The Changing Landscape of Export Credit Agencies in the Context of the Global Financial Crisis

March 2010

Written by Kavaljit Singh

Edited by Richard Wainwright

Photo by Chris Lang

Designed by Deborah Lambert Perez

FERN would like to thank C. S. Mott, Sigrid Rausing Trust, and the European Commission for financial support to carry out this research. The opinion expressed in this report is that of the author and supported by FERN. The views expressed do not imply the expression of any opinion on the part of any of the donors. None of the donors is responsible for any use of the information contained within this briefing note.

IBSN 978-1-906607-07-4

Contents

Executive Summary

With the onset of the global financial crisis and the subsequent squeeze in credit and insurance markets, we are seeing a renewed global demand for export credits.

As much as 90 per cent of the world's trade transactions involve elements of credit or insurance or guarantee. Commercial banks, private insurers, regional or multilateral banks and export credit agencies are the key players of trade finance.

ECAs are quasi-governmental institutions, and an integral part of many national governments' industrial, foreign aid, trade and investment promotion strategies. Their prime objective is to take risk away from exporters and investors. This risk is borne by the ECAs and ultimately by their governments. As leading players in project finance, particularly large infrastructural and industrial projects, ECAs by and large provide guarantees for financing commercial banks' trade and investment.

With the recent global financial crisis, international commercial banks and private insurers became more risk averse and reduced support for cross-border trade and investments. A sharp contraction in global demand for goods has badly affected the volume of world trade, leading to the largest decline of the past 80 years. The result has been that demand for trade finance far exceeded supply. The deterioration of trade finance markets made trade finance transactions highly expensive. To mitigate against these negative impacts, several policy measures were announced by national governments, ECAs and regional and multilateral developmental banks at various levels.

Despite previous predictions of the demise of official ECAs, the current global financial crisis has reasserted their position as dominant players in the trade finance markets as they have stepped-in to fill the huge gap left by the private market. The crisis dramatically changed the landscape of ECAs for example, several countries took steps to launch their own Export-Import bank. Many ECAs have lately started offering new products to their clients: direct lending and working capital loan guarantees on a short-term basis. New commitments made by ECAs have been also on the rise.

Most ECAs have reported an increase in the total volume of guarantees during the crisis. Some have reported an increase of new commitments in their portfolios of between 30 and 50 per cent. Since early 2009, several new agreements between development banks and ECAs have been signed or are under negotiations. These closer ties between ECAs and regional and multilateral development banks could lead to the development of new co-financing structures and arrangements. In the coming days, public-private partnerships will be used to enter new markets and issue new products. In many ways, such partnerships would blur the traditional lines between official ECAs and private players.

However, new signs of vulnerability and risks are fast emerging at the global level too. First, the deterioration in the public finances of many countries could constrain the ability of national authorities to raise new funds for ECAs. The other constraining factor could be payment defaults, as an increase in claims has been reported in the post-crisis period – this could make their business model unviable.

The report concluded that since the operations and structures of ECAs will adapt in relation to new developments in global trade and financial systems, it is very important for civil society actors to analyse these developments as well as develop campaign tools and strategies that take this wider context into account.

A glossary is added at the end to explain some of the most widely used terms used in the document.

Introduction: The Global Financial Crisis and Its Impacts on Trade

The world economy is in the midst of a severe crisis. The housing market meltdown which was triggered by sub-prime mortgage crisis in the US in mid-2007 quickly snowballed into a global financial crisis affecting large international banks and other financial institutions. The turmoil in the financial sector and credit squeeze rapidly spiralled into the real sector, thereby leading to a global economic crisis. Given the scale and extent of the current economic crisis, it is seen as the worst crisis since the Great Depression of the 1930s.

Although an in-depth analysis of the genesis of the global financial crisis is beyond the scope of this report, it is largely attributed to a combination of factors such as the developments in the sub-prime mortgage markets; extensive use of securitisation, complex derivative instruments and the shadow banking system; excessive leverage in the financial system; lax regulation and supervision by public bodies arising from belief in efficient markets and light-touch regulation; and global macroeconomic imbalances.

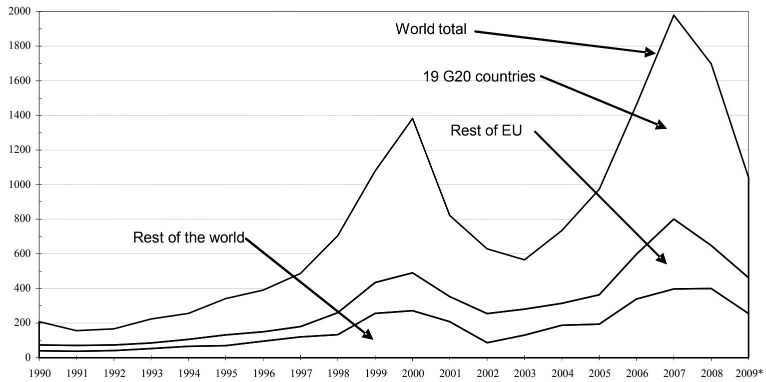
Since the collapse of Lehman Brothers in September 2008, the landscape of the global financial system has changed, both functionally and geographically. It is important to emphasise here that unlike most financial crises over the past four decades which originated in the developing world, the ongoing global financial crisis originated in the "epicenter" of the global financial system – the United States of America.

The current crisis has demonstrated beyond doubt that irrespective of the degree of global integration and the soundness of domestic policies, no country can insulate itself from external shocks. There is hardly a country in the world which has not been affected by the financial crisis through financial or trade channels. However, the degree of contagion effects differs across countries. By and large, those developing economies, which are far more dependent on trade for growth, were worse hit.

