrangement also served theoretically to separate it from the OECD, although from the very beginning the OECD premises and services have been of considerable help – which continues to be the case.

One has to be professionally involved in a given specialised field for many years to appreciate the depth of change generated by international bodies such as the Participants to the export credit Arrangement. Who would have thought that the 1978 Arrangement would substantially change the behaviour of Spanish exporters? The authors of this article, in their interminable meetings and journeys to Paris, would not have bet on opting for discipline and co-operation, but we did; and we believe that the events that have since taken place have proved us right.

Wallén, Helsinki, Schaerer *et al.*: Some Major Achievements, Some Challenges to Meet

David Stafford

Officially supported export credits has not been one of the high-profile areas of international trade negotiations. It is regarded by most as a highly technical area best left to the experts. Much of the time it has been out of the political spotlight and very much overshadowed by the multilateral trade negotiations in Geneva. This low profile has probably been an advantage, enabling the steady strengthening of disciplines to proceed at a rapid pace, at least in terms of international trade negotiations.

The establishment of the Arrangement on Guidelines for Officially Supported Export Credits marked an important point for government involvement in international trade financing through export credit agencies (ECAs). By setting, *inter alia*, minimum interest rates, maximum repayment terms and minimum downpayments, supported by extensive consultation procedures, the export credit Arrangement contained what was a rapidly developing credit race.

There was nonetheless a downside. The matrix of minimum interest rates – which set rates for various repayment periods and the relative wealth of individual countries – had the effect of institutionalising interest subsidies. Initially, matrix rates were close to prevailing market rates and the amount of subsidy involved was modest. Over time, however, interest rates moved substantially while the matrix rates remained fixed. This divergence presented a range of problems for both high- and low-interest-rate countries, not the least of which was soaring interest subsidy costs.

The Advent of the CIRR and Market Windows

Attempts to correct these problems and to work toward the elimination of interest subsidies spanned a period of some ten years. During this period of the mid-1980s, steady gains were made, problems were addressed and interest subsidies were reduced. The work on interest rates was undertaken by experts. I was then Australia's representative to the OECD Group on Export Credits and Credit Guarantees (ECG) and to the meetings of the Participants to the Arrangement but I often felt out of my depth grappling with the concepts of a Uniform Moving Matrix versus a Differentiated Rate System, various base rates, inverse yield curves and various margins to warehousing and other costs as the concept of a Commercial Interest Reference Rate (CIRR) was developed. It was gratifying to see, finally, the acceptance of the shift to a full CIRR system, which



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provided a universal approach to setting a market-proxy interest rate as a monthly basis for all currencies. To all practical purposes, this measure, combined with a six-month limit on finance offers, has now eliminated interest rate subsidies.

The CIRR system is not perfect, but it does provide a reasonable compromise in trying to formulate a proxy market rate when the market has a proliferation of rates at any one time. My experience suggests that the CIRRs are about right or, if anything, marginally high. As I see it, it is better to err on the high side rather than incur subsidy costs. Most OECD countries seem to have accepted the present CIRR and have not regarded further modifications as a priority. Some, nonetheless, argue that CIRRs are too high; others that they are too low.

It is interesting to look at some of these claims. Of course, various modifications could be made to the CIRR system, but it is questionable whether the outcome would be any better in attempting to reflect a market which is infinitely variable. Changes inevitably require trade-offs against simplicity and simplicity is a cardinal virtue when seeking international agreement. A higher CIRR would improve the competitive position of those who rely on private finance with official support by way of “pure cover” (that is, a guarantee of repayment); similarly, a higher CIRR would also favour those who operate so-called “market windows” – quasi-official institutions – and are thus able to undercut CIRR financing. On the other hand, a lower CIRR would enhance the competitive position of government export financing agencies *vis-à-vis* private-sector financiers.

No doubt, the CIRR system will continue to receive attention from the Participants to the Arrangement; yet a more pressing subject for their attention, I believe, is the emerging “market window” operations, both within ECAs and through special-purpose institutions. Such practices may not involve an explicit subsidy, but they do take advantage of their government status; they avoid the disciplines of the Arrangement; and they are not transparent. It will be interesting in the future to see whether debt recovery problems relating to “market window” financing are processed through the Paris Club as officially supported credits or left to the more difficult London Club.

Aid Credits: Subsidy by the Back Door?

It has always fascinated me to see how events unfold as the Arrangement is extended to constrain and eliminate various forms of official support for exports. “Market windows” are, I believe, a response to the effectiveness of the CIRRs. Similarly, as progress was made to wind back interest rate subsidies, a new competitive form of finance began to emerge. Relatively small amounts of aid funds were directed into softening financial terms. These “mixed credits” were aid and outside the terms of the Arrangement. Soft aid loans had been an accepted and legitimate form of aid delivery and were a regular feature of some countries’ aid programmes. Yet the rapid growth in aid credits, on relatively hard terms, was clearly commercially motivated.

It quickly reached a point where markets were “spoiled”. Tied aid credits were readily available for virtually all project and capital goods business in developing countries. The commercial concentration of this growth in aid credits was demonstrated by their concentration in the more creditworthy developing countries rather than in those which desperately required aid. Australia, for its part, was forced to divest funds from its traditional fully grant aid programme to

a new tied aid credit scheme. The alternative would have been to see Australian exporters excluded from capital-goods exports and project work in our regional markets. Other countries took a similarly defensive approach to ensure their continuing presence in other expanding areas of world trade.

Indonesia and China were key markets and there was an abundance of aid credits on offer to them. Indeed, Indonesia went so far as to issue a Presidential Decree making aid credits mandatory for all public-sector infrastructure projects. Aid credits were also prevalent in countries such as India, Pakistan and the Philippines. Gone were the days of unsophisticated buyers when a low interest rate without regard to currency often determined the award of contracts. Procurement agencies are adept at evaluating finance offers as one element of an overall package and playing willing suppliers off against one another.

It was this atmosphere of intense competition that gave the impetus to the negotiating of the Helsinki Package and its emphasis on tied aid credits.

What the Helsinki Package Achieved

Looking back, I believe that the Helsinki Package has been the major achievement in the twenty-year life of the Arrangement. It led to the elimination of interest rate subsidies; it provided for a clear separation between aid and commercial credits; it instigated the work on premium fees; and took the somewhat tentative new step towards the inclusion of agricultural products within the disciplines of the Arrangement.

Earlier attempts to separate aid from commercial financing had been based on the progressive increase in the minimum permissible grant element on concessionality. Progressive increases from 15 to 20% – and eventually to 35% – did not curb the growth in tied aid credits. Rather, increasing amounts of aid were being channelled from grants into harder aid loans. This move was not all bad. It did result in higher capital flows to the recipient countries and an acceleration of development than might otherwise have occurred.

With the benefit of hindsight, a substantial, single-step increase in the minimum degree of concessionality (rather than the staged 5% increases that occurred over several years) may have achieved the desired brake in tied aid credits – but it would have been virtually impossible to negotiate such a large quantum leap.

It is with some satisfaction that I can look back at having made a real contribution to breaking the bypass that had developed in negotiations on disciplines for tied aid credits. As a Vice-Chairman of the ECG and of the Participants to the Arrangement, I had been involved in a series of side meetings between the Export Credit Bureau (made up of the Chairman and Vice-Chairmen of these two Groups), the European Community represented by the European Commission, the United States and Japan. These meetings had failed to advance the issue and had rejected any suggestion of a sectoral approach. But I was struck by a statement from the European Community representative, Hans Neumann, who said (as I remember it): “I cannot accept any proposal which infers that tied aid credits are inherently bad. However, I do accept that some projects should not be financed with aid.” I pondered on this statement during the long flight back to Australia. On arriving back in the office, I sent off a message to John Ray, who headed the team from the OECD Secretariat, pointing to Neumann’s words and suggesting that they might

give us the key to move forwards. I proposed that projects which could generate sufficient revenue to repay a loan on standard Arrangement terms should not receive aid. Ray took this suggestion to a Bureau meeting in Helsinki where it was developed further with the “commercial viability” test. This became the basis for the resumption of negotiations which ultimately resulted in the effective separation of aid and trade motivated credits.

The agreement covering eligibility for tied aid credits was, on the surface at least, very loose and undefined. This vagueness raised concerns that exporters’ aid agencies and ECAs would be faced with uncertainty. Similarly, the “escape clause” was seen as a real loophole, since it enabled a donor to proceed with a project, even though it had failed the eligibility requirements, by having a Minister write a letter to the Secretary-General of the OECD to explain the over-riding non-trade national-interest grounds for such action.

In the event, it did not take very long for quite firm parameters of eligibility to emerge, even if the early difficulties which surrounded project assessments were considerable. And in spite of an approach which assessed cases on their individual merits, a good deal of certainty has resulted as the body of experience has accumulated. The evaluation of individual projects for tied aid eligibility has now slowed to a trickle.

The test of “non-commercial viability” and the Participants’ peer assessment/consultation procedures were not simple. As the Consultations Group of the Participants grappled with difficult issues, such as “project definition”, “appropriate pricing”, “projected cash flows” and “substantial support”, I often felt that we had created a monster. The consultation process generated an enormous amount of additional work for both the project sponsor and for the proper examination of the project by the Consultations Group. The ultimate success of the tied aid credit disciplines was, I believe, largely due to the tremendous amount of examination work undertaken by the United States (particularly its Treasury representative Steve Tvardek), and the strength of the Chairman of the Consultations Group, Birgitta Nygren. And in spite of early concerns over the use of the “escape clause”, the requirement of a ministerial letter to the Secretary-General has also been an effective discipline. My view had always been that ministers and their governments would not want to be seen to be out of step with international opinion too often; that has proved to be the case and the disciplines have held.

A Move Towards Untying Aid?

The rules that make up the Arrangement are honoured without any formal, binding commitment or dispute panel. But having made these rules, and even though we abide by them, we return to our capitals and work just as hard to develop new techniques and programmes to give our exporters a competitive edge; market windows are an example. As the tied aid credit disciplines bite, there has been a shift toward untying of aid credits – which is another example of efforts to avoid the Arrangement disciplines.

Such a shift towards untying aid credits does not surprise me. I have felt for many years that the conventional wisdom, that untied aid is more effective than tied aid and that it is better aid, is dated and no longer holds true once you move away from cash grants. This is especially the case with aid credits. The volume of aid credits on offer, whether tied or untied, is sufficiently large to enable recipients

to shop around and, of course, they do so. Aid quality is far more dependent on good project evaluation by the donor and sound practices within the recipient countries than on the tying status of the loan.

I also felt at the time of the Helsinki negotiations on tied aid credits that the preferred status for untied aid credits was not justified. Yet one had to be realistic about what could be achieved at that time. The effect of this differentiated treatment was to leave Japan's extensive aid credits unaffected by the new disciplines as they are, in the main, untied. A high proportion of the projects involved would lend themselves to Arrangement financing and would not pass the Helsinki "non-commercial viability" test. Furthermore, there has been very little procurement flow from Japan's untied aid credits to other OECD countries. If the theoretical benefits of untying are to be delivered, one could expect to see a reasonable leakage to other OECD countries. But to Japan's credit, over the last few years they have provided notification to all OECD countries of projects to be financed with untied aid credits so that procurement opportunities might be pursued – although, the reality still seems to be that there is very little leakage in procurement away from Japan or, I suspect, Japanese affiliates in the developing countries.

With other countries beginning to look at the untying option, I believe it is now essential to extend the Helsinki test of "non-commercial viability" to all aid credits. If this measure is not undertaken, there is a real risk that the gains which have been made in separating aid from trade will be lost.

Onwards from Helsinki: Premium Fees and Agricultural Credits

Beyond CIRRs and tied aid credits, two important new areas of work loomed. The first was the risk premium fees charged by ECAs. Interest here was driven by several concerns including the large losses that ECAs had incurred and the substantial variations in risk premium fees between agencies for what were essentially the same risks. These variations amounted to several percentage points and had a direct effect on competitiveness.

More realistic premium rates in themselves will not provide the solution to future debt problems for ECAs. No premium rate makes up for a poor underwriting decision. Moreover, the rationale behind the provision of official support for export credits and the existence of ECAs is the unpredictable nature of events such as the debt crises of the 1980s, the Iraq war and the break-up of the Soviet Union. Recent events in Asia offer another example of how quickly circumstances can change.

On the other hand, properly priced, risk-based premiums, which reflect differences in sovereign risk between countries and varying repayment terms should be an essential feature of the operation of ECAs. Anything less must be regarded as a subsidy with consequent trade distorting effects.

The "Schaerer Package" of 1994 gave the final green light to the negotiations in Participants for risk-based premium fees. From the outset, the complexity of the issues surrounding the whole question of premium rates caused considerable difficulties, extending even to reaching agreement on the terms of reference for the Participants' Working Group of Experts who were to study the subject. In the

circumstances, I felt that an achievable first step might be to establish a framework of “guiding principles” that would amount to little more than soft rules with scope for agencies to explain their circumstances when they departed from these “principles”. Others were more optimistic and viewed “guidelines” in the same manner as the other hard rules of the Arrangement. As it turned out, their optimism was justified. The enthusiasm with which each issue was tackled by the Experts in monthly meetings at the OECD in Paris had to be experienced to be believed. The agreement which was reached in June 1997 – the “Knaepen Package” – is a reflection on this enthusiasm and especially on the hard work put in by the Chairman of the Working Group, Pierre Knaepen, and the OECD Secretariat’s export credit team led by Janet West.

The second area of work from the “Helsinki” and “Schaerer” Packages was to begin negotiations to bring agricultural products within the scope of the Arrangement. This is an important issue for Australia, as for many other countries. I had a personal interest, too, as I had played a leading role in the development of a draft “sector understanding” many years earlier. At that time, and over the intervening years, the United States refused to proceed on agricultural credits in isolation to progress in the Uruguay Round negotiations in Geneva on agricultural subsidies in general.

Little substantive progress has been made since the conclusion of the Uruguay Round. The United States has acknowledged that its precondition for negotiations has been met, but it has continued to stall. To complicate what should have been a relatively simple negotiation, the United States has legislated an extensive agricultural credit programme providing for credit terms of up to ten years. Even accepting that agriculture in all its aspects is a politically charged subject, the attitude of the United States has been particularly disappointing, especially when it is remembered that the United States has achieved virtually all its goals in tightening disciplines on export credits and often has required others to make substantial concessions. It is now time that the United States face the fact that it too will have to make concessions and recognise that extended credit terms for agricultural commodities is poor policy and unacceptable practice for a credible international trading nation. Indeed, it is difficult to see how the United States can expect to achieve any further gains under the export credit Arrangement without them being linked to a responsible outcome on agricultural credits. Probably my only regret over my fifteen years of the Arrangement is not to have been involved in reaching such an agreement.

In my early days at the OECD a colleague who was involved in the GATT negotiations in Geneva referred to the OECD as nothing more than a talkshop. Without getting into a debate on the undervalued role of the OECD, I can say with certainty that a meeting on export credits seldom went by without genuine decisions being taken – decisions that were practical, of direct commercial impact and usually favourable to national budgets.

The Birth of the “Helsinki Package”

Eero Timonen

On 31 May 1990, after the customary two-day conference, the Communiqué issued by Ministers at the Meeting of the Council of the OECD at Ministerial level contained the following paragraph:

Ministers welcome that the competent bodies in the OECD continue closely to monitor implementation of the 1987 package of reform measures on the OECD Arrangement on Guidelines for Officially Supported Export Credits. They also welcome that these bodies have started negotiations on a balanced package of measures to reduce substantially, through improved discipline and transparency, those distortions resulting from use of officially supported commercial and tied aid credits. They urge that negotiations should be expedited and that a final report should be submitted to Ministers in 1991.

By the time of that Communiqué, the Participants to the export credit Arrangement had already, for about a year, been sounding one another's opinions on the success or otherwise of the implementation of the rules of the Arrangement then prevailing. In these discussions, expressions of concern were heard from various Participants to the extent that not all the targets presented in the 1987 “Wallén Package” had been met, and that there was further scope for strengthening the multilateral discipline on trade and aid-distorting export credit subsidies. Indeed, the Participants had concluded at their meeting in November 1989 that further efforts seemed necessary and had decided to seek agreement on a new, balanced package of measures covering:

- export credits;
- aid credits;
- selected problem sectors.

We started working with that programme, with the aim of completing it in time for the 1991 Ministerial Meeting.

I invited the Export Credit Bureau, made up of my Vice-Chairmen, and also the OECD Secretariat to come to Helsinki on 6 July 1990 for a meeting designed to produce a draft set of measures to be proposed to the Participants to assist the discussions and help keep them focused. Those present – Anthony Burger (Canada), Geb Ledeboer (the Netherlands), Kurt Schaerer (Switzerland), John Ray (the Secretariat) and myself – worked out the first proposal, the so-called “Helsinki Package”. We were able to agree on the text in one day. Geb Ledeboer volunteered



Eero Timonen was from 1989 to 1991 Chairman of the Participants to the Arrangement on Guidelines for Officially Supported Export Credits and of the Group on Export Credits and Credit Guarantees.

to serve as typist as we constructed the sentences. I remember him sitting at my PC, a large cigar in his mouth dropping ashes on the keyboard as he wrote. The work was done in genuine harmony and so swiftly that we had time to enjoy a sauna, dinner and drinks that evening. Indeed, we were proud of our achievement. Two weeks later, the results of our work were presented to the Participants as a Room Document at their meeting on 19 and 20 July 1990. They welcomed the draft Package politely, as a useful first step, but the harmony that had attended earlier discussions was not now as noticeable.

Since our target was to present the new Package to the OECD Ministers in May 1991 the Participants were faced with some intensive negotiations during the year. No fewer than five official new versions of the Package were issued by May 1991, when another meeting of the Participants was held, the final one before the Ministerial Council Meeting. In addition, I had held several Chairman's Consultations and other restricted meetings for which at least another five drafts of the Package were composed. I opened that pre-Ministerial meeting, on 17 May, with the following words:

We held the meeting a month ago, a plenary meeting and, in addition to that, quite many and extensive consultations and negotiations with various Participants in different compositions. We were seeking once again a compromise that we have already done actually for one year, a compromise in order to agree in principle on a balanced package of new measures in order to increase discipline and transparency in the use of export credits and trade-related concessional or aid credits under the "Arrangement". We have the mandate given by the Ministers to do this job and we have the obligation to report to the Ministers in two weeks time what we have achieved.

I had hoped that by the end of the last meeting we already could have agreed on the elements of the new package. After the extensive negotiations and consultations I was very optimistic because I knew that great progress had taken place in the attitudes towards compromise. Therefore the Bureau submitted the Helsinki V paper at the end of that meeting. However, I had to close the meeting without final success. But we really were, and I wish to say still are, very close to an agreement.

Now, you all know that this meeting is the final one if you wish to have an acceptable compromise package to be submitted to the next OECD Ministerial Meeting of Council for consideration. Really, at the end of this day I must know what I can report to the Ministers. I am in your hands totally.

But in spite of my plea the Participants were not yet in the position to agree on the Package. A particular stumbling block was that the European Community had not yet found a common tune, and so I had to close the meeting with this rueful statement:

We have worked together for about two years now. We have worked hard and reached a large degree of agreement. We almost reached full agreement. But "almost" is not enough. I must now report to Ministers that we have failed to meet the Ministerial Mandate, that we do not have a balanced package of measures to reduce trade and distortion. I shall report to them the progress that we have made and I will request political guidance on how to build on this progress in the future.

My frustration must have been obvious. But there was a promising signal from the European Community in July and I decided to reconvene a new meeting of the Participants in September and a last one on 28-30 October 1991. In my opening speech I used carrots and sticks, I pleaded and I threatened:

I start once again reminding you of the Ministerial Mandate which has been the main guideline to us in our negotiations, at least to the Chairman and the Bureau.

The Bureau and myself have been trying to follow all the time your wishes and the language given by the Ministers to negotiate “a balanced package of measures to reduce substantially, through improved discipline and transparency, those distortions resulting from the use of officially supported commercial and tied aid credits”.

I also want to refer to the various reports prepared by the Secretariat regarding the experience with the tied and partially untied aid finance under the existing rules of the Arrangement. The latest one was drafted in July this year. You remember that the report gives the data based on notifications given by the Participants, by all of us. I'd like to quote the two first paragraphs from the latest report:

- “The rules of the ‘Wallén Package’ have been fully in effect since July 1988. Although it is still too early to make a definite judgement, it is perhaps not too early to attempt to draw some tentative conclusions. To do this, we must recall the goal of the ‘Wallén Package’. This was to limit the use of aid credits to gain commercial advantage. It was thought that, if the cost of extending tied-aid credits was increased, Participants’ aid agencies would be less willing to allow their scarce aid funds to be used to improve the competitiveness of their exporters in bidding for commercial projects of limited development interest. This would be shown by a fall in the share of ‘hard’ aid credits, which are most likely to be commercially motivated.
- This has not happened. In point of fact, use of ‘hard’ credits has grown, both absolutely and relatively, over pre-implementation levels. Aid credits are now going more to the more credit-worthy relatively well-off developing countries than to the poorest. It is not at all sure that these regressive phenomena are caused by the reforms of the ‘Wallen Package’. But a case can be made that it encouraged them. This is a serious and troubling conclusion.”

Having in mind what I just quoted, I believe firmly that the Chairman’s proposal, “Helsinki V (Rev.)”, follows the strong mandate given by the Ministers. If the Participants really want increased discipline in order to reduce substantially, the use of trade-related tied-aid credits, we have a balanced package. The Secretariat data show very clearly that the measures taken in 1987 have worked actually in a different direction in spite of the increase of the minimum permissible concessionality level and other tightening measures. So the new measures simply must be stronger.

I wonder what else the Ministers might have meant by giving the mandate, if not something like what we have in Helsinki V. I have seen that at least ten Participants have agreed the same way of thinking because they could have accepted the Chairman’s proposal. However, one Participant, the European Community, has been of the opinion that there is not sufficient balance in my

proposal. One month ago we had a meeting in which we discussed the problems that the Community has seen in it and we had an exchange of views based on a list of proposed modifications prepared by the Community.

Well, if these points made by the Community are those which still are banning the compromise, we have finally set out the areas where remaining problems may be troublesome. In my view these areas are rather small. So if the general spirit among all of you is really in favour of an agreement, we have good prospects to close this meeting with an agreed compromise package.

The package proposal, "Helsinki V (Rev.)", the Chairman's proposal, is still there. I am, of course, ready to change, add and delete items in this proposal which you can commonly agree at this meeting in order to come to an acceptable solution. Please remember, however, that my chairmanship will end by the end of this year. Consequently, as this proposal in front of you is Chairman's proposal I must know by the end of this meeting what chances it has. I cannot any more reopen the whole discussion on it. Therefore, if we do not reach in this week an agreement at least *ad referendum*, I shall not convene another meeting this year. Let then the new Chairman and the new Bureau try to solve the problems with you next year.

Now, Ladies and Gentlemen! Please, take the floor and advise me where we are. Please, indicate your positions and we shall see what can still be done. I promise to do what I can to encourage an agreement during this week, if it is possible.

At the end of the meeting on 30 October 1991 at noon, I was able to conclude that the package was accepted *ad referendum* until 16 December 1991.

When writing these "memoirs" I have been thinking with much gratitude and appreciation of my fellow members of the Bureau. Although they each represented different Participants, we all kept the spirit of solidarity right to the end of negotiations. I am especially grateful to John Ray of the OECD Secretariat, who always took good care that the Chairman had proper notes and briefings at every meeting and who, sitting beside me during the negotiations, gave invaluable support. Those negotiations were not easy. But we can now see that we have succeeded.

Mission Impossible: Enhancing Discipline in Tied Aid Credits

Birgitta Nygren

My relationship with the Arrangement on Guidelines for Officially Supported Export Credits began in 1982, allowing me to participate, over the years, in many discussions on how to avoid trade-distorting competition in tied aid credits. An early proposal for resolving the tied aid issue was to raise the grant element, and later the degree of concessionality, in the hope that it would become too “expensive” to use scarce aid resources to compete with tied aid credits. But successive increases in concessionality – up to 35% – did not seem to help. Alternative ideas, such as banning tied aid credits to “spoiled markets”, were discussed but they did not meet with the approval of the Participants to the export credit Arrangement.

In 1990, after I had left the world of export credits, I heard from colleagues about discussions that were underway with the aim of barring tied aid credits to projects deemed commercially viable. My gut reaction at the time was that such an approach to enhanced discipline was interesting but would have little chance of succeeding.

Some time later, having joined the Swedish Delegation to the OECD, I was asked whether I would be interested in chairing a group that, if the proposed new tied aid rules were to be accepted, would develop the body of experience that would be required to indicate whether a project was commercially viable or not. I still didn’t believe it would get that far, but felt I had to agree, in part in the hope of renewing contact with old friends in the Arrangement community. The Helsinki Package was indeed concluded and I found myself the first Chairman of the Participants’ Consultations Group which mandated to evaluate individual projects notified for tied aid.



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The New Rules on Tied Aid

To describe what then happened and to comment on the implementation of the new rules on tied aid in the “Helsinki Package”, I begin with some quotes from the Arrangement. The main rule states that:

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

The rules on commercial viability are equally straightforward:

- The key tests for such aid eligibility are:
 - a) whether the project is financially non viable, i.e., does the project lack capacity with appropriate pricing determined on market principles, to

generate cash flows sufficient to cover the project's operating costs and to service the capital employed, or

b) whether it is reasonable to conclude, based on communication with other participants, that it is unlikely that the project can be financed on market or Arrangement terms.

- So, too, is the text on implementation:

Through the consultation process, a body of experience is expected to develop over time that will more precisely define, for both export credit and aid agencies, *ex ante* guidance as to the line between the two categories of projects.

Prior notification of tied aid credits was already required. But now, under the Helsinki rules, such credits could be challenged and, if a participant still wanted to go ahead with a project, it would be discussed at a meeting of the Consultations Group. At such a meeting, discussion would establish whether the project in question could be considered commercially viable or not and whether there was "substantial support" for it. As a last way out in the event of disagreement among the Participants on commercial viability (something to be avoided, of course), a donor who wished to proceed despite lack of substantial support should outline, in a letter to the Secretary-General of the OECD, the results of the consultations and explain the overriding non-trade reasons, related to national interest, that made the project necessary nonetheless.

