

Briefing Note

05

Export Credit Debt How ECA support to corporations indebts the world's poor

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Summary

This paper highlights the fairly hidden role of Export Credit Agencies (ECAs) in the debt problems of many developing countries. It explains how export credit debt comes about, and how ECAs are instrumental in turning the private risks of corporations into debt for developing countries. It clarifies how the cancellation of export credit debt is written off with Official Development Assistance (ODA) money. As most ECA supported activities never served development purposes – the contrary is often the case – this paper questions the justice of using ODA to support export credit debt cancellation. The paper also looks at ECAs' claim that they comply with the self-imposed requirement to financially break even in the long run. It concludes with suggestions about how ECAs should change, in order to improve and limit their operations and become coherent with international efforts to reduce poverty through sustainable development.

Export Credit Agencies (ECAs) are governmental or quasi-governmental departments that use taxpayers' money to help companies invest and export overseas. ECAs typically provide financial backing in the form of guarantees, insurance or direct loans. Their purpose is to protect companies against the commercial and political risks of not being paid while operating abroad. ECAs underwrite 10 percent of global exports from large industrial countries. The European ECA Reform Campaign works to achieve binding environmental, social and human rights guidelines for ECAs.



The peculiar role of Export Credit Agencies

Government supported – official – export credit agencies (ECAs) aim to support domestic companies in doing business abroad. Cover is usually provided for transactions with a repayment term of 2 years or more. ECAs provide cover for risks that are considered too big for private export credit insurance companies working under market conditions.

A government supported ECA can take more risks since government backing allows ECAs much more patience and leverage in recuperating arrear payments than private insurance companies would be able to afford. Due to this, ECAs tend to provide cover for socially and economically risky transactions that would never materialise without official ECA support.¹

Most industrialised countries' ECAs have agreed to common principles within the *Arrangement on Officially Supported Export Credits of the Organisation for Economic Cooperation and Development* (OECD)², which provides a financial framework and level playing field for their operations. ECAs always charge interest and/or a premium for the financial services they provide. One of the principles of the OECD Arrangement is that the participants agree to charge a Minimum Premium Rate (MPR) for the cover provided to companies. These premium rates also "shall be risk-based, shall converge and shall not be inadequate to cover long-term operating costs and losses".³ This financial break-even-requirement has been incorporated into EU law.⁴

The WTO's *Agreement on Subsidies and Countervailing Measures* (ASCM)⁵ provides the legally binding international framework for regulating government subsidies and other private sector support. It aims to minimise government support for private sector activities but does allow government support to business through ECAs. In item (k) of Annex I to the ASCM, reference is made to the OECD Arrangement, stating that export credit support to corporations in compliance with this Arrangement shall not be considered an export subsidy (which is forbidden by the ASCM). This means that it is up to the participants of the OECD Arrangement themselves to define how much support from their ECAs is permissible within the WTO.

The purpose of ECAs is to support domestic companies without any specific reference to sustainable development or poverty

reduction. This leaves ECAs able to provide backing for projects that would not receive funding from development institutions such as the World Bank. Serious negative environmental and social impacts of ECA supported activities are often held to account by investigations of project-affected communities, their organisations and NGOs.⁶

How private companies' credit turns into developing countries' debt

ECA support provides companies in industrialised countries with the certainty of obtaining the revenues they anticipate from their business ventures abroad by compensating the company if a business partner in a developing country does not pay. In other words, the ECA takes over all the risks that the private company would otherwise hold. A company that has a business agreement with a private counterpart in a developing country may also use the government supported ECA to exert pressure on the developing country's government to fulfil that agreement.

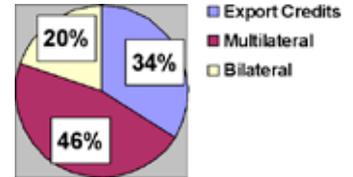
In general, the conditions attached to ECA supported transactions are not publicly disclosed. The claims made by ECAs are often accepted by developing country governments out of concern about the possible damage to trade and investment relations with industrialised countries. ECA claims may also be supported by what is known as a *sovereign counter guarantee* from the developing country government. This is an official declaration that the host government will assume responsibility for defaulting private sector transactions. There are also cases when bilateral trade or investment agreements include the protection of ECAs. What all of this means is that ECAs have the unique ability to pass the original risk of a private company on to host governments in developing countries. In other words, ECAs make it possible to turn business risks of private companies of industrialised countries into public sector debt of developing country governments.