The crisis has led to sharp deterioration in the global economy, which contracted in 2009, for the first time since World War II. Despite massive bailout programs for weak banks and fiscal stimulus packages announced by governments throughout the world, the global economic recovery is still not in sight, with demand still faltering and production falling, the squeeze in credit markets continuing and job losses growing. With most developed economies still not out of recession, the developing ones (particularly Asia) provide some signs of early regional recovery, albeit at a slower pace.

Due to the financial crisis, private capital inflows (particularly cross-border bank lending and portfolio investments) to the developing world witnessed a sharp decline, from US$617 billion in 2007 to $109 billion in 2008. Global foreign direct investment (FDI) inflows have also declined from $1.7 trillion in 2008 to $1 trillion in 2009 (Figure 1). The decline in FDI inflows have been throughout the world. The volume of global cross-border mergers and acquisitions (M&As) by international firms declined 36 per cent in 2009.

Figure 1
FDI Inflows, Global (and G20), 1990-2009*
Billions of US dollars



* Preliminary Estimates for 2009.

Source: UNCTAD

In particular, the crisis has badly affected the volume of world trade, which witnessed the largest decline of the past 80 years. The International Monetary Fund has reported that world trade contracted by 12.3 per cent in 2009.[1] Interestingly, the decline in cross-border trade in goods was greater than the decline in trade in services. In fact, trade in certain services (such as IT) has remained buoyant due to them depending less on external financing. Of late, there are some signs of a recovery in trade in the Asia region led by China, but globally the trade crisis is far from over.

1 International Monetary Fund, *World Economic Outlook Update*, January 26, 2010, p.2.

The decline in world trade was largely caused by the sharp contraction in theglobal demand for goods. In addition, world trade has also been adversely affected by the reduced availability of trade finance which affected the production and export capacities of companies. As trade and finance have very strong inter-linkages, trade finance became highly vulnerable during the current financial crisis.

The landscape of Trade Finance

Trade finance includes loans, insurance, guarantees, state subsidies and other kinds of financial support. The role of trade finance in facilitating the rapid rise in world trade of goods and services in the past two decades is well acknowledged. Trade finance is intended to mitigate risk and address liquidity gaps inherent in the delivery of goods and services across borders.

Since only a small portion of formal world trade is facilitated through cash or barter,[2] exporters rely on banks and insurance companies for working capital to produce goods and services and, more importantly, to undertake payment, exchange rate and other risks involved in trade transactions. It has been estimated that as much as 80 to 90 per cent of trade transactions involve some elements of credit or insurance or guarantee. In other words, the annual global trade finance market is well above $10 trillion, considering global trade at $15 trillion.[3]

Trade finance is significantly different from other forms of credit (such as bank credit) in the sense that it could be offered through external financial instruments (for example, commercial banks) but also through inter-firm instruments. In addition, trade finance is considered to be safest form of credit since it is backed by strong receivables in the form of specific goods or services.

It is important to emphasise that the majority of trade finance deals are for short-term credit at inter-firm (between partners in a supply chain) and intra-firm (within different units of a firm) levels. It has been observed that large transnational corporations rely on intra-firm and inter-firm credits in order to avoid higher intermediation costs. Some large corporations have also set up their financial subsidiaries to finance their trade and investment requirements.

2 Exchanging goods or services without involving money.

3 Marc Auboin, "Boosting the Availability of Trade Finance in the Current Crisis: Background Analysis for a Substantial G20 Package," CEPR Policy Insight No. 35, June 2009, p.1.

The Key Players

Broadly speaking, there are four key players involved in trade financing:

Commercial Banks: In relation to trade finance, commercial banks provide a variety of types of finance including working capital loans, letters of credit (L/Cs), bills of exchange and pre-and post-shipping financing. Commercial banks are the biggest players in global trade finance markets, accounting for 80 per cent of business. Typically commercial banks offer short-term trade credit (less than 180 days tenor)[4] and do not protect parties from all kinds of risks involved in transactions. Commercial banks and financial institutions rely heavily on sophisticated market instruments such as derivatives and off-balance sheet financing to manage risks in their portfolio.

Private Insurers: The operations of private insurers (e.g. Zurich) have recently expanded due to the introduction of market-oriented reforms. They usually cover short and medium-term credit insurance and political risk insurance. Like commercial banks, they use securitisation and other sophisticated financial instruments to manage risks. Private insurers work closely with commercial banks involved in trade finance. For instance, they provide insurance (and reinsurance) policies to commercial banks for their letters of credit and other financing instruments to exporters and investors.

Regional and Multilateral Banks: Through myriad programs and initiatives, regional and multilateral banks (e.g. the Asian Development Bank (ADB), the European Bank for Reconstruction and Development (EBRD) and the World Bank) provide a number of facilities including guarantees to promote trade (and investment) finance among their member-countries, particularly those belonging to the poor and developing world.

Export Credit Agencies: Since the focus of this note is on export credit agencies (ECAs), these are discussed in more details here.

ECAs are predominantly quasi-governmental institutions[5] (some are privately managed) involved in diverse activities including direct credit, credit insurance (and reinsurance) and guarantees. Their specific activities depend on their national policy mandate. Besides cross-border trade of goods and services, ECAs are also involved in promoting and protecting offshore investments.

4 Tenor refers to the length of time before it becomes due for payment.

5 There are private ECAs and public ECAs. The focus of the paper is on public ones, some of which are managed privately but guaranteed by the State.