The new text in the Arrangement was rather vague – deliberately so, I assumed – in order to get even those who were not in favour of stricter discipline on tied aid to think that the effects of it would be limited. I had no clue that views were as divided as they turned out to be when discussions in the Group started. Moreover, the development community had, once again, to accept that the Participants to the Arrangement had taken a decision affecting their area of competence without their direct consent.

The very first meeting of the Consultations Group was held in Paris on 27 and 29 January 1992. In spite of the divergent views within the Group and a rather negative attitude shown by many on the aid side of the debate, I was naive enough to think that discussion of a number of projects would help clarify the issues at stake. That view turned out to be very wrong.

When I left as Chairman in the summer of 1995, I had chaired 31 meetings at which 105 projects had been scrutinised – and still it had proved impossible to agree on *ex ante* guidance. We had nonetheless been through a long, process during which we had gathered a lot of experience and views on the difficult issues were largely converging.

Building Blocks

Discussions in the Consultations Group on projects that were challenged were, in the beginning, fumbling. It soon turned out that progress would be impossible unless the Group could agree on the definition of the key concepts.

Since it was foreseen that the Consultations Group would discuss only individual projects, the discussion on methodology was undertaken informally with interested delegations, although those sessions soon became as well attended as the consultations themselves.

In the beginning, we were confronted with two major difficulties: not only did we not know exactly what to look for; we often faced the situation that the information provided in the feasibility studies of individual projects did not provide sufficient basis for an examination of the project against the agreed criteria. In the methodology sessions we therefore sought to define what kind of questions a feasibility study should address in order to provide sufficient basis for the consultation process. A draft outline for feasibility studies was therefore developed and presented to the Group as a good basis for discussions.

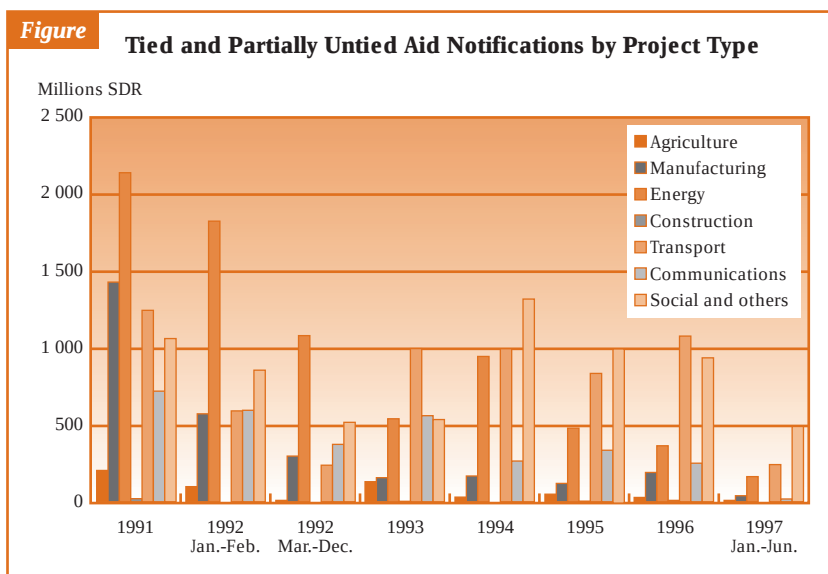
The first, and most basic, question was how a “project” should be defined. That proved to be rather difficult to agree on, although contributions from members of the Group eventually provided a basis for discussion. Another crucial element was to agree on how the “cash flow” of projects should be calculated. The most difficult concept to define turned out to be “appropriate pricing”.

It soon became clear that the projects most frequently challenged were electricity production and distribution and telecommunications projects. Here project definition and appropriate pricing were central to the outcome and very often difficult to reach consensus on. Other projects which posed problems were environmental projects with an “add-on” investment (such as a “retro-fit” for a power plant). By contrast, it was quite clear that industrial projects were to be deemed commercially viable; nevertheless, a few were notified and invariably

challenged and regarded in consultation as commercially viable. Similarly, it was rather clear that projects of a more social character (such as hospitals and sewerage plants) would be deemed commercially non-viable. Over time, as the number of projects discussed in the Consultations Group grew, these patterns become clearer.

As far as procedures were concerned, definition of “substantial support” was subject to endless discussions. Some Participants repeatedly demanded a clear-cut definition. But the Chairman of the Participants, Kurt Schaerer of Switzerland, wisely always managed to secure the agreement of the Participants that the responsibility of judging substantial support rested with the Chairman of the Consultations Group. No clear rules were spelled out: substantial support could not be a question of counting heads or weighing-up how much the different Participants spent on aid; the most important element here was the quality of the arguments advanced.

In retrospect the consultation process seems to have required an inordinate amount of time to make progress; yet there are reasons which explain this apparent delay.



Source: OECD.

Hindsight suggests that the work on methodology should have started earlier. But the shaping of a body of experience with the view to formulating *Ex Ante* Guidance for Tied Aid was not merely a technical exercise. It meant challenging, and some countries changing, long-standing traditions and values. It meant getting aid agencies to modify their behaviour because of changes agreed in a set of rules which were not theirs. And for some members, who had been frequent users of tied aid credits, it meant a loss of competitive strength in some markets.

Earlier attempts to prevent trade-distorting competition with tied aid credits had failed. This time, the Helsinki rules must largely be regarded as a success (Figure 1). But the way forward was thorny, lengthy and laborious. Some members, early in the process, could not accept the result of the consultations and went ahead with their projects after writing a letter to the Secretary-General. And each time such a letter was sent, one asked oneself how much the discipline would be eroded and for how long the rules would stand. At the same time, the strong supporters of the new rules seemed to become even more committed not only to defending the discipline when such things happened but also developing it. Without that commitment the disciplines would not be alive and kicking today.

Over to Frans Lammersen...

Mission Accomplished: *Ex Ante* Guidance for Tied Aid

Frans Lammersen

The twenty years of export credit discipline span ten years of my professional life. I first heard about the Arrangement on Guidelines for Officially Supported Export Credits when I was working as a junior staff member in the Export Financing Division of the Ministry of Economic Affairs in the Netherlands. Whenever policies were discussed to improve the position of Dutch exporters in relation to non-OECD markets, passionate debates would erupt between senior officials from the Ministries of Finance, Economic Affairs, Foreign Affairs, and Development Co-operation.

The vigour with which arguments were exchanged brought back vividly my student days when we dissected Marxist theories. I seriously doubted whether I would ever be able to participate in these sect-like debates on intentions, specific articles, detailed paragraphs, footnotes, additions and revisions of the export credit Arrangement. Reading the Arrangement did not improve my confidence. The text was as impenetrable as the more obscure Marxist treatises I had been forced to study years before. It was only after being initiated by one of the experts in the secrets of the Arrangement, that I started to understand its instruments and objectives.

Various functions in the Ministry of Economic Affairs kept me involved in officially supported export credits. After several years of moving around in the periphery, I was allowed to represent my country in meetings of the OECD Group on Export Credits and Credit Guarantees and of the Participants to the Arrangement. It was only during those meetings that I truly started to appreciate not only the effectiveness of the Arrangement but also the focused debates and friendly atmosphere among delegates.

In 1995 I was asked to succeed Birgitta Nygren as Chairman of the Participants' Consultations Group. As a delegate I had participated in several Consultations Group meetings, and I was impressed by the high degree of competence of the Chair and delegates. I doubted very much whether I had the skills to chair; fortunately, the consultation process was well established, and so I only had to "keep the process going".

The Consultation Process

The process consisted of two types of formal meetings: those in which the appropriateness of tied aid financing for specific projects was argued; and those



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to discuss more generic topics, including the methodology sessions. More meetings, of an informal kind, surrounded the consultation process:

- the co-ordination meeting of the European Community;
- the informal meetings of the Chairman with the major Participants (the European Commission, Japan and the United States);
- bilateral and social meetings.

In my view all of these played an essential role in establishing *ex ante* guidance on the projects which could be financed on concessional terms and which should be financed commercially.

The formal consultation process was based on the two basic principles which also underpin the success of the Arrangement: disciplines and transparency. The disciplines for tied aid financing had been agreed upon, and transparency was used to clarify them. Contrary to popular belief, especially among exporters, governments really can behave like gentlemen: they might not tell all their tricks, but when specifically asked about those tricks they will not lie. The result was that, during the consultations, a notifying country would present all the arguments in support of the commercial non-viability of a project while trying to hide any facts which undermined its case. Other Participants would try to find all the counter-arguments in order to convince the Group that the project was commercially viable. During discussion, the pertinent information would eventually surface, since failure to submit the information would delay the Group's decisions.

Formally, indeed, the Group did not take "decisions"; instead, delegates expressed their opinion. The process of reaching a conclusion from the Chair was complex. The opinion of the Member States of the European Community (EC) had to be voiced by the representative of the European Commission. But before the Commission could express the EC opinion, its Member States had to co-ordinate, which meant that the Consultation Group meeting would be adjourned to give the EC time in which to reach an opinion. Since most of the projects were notified by EC Member States, such discussions could become quite heated.

The weight of EC opinion in establishing whether a project received substantial support or not – that is, whether it could be financed with aid money – was a thorny issue. Birgitta Nygren commented on the wisdom of the Participants' Chairman, Kurt Schaerer, "who always managed to get the Participants to agree that the responsibility rested with the Chairman of the Consultations Group". But I am not a diplomat by profession, and the issue of substantial support blew up in my face during one of my first meetings.

With increased membership of the European Community, some of its members felt that more weight should be given to the Community opinion. As a Chairman coming from a small economy, I considered that the weight of the respective Participants did not matter that much, and was very difficult to quantify anyway. In the best OECD tradition I felt, like my predecessor, that arguments should win the day. But that point of view was not necessarily shared by all members of the Group, who brought the issue again to the attention of the Participants, as well as to that of the Secretary-General of the OECD. Bilateral contacts were initiated to work out a magic formula. (The last I heard about it was when one Participant suggested weighing the respective value of the Participants on the basis of the number of nuclear warheads in their possession.) But no compromise was found and the issue has lost its relevance for the time being.

Since the consultation process involved real money and often political commitments were at stake, debates could be quite passionate. Informal meetings with the major Participants helped keep the process manageable. Issues would be flagged, and possible compromises tested. But the most constructive element of the process was the social gatherings. Delegates would often meet with the Secretariat over drinks and dinner to discuss, on the surface, anything but work. I must admit that I sometimes wondered whether the Participants would accept compromises because they wanted to leave the meeting room to recover from the intensive, lengthy consultations of the night before.

Technicality and Transparency

The issues which were discussed in the methodology sessions of the Consultations Group were of an extremely technical nature. Many of them had been clarified by my predecessor, but some thorny ones remained. The issue of “appropriate prices” seemed to be beyond compromise. The negotiators of the Helsinki disciplines had decided that the commercial viability of a project should be assessed “with appropriate pricing determined on market principles”. The central question of the debate was what constituted “market principles”. Since no two economists are able to agree on anything, consensus on a definition remained elusive. The solution proved to be increased transparency: the theoretical differences disappeared to a large extent when the Group discussed the actual pricing used in a feasibility study.

It was, in principle, agreed that appropriate pricing should be based on local economic conditions, without excessive government intervention, and free of excessive market distortions. Notifying participants were encouraged to offer maximum transparency, which was necessary in order to evaluate the pricing employed in the feasibility study, and whether particular local circumstances existed that suggested an approach other than the immediate removal of current market distortions.

Three approaches were agreed upon:

- if the Notifying participant considered that local prices were appropriate, the study should explain the specific local market characteristics that supported the argument for local prices being appropriate;
- if the Notifying participant considered that local prices were not inappropriate, the study should “adjust” the pricing in an attempt to estimate prices that would be expected to prevail in the market of the recipient country under competitive, non-distorted market conditions;
- if the Notifying participant considered that adjusted prices should be “phased-in” over time, a description of local market characteristics supporting such an approach should be provided (for example, the inability of the targeted beneficiaries to pay for the final product of the project could support this approach).

A second topic, which defied agreement for a long time, was the treatment of projects with an environmental aspect. The Participants agreed that environmental arguments as such would not be enough to justify financing projects with aid money, on the grounds that any new investment would be almost always less polluting than the old technology it would replace. Allowing for an environmental escape clause would thus create a significant loophole.

Here, too, a solution was found in improved transparency. The Group agreed to consider, amongst other elements, the following points when assessing a project under the Helsinki disciplines, and that these should only be taken into account by the Group when discussing add-on investments with external environmental effects, for projects where the cash flow is marginally positive:

- the seriousness of the environmental problem;
- the adequacy of the technical solution;
- the local and regional environmental legislation and enforcement;
- the capability and/or ability to pay for the add-on component of a project;
- the revenue or output consequences of the add-on component to the overall project.

The issue of the definition of a project was already agreed upon. The Group had decided that a project should be defined as “the smallest complete productive entity, physically and technically integrated, that fully utilises the proposed investment and captures all financial benefits that can be attributed to the investment”.

With the important components of the evaluation of projects agreed upon, it was relatively easy to reach consensus on what came to be known as “the Checklist for Information in Feasibility Studies”. This Checklist aims at giving guidance to export credit and aid agencies on the information and data on which the Consultations Group is required to express an informed opinion on the commercial viability of projects. The information requirements might have been clear to the Participants, but they were often quite obscure to external consultants who prepared the feasibility studies and presented their findings to the Group. These consultants often expressed utter incomprehension when it was explained how the Group treated certain issues. They were right because the Group’s treatment was quite different from generally accepted financial analyses – different, but effective.

Guidance Established

While agreement on the Checklist for feasibility studies was in the making, discussions progressed on *ex ante* guidance to define more precisely, for both export credit and aid agencies, the line between projects that should be financed with tied aid or on commercial terms.

The detailed examinations, by Professor Tony Owen, of the projects discussed by the Consultations Group were a most helpful starting point for the discussion on *ex ante* guidance. The high quality of his analysis meant that there was little disagreement concerning the collective experience of the Group. And starting with this agreement, it proved surprisingly easy to reach final consensus. In fact, discussions were still continuing on a Chairman’s strategy paper (whether it was too ambitious, what its status was, the scope for additional clarifications, revisions) when agreement on *Ex Ante* Guidance for Tied Aid was proclaimed in November 1996.¹

In short, the guidance brings aid financing into line with general economic thinking. Projects are considered to be commercially viable, and thus do not require subsidies, when the project can be linked to the international market for goods and services. Projects that were usually ineligible for tied aid financing included manufacturing facilities that produce for regional, national or export

1. Cf. OECD Document
OECD/GD(96)180,
December 1996.

markets; oil-, coal-, and gas-fuelled power plants; hydropower plants; power transmission lines and equipment; telephone equipment serving areas of high and medium population-density or inter-urban or long-distance communications; and air traffic control projects.

When the project is clearly isolated from the international market, market failures might exist which make subsidies necessary to generate enough financing to start up the project. The general characteristics of financially non-viable projects include projects whose principal output held to be a public good, capital-intensive projects with high per-unit production costs and slow capacity uptake, and/or where the beneficiary group (normally household consumers) is deemed unable to afford the output at the appropriate market-determined price.

Projects that were usually considered eligible for tied aid financing included sanitation; fire-fighting; public safety; housing; schools; clinics; roads; bridges; farming co-operatives; non-power producing and other irrigation schemes; small-scale manufacturing facilities that produce for a localised rural population; urban water-treatment facilities; telephone equipment serving areas of low population density; passenger railroad services; airport construction. It is nonetheless clearly recognised in the *Ex Ante* Guidance for Tied Aid that each project should be considered on a case-by-case basis in relation to its particular circumstances.

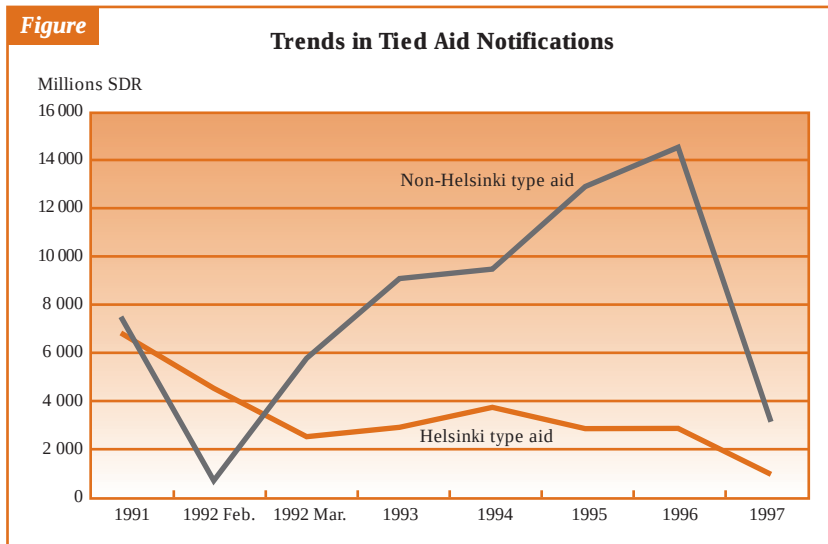
How Effective?

In February 1992, Jean-Claude Paye, then Secretary-General of the OECD, noted in a statement to the press the objectives of the tied aid disciplines:

- to provide required external resources to countries, sectors or projects with little or no access to market financing;
- to ensure best value-for-money and minimise trade distortion;
- to contribute to developmentally effective use of scarce aid resources.

It is difficult to judge whether the disciplines have succeeded in redirecting necessary external resources to countries, sectors or projects with little or no access to market financing, although it is noteworthy that during the 1990s total Official Development Assistance from DAC countries² to developing countries and multilateral organisations, has remained relatively stable, at around US\$60 billion.

Before the tied aid disciplines were agreed, “Helsinki”-type projects with a total value of SDR 6.8 billion were notified. In 1996 this figure decreased to SDR 3 billion. Simultaneously, the total value of “non-Helsinki”-type notifications



Source: OECD.

2. The Development Assistance Committee (DAC) of the OECD comprises 21 of the 29 OECD countries.

has doubled over that period, from SDR 7 billion to 14 billion. Statistics derived from projects themselves make it apparent that tied aid credits are no longer used to finance projects which are commercially viable.

These numbers support the conclusion that the disciplines have been effective in minimising the distortion of trade with tied aid, and have not decreased external resources to countries with little access to market financing.

Whether the disciplines have contributed to the developmentally effective use of scarce aid resources is more difficult to establish. The developmental quality of the projects did not play a major role during the consultation process; indeed, anecdotal evidence suggests that Member countries remain more concerned with the promotion of their domestic export industries than with the effectiveness of these scarce resources in promoting development.

Other Challenges?

Even though the Helsinki disciplines achieved impressive progress towards minimising trade distortion, some outstanding issues on other fronts remain for the Participants.

Small Projects

It was decided during the Helsinki negotiations that projects under SDR 2 million would not be subjected to the consultation process. It was understood that the disciplines would apply but that the process should not be overburdened with too many projects. Unfortunately, during the last four years the understanding that small projects were exempt only from the administrative procedures, and not from the disciplines, has been eroded. Small projects under SDR 2 million are now being used, contrary to the spirit of the disciplines. Even though the total value of the small projects remains quite low, the total number of notifications has risen. This constitutes a loophole which, in the long run, might undermine the credibility of the disciplines. Something should be done to close it before that occurs.

Untying of Aid

When concluding the Helsinki Package, the Participants agreed to develop targets for the global untying of aid, on the grounds that that global untying is one of the best ways to reduce trade distortion. The Participants agreed to co-operate with the DAC to develop these targets. Over the years a considerable body of research, both from the DAC as well as from OECD countries themselves, shows that:

- the domestic benefits from tying are much smaller than anticipated, and are very marginal to the aggregate employment, budget or export situation of the donor;
- domestic benefits accruing from tying do not offset the cost of the subsidy to domestic companies, and particularly the costs of tying to the recipient;
- domestic companies have much more to gain from competitive access to a much larger pool of untied aid than from reserved access to a small pool of tied aid;
- the ability to maintain public and budgetary support for aid rests first and foremost on the quality and effectiveness of the aid delivered in partner

countries; tying may indeed be counterproductive in this respect, to the extent it reduces the quality and impact of aid and can thus contribute to the problem it aims to resolve.

These arguments, together with the increasingly explicit preference of the recipients for untied aid, have created a momentum for OECD countries to take concrete measures to untie more aid.

Coverage

The rules on officially supported exports credits have evolved considerably during their twenty years of existence. Initially, the Arrangement could be considered as an offshoot of the Subsidy Code of the General Agreement on Tariffs and Trade, Article 3.1(a) footnote (k) of which states that:

- if a member is a party to an international undertaking on official export credits [...] or if in practice a member applies the *interest rate* provisions of the relevant undertaking, an export practice which is in conformity with those provisions shall not be considered an export subsidy by the Agreement.

But the tied aid disciplines do not apply directly to interest rate subsidies; instead, they limit concessional financing to certain type of projects – those which are commercially non-viable.

During the course of twenty years the Participants to the Arrangement have been very successful in creating a level playing-field amongst themselves. They should now aim at convincing non-Participants of the benefits of their gentleman's agreement. Failure to do so might very well undermine their competitive position and lead, in the end, to an unravelling of their hard work to reduce government involvement in the financing of what are basically commercial operations.

Mission Assessed: What Grounds for Commercial Viability?

Tony Owen

Early in 1995 I was asked by Janet West, Head of the Export Credits Division of the Trade Directorate of the OECD to analyse the body of experience gained since 1992 under the tied aid disciplines of the Arrangement on Guidelines for Officially Supported Export Credits. The task involved a detailed reading of each project evaluated by the Participants to the Arrangement under a consultation procedure, and the derivation of *Ex Ante* Guidance for Tied Aid as to why projects in particular sectors were more likely to be successfully challenged than others. Thus I had the daunting task of reading and summarising 79 feasibility studies, the quality of which varied from cursory to comprehensive.



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Grounds for Commercial Non-viability?

The general characteristics of financially non-viable projects which would be eligible for tied aid credit include those whose principal output is judged to be a public good (roads or water supply, for example), capital-intensive projects with high per unit production costs and slow capacity uptake (such as new rail networks), and/or where the beneficiary group (normally household consumers) is deemed unable to afford the output at the appropriate market-determined price (public transport systems, for instance).

The projects are grouped into nine fairly heterogeneous sectors according to the classification under the Creditor Reporting System of the OECD; five of these sectors have dominated notifications from donor countries. By far the largest is "Social and Others", which had accounted for 44% of all notifications between March 1992 and June 1995.

Power projects for electricity generation and transmission were placed under particular scrutiny by the Participants' Consultations Group and, as a consequent, frequently generated lengthy and detailed discussion. The primary issue was generally whether the project could reasonably be "isolated", both technically and financially, from the integrated power grid. If it could, then it could be treated as an incremental investment and high initial investment costs and relatively slow capacity uptake would tend to favour a conclusion of financial non-viability. Otherwise, the project would be treated as part of the integrated grid and, when assessed on that basis, that would tend to favour a conclusion of financial viability.

Telecommunications projects with relatively high installation costs per line, low rates of growth of capacity utilisation, and predominantly poor, rural household

customer bases, often in geographically inhospitable environments (and therefore with high operating and maintenance costs), would tend to favour a conclusion of financial non-viability.

Transport projects associated with large capital investments and slow capacity uptake (for example, roads, bridges, “greenfield” airport or rail infrastructure projects) would tend to be financially non-viable. Financially viable transport projects (say, infrastructure “upgrades” and replacements, and air navigation equipment) would tend to be those projects where capital investments were relatively small, where marginal benefits could be isolated and beneficiaries had the ability to pay.

Manufacturing projects, involving the creation or expansion of the output of a commodity that is priced on market-based principles, would tend to be financially viable unless it could be demonstrated that the beneficiaries were unable to afford the product.

The Benefits of Experience

The content and rigour of feasibility studies associated with projects which underwent the consultations process, in general, improved substantially between March 1992 and the beginning of 1995. This improved degree of clarity would appear to be the result of the Participants’ becoming familiar with the idiosyncrasies of the “unique” form of cumulative cash-flow table required for the financial appraisal of each project under the terms of the tied aid disciplines of the Arrangement.

In addition, a body of *ex ante* experience was being established through the 1992, 1993 and 1994 deliberations of the Consultations Group. These deliberations tended to focus the Participants on projects that the Group was unlikely to determine to be financially viable and would therefore proceed unchallenged, with a consequent saving in both time and money. This trend was reinforced by the agreement and publication of *Ex Ante* Guidance for Tied Aid¹ and is reflected in the types of projects notified (with notable decreases in the volume of aid notifications in the energy and communications sectors) and the dramatic decrease after 1995 in the number of project challenges.

Remaining Issues

Although the *raison d’être* for the Helsinki tied aid disciplines is avoidance of trade distortion, it must be remembered that donor nations are supporting financially non-viable projects generally using dedicated finance from their respective “aid” budgets. The world is full of potential projects that would be financially non-viable, and the vast majority are rejected because they are potential financial disasters. More emphasis should be placed on a sound economic justification for investing in an otherwise financially non-viable project. Certainly, if, by the end of the maximum credit period allowed under the Arrangement, a project continues to have a negative annual net cash flow, the benefits would have to be major to prevent the project from becoming a financial bottomless pit.

A second remaining issue is the question of the treatment of environmental projects. The tied aid disciplines are concerned with the commercial viability of

1. OECD Document OCDE/GD(96)180, December 1996.

projects under the two key tests. If a project is deemed to be commercially viable based on these two tests, and the polluter-pays principle is adopted, the “special circumstances” clause is then clearly irrelevant (as far as the environment is concerned). If a project is deemed to be commercially non-viable, its environmental impact is plainly irrelevant (as far as export-credit issues are concerned) and will generally be ignored. Essentially, therefore, the environment receives no special consideration under the Helsinki disciplines. Nonetheless, a project containing environmental equipment that is incorporated into the eligible contract value effectively receives favourable treatment since its cost is included in the cash flow of the project whereas its (intangible) revenue is not. Such projects must be distinguished from environmental “add-ons” (the installation of flue gas desulphurisation (FGD) units on existing coal-fired power stations, for instance), since the latter would be assessed in consideration of the “smallest productive unit” (the power station in this example).

More flexibility is therefore required in the approach to environmental projects, especially when dealing with developing countries since their priorities for a clean environment are undoubtedly different from those of the donor nations. If donors wish to impose far higher environmental standards on recipient countries than they can readily afford or desire, there should exist a mechanism whereby mixed credits can effectively reduce the cost of the investment even if the “smallest productive unit” happens to be commercially viable. A developing country may wish, say, to use higher stacks on its power stations so as to avoid localised pollution at a far lower cost than FGD technology. But that simply shifts the problem to another location, which may be another country.