In order to exercise their debt claims, ECAs have specific collection or recovery departments.⁷ These departments apply pressure on host country governments to negotiate and enforce repayment schemes for export credit debt. Debt collection and recovery activities are shrouded in secrecy, so it is hard to establish how these departments operate in detail. One can assume however that debt collection departments maintain extensive databases



with information on companies and countries, in addition to the detailed records on all their debt claims. Whilst indebted countries are not making any payments, they accumulate large amounts of interest and fines for arrears.⁸

Multilateral	489,738
Bilateral	206,477
Export Credits	368,503
TOTAL	1,064,718



External official debt (million US\$) of all aid recipients at the end of 2002 (source: OECD)

Debt collection and transparency

Hardly any information on debt collection departments of ECAs is publicly available. Except for aggregate figures on the recoveries made, annual reports of ECAs hardly reflect on their efforts in this field.

While it is understandable that information on individual transactions and companies is subject to regulations regarding commercial confidentiality, it is not clear why information on closed cases remains shrouded in secrecy. Such information is essential to be able to establish insight into reasons for defaulting.

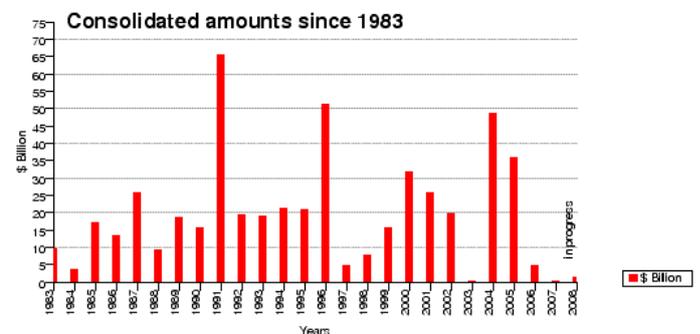
Indeed, failed cases in particular should be made public so as to be able to see what went wrong in providing cover. Such information would be helpful in improving the policies and criteria that determine the approval of new applications, and diminish the likelihood of ECAs providing cover for socially and economically high-risk transactions.

It is common knowledge that the debt burden of many developing countries is one of the most pressing obstacles for their development. Although ECAs are important creditors, they are not very forthcoming in acknowledging their co-responsibility for such problems. Indebted developing countries are left to negotiate the rescheduling or cancellation of their debts, not with the individual ECAs, but with all creditors collectively. This happens at the *Paris Club*, an informal group of 19 industrialised creditor countries hosted at the French Ministry of Finance. As ECAs manage most of the bilateral debt claims, they are key participants in the delegations of *Paris Club* member states.

Since 1983, the total amount of debt covered in agreements decided by the *Paris Club* or ad hoc groups of *Paris Club* creditors has been \$505 billion.¹⁰ The table below shows that within this, exceptional peaks occur, usually as a result of one or more countries receiving very substantial cancellation agreements. The most recent peaks happened in 2004 and 2005, for the most part explained by agreements on the cancellation of export credit debt of Iraq (2004, US\$ 38 billion) and Nigeria (2005, US\$ 30 billion).

How ECAs manage debt claims

When developing countries are unable to meet payment obligations for ECA supported activities, they accumulate debt. Collection of these debts is one of the least publicised ECA activities, but export credit debt forms the biggest part of the bilateral debt of many developing countries. Recent data detailing the levels of export credit debt as compared to other types of debt are hard to obtain but most debt statistics⁹ indicate that it fluctuates between 30-40 per cent of the total official public sector debt.



Source: Paris Club



The Paris Club: a cartel of creditor ECAs

The Paris Club describes itself as an informal group of official creditors whose role is to find co-ordinated and sustainable solutions to the payment difficulties experienced by debtor nations. Paris Club creditors agree to reschedule debts due to them. Rescheduling is a means of providing a country with debt relief through a postponement and, in the case of concessional rescheduling, a reduction in debt service obligations.