Unlike private insurers, public ECAs have a very long history. The world's first ECA, Export Credits Guarantee Department (ECGD) was established by the UK in 1919, the majority of ECAs were established in the post-World War II period. Historically, ECAs were used as a policy tool by governments to support national companies to export or invest overseas. Over the years, however, their mandates, institutional structures, ownerships and business models have changed considerably. Nevertheless, they are an integral part of many national governments' industrial, foreign aid, trade and investment promotion strategies. At present, there are over 80 countries with some kind of ECAs.

Even outside of the financial crisis, there are always far-reaching economic and political changes taking place throughout the world and these mean exporters and investors face a number of unexpected risks. The prime objective of ECAs is to take risk away from exporters and investors. The risk is borne by the ECAs and ultimately by their governments. [6] Apart from commercial risk, ECAs also cover the most complicated political risk arising out of foreign exchange restrictions, debt moratorium, war and political instability in the host countries. Since such political risks are generally not covered by market players, some industry representatives have termed ECAs as "insurers of the last resort."[7]

For providing their service, ECAs charge premiums and/or interest from clients. The premiums charged by ECAs are usually lower than those of commercial players. The majority of ECAs provide insurance and other services for medium-term (up to 5 years) and long-term (5 to 10 years and above) transactions which are usually associated with large projects. Consequently, they have emerged as one of the leading players in project finance, particularly large infrastructural (such as power plants) and industrial projects, which are risky, highly capital intensive and have long gestation periods.

By and large, ECAs provide guarantees to financing of trade and investment by commercial banks. To illustrate, take the recent case of Ex-Im Bank guaranteeing a private US bank's loans to an Indian company. In January 2010, Ex-Im Bank issued a guarantee to a $1.1 billion loan (of 11 years tenor) extended by JP Morgan Chase

6 In many cases, as noted in the India-Boeing example, the importing country gives a sovereign guarantee, particularly if the export is for a state backed project or company, so the risk is ultimately borne in such instances not by the ECA's government but by the importer government. For instance, 90 per cent of the developing country debt owed to the UK is export credit generated debt

7 See, for instance, Raoul Ascari, "Is Export Credit Agency a Misnomer?: The ECA Response to a Changing World," *Working Paper No. 2*, SACE, February 2007.

& Co. to the National Aviation Company of India Ltd. (the holding company of state-owned carrier, Air India) for financing of commercial aircraft sold by Boeing to Air India. In return, the Indian government has extended a sovereign guarantee to Ex-Im Bank. In the absence of such guarantees, this transaction may not have taken place.

The collective economic clout of the ECAs can be gauged from the fact that the 51 members of the Berne Union (an international association for the export credit and investment insurance industry) covered over $1.5 trillion worth of business in 2008.

The collapse of Trade Finance Markets

The global trade finance markets (both credit and insurance) began deteriorating in mid-2008, with the squeeze in liquidity and growing concerns over counter-party risk and payment defaults. Banks were not willing to increase credit lines due to increased volatility in global currency markets and reduced inter-bank lending. The decline was much sharper in early 2009.

Initially, the decline was limited to developed countries' markets as the financial crisis originated there, but by the end of 2008 it had spread to the poor and developing world. In particular, Asian and Latin American countries, which mostly rely on developed countries for exports, were badly affected in the first half of 2009. Commodity exporting countries from Africa were also affected by the drop in international commodity prices.

As international commercial banks and private insurers became more risk averse to support cross-border trade and investments, demand for trade finance far exceeded supply. Various estimates from industry analysts to the World Bank put the market gap in trade finance in the range of $25 billion to $500 billion during late 2008-early 2009.

The deterioration in trade finance markets led to a sharp rise in spreads on credit and insurance costs, which in turn made trade finance transactions highly expensive. In the case of India, Brazil and several other developing countries, the Spreads on 90-days L/Cs soared to 300 to 600 basis points above the London Inter-Bank Overnight Rate (LIBOR), compared to 10 to 30 basis points in normal times. In some countries (for example, Chile), markets for trade finance products with 365 days and above tenors almost disappeared during the crisis.

In the case of export credit insurance, the impact of the crisis was more on the volumes of short-term commitments which dropped 22 per cent between the second quarter of 2008 and the third quarter of 2009. However, medium to long-term trade insurance commitments remained stable during the crisis.

The impacts of contraction in trade finance markets have been disproportionately felt by small-and medium-enterprises (SMEs), notably in the poor and developing world. Evidence suggests that SMEs in Philippines, India and Mexico were crowded out by large firms trying to access to trade finance.

BOX 1: THE SOUTHEAST ASIAN FINANCIAL CRISIS AND TRADE FINANCE

In the earlier episodes of financial crises in emerging markets such as the Southeast Asian financial crisis in 1997 and the Argentine crisis in 2001, trade finance (particularly short-term segment) tumbled.

During the Southeast Asian financial crisis, commercial financing almost disappeared. Big commercial banks and private insurers withdrew credit limits in the crisis-hit Asian countries. In Indonesia, for instance, trade finance dried up completely during the crisis, as international banks refused to confirm L/Cs issued by Indonesian banks due to a loss of confidence in the local banking system.[1] As Indonesian exports had very high import content, the country's exports suffered considerably during the crisis. To mitigate the situation, in 1998, the Indonesian central bank in 1998 deposited a $1 billion collateral fund with international banks in Singapore to guarantee any default on L/Cs issued by local banks.[2]

As most Southeast Asian countries rely on exports for economic growth, the regional developmental banks, ECAs and national governments undertook several policy measures to restore stability in trade finance markets. The Asian Development Bank (ADB) extended guarantees to international banks confirming L/Cs issued by local banks.