A Development Co-operation Perspective on the Helsinki Tied Aid Disciplines

Bill Nicol and Gerry Duffy

Asking someone from the aid community to comment on how export credit officials implement the Helsinki tied aid disciplines is a bit like asking a soccer fan to comment on American football. The outsider will certainly admire, and not merely out of kindness, the energy, skill and support for the other game. But he will equally feel obliged, even if not fully aware of all of the rules of the game, to comment on some of its underlying fundamentals, including the size of the playing field and the shape of the goals.

Both aid and export credit agencies are, in the end, concerned with the efficient use of taxpayers' money through official support to projects. But they approach this goal from different perspectives. Aid agencies are concerned with the quality of aid – supporting sound projects that demonstrably foster sustainable development. Export credit agencies (ECAs) have the task of promoting the exports of domestic companies within the framework of the Helsinki tied aid disciplines to avoid the trade distortions that would otherwise result from uncontrolled competitive subsidisation. In general, these are highly complementary objectives but the processes in national capitals for formulating tied aid projects and the implementation of the Helsinki disciplines by the Participants to the Arrangement on Guidelines for Officially Supported Export Credits do not always deliver the desired product.



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Gerry Duffy was a Principal Administrator in the Development Co-operation Directorate of the OECD from 1995 to 1997.

The Importance of Discipline

In recent years, aid budgets have remained stagnant; indeed, they are even declining for some donors. They have not been isolated from the general budgetary pressures faced by all countries. But equally, there is a more demanding attitude by parliaments and publics regarding the reputation and efficacy of the aid effort – in itself a healthy development. The perception that aid is under pressure, coupled with growing commercial interests in aid because of the economic situation in donor countries, reinforced the views of some practitioners that aid budgets can be defended by demonstrating immediate returns to the donor economy in terms of exports and jobs – via tying. As this view gained ground, it was paralleled by an expansion of the commercial orientation of aid programmes which could have threatened to distort the real issues, options and challenges of contemporary development co-operation.

It is too simplistic to say, from a development co-operation or aid effectiveness perspective, that tied aid is “bad” and untied aid is “good”. Nevertheless, the

pressure to introduce discipline reflected well-documented concerns about tied aid. The Helsinki tied aid disciplines did not set out to ban tied aid. But they did aim to avoid distorting aid for commercial ends and, equally importantly, to build confidence in the uses of tied aid by ensuring it was used in developmentally sound ways. This is a crucial development objective of the disciplines. The ability to maintain public and budgetary support for aid rests first and foremost on the quality and effectiveness of the aid delivered in partner countries. Unless the disciplines can ensure sound uses of tied aid, tying practices can weaken support for aid rather than reinforcing it. Not only from a trade perspective but also from an aid viewpoint, therefore, the introduction of the disciplines in 1992 can be seen as a landmark, and one that has not been surpassed. Even the 1995 Government Procurement Agreement of the World Trade Organisation explicitly excludes tied aid from its coverage, leaving the export credit Arrangement with the world's only operational discipline governing the aid subsidisation of exports.

The compatibility of tied aid with the objectives, targets and means of contemporary development co-operation is again under the spotlight as the member countries of the OECD Development Assistance Committee (DAC) examine possibilities of liberalising aid procurement and making it subject to the same standards that guide other international transactions. There is also a growing body of research in the DAC and its Member countries which shows that the domestic benefits accruing from tying are much smaller than anticipated and, in the aggregate, have a highly marginal effect on the volume of employment and export earnings of the donor. Companies stand to benefit more from competitive access to a significantly expanded pool of untied aid than from reserved access to a much more limited national, tied pool. And these immediate benefits are likely to be dwarfed by the longer-term benefits of successful development co-operation efforts to help developing countries to integrate into global markets, bringing international business access to open and expanding new markets.

Although a growing number of donors have taken steps to disband some tied aid regimes and there is more willingness among them to look afresh at untying more aid, a wholesale withdrawal from tied aid is not expected. Forceful and effective tied aid disciplines have helped build this increased willingness to investigate untying, but they are also necessary to police continuing tied aid policies. So even solely from an aid perspective, the tied aid disciplines were thus necessary when introduced in 1992 and they are just as necessary now.

Aid and Trade Complementarity

The Helsinki tied aid disciplines were designed to reflect the essential complementarity of aid and trade objectives in policing the use of tied aid credits. The fact that two separate bodies, the Participants and the DAC, both adopted the same tied aid disciplines in 1992 underscores this message. Indeed, the text of the disciplines explicitly states that:

Policies for export credits and aid credits should be complementary; those for export credits should be based on open competition and the free play of market forces and those for tied aid credits should provide needed external resources to countries, sectors or projects with little or no access to market financing, ensure best value for money and minimise trade distortions, and contribute to developmentally effective use of these resources.

This quote, together with the focus of the tied aid disciplines on commercial viability, illustrates the essential complementarity of aid and export-credit perspectives. To the extent that the disciplines discourage the subsidisation of commercially viable projects – as they undoubtedly do – both trade and aid objectives are met, and in so doing they promote the objectives and targets set out in the OECD's strategy for development co-operation into the 21st century.¹ Preventing subsidies to such projects avoids trade distortion. Although commercially viable projects are certainly also good development projects, there is simply no call to subsidise them from the aid budget. These projects should be able to go ahead on the basis of market financing, leaving scarce aid resources to be used to support development projects that would otherwise not go ahead, thereby ensuring additionality and value for money from aid expenditures.

A further example of this complementarity concerns untied aid. The text of the tied aid disciplines acknowledges “the valuable role of untied aid for the development of recipients' economies and societies as well as for minimising trade distortions” and encourages aid agencies to provide aid in this form wherever possible. The ongoing efforts of the DAC to promote the use of untied aid are actively supported by the Participants and the Helsinki disciplines:

- effective disciplines on tied aid credits can and do cause countries to consider the benefits of means financing outside the disciplines by supporting projects with untied aid;
- in the work programme agreed when the disciplines were adopted, the Participants also stated that untied aid was one of the best ways to reduce trade distortions and agreed to co-operate with the DAC to promote its use.

Questions of Coherence

Economic theory suggests that trying to address two objectives (in this case, avoiding trade distortion and ensuring aid quality) through one instrument (the tied aid disciplines) may not necessarily lead to the desired results on both fronts. Where the theoretical compatibility of aid and trade objectives is not delivered (or at least not proven) in reality, it can to some extent be traced to the lack of a systemic approach to the issue of tied aid, in the sense of how tied aid projects are put together in national capitals and how the disciplines are implemented in the OECD.

As much as anything, the disciplines are about building transparency and confidence in the uses of tied aid. The essential locus for ensuring the compatibility of aid and trade objectives lies in capitals – the co-ordination between aid and export-credit agencies in formulating tied aid proposals. The form and degree of this inter-agency co-operation – and the effectiveness of the aid agency voice in the process – varies between countries, but forthright discussions of this process in the DAC suggest that there is often considerable room for improvement.

The separation of OECD procedures for implementing the disciplines, between the Participants to the Arrangement (focusing on trade distortion via the test of commercial viability) and the DAC (addressing issues of aid quality) does not lend itself to resolving any difficulties that arise from less than adequate inter-agency procedures in capitals. It is outside the mandate of the Participants to address questions of aid quality. There is the further concern that such discussions in the Participants could cloud and complicate already difficult assessments of

1. Cf. *Shaping the 21st Century: The Contribution of Development Co-operation*, OECD Publications, Paris, 1996, and *Development Partnerships in the New Global Context*, OECD Publications, Paris, 1995.

commercial viability. But in determining whether or not projects can go ahead, they also take *de facto* decisions on aid expenditures or, more broadly, on the use of taxpayers' money. All would be well if there was more transparency and confidence that tied aid projects demonstrably pursued the prime objective of promoting sustainable development and were less supplier-driven and influenced by commercial interests in OECD countries. But this characteristic is not always evident:

- manufacturing projects supported by tied aid credits have passed through the Helsinki disciplines, despite the early and broad understanding that such projects should be able to attract market financing and therefore do not require subsidisation from aid budgets;
- projects with a highly negative economic internal rate of return are seen by the Participants as compatible with the disciplines on the grounds that they are not commercially viable – yet the development benefits of such aid-supported projects (sustainability and delivery of the expected benefits, priority for the recipient, debt implications) and their opportunity costs to the donors are questionable indeed.

It is very important not to let the perfect be the enemy of the good. No international discipline is perfect, and overloading the Helsinki process could well jeopardise its internationally recognised impact. The answer to a more systemic and coherent approach does not lie in joint and integrated Participants/DAC assessments, with projects having to pass through tests of both commercial viability and aid quality. The issue is not whether the tied aid disciplines let “bad” development projects off the hook, but rather the importance of demonstrating that they promote sound projects through building *ex ante* guidance, transparency and confidence in the uses of tied aid that are fully compatible with the objectives of the disciplines. Doing so does not represent an insurmountable task, but will require commitment and effort from governments to build on and exploit more fully the provisions and procedures that already exist in the disciplines.

For example, “aid quality assessments” may be called for or could be offered by countries to demonstrate the development benefits of a given project. A checklist of what such assessments should address has always been part of the Arrangement. But few have been called for (given the focus of the Participants on commercial viability, not aid quality) and few are offered as part of the feasibility study put forward to demonstrate the compatibility of proposals with the disciplines. Yet aid agencies conduct such assessments to justify expenditures. Including them with proposals or feasibility studies would go a long way to building the confidence that the disciplines do not encourage, or at least condone, poor aid projects. This approach may imply some additional administrative burden to tailor internal assessments to external demands, but the benefits to transparency and confidence-building would be well worth the coin.

National delegations to Participants' meetings are essentially composed of export credit agencies. Representatives of aid agencies are welcomed in the make-up of national delegations, but only a few countries have systematically availed themselves of this possibility. Whether this is because they do not feel involved in the Helsinki process or feel they have little role to play in the discussion is not clear, but if the truth lies in a bit of both, it again emphasises the overriding importance of stronger inter-agency co-operation in capitals – with an effective aid agency voice in this process.

The “Knaepen Package”: Towards Convergence in Pricing Risk

Pierre Knaepen

During the last two decades all the export credit systems of the industrialised economies have been faced with the consequences of rapid change in the international economic environment, among them the debt crisis and the changes in central and eastern Europe. More recently, and increasingly, the market has undergone substantial changes, including the behaviour of the governments of borrowing countries, as has been seen in the field of international trade and trade finance.

With the benefit of bilateral or multilateral exchanges, such as those within the Berne Union, each export credit agency (ECA) had progressively developed its export credit techniques, conditions of cover and its own methods of assessing and of pricing the risks of non-payment. The emphasis was nonetheless on the importance of being competitive.

Not surprisingly, this competitive individualism led to continuing allegations of trade distortions and of subsidisations of exports – a debate confused by different approaches to the GATT requirements under item (j) in the Illustrative List of Export Subsidies in the WTO Agreement on Subsidies and Countervailing Measures that premiums should not be inadequate to cover long-term operating cost and losses.

Efforts across the OECD countries to create a level playing field were either non-existent or unproductive; this was even true within the European Union, despite the provisions in the Treaty of Rome. It was nonetheless in the framework of the European Union Single Market that a new effort towards harmonisation was undertaken in May 1991. This move led to intensive work in the European Community (EC) by a group of Experts from the ECAs of Member States under the chairmanship of Mme Tuffrau-Barriant of COFACE (France), whose mandate was to examine ways of harmonising medium- and long-term export credit insurance. The work was undertaken from March 1992 to February 1994, and was translated into a draft European Directive. Because of its rigidity and the consideration of competition from non-EC countries, this draft Directive was not adopted by Member States.

During the same period of time (early 1992 until early 1994), work was also undertaken within the OECD Group on Export Credits and Credit Guarantees (ECG) on the comparability of premium fees and of the cash results of the ECAs



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of OECD countries, which led the ECG to refer the premium issue to the Participants.

In 1994, during the course of the Participants' negotiations of another set of reforms to the Arrangement (the "Schaerer Package"), agreement was secured to undertake a full examination of the issue of pricing official support. In their Declaration of Principle of September 1994, the Participants recognised that premium and guarantee fees are an important and priority issue and agreed to investigate guiding principles with a view to producing convergence among premiums. They agreed that premium fees should not be inadequate to cover long-term operating costs and losses. They also endorsed the notion of risk-based premiums and the necessity of eliminating trade distortions, whether caused by premiums or related conditions. This objective responded also to a requirement by the OECD Ministerial Council to develop proposals on guiding principles for setting premium and related conditions. Accordingly, in September 1994, at a special session, the Participants mandated a Working Group of Experts, which I have the privilege to chair.

Setting the Scene

In setting up the Working Group in 1994, it was expected that Experts from the ECAs would provide the technical expertise necessary to put together proposals for consideration and negotiation by the Participants. Some indication of the challenge facing the Group of Experts may be given by the diversity of facilities offered by ECAs: insurance, guarantees and direct lending (a facility concentrated in non-European Participants).

Country risk assessment was likewise based on different but equally valid methods, leading to the classification of countries into four or more and in some instances ten categories, with all the consequent problems of comparability. Such country risk assessment was usually based on an evaluation of the ability of the buying country to service its external debt.

Premium rates of ECAs varied enormously. For instance, for a credit of ten years with a drawing period of three years on a sovereign borrower, rates could vary from 1.20 to 7.20% for a best risk country, or from 4.10 to 14.20% for a high-risk country.

The main differences in the quality of the product offered by the ECAs were the percentages of cover provided for country credit risk, (this varied from 85 to 100%), claims waiting periods (varying from 0 to 180 days) and whether or not interest during the claims waiting period could be covered and, if so, whether a premium surcharge would be levied. In fact, many more differences were identified but not retained for pricing purposes.

The adequacy of the then prevailing premium rates in relation to the risk, although based on different methods for assessing such adequacy (that is, cash flow accounts, accrual accounts, all in cost or market-pricing concepts), was deemed appropriate by each ECA. In addition, the absence of organised transparency allowed potential allegations, interpretations or misunderstandings of the conditions offered by the competition.

Another aspect which the Experts had to take into account was the risk period (that is, manufacturing and credit risks) and the risk covered (country risk, sovereign risk, non-sovereign public debtors, private debtors).

It was nonetheless fully understood that the purpose of the Experts’ work was neither to harmonise the different ECA schemes, nor to address the decision on cover policy or capacity of each ECA (that was and continues to be recognised as an area of national competence solely).

Meeting the Objective

It would be hard to reflect in a few sentences the amount of work and the technical (and sometimes political) problems encountered by the Experts and the OECD Secretariat, in particular Evelyne Neimetz, Tom Vis and Janet West, from September 1994 to June 1997 in their endeavours to satisfy the mandate set for them by the Participants.

During this period – almost three years – the Group met nearly every month at the OECD in Paris, with the Experts accumulating a number of working papers, room documents and exchanges on all aspects of the guiding principles that were expected to emerge. The Chairman and the Experts co-operated closely in drafting most of the technical papers and enhancing them after each discussion. The Experts’ continuing involvement and willingness to make progress, sometimes in controversial areas, has proved to be essential in securing an agreement.

The initial stage of work required a clearer understanding of the schemes, expertise and culture of each ECA, using increased transparency and exchanges at meetings. This approach created a working climate of suitable flexibility, notwithstanding the inevitable frictions which were to be expected in such a process.

In order to facilitate progress, the Experts decided to concentrate in the first instance on working towards a proposal for premium setting for sovereign and country credit risks. The first step towards convergence thus required a common approach towards the assessment of the risks of non-service of a country’s external debt; that meant the development of a commonly accepted methodology to evaluate the country risks and to classify the countries in an agreed number of categories. This classification exercise led to attempts to reconcile the diverging existing premium fees into minimum premium benchmarks.

Much more difficult to establish, because of the absence of any existing reference, was the adjustment of minimum premium benchmarks in order to reflect the quality of the products (that is, their conditions of cover). All the Experts will acknowledge the involvement, patience and perseverance of Detlev Malzkahn of Hermes (Germany), who produced countless working papers aimed at making feasible what appeared in the first instance to be hardly possible.

The development of tools to ensure that the minimum premium benchmarks remain adequate to reflect the risk, and that they conform with the GATT/WTO requirement that premiums should not be inadequate to cover long-term operating costs and losses, was also very important. In addition, exclusion of certain risks and risk-mitigation techniques (“permitted exceptions”) had to be recognised as justifying premium rates below the minimum premium benchmarks. Finally, the whole process was to be supported by an appropriate Electronic Exchange of Information System (the EEI).

In their work, the Experts developed valid technical compromises; in some areas they presented different options to the Participants for their guidance and decision.

The Agreement Emerges

On different occasions during the course of the work, the Participants gave their support to the orientations taken by the Group of Experts. In addition, there was much informal consultation between the Chairman and the Experts which included a mission to some capitals by Kurt Schaerer, Chairman of the Participants, the OECD Secretariat (Janet West) and myself. On the basis of the result of the Experts' work, the Bureau of Kurt Schaerer, Bob Crick, Alistair Smith and myself drafted a Proposal on Guidelines for Setting Premia and Related Conditions which was presented by Kurt Schaerer for agreement by the Participants at their 63rd meeting in April 1997.

Intensive negotiations took place at that meeting, with successive adjustments of the Proposal by the Bureau following the development of the Participants' position on the most important issues. A final proposal by the Bureau was tabled at the closing session of negotiations, and Kurt Schaerer concluded that the proposal was agreed *ad referendum* and invited confirmation of this (in a short time-frame) from the Participants.

With further proposals tabled by the Bureau in a special session of the Participants on 20 June 1997, clarification, refinement and elaboration brought shape to the Guiding Principles, and at the end of the session the Participants finally reached agreement on the "Knaepen Package", which has now been incorporated in the Arrangement.¹

This vital step towards the elimination of trade distortions and subsidies reflects the willingness of the Participants to achieve that objective, and underlines their flexibility and pragmatism even where, in respect of the Guiding Principles on premium fees, it was not possible to satisfy the wishes of everyone on all elements.

Elements of the Package

The Guiding Principles for Setting Premia and Related Conditions set minimum premium benchmarks for sovereign and country credit risks, as well as for country and buyer/borrower risks irrespective of whether the buyer/borrower is a private or public entity. The benchmarks:

- are risk-based/reflective;
- take account different qualities of cover;
- are not inadequate to cover long-term operating costs and losses;
- are transparent among the ECAs of the Participants.

They are derived from:

- a common reference country classification system for assessing the country risk into seven categories;
- a system of minimum premium benchmark rates for each category of risk;
- a system of surcharges and discounts reflecting the qualitative differences between ECA products, including essentially the percentage of cover;
- a system of review and adjustment with reference to aggregated results of ECAs based on a cash flow and on an accrual-accounting approach and to private-market indicators when appropriate;
- a system of permitted exceptions with premium discounts for risk exclusion, externalisation or mitigation;

1. The guiding principles of the "Knaepen Package" are available on the OECD Internet page: <http://www.OECD.org/ech/act/xcred1.htm>.

- an Electronic Exchange of Information on all aspects of the Guiding Principles.

The implementation date of the Guiding Principles is 1 April 1999, after which they will be subject to regular review to ensure their validity. The agreement is understood to be a starting point only: it is subject, over time, to improvement and enhancement in the light both of experience and developments in international trade and in the ECAs' working and political environment. It also requires a rapid adaptability to any new circumstances that ECAs may consider appropriate.

Back to Work

After the conclusion of the Package, and with the same intensity as before, the Experts of the Working Group on Premia and Related Conditions have undertaken to consolidate the different elements of the Guiding Principles, including their translation into common and workable mechanisms among ECAs, taking into account the requirements of handling day-to-day business in the new framework.

Among the issues currently under consideration by the Experts are the classification of an increased number of countries (about 140 should have been classified before the end of 1998), the determination of minimum premium benchmarks for irregular repayment profiles, the conversion of flat premium rates into a margin above the interest rate of the credit, the development of the tools to validate and adjust the minimum premium benchmarks, and the co-ordination of the reporting formats with other international reporting requirements.

At a later stage, the Experts may have to consider the issues of the pricing of the manufacturing risk and of non-sovereign buyer/borrower risks.

The New Culture

The common pricing of comparable risk was long considered to be hardly feasible; it has now been achieved. One of the main achievements has been the acceptance of a common technical assessment of the country risks and the resultant common reference classification of the countries. The impossibility – even the non-desirability – of working towards a world-wide harmonisation of different export credit schemes has resulted in a pricing of the differences in products. The system of minimum premium benchmarks and permitted exceptions are supported by a very large degree of transparency, as are all other aspects of the Guiding Principles. On the other hand, the technical tools to verify the continuing validity of the minimum premium benchmarks are aimed at meeting concretely the Participants' obligations to the GATT/WTO. Within this framework, by contrast, the fields of national competences – with regard to cover policy and capacity, availability of products, strategic targets, quality of service – are left untouched: the individual performance of each ECA remains within its hands.

The ECAs and their Experts have been placed in a new professional and cultural framework of internationally shared expertise, which will evolve as economic and financial world changes. Like the OECD Secretariat, the Experts remain firm in their technical approach but have succeeded in developing a unique climate of listening, broadmindedness and friendship which has eased the progress towards

an agreement of international interest, one which continues to offer a framework for further work. But they may yet find that one of the most difficult aspects of their task is the process of translating the results of their work into their national environment.

All those who contributed, and are still contributing, to the process have shown the capacity to unbolt a door that was a long time closed. This achievement will prevail whatever orientation the “Knaepen Package” may take in the future.

The Ragged Arrangement – or – from RAG to Riches

Bob Crick

Although my own copy of the Arrangement on Guidelines for Officially Supported Export Credits has become well worn through constant and loving use over the years, I should make clear at the outset that “RAG” in this context refers to the Redrafting of the Arrangement Group, in which I have had much fun – as well as a measure of frustration – in the capacity of Chairman.

Why the RAG?

Although the original text of export credit Arrangement carefully crafted in 1978 was no doubt a very coherent document, after nineteen years of constant tinkering by the Participants it had become something of a “dog’s breakfast”.

An examination of the last published text issued in 1992 following agreement to the “Helsinki Package” revealed a confusing mix of export credit and tied aid rules and procedures, underpinned in a primary tier by five pages of “definitions and interpretations” and in a secondary tier by over three pages of “notes”. To compound matters there was, in a completely separate document titled “Recent Interpretations and Decisions”, over ten pages of further pointers to the real meaning of the text which had been gleaned from aides-mémoires of various meetings of the Participants – a particular source of concern to the European Commission since, unlike the main body of the Arrangement text, it had no basis in European Community law.

In addition, the text had yet to be further adjusted to reflect the substantive amendments to the Aircraft Sector Understanding agreed in 1993 and the “Schaerer Package” agreed in 1994.

The RAG “Experts”

When in late 1994 it was first mooted by Janet West, Head of the OECD export credit team, that a small group of “experts” would be asked to undertake the drafting process of a new Arrangement text, I thought that it would be a good idea to be involved. The golden rule of volunteering, of course, is “don’t”, but if you do, don’t be the first in line. Having failed on both counts, I found myself as Chairman.

The rest of the RAG was made up of volunteers who rushed to enlist. The original cast was Jürgen Gerke (European Commission), Karl Heinz Koch (Austrian Ministry



Bob Crick, of the Export Credit Guarantees Department (ECGD), London, is Chairman of the Redrafting of the Arrangement Group, the Nuclear Sector and Aircraft Sector Groups, and Vice-Chairman of the Participants to the Arrangement on Guidelines for Officially Supported Export Credits and of the Group on Export Credits and Credit Guarantees.

of Finance), Eckhardt Moltrecht (Hermes), Don Vromans (Dutch Central Bank) and Ole Whist (GIEK). To repair the ravages of time, Jun Okumura (MITI) has recently joined the team. There was also ever present back-up from the Secretariat, with Sheena Bohan, Steve Cutts, Lars Binau Hansen, and occasional guest appearances by Janet West when the schedule of other export credit meetings, which were often held in parallel, permitted.

The Long and Winding Road

The first meeting of the RAG in March 1995 set the terms of reference. This was “to make the new text user-friendly, using plain language and incorporating all of the scattered notes and definitions into the main body of the text, but without altering the substance of the carefully crafted rules”.

The first step largely involved “shoe-horning” the old text into a new framework. Then the real work began, and it was at this stage that we fully realised the extent to which opaque text seemed to have been a deliberate ploy of negotiators.

The meetings of the RAG were very informal affairs, held in whatever room the Secretariat could find and, of course, without interpreters. The cast of the RAG members also varied considerably, with the numbers gradually decreasing over time as postings took their toll of the team (at least, that was their excuse for not attending).

The first published draft of the revised text of the Arrangement saw the light of day in March 1996 (we all had full-time jobs as well!). This was a culmination of at least six working drafts considered by the RAG, as well as numerous additional working documents prepared for the RAG meetings held over the previous twelve-month period. I often reflected that one of the advantages of a long daily journey to the office by train was that it passed more quickly once the RAG text was opened, if only because it sometimes acted as a powerful inducement to sleep.

The Participants

Once we had thus thrown ourselves on the mercy of the Participants, there was no going back. The new text was given a first airing at the Participants’ meeting in April 1996. It was well received, but clearly required more attention, not only to refine further the draft but also to try to tackle the logjam of numerous tricky interpretational questions which had apparently been building up for some time. By way of encouragement, the Participants agreed that for operational purposes the new text could be used on a trial basis alongside the established text.

To take the process forward, the Participants also agreed that the draft should be considered at a Workshop where matters could be discussed in more detail. This was held in June 1996 and was adjudged quite successful.

Nearly There?

After the Workshop, a new draft was issued together with the Chairman’s Report explaining the background to many of the amendments and presenting a variety of options for the text where there were differing views. This was referred to the Participants in November 1996, where I fondly and, perhaps naively, imagined that the final pieces of the jigsaw would fall into place. Wrong! At this stage I will

also mention the second tier of activity which is also a fact of life for some countries who make up one Participant. I am, of course, referring to the mysterious process of European Community co-ordination, over which I shall draw a tactful veil.