Working on the assumption that borrowers are duty bound to pay back their loans, the Paris Club operates as a cartel of creditors - particularly ECAs - aiming for the maximisation of the returns on debt financing. As an independent arbitration mechanism for solving international debt disputes is dearly missing in the international financial architecture, the Paris Club sits as a judge in its own cases.¹¹

Debt treatment agreements at the Paris Club require the consensus of all its Member States. Its decisions typically are political compromises. Geo-politically important indebted countries usually receive better deals than countries with comparable debt problems but less political clout. In the case of Iraq, for example, the US government advocated a 100 per cent debt cancellation, while other governments advocated a cancellation of not more than 60 per cent. The Paris Club decided for a compromise of 80 per cent cancellation, and a rescheduling of the remaining 20 per cent. In the comparable case of Nigeria the compromise was to grant a cancellation of only 60 per cent with the other 40 per cent to be completely repaid by the Nigerian government. Political motives rather than a sense of economic justice and fairness appear to be the guiding principles to Paris Club deals.

All Paris Club agreements require indebted countries to accept and implement macro-economic restructuring and liberalisation programmes as directed by the International Monetary Fund (IMF). The political price of a Paris Club deal is that the sovereign freedom of developing countries to prioritise public expenses for sustainable development is very much restricted.

How failed export credits are covered by overseas development

So what happens if debt is cancelled? For the creditor country, this means that export credit debt claims are removed from the balance sheet of its ECA. One of the problems with this is that the writing off is done for the nominal value of the debt rather than the much more realistic market value – the price that the debt would fetch in the debt market (usually 10-30 per cent of its nominal value). The nominal value includes all the registered arrears and interest, even though the ECA is very well aware that it will never be able to recuperate this accrued amount in full. Nevertheless the ECA writes off the full nominal value of the debt in case of debt cancellation.

In addition to this, ECAs do not write off these artificially high amounts of debt cancellation at their own expense. All OECD countries - with the possible exception of Norway and Switzerland¹² - report such expenses as Official Development Assistance (ODA). According to international regulations developed by the Development Assistance Committee (DAC) of the OECD¹³, this is allowed unless the debt originates from support for military transactions.¹⁴

The knock on effect of this is that since the recent peak years of 2004 and 2005, the huge amounts of export credit debt cancellation have been translated into a substantial chunk of the ODA-budgets of OECD countries. For example, the Netherlands has a fixed annual ODA-budget of 0.8 per cent of its GDP, and the cancellation of export credit debt ranges between 5 and 12 per cent of this budget. Of the total Dutch aid for Africa, debt



cancellation counted in recent years as high as 19 per cent.¹⁵ Despite aid budgets increasing, the substantive amounts of cancelled export credit debt resulted in materially less money being available for regular aid programmes.¹⁶ Similarly, many other OECD countries are reporting more ODA expenses, while at the same time their material commitments for regular aid programmes fall behind earlier promises.¹⁷

The cancellation of export credit debt emerges as the main source of increased aid budgets. As most ECA supported activities never aimed to serve development purposes, offsetting the loss with ODA is hard to defend.

How ECAs may make profit instead of breaking even

As outlined in the first chapter, the OECD, WTO and EU's legally binding regulations require that ECAs break even in the long run. They are not meant to make profit. The most important guidance they are given for how to comply with this requirement is the *Knaepen Package* which complements the Arrangement of the OECD.¹⁸ Its main aim is to ensure that the interest and premium charges of ECAs cover the credit risk and the long term operating costs and losses. A working group of experts determines and establishes the Minimum Premium Rates (MPRs) to be charged by all ECAs by reviewing the classification of countries according to the perceived risks of doing business there and comparing these data with the financial services offered by ECAs. Given the regular variations in the MPRs it is quite remarkable that there is no internationally agreed reporting mechanism in place that allows for the monitoring of the compliance of ECAs to their break-even-requirement.¹⁹

The theory of the break-even-requirement is that the losses of an ECA are in the long run to be balanced by its profits. This would result in the following equation:

$$premiums + interest + recoveries = operational costs + debt cancellation$$

ECAs' only costs are its operating costs and any losses due to debt cancellation following *Paris Club* Agreements. As outlined above, these debt cancellations are high due to the use of the

nominal value of the debts, rather than their market value. The break-even-requirement should thus boost the income side as well. Since premiums and interest levels are determined by factors outside the direct control of ECAs, their decision to cancel debt at nominal value may work as an incentive to boost recoveries from countries facing arrears.