ECAs emerged as an important source of trade-related financing in crisis-ridden Asian economies. Some ECAs from the developed countries (e.g. Ex-Im Bank of US) also issued short-term insurance and trade facilities on a bilateral basis.

1 Marc Auboin and Moritz Meier-Ewert, "Improving the Availability of Trade Finance during Financial Crises, WTO Discussion Paper, WTO, 2003, p.4.

2 Ibid., p.10.

Various surveys have confirmed the deterioration in the trade finance markets during the crisis. A survey conducted by the International Chamber of Commerce (ICC) in March 2009 found that 47 per cent of the 122 banks (based in 59 countries) reported a lower volume of letters of trade credit in the last quarter of 2008.[8] Over 40 per cent of the respondents reported paying higher fees for L/Cs, standbys and guarantees.[9]

Three surveys of 88 major banks (based in 44 countries) conducted by the IMF in cooperation with Bankers Association for Finance and Trade (BAFT) also found that the cost of trade finance had significantly increased and there was lower supply of trade finance instruments during late 2008-early 2009.[10]

Similarly, a World Bank survey of 425 companies and 75 banks in 14 developing countries of different income groups also found that trade finance has become more expensive and less available.[11]

By early 2010, Spreads have considerably reduced from their peaks in 2009 due to massive interventions by central banks, multilateral banks and ECAs to improve the supply of trade finance and insurance. At the time of writing this note (i.e. March 2010), the Spreads are still much higher than pre-crisis levels. Although there are signs of recovery in certain segments and some regions (for instance, Asia), trade finance markets as a whole have not yet fully recovered.

The Policy Response

To mitigate against the negative impacts of turmoil in the global trade finance markets, several policy measures (both short and long-term) were announced by national governments, ECAs and regional and multilateral developmental banks at various levels. Some of the important policy measures are listed on the following page:

8 International Chamber of Commerce, *Rethinking Trade Finance: An ICC Global Survey*, March 31, 2009.

9 Ibid., p.5.

10 IMF and BAFT, "IMF-BAFT Trade Finance Survey: A Survey Among Banks Assessing the Current Trade Finance Environment," BAFT, 2009.

11 Mariem Malouche, "Trade and Trade Finance Developments in 14 Developing Countries Post September 2008: A World Bank Survey," *Policy Research Working Paper 5138*, World Bank, November 2009.

- Central banks in India, China, Brazil and other developing countries took several steps to increase liquidity to banks and provided additional credit lines to exporters. India, for instance, lowered its foreign currency export credit rates to aid the country's exports. It also increased the period of entitlement for reduced rate trade credit. Several developing countries also launched new programs to make foreign exchange available to exporters and increase the competitiveness of their export.

- Throughout the world, governments have expanded the coverage and capital of their ECAs and similar institutions. In the post-crisis period, some countries have announced the establishment of new agencies. In 2009 for instance, Indonesia launched Indonesia Eximbank and Kenyan authorities recommended the creation of an Export and Import Bank. In addition to credit insurance and guarantees, some ECAs from developed countries (e.g. Ex-Im Bank of US, JBIC of Japan and SEK of Sweden) have launched new products such as short-term direct lending in the form of working capital to exporters. Most ECAs have enhanced the scope of their existing programs. The Ex-Im Bank now provides credit and insurance support to US firms, which do not export directly but supply their products to US exporters. Several ECAs (e.g. EDC of Canada and SERV of Switzerland) have increased the ceilings for the business volume and insurance cover ratio. Many ECAs are now covering up to 100 per cent of the risk. Some governments have also recently launched bilateral trade finance packages (such as the $20 billion package between US and China) which will be managed by their ECAs.

- Regional development banks including the Asian Development Bank (ADB), the African Development Bank (AfDB), the European Bank for Reconstruction and Development (EBRD), and the Inter-American Development Bank (IDB) have expanded their programs to provide additional guarantees to international banks in case a local bank in member-country defaults in its obligations under L/Cs and other trade finance instruments.

- The World Bank Group increased its assistance through the doubling of the International Finance Corporation's (IFC) Global Trade Finance Program ceiling from $1.5 billion to $3 billion to meet the demand for trade finance from banks in the developing countries. The IFC also launched a Global Trade Liquidity Program in April 2009, which aims to provide up to $50 billion of trade liquidity support to developing countries over the next three years.

- At the London Summit of April 2009, the G20 agreed to provide $250 billion of support for trade finance (Box 2). This financial support is mainly targeted at poor and developing countries, through additional bilateral and multilateral support programs.

BOX 2: G20 ON TRADE FINANCE

"We will ensure availability of at least $250 billion over the next two years to support trade finance through our export credit and investment agencies and through the [Multilateral Development Banks] MDBs. We also ask our regulators to make use of available flexibility in capital requirements for trade finance." – London Summit Communiqué, April 2, 2009.

"We welcome the swift implementation of the $250 billion trade finance initiative." – Leaders' Statement: The Pittsburgh Summit, September 24-25, 2009.

The Impact

Given the fact that most policy measures aimed at reviving global trade finance were taken in early 2009, it is too early to comment on their actual impact and effectiveness. Also some policy measures are long-term in nature, which further makes the task difficult. Undeniably, in the absence of policy initiatives by public authorities, the trade market conditions would have been much worse. It is also important to highlight here that trillions of dollars of public funds were poured into the global banking system to restore market stability. Therefore, developments in trade finance markets were also influenced by other policy initiatives to restore stability in the global financial system.