In November, the Participants were broadly content with the new draft but required the further clarification of certain issues. After two more meetings of the RAG a revised draft was circulated. Realising that the text required more careful scrutiny than one session in a Participants' meeting would allow, it was decided to hold a special Participants' meeting in February 1997 dedicated to the RAG, with a view to achieving formal adoption of the text at the plenary meeting of the Participants in April 1997.

By this time, the RAG had also tried to get to grips with the Sector Understandings relating to the export of ships, nuclear power plant and civil aircraft. These included the full horror of the Large Aircraft Sector Understanding, whose mysteries were hitherto known only to a few initiates.

Back to Participants

April 1997 was a busy time for the Participants: the negotiations on an agreement to establish premium guidelines were approaching a final and sometimes fraught closing stage. In retrospect, it was perhaps not an auspicious time to be holding long sessions on drafting issues, not only in the Participants Group, but also in the Aircraft Sector and Nuclear Sector Groups, (which given the premature retirement of our Australian friend and colleague, David Stafford, I also happened to Chair).

Ironically, the first successes came with the adoption of the Nuclear Sector and Aircraft Sector Understandings following successive meetings spanning a full morning, whilst "restricted" meetings were taking place on the premium front. I am personally of the view that agreement to the Sector Understandings, which process from start to finish spanned only a few months, was a significant "cameo" achievement. That it was achieved so quickly reflects not only the efforts of the RAG, but also the flexible way in which the Participants tackled the remaining thorny drafting points during the course of their April 1997 meetings. It is also amusing to contemplate that, at one stage, there existed the entirely possible prospect of agreement on the two Sector Understandings without similar agreement on the main text of the Arrangement which they complement.

Text Agreed

I like to think that Arrangement stories have a happy ending, and so it proved. The April 1997 meeting of the Participants saw the adoption of the new text in its own right, albeit with the blot of three "differences of interpretation" which the Participants resolved to address as a matter of urgency (more of that later). Said quickly, it sounds easy. At this stage it was also agreed that the RAG should become a standing technical sub-committee of the Participants, ready to come into play whenever necessary.

Only One More Hill to Climb

It was, perhaps, inevitable that the moment of success in reaching agreement on the new Arrangement text was accompanied by the more momentous

agreement on the premium guidelines (the “Knaepen Package”). This meant that as soon as the new text had been agreed, it needed updating to incorporate the complex package skilfully crafted by Pierre Knaepen, Chairman of the Premia Working Group, and translated into political reality – in an eleventh-hour compromise when all seemed lost – by the Chairman of the Participants: Kurt “Houdini” Schaerer.

Following only one more RAG meeting, complemented by further efforts on a personal front and by the OECD Secretariat, the text was discussed at a technical Workshop in September 1997. The ensuing consolidated text was finally agreed by the Participants at their November 1997 meeting. Two of the “differences of interpretation” were also resolved.

Quest for the Holy Grail: A Definition of Official Support

One might imagine that in a logical world, the first cornerstone cemented in any international agreement would be a clear description of who or what one was trying to regulate. Wrong again! The Arrangement has defied gravity for its full twenty year history in as far as the definition of the very thing that it is supposed to control – that is “official support” – is missing. It goes to show what “gentlemen” we have been for all of this time: even with this notable handicap the Arrangement has been undeniably effective in squeezing out subsidy and trade distortions in their various guises. Its other major achievement has been the building of trust through the transparency engendered by the notification and consultation procedures.

So what is official support? At this stage conversation generally turns to recognising an elephant when you see one, or not asking questions of tigers. I am sure that some of you will have heard such yarns.

In spite of a further attempt in December 1997 to foster agreement, the definition of official support is still proving elusive. Let us hope that it does not take another twenty years! Meanwhile, the RAG looks forward to any challenges which might arise from new agreements. The “Consensus Pot” still appears to be bubbling nicely.

Chapter 3

Future Challenges

The Economic Policy Benefits of International Co-operation

Timothy F. Geithner

In the twenty years since its creation, the Arrangement on Guidelines for Officially Supported Export Credits has evolved from a simple “creditors’ cartel” – intended to restrain excessive competition in export financing – to a powerful force for improved international and domestic economic policies world-wide.

Export subsidies, whether direct or indirect, are no less protectionist than tariffs, and no less damaging economically. The export credit Arrangement provides the multilateral forum in which Participants have collaborated to reduce the export financing subsidies offered by developed countries, thereby complementing successive rounds of negotiations to liberalise the world trading system within the General Agreement on Tariffs and Trade (GATT) and, now, the World Trade Organisation (WTO). Arrangement work has also reinforced what can only be described as a global shift toward increased reliance on market forces generally – in both international and domestic economic policies.

Perhaps most impressive of all, the Arrangement’s successes have been achieved while operating as a “gentlemen’s agreement” among like-minded governments, without the force of international law.

The Arrangement is an example of the more enlightened approach to resolving multilateral economic issues through discussion, negotiation and collaboration on which we must all increasingly rely in the new global economy. In relying on the Arrangement, we and our OECD partners are taking just such an approach. Its achievements are evidence that in an increasingly interdependent world, co-operation is a more effective route to achieving our individual national economic goals than acting alone. The solutions often take longer than we would prefer, but that is the nature of international co-operation. Furthermore, trade issues are always politically, as well as economically, sensitive and solutions must be fully vetted by governments before they can be broadly accepted. Overall, the Arrangement has proven itself to be an effective forum for nations to reach mutually beneficial, co-operative and sustainable resolutions of both discrete and systemic issues, even though the inherently arcane nature of trade finance issues has meant that the long-term contributions of the Arrangement to sound economic policy have been under-appreciated.



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Principal Policy Accomplishments

As others have noted, the success of the Arrangement in reducing official financing subsidies and liberalising trade has rested on three planks: first, on the

requirement for market-based interest rates – Commercial Interest Reference Rates (CIRRs) – for officially supported export financing; second, on rules that reduce trade distortions in “tied” development assistance programmes; and third, on a system of risk charges that act to reduce risk subsidies.

Between them, these agreements diffuse pressures for national export-promotion policies that would likely devolve into an OECD-wide subsidised export credit race. As a result, national treasuries save billions of dollars each year. These agreements also systematically reduce protectionism and trade distortions that misallocate global resources. Finally, they promote better overall domestic economic policies in both OECD and developing countries.

Export subsidies do not merely drain government budgets. They can undermine the longer-term competitiveness of domestic industries, delay adjustment to economic change, and transfer income from all taxpayers to exporters. Seen in this light, the discipline afforded by the Arrangement delivers multiple benefits to policy makers. It limits the direct use of taxpayer funds for promoting exports; it fosters reliance on market principles in the development of national export policies; and it helps to develop an environment for international trade in which individual exporters face well-defined parameters for competition in official export financing and can expect to compete on a level playing field.

Reducing protectionism and trade distortions also provides major benefits to developing countries. The Arrangement disciplines have supported bilateral and multilateral efforts to promote increased reliance on the market and have contributed significantly to rationalising investment decisions and economic activity generally.

Promoting Good Policy in Practice: The Example of Tied Aid

Negotiations to set rules for the proper use of tied development aid demonstrates the success of the Arrangement as a forum that simultaneously promotes sound international economic and development policies while averting what otherwise would have developed into an export subsidy race.

At the start of the 1990s, approximately \$10 billion annually in official development assistance from OECD countries took the form of “tied aid” – much of it aimed at promoting exports of highly competitive capital goods. Negotiations among the Participants to the Arrangements to determine OECD-wide rules for tied aid use were admittedly long and contentious but, in the end, produced the “Helsinki Package” that took effect in 1992. Continued co-operation among the Participants in implementing the Agreement reduced annual volumes of tied aid by more than half, to \$4 billion in the years 1993-96. Preliminary data for 1997 indicate that that figure has declined yet further. More importantly from a policy perspective, the fact that the tied aid that remains is now focused on *bona fide* aid projects that cannot service financing terms at market rates, and not on subsidised export promotion, is a major economic policy success.

It is important to remember that things could have turned out very differently. Ten years ago, exporters were complaining loudly over the use of tied aid to win sensitive export contracts. Government officials and legislatures were gearing up for an expensive and trade-distorting export subsidy race. Instead, the Arrangement rules for the use of tied aid have diffused subsidy pressures in donor

countries, enhanced the value of development assistance to recipients, and saved a good deal of taxpayer money.

To be sure, success did not come easily. There were powerful economic and political forces at work in every stage of the negotiations, and they took time and detailed negotiation to overcome. Aid had typically been considered by trade negotiators to be a resource transfer to foster economic development, and not a trade subsidy *per se*. But, as the Arrangement disciplines eliminated interest rate subsidies that could be used to promote exports with standard export credits, competitive pressures led to aid financing increasingly being used to provide export subsidies. Aid agencies began financing major projects in power, manufacturing and telecommunications, and there were strong exporter constituencies in favour of continuing this practice.

Such tied aid financing was undesirable from a number of standpoints. It often distorted trade and the global allocation of resources away from the most efficient producers to those with access to concessional tied aid resources. It was concentrated in capital intensive sectors in the fastest-growing developing-country markets where export competition was fiercest, as well as in the relatively richer developing countries. Such tied aid therefore hardly represented an efficient use of scarce aid flows, particularly when both categories of countries have substantial access to private capital for such projects.

Even the recipients found that tied aid was a mixed blessing: it distorted their development aid programmes in favour of investment that was overly capital-intensive, and toward specific technologies eligible for the donor's tied aid subsidies. The equipment financed with tied aid also tended to be more expensive than that purchased through open competition, reducing the real resource transfer to developing countries and shifting some of the export subsidies back to the exporter. Increasingly, purchases for development projects were being determined not by price, quality and service, but by the availability of subsidised financing. As a result, resources were being misallocated and good international economic and development policy was being undermined.

It was perhaps predictable that initially the loudest opposition to the rising amount of tied aid financing came from exporters and national legislatures in countries which lacked major tied aid programmes and felt that they offered unfair advantage to their competitors. And while political pressures centred on the competitive disadvantages of tied aid, policy-makers were increasingly troubled by the budget pressures and trade distortions produced by tied aid, and its effect on global and domestic economic efficiency.

Policy makers could respond to the outcry in one of two ways. The best outcome from an economic standpoint was to negotiate rules to rationalise the use of tied aid. A second, non-co-operative outcome, by contrast, seemed all too possible – that all countries would embark on a self-defeating credit race with tied aid. That would have meant all donors chasing the same aggregate amount of export business but offering more and more subsidies to win it. In the end, the combination of common sense and the ready availability of the Arrangement as a forum to address the issue led policy makers to opt for a negotiated solution.

The “Helsinki Package” tackled trade distortion by “graduating” the richer developing countries from tied aid eligibility, and prohibiting tied aid for projects considered

“commercially viable”. Projects that have the capacity to earn cash flows sufficient to service financing on commercial, or market-related, terms (such as those offered by official export credit agencies (ECAs)) would no longer be permitted tied aid.

The economic benefits of the agreement are clear. First, competition for projects with the highest real financial returns are forced back into the market where price, quality and service dictate rational procurement decisions and global resources are allocated in favour of the most efficient producers. As a result, national budget pressures are also reduced.

Second, by not allowing aid financing to “crowd out” commercial financing, the total financial resources available for development are maximised and allocated rationally. Higher-cost market financing is allocated to projects with the capacity to afford it, leaving concessional funds to finance projects with high economic but lower financial rates of return.

Third, scarce aid resources are now focused on the poorer countries where they are most pressingly required.

And finally, the financial bias in favour of overly capital intensive development has been removed. In practice, aid for projects in the power and telecommunications sectors is now restricted to small-scale, rural development projects, with larger projects reserved for private capital and official ECAs. All but the very smallest manufacturing projects are now required to use market-rate financing as well.

And yet, in itself, the “Helsinki Package” did not guarantee this outcome. It was an agreement merely on principles and concepts – the negotiators left the precise interpretation of the agreed principles and concepts as they apply to individual aid projects to a Tied Aid Consultations Group of the Participants to the Arrangement. Eligibility for tied aid was negotiated project by project. In parallel, broader methodological work was undertaken by the Group to define key technical concepts included in the “Helsinki” disciplines. Negotiators and project specialists held tied aid consultations meetings almost monthly at the OECD in Paris for four years and ultimately forged a “case law” of project decisions.

It took a lot of work, patience and good will but, in December 1996, the Participants finally produced their “*Ex Ante* Guidance for Tied Aid”. This document drew conclusions from over 100 individual project decisions and codified them as future guidance for aid and ECA programmes to avoid the re-occurrence of the tied aid trade distortion problem. It also provides an agreed methodology.

Periodically, a tied aid offer will still raise the issue of possible trade distortion, but the “Helsinki” disciplines and the case law developed in the Arrangement have virtually eliminated the systematic use of tied aid for most export promotion. In doing so, the Arrangement eliminated what had been a source of considerable political friction between OECD countries. And it was done in a way that made a major contribution to the international economic and development policy climate.

Next Steps

Clearly, then, the Arrangement has repeatedly proven its value as a forum in which governments can collectively develop common ground on the principles of

good international economic policy and impose disciplines to limit the periodic unilateralist impulses of individual governments. As we go forward, we must have two priorities: first, to protect the achievements already made, and second, to build on them.

Protecting Past Gains

This will mean, among other things:

- implementing procedures for premium fees that reduce subsidies in both the shorter and longer run as risk conditions change, and doing so in a manner that generates confidence in the premium system (the so-called “Knaepen Package”) among governments and exporters;
- adapting to new trade finance pressures in project-finance structures without undermining the fundamental concept of discipline that is at the core of the Arrangement;
- updating the CIRR procedures to keep abreast of trade finance practices without unbalancing the playing field.

Building for the Future

It is clear that as a group we should focus on ways to extend the reach of the Arrangement beyond the narrow technical aspects of official export credits, in particular to:

- prohibit the use of bribery in officially supported export credit transactions;
- ensure that environmental issues are taken into consideration in officially supported export credit transactions;
- see that financing disciplines are not circumvented through the use of quasi-official institutions – “market windows” – and ensure that they do not distort trade by undercutting both the market and officially supported export financing;
- ensure that tied aid disciplines are not undermined through the use of untied aid to achieve the same export promoting objectives.

This future work deserves some elaboration.

Prohibiting Bribery

The recent OECD “Convention on Combating Bribery of Foreign Public Officials in International Business Transactions” is a landmark action and another feather in the cap of international co-operation. The next step is the process of legislative approval and the development of mechanisms to enforce national anti-bribery laws. It follows logically that governments should also take parallel steps to ensure that the implementation of all government programmes reinforce these new laws. One obvious step is to ensure that official ECAs do not inadvertently support transactions that include bribes. The Arrangement is the appropriate forum for this work, which should be a top priority.

Dealing effectively with this issue does not have to be bureaucratically cumbersome or overly intrusive or subvert the mission of official ECAs, as some commentators fear. The United States passed the Foreign Corrupt Practices Act twenty years ago and has developed policies and procedures that offer reasonable assurance that the programmes of the US Ex-Im Bank do not support bribery. We require disclosure by exporters of all payments of fees/commissions associated

with a contract to be financed and the signature of a supplier's certificate attesting that no bribes or other extraordinary payments were made in the context of the contract before Ex-Im Bank will offer financing. The United States Government will prosecute if such payments are discovered. We believe this approach has worked well and offer it as a model for other ECAs in the forthcoming Arrangement discussions of the issue.

Protecting the Environment

We have an opportunity to avoid unnecessary environmental damage as we pursue our traditional goals of reducing export financing subsidies, maintaining a level competitive playing field and facilitating national exports. The idea that ECAs should take the environment into consideration has not only been proposed by many economic policy makers, but it was also endorsed politically at the G8 summit in Denver in 1997.

The development within the Arrangement of minimum environmental standards for government-financed equipment that affects the environment would be a major step toward this goal. Such standards would improve the environment as well as reinforce the environmental policies of the multilateral development banks and those of an increasing number of developing countries. Increasing investment in more environmentally friendly technologies is in the long-term interest of both exporting and developing countries.

This is an issue whose time has come and it should be addressed by the Participants to the Arrangement to ensure that the standards that emerge are compatible with the operations of official export financing institutions. Again, the US Ex-Im Bank is successfully following environmental guidelines in its own operations and is prepared to share its experience with others in the course of collaborating on an Arrangement-wide approach to environmental standards.

Quasi-Official Financing Institutions: Market Disciplines for Market Windows

The rules and disciplines of the Arrangement apply only to government institutions. Currently, these include only official ECAs and the windows of private entities that explicitly act on behalf of a government. But the spectrum of institutions that finance exports is broad and many have varying degrees of government involvement. If the Arrangement is to maintain a level playing field for competition in export financing, we must ensure that institutions that finance exports and benefit from various forms of indirect government support or are owned or effectively controlled by governments are fully subject to market disciplines and behave like market actors if we are to justify continued exemption from Arrangement rules. Otherwise, they may be able to undercut both private market financing and official ECAs, flaunt the intent of the Arrangement and create trade distortions.

Work should continue to determine if the structure and behaviour of these institutions is purely market-based or if they have to be brought under the Arrangement rules. Their potential to undermine twenty years' worth of hard-won disciplines for official financing is very real.

***Untied Aid:
Avoiding Trade Distortions***

As the OECD's Development Assistance Committee (DAC) pursues aid-untying initiatives to increase further the efficiency of development assistance, the Arrangement Participants will have to ensure that the broad benefits of the tied aid disciplines are not undermined. Clear international rules and procedures governing the untying of aid will have to be developed to ensure that trade distortions do not re-emerge in a different form. The Participants should work closely with the DAC and should take the lead on developing the competitive rules and procedures that will be required to ensure that exporters' concerns are fully addressed. These rules and procedures will also be required to convince national legislatures that the procurement opportunities expected from the untying of aid are real and that they justify the untying of currently tied development assistance programmes. Of course, policy makers will want such rules and procedures to ensure that untying aid actually improves the efficiency of global resource allocation.

In sum, the export credit Arrangement has built a solid twenty-year record. The challenge of the next ten years will be to expand its scope to address emerging issues as we enter a new century. With two decades of experience in multilateral co-operation behind it, I am confident that the Arrangement and its Participants will rise to the challenge.

That will require clarity of vision, sound technical analyses, skilful negotiation, sound economic policy judgement and – most important of all – a ready and plentiful store of goodwill. If we all work to bring these qualities with us to the negotiating table in the years ahead, the Arrangement should continue to play a major role in deepening international co-operation and implementing sound international economic policy.

From Simple to Sophisticated

Hidehiro Konno

It is with a sense of pride, no doubt shared by all my colleagues within the Participants, that I welcome the twentieth anniversary of the Arrangement on Guidelines for Officially Supported Export Credits. Allow me, as one who has been involved, directly and indirectly, at various stages of his career in export credit administration, to reflect on our past achievements, and offer my views on what the future may hold for us.

If trade is the engine that drives the increasingly integrated global economy, export credit is the fuel that powers it. Export credit agencies (ECAs) have always played an indispensable role in providing the official support that complements private financing and enables trade to expand. This is of particular importance in times of uncertainty, when the ECAs serve as a steadying force in the face of financial stress. As for the export credit Arrangement, it provides the rules of the game, aimed at following the letter and spirit of the General Agreement on Tariffs and Trade (GATT), and now the World Trade Organisation (WTO), Agreement on Subsidies and Countervailing Duties while enabling ECAs to serve their purpose of fostering global prosperity by promoting trade.

The Arrangement has evolved over the years to serve both purposes well – remarkably so, in view of the non-binding nature of this “gentlemen’s agreement”, and the consensual process through which it has been developed and administered in the face of often divergent conditions and interests under which individual ECAs have operated.

Steps towards Market Conditions

One noteworthy achievement has been the long and arduous – yet ultimately successful – development of Commercial Interest Reference Rates (CIRRs) that reflect market conditions for each individual currency and serve as minimum benchmark interest rates for officially supported export credit.

The roots of the CIRR system can be traced to the minimum interest rates laid out in the initial Arrangement adopted in 1978 and the informal “Consensus” of 1976 that preceded it. At first sight, the rates appear to be a rather crude instrument. Although actual interest rates differed widely from currency to currency, the minimum rates were set uniformly across all currencies within a rather narrow range, taking into account the repayment period of the official support and relative income of recipient countries – no easy task, given the



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disparate practices of individual ECAs and the almost total lack of discipline in this field at the time.

In 1983, CIRRs were introduced as an alternative to enable the users of low-interest currencies to reflect market conditions more accurately. To the same end, the cross-currency rates were also to be reviewed more frequently. In the 1994 “Schaerer Package” the last vestiges of the original rates were laid to rest, with the CIRR determining minimum rates for each individual currency. It is also important to note that, in the beginning, concessional loans were for the most part tied to purchases from the lender country, and were often closely associated with normal export credits. Here again, there has been success, with the development of a much clearer distinction.

The conclusion last year of the negotiations on premium rates, the “Knaepen Package”, which means there is now an international consensus on minimum premium benchmarks to reflect actual credit risks, is another remarkable achievement, given the number of countries that are Participants to the Arrangement, each with its own history and practices. (Imagine a similar number of private banks getting together and coming to a similar agreement on risk assessment!)

These and other developments have clearly brought ECAs closer in line with market conditions. But they are not merely a series of reactive efforts to minimise the threat of downward-spiralling interest-rate competition. Instead, they are aimed at reflecting more closely the spirit of the WTO Subsidies Code under which we ultimately operate. More importantly, they are also part of the growing consensus on the recognition of the efficacy of market forces in all aspects of an increasingly globalised economy.

This evolution is occurring against the backdrop of an innovative and rapidly evolving array of financial instruments, which in turn is being supported by the ongoing revolution in information technology. The premium issue, for instance, is one that would never have been resolved in its current form without the availability of cheap and powerful information technology. Another, more recent example that reflects new trends in long-term financing is the issue of project financing, which is progressing in the Participants’ to the negotiating stage.

Growing Issues

Of course, there are other developments that affect economic activities. The environment is an area where entirely reasonable concerns over the impact of economic activities must be balanced with the objective of the activities themselves. There is no easy answer to such questions, but ECAs cannot remain aloof from them.

So this is a good time to contemplate the future of the Arrangement. The development of a simple, uniform system into the sophisticated and complex array of rules that now form the Arrangement is something to be proud of. But it is also important to be able to respond flexibly to new developments that demand creative reactions on the part of ECAs. The right balance has to be found between the stable and market-based structure that we seek and the flexibility that the rapidly changing market conditions themselves demand. The recent developments in project financing and the positive response to it from the Participants to the

Arrangement are thus a very encouraging development. And as we advance on this issue, we must be mindful of the rapidly evolving and varied nature of the projects themselves and the demands they make on financing instruments.

As we head into the 21st century, we are responsible to bring further prosperity to the global economy through our activities in export credits and financing. Let us continue our work, so that, twenty years from now, our successors can look back with similar pride, and go forward with renewed confidence.

And finally, I wish to express my heartfelt gratitude and admiration for the strong leadership provided over the years by the export credit Secretariat, and the unstinting support from the OECD staff.

A National Perspective: The View from Germany

Michael Kruse and Eckhardt Moltrecht

Two decades of continuous effort have developed the Arrangement on Guidelines for Officially Supported Export Credits from its early origins to a relatively comprehensive regime that reduces considerably the potential for distortions of competition in the field of officially supported export credits. The government of the Federal Republic of Germany, represented by the Ministry of Economics and Hermes Kreditversicherungs AG, has actively supported this successful process from the outset. The direction taken all those years ago is entirely in line with both the aims and guidelines of German foreign and economic policy. Multilateral agreements which encourage market forces are, in our view, of utmost priority.

The focus of the work done by the Participants to the export credit Arrangement themselves and the reforms agreed have changed over time, reflecting the changing priorities and concerns in the world of export credits. The Arrangement has to adapt to changing realities, or, as a former Chairman of the Participants put it, the Arrangement “is a little like a bicycle: it must move forward to stay upright”.

Past Successes

The early 1980s were marked by efforts to reduce and eliminate interest subsidies. It took a long time to move from the “Wallén Package” of 1987 to the final phasing-out of SDR-based rates in the “Schaerer Package” of 1994. The fact that these issues were linked to tied aid issues, such as the calculation of the differentiated discount rate and the increase of the overall grant element, did not make the negotiators’ work any easier. Germany, a traditional provider of pure cover with very limited official finance support available, whole-heartedly supported all efforts to eliminate subsidised rates and to create an efficient interest-rate regime, that is, the Commercial Interest Reference Rate (CIRR) system.

Trade-motivated tied aid credits were another important issue. It became evident that some markets and some types of project attracted aid funds to a considerable extent. The “Helsinki Package”, agreed in late 1991 after tough negotiations, did not rule out tied aid credits for specific sectors but it set up a consultation process for individual projects. We admit that there was a degree of scepticism in Germany



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when the consultation process started in 1992. That process proved to be cumbersome, time-consuming and sometimes led to unexpected results, although it must be admitted today that the body of experience and the agreement reached on methodological issues so far provide for a degree of predictability, which both exporters and aid agencies require.

After the implementation of the “Helsinki” and “Schaerer” Packages new avenues have been explored. The Arrangement did not provide guidelines for premium fees which, when they differ widely among OECD countries, are a major obstacle to the creation of a level playing field. The “Knaepen Package” on premium fees, agreed in 1997, is a remarkable achievement, given the different institutions (insurers and guarantors versus direct lenders) and products (insurance versus unconditional guarantee) in Member countries. The German government considers the Knaepen Package to be a first step in the right direction. A converging premium system in OECD countries would have to include premium guidelines for the manufacturing risk and for private-buyer risks. Any premium system that does not include these items would remain incomplete and fall short of levelling the playing field.

Paths Forward?

The future of the Arrangement will depend largely on the ability of the Participants to adapt the rules to the challenges that lie ahead. It will be difficult (if not impossible) to change the Arrangement in a way that reflects ideally all the requirements of the exporting community. Such a requirement might put too much of a strain on the Arrangement. The Arrangement should limit the aggressive promotion of exports and should thus set maximum standards for official support. For example, it would probably be over-ambitious to adapt the relatively simple and straightforward CIRR system to the subtle techniques available on the financial markets.

The Arrangement rules should nonetheless reflect market realities to the extent that they should not deter exporters from making use of official export credits. In this context, project finance should be mentioned. The rigid rules of the Arrangement in respect of repayment profiles have long prevented banks and exporters from arranging tailor-made financing that structure the repayment of the loan in accordance with the expected cash flow of the project. We have seen the bond markets develop tools for project finance, thus luring away exporters and project sponsors from export credit agencies (ECAs). Existing Arrangement guidelines would hinder underwriting possibilities and leave ECAs with the “worst cases” that are unable to attract commercial finance. Default risks for ECAs would increase.