Key data of Dutch ECA Atradius DSB for 2006

	2006	2005	2004
Premium income:	€ 82 million	€ 47 million	€ 77 million
Claims:	€ 17 million	€ 39 million	€ 83 million
Recoveries:	€ 880 million	€ 549 million	€ 205 million
Number of applications:	278	314	244
Number of promises and advices of cover issued:	152	200	122
Number of policies issued:	130	121	112
Value of promises and advices of cover issued:	€ 3.9 billion	€ 6.9 billion	€ 4.8 billion
Value of policies issued:	€ 2.4 billion	€ 2.3 billion	€ 2.1 billion

Source: Annual Review 2006, Atradius DSB

The key data of the Dutch ECA Atradius DSB show that in comparison to the premiums received by this ECA, recoveries are a very significant source of income. However, the political reality that ODA covers debt cancellation means that the ECA can defer losses and does not suffer when export credit debt is cancelled. In other words, one could say that ECAs are actually subsidised by ODA-budgets. This changes the break-even equation so that in reality it looks like this:

$$Premiums + interest + recoveries + ODA subsidies = operational costs + debt cancellation$$

To break even, the only costs that the premiums + interest + recoveries then need to take care of are the operational costs. This means that ECAs do not just break even - they are likely to make substantive profits.

The shadowy nature of ECAs mean that it is not possible to suggest the sorts of profits that they do make. Only a full cumulative results assessment that includes the oldest claims still on ECAs' books would allow for the drawing up of a realistic balance sheet. Such a results assessment should be transparent enough to allow for an independent accountant's review. As long



as ECAs do not publish independently verified annual accounts including transparent balance sheets this question will still be valid: do ECAs comply with their legally binding requirement to break-even or are they actually raking in profits?

How ECAs seek to contribute to debt prevention

In addition to putting an end to the use of ODA to pay for export credit debt cancellation, and promoting compliance to the break-even-requirement, it is also important to prevent new export credits turning into more unpayable debts. ECAs acknowledge a certain responsibility in this regard.

Until recently, the ECAs of OECD member countries committed to a statement of principles²⁰ designed to discourage the provision of officially supported export credits for 'unproductive' expenditures in Heavily Indebted Poor Countries (HIPCs) and International Development Association (IDA)-only countries.²¹ 'Unproductive' expenditures referred to transactions that are not consistent with these countries' poverty reduction and debt sustainability strategies and that do not contribute to their social and/or economic development. The statement never intended to preclude export credit support for military transactions, as military equipment may be considered legitimate to the debtor country's national security or required to combat activities such as the drug trade, smuggling or piracy.

In early 2008, OECD member countries adopted a new set of principles and guidelines²² to ensure that loans supported by their ECAs are in line with more general sustainable development objectives. The latest principles and guidelines not only aim to prevent export credit support for unproductive expenditures. They aim to promote lending that supports the economic and social progress of a borrowing country without endangering its financial future and long-term development prospects. Members of the OECD's Export Credit Group (ECG) pledge to observe the minimum concessionality requirements of low-income countries (LICs) to the IMF and to the International Development Association of the World Bank.

The provision of official export credits should also take into account the results of the most recent IMF/World Bank country-

specific debt sustainability analyses (DSAs) conducted within the joint Debt Sustainability Framework (DSF). Larger transactions with a repayment term of more than two years are required to be in line with host government's borrowing and development plans. The secretariat of the ECG is in charge of sharing relevant data on the official export credits provided to LICs with IMF and World Bank staff on an ongoing basis. It is noted in the new principles and guidelines that much of the operational details remain subject to further discussions, which may also include non-OECD members and private creditors.

Many development NGOs have expressed severe criticism of the DSF.²³ A key issue is that the DSF does not really take into account the needs for development finance that many of the poorest countries in the world have (e.g. to finance the Millennium Development Goals). Many of these countries could benefit more from receiving grants, rather than credits. But to make such grants happen, ODA-levels of most OECD countries need to be increased substantially.

The implication of a shift to grants only for LICs also implies that new credits should not be issued. In other words, ECAs should not be allowed to fund business transactions in such countries. Such a move could be easily justified given the absence of development in ECAs' mandate. Further justification comes from the fact that ECAs do not provide irrefutable evidence that their operations are not subsidized by ODA. In these circumstances ECAs do not have a role in many developing countries.