Nevertheless, there is growing concern over the lack of information about the actual implementation of some policy announcements. For instance, leaders at the G20 Summit in London made an announcement that they were providing $250 billion worth of support for trade finance through ECAs and multilateral development banks. At the Pittsburgh Summit held in September 2009, G20 leaders welcomed the implementation of this initiative. Several months have now passed, however, and the world still does not know how much money has been raised and by whom.

There are no details available to answer the following questions: How will the $250 billion be disbursed between ECAs and multilateral development banks? Who will get this support and under what conditions? Will SMEs in poor countries, which have been hardest hit by the crisis, get any preferential treatment?

In the same vein, commercial banks have complained about the lack of information about specific support provided by national ECAs and multilateral banks in relation to new policy measures. It would not be surprising if some policy measures may not become operational due to lack of information and coordination among stakeholders.

Anecdotal evidence suggests that not all poor and developing countries are benefiting from policy measures announced in relation to ECAs and multilateral developmental banks.

There is also an apprehension that funds assigned for increased liquidity in trade finance markets may get diverted to other purposes by private banks and financial institutions.

Exporters have already used the financial crisis to press some ECAs like ECGD, to strip back their environmental safeguards. In 2009, the British Exporters' Association called for ECGD to "modify, if not scrap altogether" their social and environmental policies as embodied in its Business Principles.[12] This was followed in March 2010 by ECGD announcing that it will no longer screen or assess short term credits or credits under Special Drawing Rights (SDR) 10 million.[13]

12 For more information see paragraph 29 of the British Exporters Association's submission to ECGD's Consultation on its proposed Letter of Credit Guarantee Scheme, available at http://www.bexa.co.uk/docs/LC%20Submission%20final.doc

13 http://www.ecgd.gov.uk/index/public-information/public-consultation

The changing landscape of ECAs

Following the financial crisis of 2008, the world of ECAs has changed dramatically. Just three years before, it had become fashionable in some circles to predict the decline and ultimate demise of official ECAs.

Against the backdrop of excessive liquidity and a booming derivatives market, there was a strong belief that the ascendancy of private players and new risk management products would make official ECAs obsolete. Serious questions were raised about the very existence of ECAs. However, the current global financial crisis has completely changed this thinking.

Instead of demise, the crisis has given ECAs a new life and offered the opportunity to reassert their position as dominant players in the trade finance markets, particularly in bad times. As part of counter-cyclical measures, official ECAs have stepped-in to fill the huge gap left by the private market. It is interesting to note that several banking sector lobby organisations (e.g. Bankers' Association for Finance and Trade) have strongly pushed for a greater role of official ECAs to fill the gap left by market players. The role of ECAs during the crisis has been praised as "heroic" by John Ahearn, Global Head of Trade at Citigroup.

Most ECAs have reported an increase in the total volume of guarantees during the crisis. The landscape of ECAs in 2010 is markedly different from the one seen in the recent past. Some of the important new developments related to the world of ECAs are discussed below.

The Emergence of New ECAs: As discussed earlier, given recent market failures, several poor and developing countries (from Cambodia to Costa Rica) have shown interest in establishing their own ECAs. Some countries (e.g. Indonesia, Ukraine and Kenya) recently took steps to launch Export-Import banks. There is considerable interest among official aid agencies in providing technical and financial support to poor countries in setting up ECAs.

Whether poor and developing countries should establish ECAs is a highly complicated question. The decision to establish an ECA should be guided by several factors including national developmental priorities, export capabilities, the strength of financial and real sectors, business models, institutional capacities and the state of political economy.

A recent research paper by the World Bank noted that "ECAs are institutions that can – under appropriate circumstances, rules, and discipline – help alleviate market failures in trade finance but conditions for their effectiveness are demanding in terms of economic environment, institutional design, and governance."[14] The paper further stated, "Given the fact that restructuring, reforming or abolishing a public institution is more difficult than establishing one, the decision to set up an ECA should come as a result of a comprehensive evaluation process."[15]

It is also worth underlining that most poor countries lack the sufficient financial resources required for setting up an ECA.

Since ECAs have close relationships with the private sector as well as with governments, the potential for abuse and misuse of ECAs cannot be overlooked. There are plenty of examples of abuse of ECAs throughout the world. It is also well known that many poor and developing countries have weak institutional, regulatory and supervisory capacities and in such a scenario, there is a high probability that ECAs would serve a few vested interests, influenced by economic and political power.

Therefore, the one-size-fits-all strategy may prove to be counter-productive and should be avoided.

New Products and Clients: Besides providing guarantees and credit insurance, many ECAs have lately started offering new products to their clients.

In particular, ECAs are providing direct lending and working capital loan guarantees on a short-term basis. There is no denying that certain ECAs (e.g. JBIC of Japan, Ex-Im Bank of US and EDC of Canada) have been providing direct funding for some time, but they have substantially expanded its scope in the aftermath of financial crisis. For example, US's Ex-Im Bank has enhanced the amount of a working capital loan guarantee from 10 to 100 per cent. This would also be available to American firms which do not export directly but supply their products to US exporters.

Of late, JBIC has announced that it would provide loans and guarantees to Japanese companies to support their exports to developed countries.

14 Jean-Pierre Chauffour, Christian Saborowski and Ahmet I. Soylemezoglu, "Trade Finance in Crisis: Should Developing Countries Establish Export Credit Agencies?," *Policy Research Working Paper 5166*, World Bank, January 2010, p.17.