The example of project finance shows that the Arrangement rules that have been considered reasonable for some time might prove to be a straitjacket – at least for some types of transaction. Yet the general agreement reached in November 1997 to negotiate terms to accommodate project-finance transactions will enable ECAs to provide support for more flexible repayment profiles in the future. The Participants have proved that they are willing to adapt the Arrangement guidelines to market realities.

One might argue that the reforms of the Arrangement come too late or represent a compromise that is far from perfect – and that is certainly true. Everyone who is

involved in the negotiating process knows how lengthy these negotiations are and how difficult it proves to amalgamate divergent interests in a “package”. Nevertheless, the past twenty years have proved to be a success story. If one bears in mind the fact that the Arrangement is a “gentlemen’s agreement” which can be changed only unanimously and that the interest behind the Arrangement is not a general or global one, the progress achieved so far is remarkable. There are differing economic philosophies within the OECD, and there are differing ways of supporting national exporters. Some ECAs compete with the private markets; others – and this is rather the German approach – perceive themselves as lenders or insurers of last resort. In these circumstances, the success of twenty years of the Arrangement has to be attributed equally to the astuteness of the Chairmen, the assiduity of the Secretariat and the initiative and the patience of the Participants.

It seems certain that the Arrangement will continue to have an important function in international trade policy. It will probably succeed in accommodating conflicting interests. It will have to keep up with market developments. It will have to reduce trade distortions yet further. And it will have to ensure that the overall premium income enables ECAs to break even. Last but not least, it will have to find its role in a larger OECD whose new Member countries are not necessarily traditional providers of export credits.

The Export Credit Agency in a Market Environment

Vivian Brown

One of the first things I have been trying to understand since my arrival at the Export Credits Guarantee Department (ECGD) of the United Kingdom only a few months ago is the link between government and the private sector. Twenty years ago, when the Arrangement on Guidelines for Officially Supported Export Credits was established, export credits operated in a very different environment that of from today. Most short-term export credit insurance was carried for the account of the state. Medium-term business – particularly in high interest rate countries like the United Kingdom – had the potential for huge subsidies. And of course the 1980s debt crisis was waiting round the corner.

Today much short-term business is written by private-sector insurers for their own account. In the United Kingdom we privatised our short-term operation almost completely some years ago. Although we have retained the ability to offer reinsurance, both commercial and political risks have been readily accepted by the private market.

On the medium-term front, thanks to the efforts of many years of negotiations, subsidy has almost been squeezed out of interest rate support. This left as the biggest challenge the exercise to harmonise premium rates. The “Knaepen Package” signed in June 1997 was a major achievement, for the first time setting a policy of minimum premium benchmarks for export credit insurance operations. It is important to maintain the momentum behind this initiative, and much remains to be done before the implementation date of 1 April 1999.

It might then be asked: if subsidy has been largely withdrawn from export credits, what is the role of government? Should it not be left entirely to the private sector? Indeed, we are seeing a steady withdrawal of government from export credit activity, medium- as well as short-term. Not only is there a decreasing role for subsidy; the private market is showing an increasing appetite for medium-term commercial and political risk. In a number of recent large projects, official export credit agencies (ECAs) have been working alongside the private market – banks and others – in setting up the funding arrangements. In one or two cases the banks and bond market have shown more willingness to take on risk than anyone had expected at the outset and in effect have pushed the ECAs out of the funding arrangements. We have also seen the growth of other instruments such as forfaiting. Two responses to this type of experience might be considered – in theory:



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- the tactical (or strategic) withdrawal – if the banks are able to fund exports, let them do so. If, this argument runs, banks are willing to take on these risks, the state has no role in competing with them. By doing so it risks distorting the market and assuming substantial contingent liabilities which may be costly to taxpayers. Anyone who doubts the latter should remember the debt crisis of the 1980s;
- faced with a confident and competitive private sector, ECAs should compete in order to retain their place in the market. Some observers argue that the ECA should be a national champion supporting national exports, unlike the banks, which are only interested in the deal, not the nationality of the exports. Others see the ECA as a secure source of financing, in contrast to the private sector, which may be here today and gone tomorrow if risks increase or if they find a more profitable source of earnings.

After only a few months at the ECGD, far be it from me to offer the correct answer. But I certainly do not believe the day of the export credit agency is over. (I would hardly have joined the ECGD if I did.) Yet it is clear to me that the future for ECAs – as for governments and for banks – is one of change and continuing adaptation to the environment. Otherwise, like the dinosaur or the dodo, we shall risk extinction.

This process of change has, of course, already begun. My perception is of agencies which have adapted to a changing environment and changing rules, and which as a result are much more vigorous than they were a few years ago. And change these days is ever-present, which makes the future an exciting one.

Co-operation with the Private Sector

So what role will ECAs fulfil? We must work with the private sector. The private sector is the source of much of our business – whether in the form of the exporter who actually has to win a contract and carry it out, or the bank who in many cases seeks out new opportunities by either research or creativity, or, increasingly, the buyer.

The ECA is here to support this process. If our exporters win business without us as ECAs being involved, that does not matter – provided the exporter gets paid. We may have helped promote the export without issuing a guarantee. Simply by being prepared to take the risk ourselves, for example, we may have encouraged the private sector to take it on instead – with the taxpayer then avoiding a potential liability.

But such cases are very much the exception. If they became the norm, the days of the ECA really would be numbered – doing a lot of the work (“due diligence”) but seeing nothing in return. This is not a partnership in any real sense of the word. What we should work at is deepening our relationship with the private sector, sharing risks with them rather than being a lender of last resort. It is tempting to say we should only be involved where the private sector does not want a role. But that may undermine the objective of ECA operations (which is clearly implicit in the WTO) not to be a charge to public funds. Being an insurer of last resort implies picking up only those risks which the private sector will not touch – which undermines the principle of spread of risk which is fundamental to an insurance operation. In other words, we have to work with the banks to win and support business. To this end we have to learn new skills and particularly to understand the requirements and operations of the market.

We should also support the continuing development of the export credit Arrangement. It is particularly fitting that at present two of the major exercises in the Participants to the Arrangement and the Group on Export Credits and Credit Guarantees are the premium exercise and the work on project finance. The purpose of the first is to strengthen the principle that export credits should not – must not – involve subsidy; and to reinforce the principle of the level playing field. This is work which will require continuing effort, not only to implement the work of the Working Group on Premia but to broaden and deepen its initiative. We owe the Group, and in particular its Chairman, Pierre Knaepen, an enormous amount.

But we must also remember the importance of flexibility and here the second initiative – project finance – is particularly interesting. It is an example of the way the market has developed and of the way Participants to the Arrangement can – and must – adapt. I am sure that they will once more show the flexibility which they have shown in the past.

Other challenges await ECAs:

- the recent developments in the Far East have shown that some categories of business may be riskier than they once appeared. One consequence could be that ECAs will find themselves asked to cover deals which, only a few months ago, would have gone to the market;
- the increasing use of multisourcing. More and more project business involves sourcing from a number of countries. This requires ECAs – which are national institutions – to work with one another to support their exporters. ECGD has signed a number of co-operation agreements with OECD partners to this end: co-operation could be the basis of a multilateral ECA – in effect if not in form;
- the role of specialist financing institutions – market windows and their relationship with the Arrangement rules on export finance. Is this the last playing field we have to level?;
- dealing more and more with the private sector as buyers and borrowers in the project field, which requires ECAs to develop yet more new skills, in particular assessing corporate risks.

The last twenty years of the export credit Arrangement have been full of challenges and excitement for the OECD and for the ECAs, and one hopes the next twenty should be even more exciting. I am sure that we will come through them – but to do so we will have to show even more of the flexibility and willingness to learn that has been a feature of the years since 1978.

Soft Law, Hard Results

Jacques de Lajugie

The twentieth anniversary of the Arrangement on Guidelines for Officially Supported Export Credits warrants celebration on two counts. Through its success over the years, the export credit Arrangement has demonstrated its continued relevance despite far-reaching changes in the international economic environment. At the same time, it has also been strengthened and, for this reason, is still able to attract emerging new competitors. In short, this twentieth anniversary celebrates both maturity and modernity.

The Prime Virtue of the Arrangement: Soft Law

Although the main rules of the Arrangement are well known to those who implement them, few people are aware of the actual status of the Arrangement which in itself is somewhat of a legal curiosity. The Arrangement is one of the very few lasting and effective examples of “soft law”. This informal body of law, viewed as compulsory by those who apply it, is generally taught – at least in France – as an exception to treaty law.

None of the Participants has signed the Arrangement; it has no ratification procedures; and it is in no way legally binding. Just as atypically, the Arrangement comprises no dispute-settling mechanism, nor any procedure to attest that it has been applied properly. Lastly, its interpretation, together with discussions of its grey areas, are managed entirely by the Participants, by unanimous consent.

It is generally inferred that, because this form of international law is not legally binding, it has little practical effect. This theoretical weakness might have been fatal for a document whose purpose is to set stable rules in an environment that is both highly competitive and rapidly changing. Conversely, a move to bolster the Arrangement could have taken place, ultimately codifying it into a conventional international treaty.

Yet neither of these things has occurred, surely because the primary competitors – the Participants – feel it is more advantageous to apply common rules that are set informally by unanimous consent. The benefits of this approach are twofold:

- to keep the Arrangement flexible, always readily adjustable by consensus in response to changing international competition;
- to give precedence to a forum where information can be exchanged, one in which export credit agencies can expand their knowledge of one another and swap experience.



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These two advantages have clearly been appreciated by emerging new economic competitors, judging from the determination of some of the new OECD Member countries to subscribe to the Arrangement. For these reasons, the Arrangement is a unique element of international commercial law, which in contrast has a tendency to strengthen multilateral rules that are binding and that carry sanctions.

Through its pragmatic management, the Arrangement has firmly established its credibility and its usefulness. By causing substance to prevail over form, the Arrangement has reached its maturity.

Modernity of the Arrangement: Adjusting to New Forms of Financing

The history of the Arrangement coincides with a shared determination to limit the subsidies countries grant their exporters by setting ground rules for officially supported export financing. This goal has been achieved to judge, for example, by the reduction in tied aid and the fact that such aid has been shifted to sectors deemed not commercially viable. The flexibility of the Arrangement has also allowed its scope of application to be gradually extended, the latest example of this being the adoption in 1997 of common rules for the pricing of officially supported export credit premium fees.

Yet these changes in content must not mask the importance of updating the form of the Arrangement in order to make it clearer and easier to use. A document born of negotiated compromise can indeed be difficult for practitioners to grasp, especially insofar as a number of points remain open to interpretation. The new Arrangement text, agreed by the Participants towards the end of last year, is welcome and should remedy this initial defect.

In the future, the Arrangement must endeavour to adapt to a changing environment. Historically, it has helped to discipline the terms of official export financing. It is now going to structure the prices and products offered by official export credit agencies (ECAs), by way of new rules applicable to premium fees. But, although the Arrangement focuses on the official component of the supply of export credits it cannot disregard changes in its main competitor, the market, which is taking account of constraints on government financing, along with the new demands of exporters, and exhibiting ever increasing inventiveness in developing new financing options.

In this context, the Arrangement faces three main challenges:

- Should it be confined to regulating the financing terms of last-resort official ECAs, acting in a back-up capacity in areas where the market is inadequate or non-existent?
- To what extent should it draw on market techniques to ensure that ECAs are as competitive as possible?
- What resources should it obtain to ensure the long-term equilibrium of ECAs, such equilibrium entailing, in particular, a balanced risk portfolio?

In any event, the Arrangement must move towards increasingly comprehensive coverage of the activities of ECAs which act on behalf of national governments. Its credibility would be impaired if it confined itself to setting rules to control “past” activities, which represent a declining proportion of ECA business, whilst allowing them to operate without common guidelines in new segments inspired

by the market. Here, the speed with which the Arrangement can adapt to new methods of financing (such as project financing) will guarantee its credibility with economic agents and governments alike. This ability to change is especially important when financial developments are rapid and far-reaching, and turn arounds abrupt.

Moreover, in the realm of development assistance, it is also conceivable that the export credit Arrangement could focus more closely on forms of untied aid, so as to equalise the terms of competition in that area as well.

The Participants therefore face a full programme of work – one that has to be tackled without delay.

A New World for the Export Credit Agencies

A. Ian Gillespie

Twenty years ago, in 1978, it made sense to adopt a set of rules restricting the terms and conditions for officially supported export credits. It was a time when governments with deep pockets were only too happy to blur the lines between trade and aid. Co-ordinated trade policies and workable trade rules were in their infancy. In the absence of private appetite for riskier markets, no market-based disciplines existed. A set of rules-based disciplines to impose some degree of control over export credits was the only workable alternative.

It also made sense in 1978 to establish an institutional framework to ensure an orderly export-credit market. As government-based institutions, export credit agencies (ECAs) could secure a competitive advantage for their exporters as long as their governments were willing to stand behind them with virtually unlimited funds to cover the “subsidies”. These institutions could not be expected to do business in a manner that would break even or emulate commercial institutions. At that time, an institutional framework based on government ownership and control was the best available option.

Clearly, the Arrangement on Guidelines for Officially Supported Export Credits has proven useful. Exchange of information between the Participants in the Arrangement has improved underwriting and improved the understanding of the characteristics of the systems of other Participants. The export credit Arrangement disciplines have enabled ECAs to increase their effectiveness as instruments of export promotion and increase the transparency of their operations, simultaneously reducing costs to governments. It has helped bring about a rather uneasy balance between providing the most competitive support to national exporters and avoiding a destructive and expensive export-credit race. The 1991 “Helsinki Package” of reforms to the Arrangement has succeeded in bringing discipline to tied aid programmes, an achievement that has improved the allocation of scarce aid-resources to projects that are not commercially viable.

But these accomplishments, particularly in tied aid, should not permit complacency about the continuing relevance of the export-credit rules themselves. The market has become increasingly sophisticated. Fingertip access to real-time occurrences in markets around the world has changed the underlying assumption that indicators of market disciplines are not readily available. Moreover, some government-owned export credit institutions are demonstrating a capacity to do business on a commercial basis and that export credit support does not have to rely directly on government but, instead, can be delivered on the basis of sound



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underwriting principles and commercial disciplines. At the Export Development Corporation (EDC) of Canada, for example, we continue to enjoy the benefits of a commercial approach. These benefits manifest themselves through increasing volumes of business and financial success, as well as an increasing base of satisfied and supportive exporters as our customers.

But do the far-reaching changes in the market over the past two decades undermine the relevance of Arrangement rules and those institutions governed by them? Perhaps this twentieth anniversary of the Arrangement is an apposite moment to step back and re-think the role of the Arrangement and how we ECAs do business.

Changes in the World Economy

The world trade stage has changed dramatically over those two decades. There has been a surge in international trade and the demand for trade finance. Deregulation and privatisation have become hallmarks of the political and economic environment around the world. Countries grappling with fiscal and external debt-constraints have recognised that governments do not have to – indeed, should not – be entrepreneurs. Many of these countries have re-defined the role of government as policy-maker and regulator, dramatically cutting public expenditures and moving away from a position where the government acts as borrower for imports and project development. ECA portfolios bear witness to these changes. Where once our business was dominated by loans to sovereign entities, a much larger portion of it is now done with commercial buyers and borrowers.

A market-driven philosophy has emerged in developing countries, too, making so-called higher-risk markets much more attractive for private capital. As a result, commercial banks, equity and bond markets have moved into markets once dominated by export credit institutions and multilateral aid organisations. In 1990, for example, official development finance (that is, grants and loans from export credit and multilateral institutions combined) represented 56% of total flows. By 1996, their share had fallen to only 14%. In contrast, private sources of capital have witnessed enormous growth. Capital-market flows have increased by more than 1 000% since 1990. Over the same period, foreign direct investment has grown five-fold.

Capital sources have also become more sophisticated. As the ability of the market to analyse and distinguish between commercial and political risks has increased, so too has its capacity to accept those risks in whole or in part. In turn, market forces are playing an increasingly effective role in determining the most efficient allocation of new capital.

A New Role for ECAs?

Such sweeping changes have thrown the traditional ECA role of lender or insurer of last resort into question. Today, we no longer enjoy the luxury of setting the terms and conditions of support. We are facing increasingly complex risk-sharing propositions that test our capacity to be flexible to respond to the demands of the market. Unfortunately, as a group, we continue to be characterised as rigid and slow. Some commentators, citing the origins of ECAs as government institutions, question whether we continue to have a role to play at all. Whether

deserved or not, these perceptions make us undesirable risk-sharing partners by those who hold them.

If the premise that ECAs exist to correct market deficiencies, or to fill gaps, is to be maintained, it has to be clear where these gaps occur and how our presence can most effectively fill them without distorting trade. But the gaps in markets where private capital is flowing freely are substantially different from those where there is still minimal private appetite for risk. And ECA activity can distort the market in both cases.

A level playing field between ECAs might distort trade if, for example, the terms offered either kept private sources of capital out of a market or, alternatively, kept ECAs themselves from participating in a market. Commercial lenders, too, have finite lending limits in developing-country markets. In such cases, there is risk-sharing potential for ECAs which are flexible and thus are able to follow market terms. Of course, in markets where private capital has little appetite for risk, ECAs can still perform their more traditional gap-filling function – and in this case, where we do not have sufficient market disciplines to guide us, the traditional rules-based system works better.

It is perhaps worth reviewing the various forms of gaps that a flexible, forward-looking ECA might notionally be well positioned to fill. Gaps can occur where innovation risks are high, that is, where private financial institutions may not have the appetite to structure dramatically new solutions to meet the financial requirements of developing markets. ECAs wishing to fill this kind of gap should develop and maintain leading-edge expertise in structuring financial solutions.

Gaps can occur also where product risks are high or, more traditionally, where a new buyer with a very short track-record emerges. An ECA working on behalf of an exporter might be more inclined to provide support in the early stages of sending a new product to market than would an entity driven purely by profit. Likewise, an ECA will more readily accept a new buyer in the interests of helping an exporter develop a market for its product.

There is, furthermore, gap-filling potential for ECAs moving “down-market”, by helping smaller, as well as larger, exporters. Such a move would require more flexibility and less bureaucracy in the services offered smaller exporters, perhaps even translating into an “Arrangement pro minimis”.

Gaps can certainly occur as a result of the ebb and flow of private capital in response to business cycles or, as we have seen in Asia recently, times of financial crisis. The recent turmoil in Asia underscores the volatility and serious damage a lack of confidence can have. Where commercial entities might temporarily withdraw from such situations, ECAs, which are less fickle, have the mandate and capacity to sustain trade and mitigate the debilitating effects throughout such cyclical or crisis-driven downturns. Yet to maintain that capacity, ECAs have to keep in mind that maintaining institutional expertise even during upswings, when capital is flowing more readily, is vital if they are to be able to step in when required.

To carve out a new role for ECAs, to prevent our becoming obsolete in the next century, the EDC believes that the ECA community in the OECD countries should not be satisfied with the implications of a “lender of last resort” mentality. Nor should we be content with a role as a source of cheap funds. We cannot accept

distortion of the market by providing grants and subsidies to commercially viable projects. We would be ill-advised to act simply as an underwriter of run-of-the-mill deals.

Instead, we must continuously look to the market to identify where the gaps exist and where and how our services are best provided. We must become flexible, innovative risk-management problem-solvers, not rigid, rules-based institutions offering “cookie-cutter” solutions. It is particularly important for ECAs that do not have domestic partners (that is, global banks) to upgrade their skills to become leaders rather than followers in tackling market gaps.

We would do well to maintain a market philosophy (with the objective of, at least, breaking even) as we undertake all types of gap-filling activities. Again, institutions such as the EDC have already concluded that gap-filling need not be a money-losing proposition and a drain on government finances. Indeed, they understand that a healthy bottom line is an essential ingredient in expanding risk capacities even further. These institutions are recognising the value of balanced portfolios and better measures of financial success (i.e., accruals-based versus cash based accounting of profits and losses).

Updating the “Rules-based” System

Over the past 20 years, the Arrangement has focused on trying to encourage competition on the basis of the quality and price of goods and services exported, not on direct government support. This rules-based system retains its value. But the rules have to be reasonable and relevant for today’s economy. They have to make commercial sense, or they will produce bad underwriting. There are potential increases in risks if, for example, a rules-dictated repayment structure forces pay-back before a project can generate sufficient cash-flow. Repayment terms linked to per capita income of countries, when ECA business is moving away from sovereign risk and into commercial risk, no longer make sense. Structures more restrictive than those the private market is willing to provide are unhelpful.

A more effective institutional framework for export credits must also be comprehensive to be orderly and fair. There are still export-support programmes and institutions in the OECD countries that apply neither market disciplines nor the negotiated rules. As the underlying assumptions of the rules-based system are re-thought, it would be wise also to examine whether the scope of application of those rules should be update.

It is the view of the EDC that a workable alternative, specifically a set of flexible rules that forces commercial discipline onto the operations of an ECA, is within our grasp; indeed, there is evidence in various Arrangement discussions that this evolution may already be happening. Such a movement will do much to accommodate the desire of our institutions to be involved in the world’s ballooning infrastructure-development activities. We are also hopeful that the discussions will move away from a question of institutional arrangements to undertake an examination of whether these activities are truly trade-distorting. After all, ECAs that are not required to break-even and run commercially risk distorting a market that has made enormous strides towards functioning with optimal efficiency and effectiveness. We are hopeful that recent discussions mark the beginning of a new age in the Arrangement.

It is the firm belief of the EDC that such an approach will go a long way towards establishing OECD ECAs as legitimate participants in the market. Over the next twenty years, we hope to see ECAs less as “official” and more as “commercial” financial institutions, still owned by governments, still fulfilling a public-policy mandate, but behaving more like the private sector. We also expect to see the Arrangement itself move towards facilitating good analysis and underwriting of risks rather than rules-based applications.

As we do so, we will be ensuring that the export-credit practices of the Participants to the Arrangement will remain relevant to the times and hence appropriate for the requirements of exporters and taxpayers alike.

New Challenges

Allan G. Dalvin

The Arrangement on Guidelines for Officially Supported Export Credits and I started dealing with export credits at the same time twenty years ago. At that point the export credit Arrangement text covered only a few pages, but it touched upon some basic principles and although it has since expanded substantially in volume and specification, both the text and the pragmatic “gentlemen’s approach” to its development and application has proved robust and effective.

That is quite remarkable. In trade we are competitors, each country basing itself on established practices that it believes are right. In order to move ahead we all have to be convinced that sometimes changes are necessary for the benefit of all and that it is not a question of winning or losing. Nevertheless, progress has been possible, and, after a recent “fitness upgrading” by the Redrafting Group, the Arrangement is a healthy young adult saying farewell to its teenage years.

As the Arrangement reaches maturity, there are some thorny problems to address. It is already 15 years since the European Community suggested that export credit disciplines for agricultural products should be introduced, starting from the general principle that the maximum credit period should not exceed the lifespan of a product. This proposition may have been somewhat premature at that time but some three years ago commitments were made both in the World Trade Organisation (WTO) and among the Participants to negotiate an agreement. I still hope that these commitments will be honoured.

The Road Ahead

We have so many other tasks waiting for us. On premium fees for officially supported export credits, we have reached important results in spite of the difficulty of drafting an agreement (“the Knaepen Package”) that will lead to equivalent premium rates in guarantee systems that are not harmonised. These results have also led to progress on harmonisation of export credit conditions within the European Community where Ministers had already decided in 1960 that action should be taken, but where the multitude of systems and the perceived desirability preserving differences had prevented progress.

But we cannot afford to rest on our laurels and new challenges are still ahead of us. As well as reaching agreement on agriculture, we have to consider extension



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of the premium system, a clearer understanding of which bodies are bound by the Arrangement, an updating of the system of Commercial Interest Reference Rates (CIRRs) and a comprehensive shipbuilding agreement that will ensure fair and equal competition in the shipbuilding industry, and abolition of restrictions on the operation of ships built under such conditions. Export credit conditions for ships have long required updating and the Arrangement does offer solutions which are tried and tested on other capital goods.

The same reasoning suggests an examination of financing rates. When discussing financing rates and premium fees we have been prepared to look at and accept guidance from the market. I do not necessarily subscribe to the philosophy that the market always is right. Markets are unsteady – one day over-optimistic, over-pessimistic the next – and their performance in evaluating credit risks has not always been impressive. Yet some analysis of the longer-term movements in the market is probably the only truly independent check on whether the systems the Participants have created can be considered free of subsidies. That objective is one that could be shared both by those who for political reasons would like the public sector to step out of this business, and those who point to the desirability of such a public service – but at minimum or no cost to the taxpayer.

CIRRs and the Euro

When considering the CIRRs we should be looking for ways of modernising a system that has been in place for more than a decade and which might therefore benefit from updating. Yet some essential elements of the present system were chosen deliberately so that the interest rates disregarded erratic day-to-day movements and, instead, reflected longer-term movements. Of course, a more stable environment of this sort ensures better transparency, which in turn helps build mutual confidence in the system.

The preparations for a euro-CIRR will also be a priority for the European Community after the important decisions at a Ministerial meeting this May. There is no doubt that the euro will become a very important currency in world trade; the only question is how quickly its use will exceed the combined volumes of the currencies it replaces. The US dollar is used in a very large part of world trade among parties which do not have the dollar as their national currency. This will not change overnight. But in the longer run it can be expected not only that European exporters will have the larger part of their costs in euros but also that overseas buyers will see an interest in diminishing their exchange-rate risks and costs by partly switching to the euro. In the Autumn, we shall have to fix a euro-CIRR based on incomplete knowledge about the still non-existent bond market; once the euro bond market becomes more fully established in a few years, it will probably prove necessary to review it.

More Flexibility in Project Finance

One of the most important tasks facing the Participants is to find a formula that allows the official export credit agencies to participate in modern project finance structures that link, to a larger extent than hitherto, the repayment profile of a credit (and the risk linked to such a repayment obligation) to the performance of and cash flow generated by the project involved. Financing rates that are not subsidised as they were a few years ago and more realistic premium fees should make it less controversial than once it was to introduce more flexibility in the

Arrangement – although it would not be in the interest of exporters and their insurance and financing institutions to go further than absolutely necessary.