Recommendations for ECAs

To put an end to a system where the world's poor pay for the cancellation of export credit debt, ECAs should urgently:

1. Stop reporting the cancellation of export credit debt as ODA.
2. Publish verifiable cumulative assessment reports showing how they comply with the legally binding break-even-requirement.

A transparent implementation of these two recommendations would generate the necessary political space for dialogue with other stakeholders on effective measures to contribute to preventing new credits turning into new unpayable debts.



¹ Cf: Insurability Of Export Credit Risks, by Alsem, K.J., Antufjew, J., Huizingh, K.R.E., Koning, R.H., Sterken, E., Woltil, M.; Som Research Report 03f07, University of Groningen, 2003; <http://keur.eldoc.uib.rug.nl/wetenschappers/4/398/>

² The latest revision is available on <http://www.oecd.org/>

³ Article 23 of the Arrangement.

⁴ Council Directive 98-29-EC, 7 May 1998.

⁵ See www.wto.org/English/docs_e/legal_e/24-scm.pdf

⁶ See www.eca-watch.org

⁷ The debt collection department of Atradius DSB is organised as a 100% subsidiary of the Dutch ECA, called Atradius Provenuen B.V.

⁸ For example, according to information previously published by the Debt Management Office (DMO) of the Government of Nigeria, the original value of the export credit debt claims of the Netherlands originating from the 1980s amounted to US\$ 438 million. This debt increased with a factor of 389% to an amount of US\$ 1.707 by the end of 2004, shortly before the country finally concluded an agreement with the Paris Club. Cf.: Export Credit Agencies In Nigeria, A Case Study, AFRODAD, June 2007, p.18

⁹ cf.: External Debt Statistics 1998-2002, OECD, 2004 and the Joint External Debt Hub (JEDH) maintained by the World Bank at http://devdata.worldbank.org/sdmx/jedh/jedh_home.html

Developments in the global economy suggest that the total amount of debt may have diminished in recent years, but fresh accurate statistics are not yet available. The credit crisis that emerged since August 2007 may also result in new payment defaults.

¹⁰ see <http://www.clubdeparis.org/>

¹¹ Cf: Civil Society Statement on the Paris Club at 50: illegitimate and unsustainable, <http://www.eurodad.org/>

¹² cf. Letter of the Dutch minister of finance to the Dutch parliament, 12 June 2007, BFB 2007-1010M.

¹³ The OECD-DAC is the international body that defines what kind of expenses qualify as ODA.

¹⁴ Handbook for reporting debt reorganization on the DAC questionnaire, OECD, DCD/DAC(2000)16, 2000, para 9

¹⁵ A study of the independent evaluation department of the Dutch Ministry of Foreign Affairs established that of the total amount of € 5.8 billion of Dutch bilateral aid for Africa in the period 1998 – 2006, about € 1.1 billion was spent on the cancellation of export credit debts.

Cf. Het Nederlandse Afrikabeleid 1998-2006, Evaluatie van de bilaterale samenwerking, February 2008, <http://www.minbuza.nl/iob>

¹⁶ HGIS-nota 2007, Kamerstuk 30803, Nr.2, p.25

¹⁷ - Hold the Applause! EU governments risk breaking aid promises, Concord, Brussels, April 2007; <http://www.concordeurope.org>, and,

- Rich countries at risk of breaking aid promises, Financial Times, February 22, 2007

¹⁸ Premium and related conditions: explanation of the premium rules of the arrangement on officially supported export credits (The Knaepen Package), OECD, July 2004, TD/PG(2004)10/FINAL

¹⁹ Letter of Dutch Minister of Finance to Dutch Parliament, 19 December 2005; BFB 2005-2539M

²⁰ The statement of principles is available at the website of the OECD, <http://www.oecd.org>.

²¹ IDA-only countries are defined as all countries with a per-capita national annual income of less than US\$ 1,050.

²² Principles and guidelines to promote sustainable lending practices in the provision of official export credits to low-income countries, OECD-ECG, Paris, 20 February 2008 (TAD/ECG(2008)1), <http://www.oecd.org/>

²³ Cf. <http://www.eurodad.org/>

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