15 Ibid. p.11.

The demand for short tenor insurance cover and related products is increasing. Earlier short tenor deals were managed by commercial market players. In the past, several ECAs (e.g. EKF of Denmark and Atradius of Netherlands) had also privatised or transferred their short-term business to the private sector. Nowadays however, many European ECAs (e.g. SERV and Hermes) are providing substantial cover for letters of credit and other short tenor products. The IFC has specifically designated $12 billion for short-term deals under its Global Trade Liquidity Program.

More and more ECAs are being approached by new customers who were earlier serviced by private players. Large corporations are even counting on ECA support to decide on purchases of equipment and services.

New commitments made by ECAs are also on the rise. Though no exact statistics are publicly available, some ECAs have reported an increase of new commitments in their portfolios of between 30 and 50 per cent.[16]

In terms of sectoral allocation, there appear to have been no major changes. Most big ECAs continue to hold their existing sectoral bias (e.g. the aircraft industry in the case of US's Ex-Im Bank and the UK's ECGD). Similarly, Chinese ECAs are overwhelmingly involved in commodity-driven sectors.

The Middle East and North Africa (MENA) region will continue to remain important for ECA covered financing given the unstable geo-political situation which prevents private players from serving in the region. In the coming years for example, some ECAs may launch new products to accommodate the demand for Shariah-compliant finance products in the Middle East region.

In the case of political risks insurance cover for foreign investments, Russia, China, Kazakhstan, Turkey, Angola and Ukraine were among the top countries in 2008.

In contrast to their European counterparts, the Asian ECAs - particularly from Japan, Korea, China and India - are expected to grow at a more sustainable pace given the relatively better economic performance of these economies. Within the region, the Asian ECAs will have a heavy focus on infrastructure development. In 2009, for instance, JBIC received a $5 billion budget to support Japanese exports and investments with a strong focus on renewable energy and water projects within Asia.

16 Organisation for Economic Co-operation and Development, "Officially Supported Export Credits and the Financial Crisis: Measures Taken at the National Level by the Participants to the Arrangement, January 2009," TAD/PG(2009)4/FINAL, March 19, 2009.

Bilateral and Regional Cooperation: In the post-crisis period, a growing number of ECAs are pursuing cooperation agreements at bilateral and regional levels. These include loans, co-insurance and reinsurance agreements. Until now, a $20 billion package between US and China is the biggest bilateral deal covering direct loans, guarantees and insurance. Under the agreement, the US through Ex-Im Bank will provide $4 billion in short-term and $8 billion in medium- and long-term trade finance facilities for US exports to developing countries. While China through its ECA (Export-Import Bank of China) will provide $8 billion in trade finance facilities for export of Chinese goods and services to developing countries.

In Asia, national ECAs are aggressively pursuing bilateral agreements on loans and reinsurance. This trend is more visible in East Asia. The $100 million loan agreement between JBIC and Indonesia Eximbank is an example of this trend.

Furthermore, multiple ECAs are getting involved in a single transaction, particularly in the area of project financing.

Another new development is the strengthening of regional networks of ECAs to support intra-regional trade. In late 2008, Japan took the lead in establishing the Asia-Pacific Trade Insurance Network (APTIN) to promote reinsurance cooperation among ECAs in the region. The Japanese ECA, Nippon Export Investment Insurance is playing a major role in expanding the activities of APTIN.

In the Middle East, Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC) is increasingly involved in covering Shariah-complaint export credit and insurance products within its member-countries.

In Africa, efforts are being made to revive the African Trade Insurance Agency (ATI) by extending its coverage to commercial risk insurance in addition to political risk.

Closer Financial Ties with Multilateral Development Banks: With regional and multilateral development banks pouring in billions of dollars to revive trade finance markets, ECAs are increasingly involved in facilitation and liquidity programs initiated by multilateral development banks. As mentioned earlier, IFC is the lead multilateral agency in reviving trade finance markets. Through co-financing with a host of ECAs (and private banks), IFC is developing financing and credit insurance solutions specifically aimed at those countries, which are not familiar with such transactions.

Since early 2009, several new agreements between development banks and ECAs have been signed or are under negotiation. For instance, the Multilateral Investment Guarantee Agency of the World Bank signed an agreement with Export-Import Bank of Korea to promote outward investments by Korean corporations. In 2009, ADB and Export-Import Bank of China signed a $3 billion co-financing agreement to support projects in developing Asia. Similarly, in May 2009, JBIC launched a $1 billion trade finance initiative in association with IFC and ADB, aimed at supporting local banks in developing countries.

The closer ties between ECAs and regional and multilateral development banks may lead to the development of new co-financing structures and arrangements.

Public-Private Partnership: The financial crisis has given a new impetus to public-private partnerships involving ECAs, commercial banks and private insurers. The partnership is more evident in the project finance sector as big private banks are increasingly looking for ECAs (and multilateral development banks) for co-sharing of risks. For instance, Citigroup is involved in a number of deals with ECAs and regional and multilateral developmental banks.[17]

The agreement between SACE of Italy and Zurich (a private insurer) is another example of this growing trend. Under the agreement, Zurich is offering reinsurance and co-insurance facilities to SACE. In February 2009, Zurich reinsured a political risk insurance policy issued by SACE covering Italian firms in Turkey. In February 2010, Zurich signed a similar agreement with the Korea Export Insurance Corporation (KEIC).

In the coming days, public-private partnerships will be used to enter new markets and issue new products. In many ways, such partnerships would blur the traditional lines between official ECAs and private players.

The International Regulatory Framework: The new developments will also impact on the existing international regulatory framework of ECAs. Essentially based on a self-regulation model, the international regulatory framework of ECAs has evolved over the past five decades. Still there is no international treaty that is binding globally on all ECAs.