Linking repayments to the cash flow generated by a project will normally lead to longer repayment periods and thus larger volumes of outstanding debt. It is often claimed that softer terms could be an advantage in relation to the buyer's economy and thus diminish the risk of a pure commercial default. Yet recent developments in Asia have drawn attention to the risks that arise from high-debt obligations in foreign currencies. As almost always, evolution is to be preferred over revolution.

The past twenty years of the Arrangement have reaped rewards for all its Participants; the challenges ahead are significant but with their usual pragmatic approach and goodwill the Participants should be able to resolve these.

Chapter 4

International Institutions' Perspectives

Export Credit Agencies and the World Bank: A Partnership

Hiroo Fukui

The World Bank is committed to forging strong and effective partnerships to achieve its developmental goals, and co-financing with bilateral, multilateral and private institutions is a concrete means of achieving these partnerships. Export credit agencies (ECAs) are natural co-financing partners for the Bank, which has been working with them for over a quarter of a century now.

The World Bank recognises that ECAs are an essential component in the financing strategies of most developing countries: ECA credits provide them with financing in circumstances and on terms that would not otherwise be available. Data from the International Union of Credit and Investment Insurers (the “Berne Union”) show a rise in new term export credit commitments of ECAs from US\$24 billion in 1988 to \$52 billion in 1990 and over \$90 billion in 1996. These figures point to the considerable scope for catalysing ECA resources in association with Bank projects and programmes, to the benefit of all parties concerned. Co-financing offers each of the parties involved – the co-financier, the borrower, and the Bank – the opportunity of achieving their objectives more efficiently by pooling scarce resources. The resulting win-win situation explains the strong expansion of co-financing activities over the past 25 years.



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Trends in Co-financing

Over the 25 years between 1971 and 1995, 18% of total co-financing (an aggregate amount of US\$26 billion) has come from ECAs (Table). ECAs have generally financed equipment purchases for projects in the infrastructure and industrial sectors, mostly in the Bank's more credit-worthy borrowing countries. ECA co-financing more than doubled over the 1970s and 1980s, although in the past decade it has fluctuated considerably – from a high of \$3.5 billion in FY1990 to only \$600 million in FY1994 and \$400 million in FY1995.

In part, the decline in ECA co-financing in the past few years may reflect a shift in ECAs away from direct lending to governments and towards direct lending to projects sponsored by the private sector. This trend is discernible in the sectoral composition of co-financing. Infrastructure is the sector that has received the most co-financing, maintaining a share of more than 50% of the total over the past 25 years. But in the 1990s, with increasing privatisation and a rise in co-financing in private projects, its share has been declining. The Bank has therefore responded with its guarantee programme to catalyse private flows of credit into private projects in developing countries that are members of the Bank. Guarantees

Table

Export Credit Co-financing by Region and Sector*million US\$, fiscal years*

	1990	1991	1992	1993	1994	1995	1971-95	
							\$ million	per cent of total
Past borrowers	–	–	–	–	–	–	9	0
Africa	17	147	1,174	10	–	–	2,054	8
East Asia and the Pacific	1,186	75	1,956	157	92	348	7,609	29
Middle East and North Africa	48	–	–	48	23	–	1,224	5
Latin America and the Caribbean	2,074	–	–	700	2	–	8,748	33
Europe and Central Asia	134	227	–	–	174	–	2,353	9
South Asia	60	746	207	289	300	50	4,256	16
Total	3,519	1,195	3,337	1,203	591	398	26,252	100
Agriculture	–	–	–	–	2	–	369	1
Telecommunications	131	45	109	–	149	178	1,941	7
Education	–	–	–	–	–	–	6	0
Financial	–	75	–	–	–	–	284	1
Energy	–	888	7	7	47	170	2,799	11
Population, health and nutrition	–	–	–	–	–	–	8	0
Industrial development finance	48	–	–	–	–	–	1,685	6
Mining and other extractive	–	–	–	–	–	–	938	4
Power	3,205	187	2,048	1,186	392	50	14,652	56
Tourism	–	–	–	–	–	–	10	0
Transportation	100	–	–	10	–	–	2,119	8
Urban	–	–	–	–	–	–	14	0
Water supply and sanitation	34	–	1,174	–	–	–	427	5
Total	3,519	1,195	3,337	1,203	591	398	26,253	100

Note: These figures are based on the financing plans. Co-financing data are reported by the fiscal year in which the project is presented to the Board of the Bank. These figures include co-financing with Bank loans and credits and projects financed by Bank-managed trust funds. The number count in this table represent the number of projects.

It should be noted that the very large amount of co-financing provided under the untied loan facility of the Export Import Bank of Japan is now technically reported under bilateral co-financing and therefore is not included in export credit figures.

Source: World Bank.

are now an important complement to Bank loans. The increasing trend toward private financing and expanded use of the Bank's guarantee is creating a closer interaction between the Bank and ECAs. We view ECAs as risk-sharers with the Bank in projects like Hub Power and Uch Power in Pakistan and Jorf Lasfar in Morocco.

We have observed four trends in recent years. First, term export credits are increasing. The IMF estimates that ECAs account for more than 20% of the total indebtedness both of developing countries and of countries in transition. Second, ECAs are refining their systems of country risk assessment and beginning to use market-related pricing. Third, ECAs are keen to improve the quality of risk portfolios and are therefore seeking risk-reduction and diversification techniques. Fourth, ECAs are placing increasing emphasis on providing cover for exports to the private sector. The increasing trend in privatisation, particularly in infrastructure, is contributing to this change. There is therefore increased scope for co-financing with ECAs in public and private projects.

Bank participation in a project can provide ECAs with the information they require on the country and sector involved, as well as the analysis they will find necessary to promote specific business opportunities. The resource mobilisation and co-financing (RMC) services of the Bank assist ECAs and regions in identifying appropriate opportunities for export credit co-financing in Bank projects and in structuring particular export credit arrangements. By promoting close working relationships between ECAs and the Bank, RMC serves as a focal point for the exchange of information on policies, projects and the terms of business of ECAs. The events of the past quarter-century have shown that co-financing is not merely a question of resources; it also involves the creation of an atmosphere of partnership within which the international community can work to achieve results.

As part of its new stress on partnerships with both official and private-sector actors, the Bank is expanding its relations with ECAs. We pursue an active, continuous dialogue with ECAs on a bilateral basis through transactions and through annual consultations. Periodically, we bring together ECAs from developed and developing countries to identify issues of mutual concern, exchange information on mutual policies and priorities and explore ways of expanding co-operation. The Bank has also an active relationship with the Berne Union through exchange of information on the prospects of individual countries and through periodic discussions on co-financing issues. In all these aspects the Arrangement on Guidelines for Officially Supported Export Credits has been an important instrument in setting standards that have facilitated co-financing with the Bank in the past. The export credit Arrangement will continue to be important in the future as consensus-building is expanded to a wider group of participants and observers sharing the standards it sets.

A Consensus for Change

Noreen Doyle

To help bring about market reforms in its countries of operations the European Bank for Reconstruction and Development (EBRD) makes use of a range of financing tools and works closely with co-financing organisations, including export credit agencies (ECAs). The Bank is eager to develop these partnerships and has increasingly appreciated the importance of the Arrangement on Guidelines for Officially Supported Export Credits in achieving this aim.

The Role of the EBRD

The EBRD was set up in 1991 to foster the transition towards market-oriented economics and to promote private enterprise in the countries of central and eastern Europe and the former Soviet Union. The EBRD currently operates in 26 countries¹ and has 60 shareholders made up of 58 countries (including the 26 countries of operations) as well as two institutional shareholders: the European Community and the European Investment Bank.

Financing from the EBRD is tailored to specific projects and is guided by a number of operating principles, which include:

- transition impact – every project must contribute to advancing the transition towards a market-oriented economy;
- “additionality” – the EBRD must not displace other sources of financing which might otherwise be available on reasonable terms;
- sound banking principles – all projects must be commercially viable transactions;
- environment – the operations of the EBRD are guided by the criteria of environmentally sound and sustainable development.

Article 12 of the Agreement establishing the EBRD stipulates that no more than 40% of the operations of the Bank may be within the public sector. They are defined as operations channelled directly at the state or those which are guaranteed by the state. All other operations are considered private.

Although the operating principles of the Bank apply to all activities, regardless of their sovereign or non-sovereign status, there are a number of important distinctions between public- and private-sector projects. For example, the EBRD can finance only 35% of private-sector operations whereas it can finance 100% of a public-sector project. This policy is established for two reasons: portfolio risk management and mobilisation of external funds.



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Development
(EBRD), London.*

1. Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, FYR Macedonia, Georgia, Hungary, Kyrgyzstan, Latvia, Lithuania, Moldova, Poland, Romania, Russian Federation, Slovak Republic, Slovenia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

Another distinction is that all sovereign operations are subject to the EBRD procurement rules, which means that contracts which are awarded under a Bank-financed sovereign operation are subject to international competitive bidding. In addition, although sovereign operations are priced at a uniform margin, the Bank charges a return commensurate with risk for private-sector transactions.

As of the end of the third quarter of 1997, the commitments of the EBRD since its inauguration in 1991 were ECU 9.4 billion, with gross disbursements of ECU 5.1 billion, of which approximately ECU 1.1 billion has been repaid. Roughly three-quarters of these commitments have been made to private-sector projects.

Co-financing

A prime objective for the EBRD, as stated in its founding Agreement, is “to mobilise domestic and foreign capital” in its countries of operations. To this end, the EBRD works with a variety of different types of co-financing institutions, including commercial banks, official agencies, institutional investors, ECAs and other international financial institutions. Each of these has its own set of objectives, criteria and methodologies for doing business, and the EBRD must understand these differences in order to work effectively with its partners. Specific financing arrangements are established by the EBRD to mobilise effectively those sources where applicable.

The ability of the EBRD to generate co-financing is constrained by the willingness of its potential partners to accept market risk, but there are also more subtle constraints on the Bank's activities in this area. The objectives of the EBRD must be congruent with those of the co-financing partner in order to be successful. Although this statement may seem self-evident, there are many instances of potential co-financing where the differences in objectives may prevent the successful co-financing of a project. Additionally, the Bank is accountable to its clients and cannot require a client to accept a co-financing partner which the client may not want.

ECAs have their own ways of fulfilling their mandate which, most broadly defined, is to support the export-related activities of companies from their respective countries. And within that broad mandate there is a wide variety of methods. It is therefore important for the Bank not only to understand how ECAs operate as a group but also how each individual ECA does business.

For each type of co-financing partner, the EBRD has a variety of financial tools. At the same time, the Bank is continually developing new forms of financing and improving existing tools in order to broaden the range of projects which can be co-financed as well as to make the process of co-financing more efficient. An example is the Export Credit Loan Arrangement Technique (ECLAT), which is a means of arranging ECA co-financing for selected public-sector contracts which are to be submitted for international competitive bidding. The EBRD introduced ECLAT several years ago and is making considerable efforts to develop it into a practical and useful co-financing product.

ECLAT permits the use of funds made available by, or with the support of, ECAs in combination with Bank funds to finance selected contracts. It allows open procurement opportunities, encouraging a wider range of bidders than is ordinarily the case under conventional parallel financing. It also streamlines

administration. ECLAT provides for the Bank to conclude a loan agreement with a borrower and at the same time establish a framework, including pre-negotiated loan documentation, for ECA or ECA-backed commercial bank loans to finance, jointly with the Bank, specified ECLAT contracts within a project, following open, international procurement.

The EBRD has recently concluded its first successful ECLAT co-financing the COFACE-supported financing by Société Générale of a turbine rehabilitation contract for the Daugava Hydropower Project in Latvia. It has taken considerable effort and patience to achieve this milestone but the experiences gained from this project and the lessons learned from the remaining projects in the ECLAT pipeline will ensure that ECLAT becomes an effective tool, where appropriate, for mobilising ECA co-financing.

To date, the EBRD has been moderately successful in mobilising ECA co-financing for private-sector projects. As at mid-1997, the Bank had mobilised in excess of ECU 500 million from twelve ECAs. The EBRD has, for projects which the EBRD finances, established co-financing with ECAs as an institutional priority. The Bank will continue to make a considerable effort to find co-financing opportunities with ECAs and ways to improve the mechanisms of ECA co-financing.

The EBRD and the Export Credit Arrangement

The export credit Arrangement has always been highly regarded by the EBRD. In the early stages of the Bank's development, the implications of the Arrangement were not fully explored, but as ECA co-financing has grown in importance, the Bank has increasingly focused its attention on the Arrangement and thus came to see its relevance to the EBRD. We realise the importance of understanding the nature of the Arrangement, and the way in which it is interpreted by those who have agreed to participate in it.

As an institution which invests primarily in specific projects, the EBRD provides limited-recourse project financing. For example, a private-sector project would typically comprise the financing of a greenfield joint-venture with an international sponsor and a sponsor from within our countries of operations. The size of the project would most likely be between US\$20 million and \$30 million. The project would be in the industrial sector and would have, on average, a one- to two-year construction period and a four- to five-year repayment period. There would be limited recourse to the sponsors during the pre-completion stage and no recourse post-completion.

A typical public-sector project for the EBRD would be a US\$100-200 million investment in a state-owned power company or railway, for, say, for the modernisation of the capital infrastructure of the entity. As a public-sector transaction, all contracts for services and equipment would go out to international tender. There would be on average a two- to three-year completion period and a twelve- to thirteen-year repayment period. The project financing would benefit from a sovereign guarantee and the loan would be subject to some degree of conditionality.

As the Arrangement applies to "export credits with a repayment term of two years or more relating to contracts for sales of goods/and or services", it would have an impact on the ability of an ECA to participate in the financing of such

projects. The “starting point of credit” and its implications on the “payment of principal” the “maximum repayment terms”, the “minimum interest rates” and the “prior and prompt notification” requirements have served either to reduce the range of Bank projects which can be co-financed with ECAs or to reduce the willingness of project sponsors to multi-source transactions.

It is only when the mandate of the ECA, the rules of the Arrangement and the nature of a specific Bank transaction converge that a successful EBRD-ECA co-financing arrangement becomes possible. In view of these requirements, the breadth of EBRD-ECA co-financing is a considerable achievement.

At the same time that the EBRD was beginning to recognise the importance to it of the Arrangement, ECAs began to consider the growing importance of the limited-recourse project-financing structure. ECAs started to note that the same constraints which limited the ability of the EBRD to co-finance with ECAs had equally constrained their ability to provide the type of financial product which their clients were beginning to demand more and more frequently.

It is at that time that the OECD Group on Export Credits and Credit Guarantees (ECG) began to review the issue of project financing. In turn, the EBRD began to explore ways in which both to increase its awareness of the Arrangement as well as to seek to influence the direction of the discussions within the ECG on project financing. The Bank sought a role in the ECG during its deliberations on project financing and was invited to attend, as an ad-hoc observer, on their deliberations on the issue.

The EBRD has sought, and will continue to seek, to encourage the Participants to reduce and eliminate the obstacles to increased ECA co-financing, but it also recognises and is very sympathetic to the concern of Participants that the hard-fought discipline instilled by the Arrangement must not be weakened by any proposed project financing flexibility.

In the short period of time that the EBRD has been in existence, the Bank has come to recognise the significance and importance of the Arrangement. With a very specific mandate to introduce new groups of co-financiers to the Bank's countries of operations, it is critically important that the EBRD understand and appreciate this international accord which is so influential over such an important group of institutions.

It is equally important that the Arrangement, which is the result of considerable effort on the part of the Participants, is not allowed to become irrelevant – nor should it render ECAs irrelevant – by ignoring the world in which it is to be applied.

The world of international trade and investment is changing rapidly. The financing structures and techniques that are being brought to bear have become increasing complex and sophisticated, and the lines between the different types of financing have become blurred and obscured. The challenge facing the Participants would be to balance the unquestionable importance of change with the threat of losing what it has taken so long to achieve. It will not be a simple task, but its necessity is indisputable.

The EBRD welcomes the opportunity to work alongside the Participants to maintain the relevance and applicability of the Arrangement, and is confident

that the direction in which the Participants are taking the Arrangement is appropriate for the international business environment today and will serve the interests of both their clients and their governing authorities.

The Balance between Discipline and Effectiveness

Malcolm Stephens

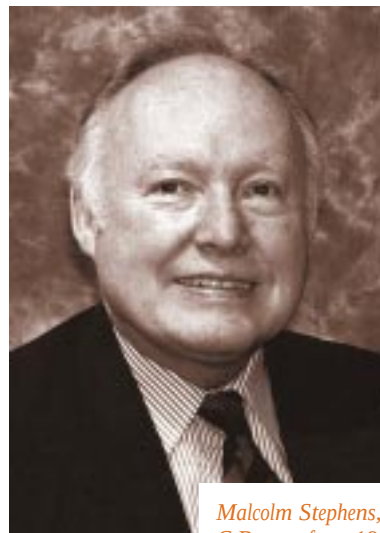
Competition, like apple pie and motherhood, is something one rarely hears opposed these days, even if it is best enjoyed when experienced by others. Yet the Arrangement on Guidelines for Officially Supported Export Credits has restricted competition, deliberately and consciously so, as have some of the Rules and Understandings of the Berne Union.¹ The basic rationale of both institutions has been to restrict competition between governments so as to encourage competition between exporters.

I first came across this concept of restricting competition in 1973 when I was Head of the General Policy Division of the Export Credits Guarantee Department (ECGD) of the United Kingdom. One day we received a telex – in those far-off days the swiftest form of communication – from Bob Fell, then the Head of ECGD. He had been meeting some of his opposite numbers in the major OECD exporting countries, and his telex contained the seeds of the idea of an informal “agreement” on length of credit and minimum interest rates.

This idea was initially greeted with some degree of suspicion and even hostility. I imagine it received the same kind of reception in the other capital cities and suspect that exporters and banks must have been similarly cautious – perhaps a reflection of a tendency common in most individuals and groups: that nothing is easier to spend than someone else’s money.

There was nonetheless an early recognition that this kind of multilateral approach had a good deal to commend it and that developments of this sort could help to curtail the risk of one of the political ogres of the time, an export credit subsidy war. The idea that having common agreed terms amongst credit insurers was a desirable thing had of course already been accepted and formalised in the cat’s cradle of Berne Union Understandings, both on credit terms generally and, more specifically, for particular goods and sectors.

The initial terms of the export credit Arrangement, of course, left a lot to be desired. There were uniform interest rates for all currencies and the arrangements for change meant that, inevitably, trying to “track” market rates was a thankless task: it took so long to reach a consensus decision that, by the time one was taken, market rates had gone in the opposite direction. But, in the two decades since those early days, progress has been considerable, producing an agreement which is much more sophisticated and wider-ranging.



Malcolm Stephens, C.B., was from 1992 to 1998 Secretary-General of the International Union of Credit and Investment Insurers (the “Berne Union”), London.

1. The “Berne Union” has 46 members from 38 countries. The Secretariat is in London.

The most important basic feature of the Arrangement is the inherent recognition that actions of this sort are better undertaken on a multilateral basis rather than through unilateral steps. The multilateral approach means not only that arrangements are much more likely to stick but also that the competitive position of exporters and banks is protected to the extent that the credit terms they receive from their export credit agency (ECA) are no worse than those received by their competitors in other countries. This even-handedness is vital if the exporting and banking communities are to be convinced of the validity of the undertaking, an important consideration if one is to avoid creating the impression that the entire exercise is being driven by finance ministries.

Although the argument that competition will benefit from the restrictions imposed by international agreements which prevent ECAs from offering terms they might otherwise have underwritten may appear perverse, on reflection it appears clear that this kind of discipline does indeed increase competition elsewhere and in areas which are probably more beneficial to buyers and borrowers – on, for example, price, quality, rapidity of delivery, and so on. And it is now generally recognised that the blanket subsidisation of interest rates hardly represents value for money for the taxpayers of the country providing the exports and offering the credit, even if this argument is based on the value-judgement that competition is best conducted between people selling the goods rather than between governments trying to encourage exports. And these considerations, of course, go far wider than the question of the terms and conditions on which exports on more than two years' credit are sold.

Why Export Credit Agencies?

Over the last few years I have spent an increasing amount of time advising governments and helping to set up export credit agencies (ECAs) in a wide range of countries. I have always been careful to point out that there are both good and bad reasons for having an ECA. Among the bad reasons are:

Encouraging Exports to Bad Payers

It is helpful neither to exporters nor banks – nor, indeed, to the exporting countries themselves – to stimulate, encourage or support exports to countries or buyers who will not pay for them.

Subsidising Medium- and Long-term Credit to Overseas Buyers

It is expensive and wasteful to use medium- and long-term export credit as a way of subsidising the interest rates paid by overseas buyers. The beneficiary of the subsidy is, of course, the overseas buyer; and the OECD countries have learned the hard way how expensive and distorting and wasteful of public expenditure these blanket subsidies can be. Although they are now being phased-out, like all subsidies they are much easier to introduce than to withdraw.

Subsidising Working Capital

It is not necessary to establish an ECA in order to provide bank finance to exporters in the manufacturing or pre-shipment stage, especially if such finance is provided at subsidised rates of interest. In any event, providing this kind of

“overdraft” finance is a normal commercial bank function. Banks are led into bad habits if the government involves itself in these day-to-day commercial banking decisions; it is also very expensive for governments, which are normally left with all the bad debts. There can be a role here for an ECA but it should best be a temporary one of providing partial security (not subsidy) to commercial banks to encourage them to provide working capital.

As a Decoration or Status Symbol

ECAs should be working organisations: they do not serve useful purposes if they are merely status symbols or provide some sort of administrative decoration.

As Substitutes for an Aid Programme

ECAs should be involved in providing commercial credit, not aid.

Beginning a Credit War

ECAs should support credit terms which are internationally competitive – not try to offer longer or cheaper or softer credit so as to “sell credit” rather than goods and services. A policy of this sort would be very expensive and, ultimately, self-defeating.

Subsidy/Propping-up Inefficient Domestic Industry

The same points apply as for the subsidy of working capital and for the supply of aid credits.

Introducing/Re-introducing Government as Guarantor of Exporters

Re-introducing government as the guarantor of the performance and financial strength of new or old companies and banks risks governments and taxpayers ending up with the worst of all worlds – taking risks without the benefit of sharing profits.

Making Exporters Uncompetitive

Although it is obviously no part of their initial design, ECAs can make exporters uncompetitive if they support – and thus institutionalise – bad or uncompetitive habits or distortions (where, for example, exporters ask their overseas buyers for 100% cash with order). Competitor exporters in other countries will not do this.

Fortunately, there are also a number of good reasons for establishing and maintaining an ECA. These include the cover of the two main categories of risks: political risks and commercial risks

Political Risks

The main kinds of political risks are those that occur when governments in buying/importing countries prevent payments being made for exports. There can, for example, be problems in transferring foreign currency, the imposition of import controls, war (including civil war), defaults by government or public-sector buyers/guarantors.

Commercial Risks

The main commercial risks arise from the insolvency of buyers, default or repudiation/refusal to accept goods/services. It is a common – and very expensive – mistake to believe that it is only political risks which give rise to problems and losses and thus that exports to OECD countries are “safe”. Most of the members of the Berne Union pay substantial commercial risk claims every year – especially during recessions – in the United States and European Union countries, a fact which reflects the large number of private companies in OECD countries which every year become insolvent or default on payments.

Protection against Risks

The traditional, and still the major, reasons for having an ECA are, first, to provide exporters with the confidence to export (that is, the confidence that they will be paid) and, second, to protect them against losses. For new or smaller companies, one bad debt can be large enough to bring about insolvency. ECAs can remove some of the most important impediments to exporting by removing or solving some of the major risks, which then allows exporters to concentrate on producing, marketing and selling.

Access to Bank Finance

Export credit insurance provides an effective security for exporters to offer their banks so they can obtain loans. Moreover, to provide even stronger security to a bank, the insurance cover can be provided direct to the financing bank by the ECA. This is a very important point in most countries but especially in countries where the banking system is undergoing substantial change or where new banks may be unfamiliar with the mechanisms and techniques of the financing of foreign trade.

Information

Information on overseas buyers and countries is expensive to obtain and keep up to date. It is not, therefore, cost effective for all exporters (or banks) to try to obtain this knowledge for themselves. Worse still is when they sell (or finance) “blind”, with no information. An ECA can offer the possibility of a single, central body collecting and maintaining information (and exchanging it with similar bodies overseas), thus obtaining economies of scale to the potential benefit of all those in the country involved with foreign trade.

Expertise

Like information, expertise in technical aspects of foreign trade and trade financing is scarce and expensive. An ECA can provide a focal point within which to concentrate these scarce resources (and a cost effective way of obtaining and developing them).

Training

An ECA can “train” exporters and banks in various facets of export and trade financing practice and by demonstrating the risks, both commercial and political, involved in exporting – even to OECD countries.

Government Policy

An ECA can provide a very flexible instrument for governments in areas of trade and financial and commercial policies.

International Competition

An ECA means that exporters can offer facilities which are internationally competitive with those being offered by exporters in other countries – including those in OECD countries. It can also help with co-operation with exporters in other countries in, for example, multi-sourcing and sub-contracting.

The main conclusion I draw from the above is that the export credit Arrangement has been a very useful development and that the progress which has been made has been not only real but also valuable. My hope, however, is that those who will be responsible for it in the future do not try to overgild this particular lily by adding more and more conditions and embracing an ever-larger number of issues and areas. The risk is of producing some kind of Frankenstein monster which will act as a disincentive to anyone wanting to take a medium- or long-term credit facility from an ECA unless all else has failed – thus forcing the ECAs to become in practice the insurers of last resort.

Chapter 5

Private Sector Perspectives

A View from the Export Market

Julien de Wilde

As a supplier of telecommunications infrastructure and services with a limited home market, Alcatel Bell (the Belgian subsidiary of Alcatel) has always relied on international markets to support our growth. Approximately 60% of our sales are achieved in these markets, in particular in countries that are not members of the OECD. The availability of credit insurance has always played an important role in our ability to do business in these markets, which often entail risks that we suppliers cannot assume on our own.

Since we are a subsidiary of an international group, we participate in multi-sourced contracts, which entails lining up the terms and conditions of different export credit agencies – a process that is essential if we are to offer a complete financing solution to our customers. Much work has already been done, but setting transparent common principles on premiums is an issue that still has to be resolved.