17 An example of this is the Kashagan oil project which is supported by JBIC, the Japanese ECA and EBRD, the European Bank for Reconstruction and Development

The Organisation for Economic Co-operation and Development's (OECD) "Arrangement on Guidelines for Officially Supported Export Credits" is the key agreement, which aims at orderly use of export credits despite the fact it is voluntary, non-binding and limited in membership. The "Arrangement" allows ECAs to provide export credit guarantees of up to 85 per cent of the contract value.

During the financial crisis, certain rules of "Arrangement" were changed to allow greater flexibility to member-countries to finance projects through ECAs. In January 2009, the Participants agreed to a change enabling a wider range of countries to benefit from 10 year repayment terms instead of a maximum of 8.5 years. There was also a temporary change to allow a 50 per cent (instead of 35 per cent) share of participation of officially supported export credits in intra-OECD project finance transactions. Some new rules with regards to the operational aspects of ECAs are expected to come into force in 2011.

In the post-crisis period, the European Commission adopted in relation to the EC state aid rules a "Temporary Framework for State aid measures to support access to finance in the current financial and economic crisis". It allows the Member States to introduce temporary new 'Funding Schemes' for export loans. Ten Member States have provided their ECAs with increased insurance, guaranteed capacity of the magnitude of €36 billion, or an average increase of 35 per cent.

In the case of commercial banks, substantial changes in the Basel II rules (under the Basel Committee on Banking Supervision of the Bank for International Settlements) are in progress to make sure that trade financing is not constrained by capital adequacy rules.

The Rise of New Policy Forums: At the international level, we are witnessing the growing influence of the G20 (including enhanced participation of developing countries (e.g. India, China and Brazil)) in important policy matters related to trade finance and ECAs.

The World Trade Organisation's (WTO) Working Group on Trade, Debt and Finance (WGTDF) is another policy forum actively engaged in trade finance issues. Since its creation at the 4th Ministerial conference in Doha in November 2001, the WGTDF has examined a number of important issues that relate to trade, debt and finance. The WGTDF reports annually to the WTO's General Council, which, in turn, reports to the next Ministerial Conference of the WTO.

As a non-official forum, the Berne Union (see below) represents and promotes the interests of global export credit and the investment insurance industry.

Established in 1934, the Berne Union (also known as The International Union of Credit & Investment Insurers), is headquartered in Berne, Switzerland. It has over 50 members consisting of both official and private agencies. Some of the biggest ECAs in the world (e.g., Ex-Im Bank, Hermes, ECGD and EDC) are members of Berne Union. The smaller and newer agencies are first given membership of the Prague Club before meeting the requirements of full membership of the Berne Union. With more and more agencies seeking its membership, the influence of Berne Union on policy matters of ECAs is expected to rise.

Constraining Factors: Despite political commitments to enhance the capacities of ECAs, there are two major factors which could act as an impediment to their expansion.

The predominant factor is the deterioration in the public finances of many countries as this will put limits on financial support to ECAs. In particular, the excessive levels of public debt in several European countries would constrain the ability of national authorities to raise new funds for ECAs.

Unlike private players, ECAs are not highly leveraged institutions. Typically ECAs do not widely use complex derivative products and off-balance sheet financing to reduce risks and expand portfolios.[18] On top of this, raising new funds for ECAs through international bonds will be prohibitively expensive given the prevailing weak market conditions. Therefore many ECAs will find it difficult to raise new funds to meet the growing demand for their services.

The other constraining factor could be payment defaults. The Berne Union has reported an increase in claims in the post-crisis period. A joint report by the OECD, WTO and United Nations Conference on Trade and Development (UNCTAD) noted that Berne Union's members have registered 60 per cent year-to-year increase in claims.[19] Since 2008, many European ECAs (e.g. Italian SACE, Greek ECIO, Belgian ONDD and German Hermes) have reported significant increases in claims notifications and requests for prolongations.

18 Although there is widespread use of derivatives by ECAs in the EU, , particularly in UK, Netherlands and Italy

19 WTO, OECD and UNCTAD, "Report on G20 Trade and Investment Measures (September 2009 to February 2010)," March 8, 2010, p.17.

The majority of claims belong to the short-term segment of credit insurance. Some ECAs (e.g. Sweden's EKN) have also reported higher levels of arrears. The developments in claims and defaults need to be watched closely.

Since official ECAs do not hold loan loss provisions, and are ultimately covered by their national governments, a substantial increase in claims could make their business model unviable.

BOX 3: LACK OF STATISTICS ON GLOBAL TRADE FINANCE

Reliable and timely data on global trade finance is not publicly available. Earlier, IMF along with the Bank for International Settlements (BIS) and other financial institutions used to compile such statistics, but this was discontinued in the mid-2000s. Even commercial sources such as industry journals, reports and directories do not provide comprehensive data about trade finance.

Big private banks and institutions are reluctant to share statistics, claiming the information to be commercially-sensitive. Some short-term trade related financial transactions are also difficult to monitor.

Statistics and information on ECAs are therefore sketchy and often based on media reports. Due to sustained campaigns by NGOs and citizens' groups, a few ECAs have recently started sharing information about their transactions. Some quantitative data about credit insurance of ECAs is available from the Berne Union database.

The Need for Trasparency and Public Accountability

Throughout the world, ECAs have come under criticism for their secretive and corrupt practices leading to serious violations of human rights and international norms. Critics have pointed out that a substantial part of ECA backed financing is related to the weapons and arms trade to developing countries. Described as hotbeds of the corporate welfare system, NGOs and civil society actors have been demanding serious reforms of ECAs.

Despite an enlarged presence of ECAs in the post-crisis period, transparency, responsible behaviour and public accountability will continue to determine their functioning. To a large extent, the existing international regulatory frameworks, practices and policy forums have failed to meet these important concerns. It remains to be seen how ECAs will perform on these parameters in the future.

Whether ECAs will continue to subsidise those who already have an advantage or begin to support small businesses which have been hardest hit by the contraction in trade finance markets is a moot question.

Conclusion

The effects of the current global financial crisis will continue to be seen for years to come, and these developments will have a direct bearing on the landscape of ECAs and global trade finance.

Although there is no denying that stock markets have recovered quickly, overall financial conditions have not much improved, leading to a squeeze in credit and insurance markets. This has in turn created a renewed global demand for export credit and investment insurance products offered by ECAs.

Therefore, it is imperative for civil society actor monitoring ECAs to stay engaged and continue to monitor these developments. The need for public scrutiny of ECAs is in fact greater than ever before.

Since the operations and structures of ECAs will adapt in relation to the new developments in the global trade and financial system, it is very important for civil society actors to analyse these developments as well as develop campaign tools and strategies that take this wider context into account.

Glossary

Basel II: Issued by the Basel Committee on Banking Supervision in 2004, Basel II is the second of the Basel accords related to banking regulations. The name for the accords is derived from Basel (Switzerland) where the Basel Committee meets. The Basel II provides an international standard for capital adequacy rules (i.e. calculating the minimum amount of capital banks must hold relative to their assets to protect against various kinds of risks).

Bill of Exchange: A bill of exchange is a kind of check used primarily in international trade and is a written order by one party to pay another party a specific sum on a specific date in the future.

Derivative: A financial instrument whose value is contingent on the value of an underlying security. For instance, a futures contract or an option on a stock, stock index, or commodity.

Foreign Direct Investments (FDI): An investment in a country by a foreign institution in which real assets are purchased. These include real estate or plant and equipment assets and involve effort to manage and control. FDI flows have three components: equity capital, reinvested earnings, and other capital (intra-company loans as well as trade credits). FDI inflows are capital received, either directly or through other related enterprises, in a foreign affiliate from a direct investor. FDI outflows are capital provided by a direct investor to its affiliate abroad.

Inter-firm Instrument: Informal arrangements between firms consisting of supply of goods in the form of trade credit. Inter-firm credit is an important source of financing for small and medium enterprises, particularly in the developing countries where formal credit arrangements through public institutions are scarce or expensive.

International Bond: Bonds are debt instruments issued by a borrower, usually including regular interest payments plus a final repayment of principal. International Bonds are exchanged and traded in financial markets.

London Inter-Bank Overnight Rate (LIBOR): The LIBOR is an interest rate at which banks can borrow funds from other banks in the London inter-bank market. Fixed on a daily basis by the British Bankers' Association, LIBOR is the most widely used benchmark for short-term interest rates.

Letter of Credit: Widely used in trade finance, a Letter of Credit (L/C) is a form of documentary credit issued by banks and financial institutions. A standard letter of credit usually provides an irrevocable payment undertaking that the bank will make a payment to a seller (exporter) on behalf of a buyer (importer), provided that the terms specified in the L/C are fulfilled.

Off-balance Sheet Financing: A kind of financing in which large capital expenditures are kept off of a company's balance sheet through various methods. Often companies use off-balance-sheet financing to keep their debt to equity and leverage ratios low.

Prague Club: Launched by Berne Union in 1993, the Prague Club is a network for new and emerging ECAs (e.g. KUKE of Poland and Thai Eximbank). The name is derived from the city of Prague where its inaugural meeting took place. Initially most members of Prague Club were ECAs belonging to Central and Eastern Europe, but over time its membership has spread across the world. At present, the Prague Club has 32 member ECAs.

Real Sector: The sector of economy in which people produce, trade and use goods and services.

Securitisation: A structured finance process of turning an illiquid asset (e.g. real estate or stock which is not easily convertible into cash or not tradeable due to uncertainty about its value or the lack of a market) into a security. Mortgage-backed security is an example of securitization.

Shadow Banking System: It refers to financial intermediaries not subject to regulatory oversight (such as hedge funds) involved in the creation of credit and other financial instruments across the global financial system.

Shariah-compliant Financial Products: As an integral part of Islamic finance, these products are structured according to the requirements of Shariah which prohibits transactions that involve interest, gambling, speculation and unethical investments. Murabaha is one of the most widely used Shariah-compliant financial products.

Sovereign Default: It occurs when sovereign borrowers such as nation-states are unable or unwilling to pay their debt obligations. For instance, Argentina defaulted on $1 billion of debt owed to the World Bank due to the financial crisis in 2002.

Sovereign Guarantee: A guarantee issued by government that an obligation will be honoured in case the primary obligor (i.e. borrower) defaults.

Special Drawing Rights (SDR): A Special Drawing Right is the monetary unit of the reserve assets of the International Monetary Fund. For the period of 2006-2010, one SDR is the sum of 0.6320 US Dollars, 0.4100 euro, 18.4 Japanese yen and 0.0903 pound sterling.

Spread: The difference between the bid and the ask price of a security or asset.

FERN works to achieve greater environmental and social justice, focusing on forests and forest peoples' rights in the policies and practices of the European Union.

FERN's UK office:
1C Fosseway Business Centre, Stratford Road,
Moreton in Marsh, GL56 9NQ, UK

FERN's Brussels office,
26 rue d'Edimbourg, 1050 Brussels,
Belgium

www.fern.org