To a certain extent, governments consider export policy as part of their foreign policy and so are reluctant to abandon their oversight of this area. Over the years the Participants to the Arrangement on Guidelines for Officially Supported Export Credits have concluded agreements to phase-out subsidies and to put in place new guidelines for aid financing. The *Ex Ante* Guidance for Tied Aid recognises that each project should be considered on an individual basis and makes recommendations for each project area; telecommunications, by contrast, remains a contested one. The question of tied and untied aid is a delicate one, in any event, and debate on how “untied” aid really is will probably go on for some time.

The export credit Arrangement has significantly helped to level the playing field, but financing has always been and will increasingly be a major factor in a buyer's decision to award a contract. This means that suppliers will continue to enhance the attractiveness of their offers by including a financing package, especially in such highly competitive markets as telecommunications. Moreover, Alcatel Bell sometimes competes with suppliers from countries that are not Participants to the Arrangement and whose financing packages can therefore be quite aggressive.

Two Important Considerations for Suppliers

As a supplier, Alcatel Bell would like to highlight two specific issues of particular importance to us and which we hope will be addressed by the Participants to the



*Julien de Wilde is
President and Chief
Executive Officer of
Alcatel Bell, Brussels.*

Arrangement in the future: project finance, and the maintenance of the Commercial Interest Reference Rate (CIRR) system of the Arrangement.

Our customer base, like that in other industries, has changed substantially over the past few years. We have generally worked with the public operator in a given country, generally with a monopoly in the supply of telecommunications services that entails mainly a sovereign risk. With privatisation of state-owned telecommunication operators and the liberalisation of the telecommunications market, many new players have arrived. Furthermore, technology and the role of the supplier have changed: the customer now expects a complete package from us – supplying network infrastructure (or goods) is now only one part of a large contract. Project finance plays a pre-eminent role, and even incumbent public operators are interested in revenue-sharing schemes or BOT (Build Own Transfer) structures. The current Arrangement rules are very strict as to the starting-point of financing, repayments profiles and the maximum repayment period. In view of the growing importance of these projects, our hope is that the Arrangement guidelines will allow for more flexible repayment in the future, allowing us to propose a financial package that is tailored to the cash flow expected from the underlying project. In this respect, we welcome the current deliberations by the Participants to the Arrangement to introduce more flexible terms for project finance transactions.

Although the existence of the CIRR is now being questioned by some Participants to the Arrangement, exporters have to be able to continue to offer customers a financial package with a fixed interest rate in a currency that is different from that of their home market. Although financial markets offer fixed interest rate products over a relatively long period, the products do not always coincide with the specific requirements of export finance. Nor do our customers always have access to these products in their own country. As a result, they ask suppliers to offer financing at a fixed interest rate starting with the contract signature or credit arrangements. This is very difficult to set up and, when it is possible, it is very expensive in the case of an export credit since the exact draw-down dates may not be known (depending on the implementation dates of the project) and the many draw-downs may extend over a relatively long period, and because of the repayment profile of the credit.

We therefore believe that for many customers our ability to offer a fixed interest rate in the form of a CIRR is very important since it allows them to manage repayment obligations with more security than if a floating rate were to be involved. We hope that the Participants will examine this matter closely before making any changes to the existing system of stabilisation, particularly as it does not necessarily result in a subsidy if it is managed globally by the authorities involved.

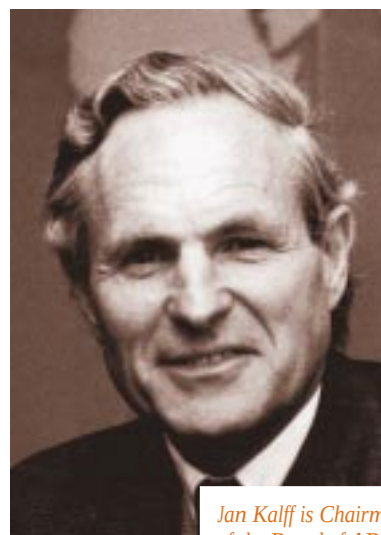
Over the years, many steps have been taken by the Participants to the Arrangement to level the playing field. It is the hope of Alcatel Bell that, in a fast-changing industrial and financial environment, the OECD countries will continue to develop the Arrangement in order to allow competitive and, above all, flexible financing packages for our exporting industries.

An International Banker's View: Important Developments and the Challenges and Opportunities They Bring

Jan Kalff

As chairman of ABN AMRO I am both honoured and pleased to contribute to the celebration of the twentieth anniversary of the Arrangement on Guidelines for Officially Supported Export Credits by sharing some thoughts about it from an international banker's point of view.

Looking back at the past twenty years one can only conclude that the export credit Arrangement – the purpose of which is to create a level playing field for OECD exporters and to prevent a credit subsidy race between OECD governments – has been very successful. I would like to share some ideas and thoughts about how we at ABN AMRO perceive certain trends and developments in international trade and investment which will have an influence on the present and future activities of international banks, exporters, importers, multilateral development banks (MDBs), export credit agencies (ECAs) and the OECD governments behind the ECAs. I shall therefore focus mainly on these developments and the implicit opportunities and challenges for all parties concerned.



Jan Kalff is Chairman of the Board of ABN AMRO NV, Amsterdam.

Four Important International Trends

Liberalisation of economies and globalisation

The clear trend of economic liberalisation is leading to globalisation and a more integrated world economy where national borders are disappearing and trade and investment flows – and consequently also flows of money and capital – are free to move from one country to another. This trend appears clearly when one makes a comparison of the volume and pattern of trade flows between OECD high-income countries and low- and middle-income countries in 1985 and 1995 (Table 1).

From a development point of view the substantial increase of exports of manufactured goods from low- and middle-income countries (525%) is interesting since this type of export has an important positive impact for the developing countries, in particular on local job-creation and economic growth.

Table 1**Trade between OECD High-income Countries
and Low- and Middle-income Countries**

	Exports from OECD to LMI countries			Exports from LMI to OECD countries		
	1985 US\$ billion	1995 US\$ billion	% change	1985 US\$ billion	1995 US\$ billion	% change
Food	27.5	60	218	47.8	89.6	187
Agricultural raw materials	6.9	16.6	241	12.2	26.1	214
Ores and non-ferrous metals	5.6	14.1	252	19.2	43.8	228
Fuels	6.6	11.8	179	136	128.6	95
Manufactured goods	194.7	559.7	287	84.9	445.4	525
Miscellaneous goods	4.6	18.2	396	2.8	11.3	404
Total	245.9	680.4	277	302.9	744.8	246

Source: World Bank.

Trade instead of aid:***The increase of private capital flows to developing countries***

The liberalisation of economies and globalisation appears also when one looks at the development of net capital flows to developing countries (Figure 1). According to the World Bank, these flows have increased from US\$100 billion in 1990 to \$284 billion in 1996, an increase of more than 280%.

Figure 1 shows clearly that official development finance has decreased during the past six years, whereas private finance has increased substantially. In 1990 official finance was the main source of external finance for developing countries; in 1996 it was the private sector. It is very likely that the international trend of liberalisation and globalisation will persist. It can therefore be expected that, despite the currency crises in Latin America (1994) and Asia (1997), private-sector finance to developing countries will increase further in the future. Finance on market terms has become much more important than aid.

A breakdown of private capital flows into different types of private financing shows that direct investments and portfolio investments play an important role in financing the capital requirements of developing countries (Figure 2). This, too, has a large extent to do with the increase of project financing in developing countries. The substantial growth of direct investments is also a indication for the degree of integration of the developing countries into the world economy. For these investments are of a strategic nature: they lead to a long-term business relationship between the investor and the host country and result in an increase of local production and trade flows with the country.

Retreat of the public sector and privatisation

This trend is fed by a strong belief that economic growth and increase of welfare depends considerably on the development of the private sector in a country. The earlier belief that central government should play a dominant and steering role in achieving economic growth (with state-controlled companies playing an important role) has nowadays given way to the realisation by a large majority of

governments – both in the developed and the developing world – that the main task of a government is to set the right conditions for an attractive investment and business climate.

The view that the private sector is vital for economic growth is clearly derived from the fact that, operating in an open and competitive environment, it is in general much more efficient than the public sector or subsidised, state-owned companies, many of which have therefore been privatised. It also the reason for the explosive growth of project financing in developing countries, particularly for infrastructure, such as oil and gas, power, telecommunications and transport. Infrastructure was traditionally the domain of the public sector, but that, too, has changed significantly. In 1986 about 7.4% of infrastructure financing in developing markets was lent to private borrowers. In 1995 this figure had increased to 70% (Table 2).

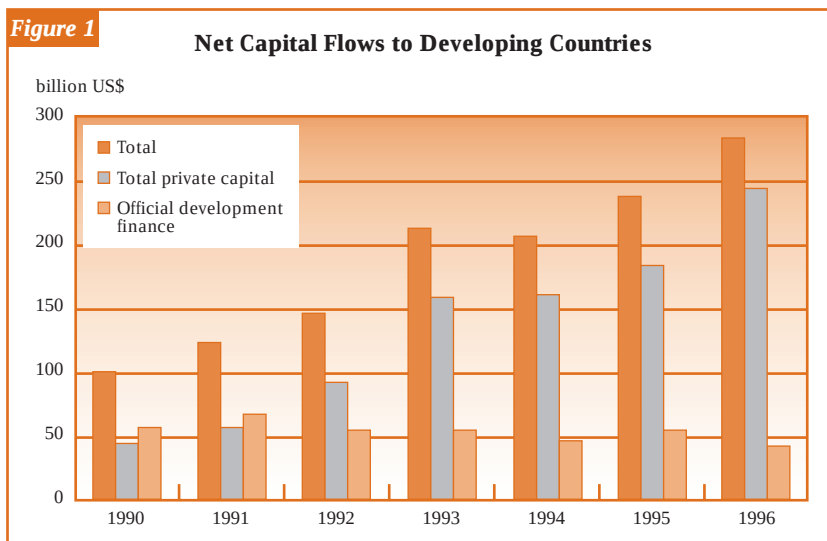
There is a clear link between the degree of integration of a country into the world economy and its economic development. In fact, openness to external trade and investment is often the necessary first step to solid, sustainable economic development.

Integration of financial (export credit) and capital markets

The increase in private capital flows to developing countries would not have been possible without the direct involvement of the international capital market. Only six years ago the main source of private finance to the developing world consisted of commercial bank loans. Although this type of finance has doubled – from US\$ 4 billion in 1990 to \$28 billion – in six years, financing through the equity and bond markets has grown much more substantially, from \$5 billion in 1990 to \$61 billion in 1996.

The integration of the export credit market with the capital market appears, in particular for project financing, where for the construction and exploitation of a project by a special purpose company (SPC) a combination of different types of financing (equity, bond and bank loans) is being made available.

In the United States in particular there is a clear appetite for investments in developing countries. This has not only to do with the liquidity and depth of the US capital market, but also with the competitive pressure on US investors to earn higher margins on their investments. Furthermore, credit rating of (for example) project bonds is generally perceived as being an objective and sound instrument for measuring and pricing the relevant investment risks. It is interesting to note

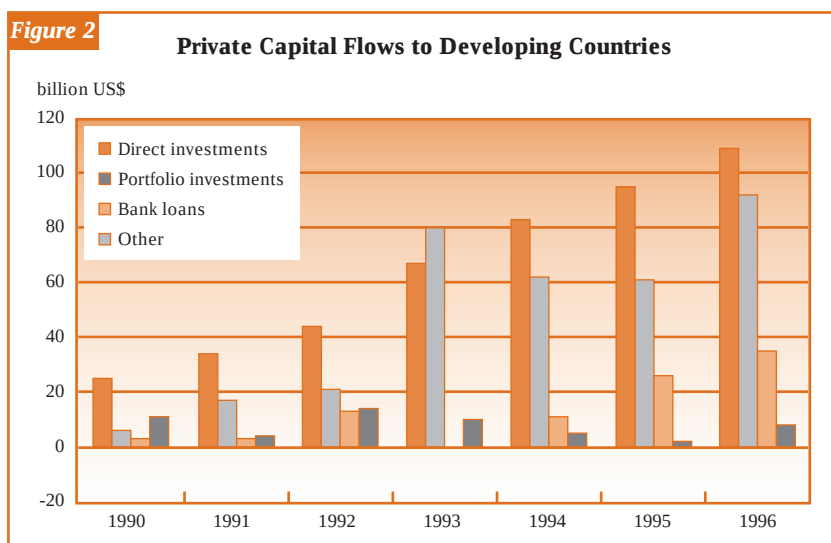


Source: World Bank.

that certain projects, depending on the structure of the financial package and its securities, can have a better rating than the sovereign rating of the country in which the project is located. This is particularly relevant for projects which generate hard foreign currency. These foreign-currency earnings can be placed on an escrow account, which mitigates the credit risks and provides more comfort to both lenders and investors.

Within ABN AMRO we expect that credit ratings will become more important for the European financial and capital markets, a trend that is being stimulated by the following four factors:

- the introduction of the EURO, which will broaden and deepen the European capital market;
- the reduced financial requirements of European governments, which diminishes the investment opportunities of European investors;
- the increasing pressure on European investors to realise higher profits;
- the substantial demand for capital in eastern Europe – it is estimated that eastern Europe for the next five to seven years requires approximately US\$100 billion to finance its infrastructure investments; it is expected that a substantial part of the demand from eastern Europe will be financed by means of project bonds.



Source: World Bank.

International banks – often in close co-operation with ECAs and MDBs like the International Bank for Reconstruction and Development (IBRD), the Multilateral Investment Guarantee Agency (MIGA) and the Asian Development Bank (ADB) – play a vital role in financing trade and investments to and from developing countries. Commercial banks are the centres of expertise for different kind of financial services and their activities follow changes in trade and investment flows. Their main objective is to facilitate these

flows and this is done, of course, on a commercial basis. Since the flows of trade and investment to and from developing countries have increased substantially during the past ten years and are likely to increase further in the near future, many banks have expanded and invested substantially in setting up new offices in developing countries. ABN AMRO, for example, is represented today in more than 70 countries. Internationally it is one of the leading banks which is active in almost every country of the world; a network bank in an environment where national borders are disappearing.

These four main trends clearly show that in the area of trade and investment finance, many important changes have occurred. The world has become smaller, but also more complex and the financial challenges and opportunities for all parties involved – banks, ECAs, importers and exporters – are enormous.

Challenges and Opportunities for ECAs and their Governments

Multi-sourcing and the co-operation between ECAs and banks

The integration of the economies has led to a substantial growth of multi-sourced transactions, where the buyer in an importing country obtains its goods from different exporting countries. For banks, exporters, importers and ECAs this implies a substantial amount of work. To obtain adequate cover, negotiations have to be held with all ECAs involved. Different application forms have to be filled in, various underwriting criteria have to be met, diverse conditions of cover have to be taken into account and each ECA charges its own premium. A lot of time, and thus money, could be saved if the ECAs co-operated more closely with one another.

Standardisation of policies and premium fees would be very helpful to all parties concerned. A first and very important step has been made last year when the Participants to the Arrangement reached an agreement about minimum premium fees for political credit risks – the “Knaepen Package” – but there are still substantial differences in the working procedures and policies of ECAs. Co-operation between ECAs on the basis of (for example) mutual re-insurance agreements would allow one ECA to provide cover for the whole (multi-sourced) transaction. Some ECAs have already made some progress in this area, but there is still room for improvement.

Table 2

Infrastructure Financing Raised by Developing Countries by Type of Borrower

	1986 US\$ million	1986 % of total	1995 US\$ million	1995 % of total
Public	1,251	92.6	6,690	30
Private	100	7.4	15,607	70
Total	1,351	100	22,297	100

Source: World Bank.

Product development

We expect that the “Knaepen Package” on premium fees will lead to additional efforts by ECAs in product development. It is very likely that many ECAs will develop the different qualities of insurance/guarantee products as described in the Package. In this respect it is interesting to note that international banks tend to have more appetite for medium- and long-term commercial risks, arising from the fact that many banks operate locally in the developing markets. Through their foreign branches banks are able to assess the commercial risks more accurately and, if necessary, to arrange adequate securities from the private enterprise.

The appetite of banks for political risks, however, is much more limited, which has mainly to do with the nature of the risks and the limited spread of risks. It is also true that banks or exporters do not have any influence on the political risks, whereas they can have some influence on the credit risks of private buyers, since both parties have a commercial relationship with the importing buyer/borrower. Political risk cover is therefore more or less traditionally the domain of ECAs and their governments. Against this background we expect that the demand for political risk cover only will increase. Furthermore it is likely that more ECAs will develop 100% cover for political risks in isolation or in combination with a lower percentage of cover for the commercial risks.

Product development is also important because of the fading borders between export credit and capital markets. Project bonds will be used more often, which implies that investors will assume transfer and convertibility risks. Consequently comprehensive political-risk cover is not required in all project financing transactions. In certain transactions ECAs could simply provide cover for political risks such as war, expropriation and in particular breach of contract by a public entity (central or local government), which is involved in the project, either as supplier (for example, oil for a power plant) or as off-taker (for instance, electricity from the power plant). Some ECAs do provide breach of contract cover but most of them do so in combination with the cover for other political risks. This is generally referred to as the extended political risk cover.

Breach of contract cover is usually available only when a central government is involved, but it would be very useful if contract repudiation by a sub-sovereign entity could be covered. This would stimulate the development of local projects which are in general smaller in size, but nevertheless important for the economic development of a region (a local waste water treatment plant, say).

Another area which is interesting to ECAs is the credit enhancement of project bonds, in particular for projects which are not yet attractive enough for the capital market. By insuring clearly defined political risks a project could obtain an investment grade rating, which would allow the project to be financed in the capital market. Some ECAs and MDBs do already provide political-risk cover for project bonds, under their investment insurance schemes. It can be expected that the demand for investment insurance will increase given the growth of the international bond market. Since there are no detailed rules about official support by means of investment insurance (I leave aside the concept of long-term break-even financial results as defined by the GATT) and because the borders between trade and investment finance are fading, it cannot be excluded that at some stage OECD governments will have to discuss the potential distortion of competition in this area. The present OECD negotiations about a multilateral agreement on investments do not cover this issue.

More competition for ECAs

The growing importance of the capital markets implies also increasing competition for the ECAs. This competition is coming not only from the capital-market side but also from MDBs – many of them have developed specific guarantee facilities (for example, the partial-risk and partial-credit guarantee of the World Bank) – and private insurers, who are able to provide medium- and long-term political-risk cover. This development of increased competition will stimulate the performance of ECAs. In this respect it is worth mentioning that some private insurers are capable of processing an application for political-risk cover in only a few days. Most ECAs and MDBs require substantially more time. There is therefore a clear challenge for improving processing time.

It is likely that the competition between ECAs themselves will intensify as well. Because of increase of international co-operation among companies from different OECD countries, the ability of multinationals to “shop around”, the exchange of information between ECAs in the OECD and the development of international rules for credit risks, the products and policies of ECAs will become much more transparent. It is expected that increased competition will arise in particular in the areas of pricing buyer risks, the conditions of cover, processing time and

underwriting criteria. We may even see that more ECAs will implement a matching principle in their programmes.

More private buyer risks

Because of the retreat of the public sector, the privatisation of state-owned companies and the growth of project financing, ECAs will increasingly be exposed to commercial risks on private entities. This implies a more sophisticated and detailed credit analysis and is likely going to lead to a closer co-operation between banks and ECAs. Each party could help the other by sharing their experience with and their expertise about the private sector in a developing country.

Many ECAs have a rather rigid pricing system for private-buyer risks. It thus differs substantially from common market practices. There is room for the development of a more market-based pricing system of private-buyer risks.

Project financing and asset-based finance

As well as project financing, asset-based finance, such as lease and export sales secured by a mortgage, will become more important. Asset-based finance is already quite common in the exports of aircraft, ships and other movable assets. The general feature is that the legal title of the movable asset remains (indirectly) under the control of the financing bank. For certain transactions, however, the nature of the exported goods (that is, non-movable assets) does not allow an asset-based finance structure, but that does not imply that for these transactions asset securities cannot be obtained to mitigate the relevant buyer risks. For some countries it is possible to arrange a reliable security on existing assets of the importing company, such as a mortgage on a factory. It can be expected that this will become more important for future activities of ECAs, because they will be increasingly faced with private buyer risks.

The strict application of the rules of the Arrangement – in particular regarding grace period and repayment profile – is sometimes a constraint for project financing, which explains the requests for more flexibility. We understand that more flexibility on project financing might have a detrimental effect on the Arrangement disciplines in general and that for that reason ECAs and governments are reluctant to adjust the existing rules. One way out could be to allow flexibility only when an ECA limits its cover to political risks. In that case the private parties in a project (sponsors, banks, exporters, etc.) will have to bear the commercial risks. They will ensure that the repayment conditions (etc.) will not be detrimental to the project.

These are important trends and developments, which are relevant to both the private and public parties in international trade finance. These trends provide new, interesting challenges and opportunities for all parties concerned and will certainly have an influence on the unique public/private partnership between commercial banks and ECAs. ABN AMRO is looking forward to strengthening the existing relationships and co-operation with ECAs. Each sides can learn interesting things from the other. On behalf of ABN AMRO I would like to congratulate the OECD, the ECAs and their governments for the important achievements of the Arrangement during the past 20 years. I sincerely hope that the next 20 years will be as successful as the years now behind us.

Export Credit in Context

Paul Melly

There are times when one cannot help wondering whether export credit will still have a role in the twenty-first century. Competition rules get ever tighter, eroding the scope for subsidy, while the market becomes ever more adept at offering financing and insurance instruments to underpin major international contracts.

What will be left for the official export credit schemes, and thereby the Arrangement on Guidelines for Officially Supported Export Credits? Will they find themselves relegated to a life as last-resort supporters of politically motivated deals that defy all economic logic? Or can they remain crucial providers of confidence-building assistance in a world where – as East Asia has recently reminded us – “emerging markets” are often far less stable than business might like to think.

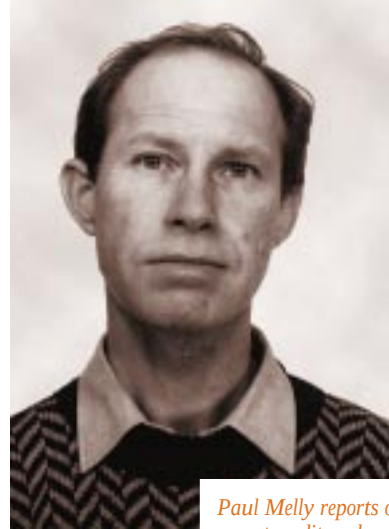
Perhaps the business groups which lobbied so fiercely over the shape of the new, harmonised export credit regime of the European Union are merely subsidy-junkies, reliant on over-generous governments to keep the river of contracts flowing. On the other hand, it may be that they are simply being realistic about the limitations of market capacity and confidence.

Either way, one thing has become clear from the fierce battles in Brussels over the past three years: both industry and the banks want export credit to stay. But it remains to be seen how far their feelings will cut ice with governments over the longer term.

Budgets are under strain, as the developed countries struggle to maintain tax revenues and wrestle with demands on domestic spending such as care for the growing number of elderly people. Support of export credit may no longer feature on the “A list” of priorities – and perhaps not even on the “B list”.

It may be, too, that export credit will become less dominant in transactions: instead of being the prime funding instrument for many big deals, it may come to fill a smaller role of confidence-building, as already happens when it is combined with Build Operate Transfer (BOT) private finance.

The recent crisis in East Asia may well have stimulated fresh demand for official export credit; exporters and banks have been reminded that even the most apparently dynamic and competitive economies can spring nasty surprises. Some BOT deals were put in question, and popular commercial market judgements



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about key Asian buyer-countries were shown up as complacent and over-optimistic. Precautionary cover from an official export credit agency (ECA) suddenly looks more attractive for companies that had been contemplating deals that were financed by purely private means.

Even so, one must bear in mind the extent to which the export financing scene has changed over the past fifteen years, since the international debt crisis broke in the early 1980s. The whole concept of private funding is now much more widely accepted than it was then. The Asian upheavals will not unwind that evolution, although they will doubtless force many people into some careful, and painful, rethinking.

The Impact of Flexibility

If export credit does gain renewed popularity, it will not take the form of a simple reversion to the pre-debt crisis scene of the 1970s and early 1980s. The range of funding structures on offer is more diverse – a fact of which both buyers and suppliers are aware; indeed, the present context is probably both more competitive and more rigorous.

Markets and techniques are more deeply integrated and more readily transferred from one field to another; trade-finance assets are even packaged up for sale to investors on US domestic capital markets. Private-market insurers have edged into insurance of long- and medium-term credit periods, if on a limited scale.

But more flexibility has also created an arena in which deals are subject to more intense scrutiny, in terms both of cost and risk, as buyers and bidders struggle to minimise the costs of financing. The entire financing structure of a project can sometimes be changed in mid-course, in order to secure a reduction in the funding burden, or to offload some risk on to new investors.

For exporters in the OECD countries, export credit can remain a vital part of the competitive arsenal; it may even become more important. But it will fulfil this role only if it remains relevant to the varied and highly competitive scene for project business today. The past fifteen years have brought massive changes, both in the economic context in which export credit is used, and more specifically, in financing techniques themselves.

In the early 1980s, development aid budgets were much larger; and export credit was overwhelmingly the main form of funding for those projects that were not fully aid-funded. Moreover, in risk terms there was relatively little focus on the operation of projects once they had been completed and handed over to the buyer – which was usually a national government or parastatal authority. The public sector played a central role in most economies in the developing world and it was therefore routine for projects to be underpinned by a sovereign guarantee. And supplies of smaller capital goods were frequently funded under credit lines extended to state banks in the buying countries.

This context was well suited to official ECAs in OECD exporting countries. They were acting as arms of government – or on behalf of government; and the key players in the buyer countries were also generally state agencies of some kind. This meant, of course, that for industry and banks back in the exporting states the

relationship with government was crucial, and often highly political. Issues of export credit and trade or aid were frequently the subject of public controversy, particularly when contracts for a prestige project, such as a bridge over the Bosphorus, were up for tender.

The major project-exporting companies, and the banks that funded the deals and designed the financing bids, had to work closely with the ECAs and with the trade ministries. Many governments took a directly interventionist line – pre-selecting exporters to support in bidding for particular projects and co-ordinating the efforts of business and banks with their own diplomatic lobbying.

Aid was frequently brought into play as a means of softening the cost of a project. Competition between exporting nations was intense, as each vied to provide the most attractive package of support for their preferred candidates for major project contracts.

Of course, this put the buyers in a strong position – a process that reached its apogee in South-East Asia in the mid-1980s, when governments began to specify in detail the terms of soft-loan offers that they would be prepared to consider. Western governments, anxious to ensure their exporters were not shut out of this vital growing market, had to reshape their own mixed credit schemes to suit the terms demanded by key buyer countries, such as Indonesia.

How the World Changed

The whole issue of project funding and export credit rose high on the business and political agenda in North America and Europe; it became the subject of bitter lobbying campaigns and government public-relations initiatives.

In Britain, in particular, there were heated debates over the extent to which all this government support was justified, with industry wielding sheaves of statistics on the number of jobs at stake among sub-contracting firms and component suppliers – while Treasury sceptics speculated aloud about leaving exporters to fend for themselves.

The doubters' most powerful argument was being provided by the first of the major upheavals which has come to shape the project-financing arena over the past decade-and-a-half: the international debt crisis.

As country after country was forced to fall on the mercy of western creditors, faith in the core principles that had underlain the growth of project exports and ECA activity was shaken to the core. For a start, the credibility of sovereign guarantees was deeply damaged. It became clear that countries really could “go bust”. For the exporting community, and ECAs, this was a heavy blow: they had to cope with the pain of rescheduling – and subsequently writing-off – massive exposures to markets such as Poland and Nigeria.

Provisioning and write-downs left gaping holes in ECA balance-sheets and sapped their ability or willingness to take on new business, both for those countries that had defaulted and others that appeared to be at risk of going the same way. The collapse of confidence in sovereign guarantees forced agencies to take a fresh look at their systems for assessing international risks and countries' ability to repay. It also led national finance ministries and treasuries to take a much tougher

line than previously, in extending government finance and guarantees in support of project bids in overseas markets. The concept of “national interest”, which had often appeared to carry a broad-brush, long-term meaning, came to be assessed in a much more rigorous or – in the eyes of aggrieved exporters deprived of support on target markets – “short-sighted” way.

For these exporting companies, times became particularly difficult from the mid-1980s onwards, as demand for basic heavy infrastructure in the rich oil states of the Gulf began to slow down (particularly once oil prices had weakened). Meanwhile, most African countries had slipped into a deep economic depression from which many were not even to begin to recover until the early 1990s.

The ECAs: Cautious and Constrained

These constraints on doing business overseas were coinciding with the new mood of caution at ECAs burned by the debt crisis. Even when agencies did begin to restore cover for debtor markets, the process was a slow one, as individual countries engaged in protracted negotiations with the Paris Club of official creditors. (Much, though far from all, debt to Club governments related to export credit business on which buyers had defaulted.) And some major economies, such as Brazil and Egypt, remained off-limits for some major agencies well into the 1990s.

For engineering firms and makers of capital goods, this has been a frustrating process: they have often felt that a country was well on the road back to financial credibility, and payment reliability, long before ECAs were willing to make the same judgement. Of course, that partly reflects the hopefulness that is fundamental to the mentality of businesses seeking to win orders in competitive foreign markets. After all, if they do not believe the opportunities are there, they are never going to stand much chance of winning business.

But the divergence of judgements also reflects the very fact that ECAs are government-owned, or acting on behalf of government and the taxpayer; they must therefore show a degree of even-handedness towards potential clients. They cannot easily be open for business on a particular foreign market unless they are open for all credible exporters who seek to do business there (on medium-term credit).

Indeed, many ECAs publish formal lists of the markets for which they are open, or even issue press releases to tell the business community when cover has been restored. Unlike private-market insurers, they cannot take a view purely on a single contract or company. For experienced exporters, with a strong track record and contacts in a country, this approach can make for frustration; the company may, justifiably, feel that its particular project is a good payment risk. But the ECA is, by its nature, bound to eschew favouritism. And sometimes that means staying off cover because a general restoration of business would not be justifiable, even if one or two individual deals look like good risks.

Yet, in spite of these constraints, there is no doubt that the range of business risks that agencies will support has widened substantially over the past few years – although recent problems in the Far East may induce a touch of caution towards Pacific Rim markets for the next few months.

The Market Emerges in the Emerging Economies

It is not only in terms of country risk that ECAs have had to become more flexible; they have also had to adapt to the increased role of the private sector in emerging economies – whether former communist markets in central and eastern Europe, or post-debt-crisis Third World states. Many key buyers and banks, which would have been state-owned a decade ago, are today private entities.

The very nature of exporting to emerging markets has evolved. Bilateral aid budgets – now at their lowest volumes for many years, in real terms – have become less important as a source of funding for capital projects. Traditional patterns of payment – where it is made by the public authorities in buying countries – have also shrunk in proportion.

Instead, much of the burden has been shifted on to the private sector. Construction and engineering exporters, who used to build infrastructure projects for buyer governments, have been forced to adapt; they have created partnerships with western utilities to develop projects in the emerging economies and operate them for lengthy concession periods, as private investments.

Sovereign guarantees of payment may not always come into play. And project developers may have to take different risks into account: how far, for example, can a government be relied upon to permit rises in power prices – to maintain real returns for investors, when exchange-rate shifts and inflation are taken into account? With an election looming, a political leader may well feel tempted to block the price adjustments necessary to ensure the continued commercial return for a private power investment.

ECAs have adjusted to the growing importance of privately financed – “Build Operate Transfer” – projects. They are frequently prepared to carry part of the risk. But that entails new thinking, because the nature of the risks has changed. Sovereign default may be less of a concern, and the influence of an IMF-supported liberal philosophy may have reduced the likelihood of exchange-control problems. But ECAs have had to learn how to assess the commercial viability of projects, rather than simply taking a view on the ability of the host country to guarantee reliable payment of the capital development cost. New political-risk issues – such as that of domestic power pricing or road tolls – are now central to the overall underwriting judgements.

Although they have been learning to work with private financiers and investors on the big infrastructure schemes, ECAs have also had to cope with changes in the shape of business that is partly aid-financed (on mixed credit terms). Aid was traditionally a means of softening finance terms and of enhancing political security. But a general desire to trim back interventionist government subsidy of trade – and questions over whether soft finance was always applied to schemes of real development value – have brought a tightening of regulations in this area.

The Helsinki tied aid rules established through the export credit Arrangement have markedly tightened the range of projects to which mixed aid and export credit funding may be applied. Projects that could be funded commercially are no longer eligible; where aid is used, it must represent a hefty chunk of the bid cost. Aid cannot be simply used as a small sweetener; it must represent a serious public-spending outlay by the exporting country.

These reforms have coincided with a period of intense budget pressures on most OECD governments. At the behest of national treasuries, many bilateral aid budgets have been trimmed back. The net effect of tighter rules, smaller budgets, and requirements for aid to be used heavily if it is brought into play at all have had a dramatic effect on the project-financing market. These trends have tended to push projects in sectors such as power and transport towards private finance.

Meanwhile, thinking among development agencies and emerging market governments, particularly in the poorer countries, has begun to place much more emphasis on basic social and economic programmes, often with a relatively small capital-project content. Some observers had assumed that, eventually, the use of mixed credits would die away, because there would be few projects left to finance. In the event, this has not happened – there has been no shortage of contracts in social or other non-commercial sectors that have proved suitable for this type of funding.

Battered but Unbowed?

Still, there is no doubt that the new shape of the project market presents difficult challenges for ECAs. They have to cater both for mixed-credit business that is more closely focused on grassroots development than in the past and, simultaneously, refine their ability to work with private-sector investors on more commercial infrastructure and industrial schemes. In some cases, this change requires ECAs to carry exposure during the difficult early-development phase of a project, only to see the risk sold down into the commercial market once the scheme is sufficiently advanced to be credible with private investors.

In the longer term, agencies are likely to find that more of their mixed-credit exporting clients are consultants, or groupings of small firms. That may lead some agencies to lose interest in mixed credit altogether. Yet big-ticket semi-private infrastructure projects certainly don't offer a soft option alternative, as recent events have underlined. The 1997 financial crisis in East Asia likewise brought ECAs face-to-face with the harsh truth about the economic and financing risks associated with even apparently buoyant emerging markets. The part of the world that was seen as a massive future source of BOT project business has suddenly looked shaky. Will this perception lead to a shift back in favour of export credit? And if it did, would the ECAs have the risk capacity to cope with a further upsurge in demand for support on major projects?

Of course, in one sense, Asia's recent problems represent a validation of the role of official export credit. At a time when private investors may become more timorous, ECAs – on behalf of the big OECD exporting countries – stand ready to help fill the gap and share the risks, to ensure that the flow of trade and infrastructure development in the Far East is not brought to a halt by the slide in commercial-market confidence.

Thus, in a perverse way, the crisis has represented something of a marketing and public-relations opportunity for the agencies. They have been presented with a fresh chance to show they still have a valid role. Having learnt hard lessons in the debt crisis in the 1980s, they are unlikely to binge on new business and will probably act with caution. Still, they may see their importance enhanced anew.

Moreover, ECA activity has also been put under the spotlight by the European Union and the attempts of the Participants to the export credit Arrangement to harmonise rules on cover and premiums. If governments were once unsure of the importance that business places on official export credit, the past three years of vociferous lobbying by banks and exporters cannot have left them in any doubt.

The Advance of the Private Sector in Short-term Export Credit Insurance

Ted Watson



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Discipline in export credit insurance has become *de rigueur*. In the last twenty years there appears to have been a pincer movement to ensure it – from one side by the public sector, not least through the Arrangement on Guidelines for Officially Supported Export Credits among others, and from the other, by the private-sector market-place. For some private-sector participants there has been an increasing air of inevitability both about what has happened during that two-decade period and about what seems likely to transpire, on the short-term side of the trade credit insurance business; and a similar trend is clearly developing for the medium- and long-term.

I concentrate in this article on the short-term insurance business and, by discussing the trends of the last ten years that have lead to the *status quo*, point to the current challenge for the whole industry. I also look at the potential for the medium- and long-term business to follow the direction of the short-term. All this is done in the context of the trade credit insurance industry as a whole.

Ten Years Ago

Ten years ago the credit insurance market was made up of a number of separate national markets, normally with one export credit insurer that was either owned by the government or by the private sector acting as agent for the government, and one or two (sometimes more) domestic credit insurers owned by the private sector. These operations did not compete across national boundaries. There were, of course, one or two exceptions to prove this rule, such as American International Group (AIG), which has long operated internationally in this field.

The ownership of the private-sector credit insurers tended to be very diverse, with most of the major players, particularly in Europe (such as Trade Indemnity of the United Kingdom, Société Française d'Assurance Crédit (SFAC) in France, Nederlandsche Credietverzekering Maatschappij N.V. (NCM) in the Netherlands and Società Italiana Assicurazione Crediti Spa (SIAC) in Italy), being owned by a variety of insurers, banks and reinsurers. The most commonly seen shareholders were the reinsurers Munich Re and Swiss Re.

There were a number of reasons for this structure. Perhaps the most important were that insurers wished to be able to offer their clients the product; banks wanted their clients to have access to the product; and to some extent reinsurers were able to control the market. But since the field of activity was perceived to be any area with difficult and potentially volatile risks, these institutions tended to isolate the business and share the risk with others, in separate joint-venture companies.

The low level of capitalisation of the private-sector companies led to a heavy dependence on reinsurance. This tendency, together with shareholding, gave the major reinsurers a bigger influence over the activities of these companies than might have been expected. One of the consequences was that insurers were encouraged not to get involved in political risk but to leave it instead to their respective governments. There were, of course, exceptions such as Trade Indemnity in the United Kingdom and the Foreign Credit Insurance Association (FCIA) in the United States, which at that time were offering combined commercial and political insurance products written for their own account.

In the late 1980s there were approximately fifty credit insurers, including government agencies, in the fifteen main European states, with six in North America, and all of them separately owned. The scene has changed dramatically since then.

The European Single Market

The development of the Single Market in the then European Economic Community (EEC) subsequently played an important part in the changes to the credit-insurance sector world-wide and may indeed be the single most important factor in the changes seen in the market over the past decade, even though the Single Market was itself part of a wider trend. Eleven years ago I viewed the development of the Single Market in Europe as being the precursor to the potential part-privatisation of the Export Credit Guarantees Department (ECGD) of the United Kingdom, and contacted the Chief Executive – then Malcolm Stephens – on this subject, outlining the potential for reinsurance to be the midwife of privatisation. And thus, I am told, subsequent developments were set in motion.

The Single Market, which for the credit insurance industry came into effect in 1990, was a threat to the EEC export credit agencies (ECAs). At least 50% of their short-term business tended to be related to exports to other EEC member countries. It was perceived that, once the Single Market was in place, these exports could no longer be categorised as such and would be seen as domestic trade. That would immediately have put the ECAs in direct competition with private-sector domestic credit insurers, although they would still be working under the constraints of the state. In the late 1980s it was felt that government institutions had the advantage over the private sector because of the strength of the government guarantee, and in the English-speaking world that was considered unfair competition (even though nowadays it is competition from the private sector, because of its efficiency and competitiveness, that poses the bigger threat). This thinking coincided neatly with the early successes of privatisation and thus (as some would say) the “privatisation train left the station”. But although the Single Market may have been the trigger, the underlying factors at the time, which have also driven the developments of the last ten to fifteen years in the credit-insurance market, have been more varied and complex.

Technology, Politics and Deregulation

Technology, and information technology in particular, has advanced dramatically. The ability to collect information, manipulate it, transmit it globally, analyse it and draw conclusions from the analysis, has changed beyond recognition. This development has driven a coach and horses through national regulatory borders. The political environment that was developing alongside, particularly that of “Thatcherism” (or perhaps it should be called “Reaganomics”), was conducive to debunking old, established ideas and proposing what, to some, was revolutionary change. These two factors provided an environment in which developments took place.

The belief that grew throughout the 1980s in the desirability of freeing economic activity from unnecessary restrictions and opening it up to a wider competitive environment led to considerable deregulation in the financial markets of (primarily) the United States and the United Kingdom, and to the much-talked-about global capital markets. It also allowed exports a much wider access to a wider variety of sources for finance and capital. The 1990 European Community Credit Insurance Directive added to this movement by giving credit insurers the freedom to write business for clients in any EEC state, leading to a further breaking-down of national regulatory boundaries and cross-border competition in the provision of export credit insurance in Europe.

On the other side of deregulation came regulation of government activity. In 1987, within the framework of the export credit Arrangement, there was a further tightening of credit insurance conditions, leading state export credit insurers to move more towards market rates. In the previous year the private sector had accounted for only 3.5% of the total volume of export credit insurance; it was considered that the competitive disadvantage of the private sector in relation to the state export credit insurers was a contributory factor to this low performance.

A further underlying factor behind the changes seen in the last decade is the increasing importance put on prudent fiscal policies, which was given a considerable boost in Europe after the signing of the Maastricht Treaty and its criteria for admission to the European Monetary Union. One consequence is that European governments have been looking more closely at the contingent liability generated by supporting export credit insurance – something that American administrations had been doing for some time.

As in all areas, the availability of information in the export credit sector on foreign buyers and markets has grown dramatically during the period under review. It is considerably more accessible and cheaper to obtain; simultaneously, the volumes that have to be handled and the sophisticated analysis that emerges have grown immensely. One of the major competitive advantages of any credit insurer has been obtained through developing technology to use this information effectively on behalf of its clients. The constant challenge of credit insurers nowadays is to reduce the unit cost of information through technological advance and developing the volumes of customers to which to apply it. The cost-saving from serving all of one’s policy-holders from a single system base has been one of the main drivers towards consolidation.

Manufacturing and Trade

Since the late 1980s much manufacturing has become globalised. Emerging economies have become more effective and cheap locations for factories, of not

only multi-national corporations; many smaller businesses have also been established. Many companies also find it sensible to locate manufacturing in the developed economies to be near or in those markets, or avoid tariff barriers, transport costs, political difficulties, and so on. ECAs, restricted by rules on local content and other such constraints, have been finding it increasingly difficult to provide cover to companies opening-up manufacturing bases in various parts of the world. In parallel, a considerable expansion in world trade, albeit with a gradual shift in the flow of world trade in favour of trade between the industrialised countries (and thus a concomitant decrease in exports to developing countries), has generally helped oil the wheels of growth of the market for export credit insurance.

Reinsurance

A decade ago, there was a very limited capacity in the reinsurance market for export credit risk, and particularly for its political element. As more of this business has been brought to the reinsurance market, and as the market has seen a better spread of risks across all types of countries, so the capacity of the market to write higher volumes generally, and more in difficult markets specifically, has expanded. In the late 1980s only a handful of insurers – AIG, FCIA and Trade Indemnity – were ceding any volume of business to the reinsurance market. During the early 1990s, this activity was boosted substantially by the combined-risk reinsurance of NCM Credit Insurance of the United Kingdom and then the use by Compagnie Française d'Assurance pour le Commerce Extérieur (COFACE) of the private-sector market for political risks.

Since then, with the benefit of reinsurance treaties that have performed well and with much education, the reinsurance market has expanded substantially and is now estimated to be covering approximately \$400 billion of short-term exports annually. The scope of cover that the market is able to provide has broadened with the volume, to such an extent that there is now only a handful of countries for which the market will not provide cover. Furthermore, the capacity that any one insurer can obtain from the market has also grown with these increased volumes.

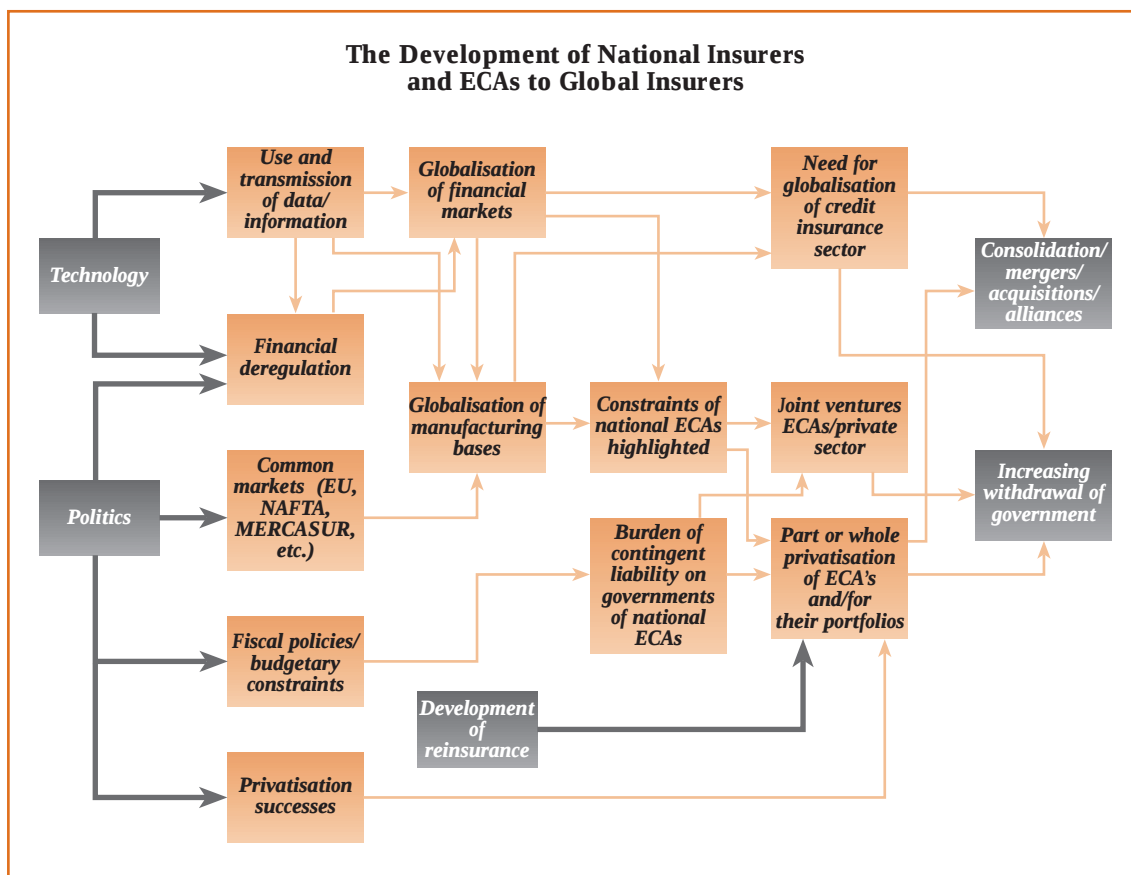
These trends have been influenced not only by the increased cessions to the private sector, but also by other factors, such as the clearer understanding of risk, the better returns that this business provides over much mainstream insurance business, the trend towards diversification and the very competitive nature of an increasingly highly capitalised reinsurance market.

The Advance of Private Sector Insurance

The following diagram tries to simplify the process of what has been the inevitable advance of national credit insurers and ECA's to global credit insurers.

The consequence of the trends described above is a credit insurance industry made up of far fewer insurers and with an ever-decreasing dependence on the public sector.

The increasing globalisation of trade in goods and capital have lead to an increasing demand from large multi-national companies for insurance for their trade to and from all parts of the world with one insurer. This trend has encouraged



the consolidation of the credit insurance market, the ownership of which had remained largely static for very many years. The vast majority of short-term export credit business is now written in the private sector by five dominant groups: Euler, COFACE, Hermes, Gerling and NCM. The dominant ultimate owners of this industry – AGF of France, Allianz of Germany and Gerling of Germany – are more tightly concentrated yet. At the time of writing, Allianz is making a friendly bid for AGF, thus posing the possibility of still further concentration. There has thus been a marked shift from a position where there were many insurers (private and government), limited in their operations to one country, to one where there are but a few, operating in many countries.

All this activity and consequent competition has led to a substantial increase in the volumes of trade generally, and exports particularly, insured in the private sector. In the last ten years premium volumes are estimated to have increased from approximately US\$750 million to over \$4 billion. The increased competition, particularly in the United Kingdom, which most would now consider the most highly developed market, has given a considerable boost to efficiency, improved practices and services and the development of related technology.

The various combined forces – of the International Union of Credit and Investment Insurance (“the Berne Union”, rightly keeping national ECAs to their own countries’ exports), the International Credit Insurance Association (encouraging members not to compete with one another across national boundaries), local insurance industries (combining forces in ownership of credit

insurers), and reinsurers (particularly Swiss Re and Munich Re pulling many of the strings through ownership and reinsurance and, in particular, by not supporting political risk) – which unwittingly conspired to discourage competition across national boundaries and between the domestic and the export insurers have now all changed their approach, leaving insurers with the freedom to operate anywhere and cover both commercial and political risks where they wish.

The technological developments are enabling the newly consolidated groups to have powerful centralised systems and processing, thus clearing the way for very much slimmer local representation.

The products now being offered are a far cry from those of ten years ago. Insurers have to be able to offer, on the one hand, one policy (or a number of linked policies) in various languages and currencies, complying with differing regulations, to the various parts of a client's empire world-wide. These policies will be supported by one administrative and underwriting system, and will be able to cover both the commercial and political risks arising from exports from and to virtually any country in the world. They can be adapted to be very much more finance-friendly than they were – one of the reasons for the growth of the business in the United States. On the other hand, they can write policies now for as little as a \$500 premium and still, apparently, make them pay. All of this can and is now done entirely in the private sector, with the active support of a very healthy reinsurance market.

The capacity of the reinsurance market is no longer the limiting factor that it was in the early 1990s. Indeed, it has developed to such an extent that it is now keen to start penetrating the medium- and long-term end of the business. Treaties (the reinsurance of portfolios of risk) are now covering terms of up to fifteen years in some very specific cases, such as that of the Multilateral Investment Guarantee Agency (MIGA). Even more interestingly, perhaps, reinsurers are now willing to structure treaties in such a way that they are prepared to take much contingent liability off the books of national ECAs and governments in a fashion that works in the interests of both parties.

All these developments – the strength of the consolidated insurers, their global reach, their competitive nature, the volumes of business being insured, increased efficiency, more adaptable products with wider scope, lack of capacity constraints, and so on – pose an opportunity (or a threat) to those ECAs which continue to provide short-term export credit insurance on behalf of their governments. The management of most ECAs are increasingly coming to recognise these changed circumstances, but few have taken the logical consequent steps that could open up the opportunity (or threaten their livelihood). Fewer governments than one might have expected have grasped the chance inherent in these changes, to withdraw to the extent they could from short-term export credit business. The consequence will be that *de facto* the private sector will take away most of what is left, leaving relatively expensive government operations to deal with rump portfolios generated on the basis of anti-selection by their customers.

The challenge for the senior management of ECAs today is to take advantage of these developments to disentangle their short-term business from their mothers' apron strings; and for governments to cut the associated costs, fees and operating expenses of their ECAs and the contingent liability. Governments should also start looking at similar opportunities in the medium- and long-term fields.

Chapter 6

And Finally

Postscript

Janet West

OECD governments are strong supporters of the export credit Arrangement. They consider that over the past twenty years it has been an essential and effective multilateral agreement, setting a level playing field for officially supported medium- and long-term export credits. But even though over those two decades the Participants have striven, successfully, to drive out trade distortions, the tale does not end here. The market will be both an ally and a competitor, and keeping its inevitable evolution in perspective whilst maintaining the integrity and validity of the Arrangement will be a major challenge. As Kurt Schaerer, the Chairman of the Participants since 1992, remarks, this task will require “as little rigidity as necessary combined with as much flexibility as possible. ... If the excellent personal and professional spirit ... of the Participants ... continues to reign over future negotiations our common cause should prevail”.

I am sure that into the next millennium the common good will prevail among an enhanced Participants’ forum and that the Arrangement will continue to serve the multilateral trading system – donors and recipients of export credits alike.

It would be remiss of me to end this Postscript and this publication without giving due recognition to all Participants, past and present, and their Chairman and Vice-chairmen for their expertise, fortitude, commitment – and sense of fun. The Secretariat has been more than fortunate to have worked with such a professional group and we look forward to more of their success. I would also like to pay tribute to my colleagues in the Export Credits Division of the OECD Secretariat who continue to amaze me with their energy and their enthusiasm in providing the Participants with, I hope, a Rolls Royce service.



Members of the Export Credits Division of the OECD Trade Directorate are, from left, front row: Tom Vis, Janet West, Imar Doornbos; middle row: Jean-Marc Salou, Evelyne Neimetz, Sheena Bohan, Don Vromans; last row: Shinya Kondo, Juliet Upton, and Steve Cutts.

Chairmen of the Participants to the Arrangement on Guidelines for Officially Supported Export Credits

1978-1998



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