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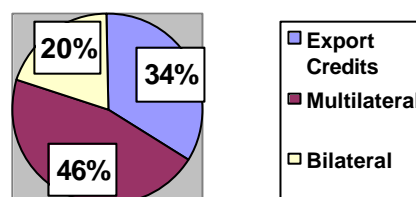
**Export Credit DEBT: briefing paper**

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**How ECAs turn private risks of corporations into debt for developing countries**

According to the most recent statistics<sup>1</sup> available at the Organisation for Economic Cooperation and Development (OECD) all aid recipient countries had by the end of the year 2002 an external official – public sector – debt of over US\$ 1,064 billion. The official debt of these countries is divided into three categories: multilateral debt, bilateral debt and export credit debt.

Multilateral	489,738
Bilateral	206,477
<b>Export Credits</b>	<b>368,503</b>
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TOTAL	1,064,718



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

The multilateral debt is owed to institutions such as the World Bank, the IMF and the regional development banks. The bilateral debt is owed to individual OECD member countries, and most of it originates from loans provided to developing countries as part of development cooperation schemes.

The export credit debt is the least well-known type of public debt. It is generated by the so-called export credit agencies (ECAs) and fluctuates between 30-40% of the total official public sector debt. This paper explains what ECAs are, how they turn export credits into export credit debt, and what should be done about it.

**Export Credit Agencies (ECAs)**

All industrialised countries have one or more ECAs<sup>2</sup> to provide government support to the domestic business sector in promoting exports and investments abroad. Some ECAs are government agencies (e.g., Britain's ECDG) while other ECAs are private companies running export credit programmes on behalf of their

<sup>1</sup> External Debt Statistics 1998-2002, ISBN 92-64-10621-9, OECD 2004

<sup>2</sup> For a list of ECAs, see: <http://www.eca-watch.org/eca/directory.html>

government (e.g., Dutch Atradius-DSB). ECAs do provide at least three types of official export credit support:

- Direct credits
- Guarantees
- Insurances

ECAs always charge a premium and/or interest for the financial services provided. Official – government supported – export credits require less premium and interest to be paid than those charged for commercial – market based – export credits. A government supported ECA also assumes more risks and offers support for even those transactions that cannot find export credit support in the financial markets. Within the so-called Arrangement on Officially Supported Export Credits of the OECD<sup>3</sup>, all ECAs have agreed to mutually binding common principles. A fundamental aspect of the premium rules in the Arrangement is that the participants need to charge a so-called Minimum Premium Rate (MPR), and that the premium rates “shall be risk based, shall converge and *shall not be inadequate to cover long-term operating costs and losses*” (Articles 23, 22, italics added).

### ***How ECA support is turned into debt***

The fundamental purpose of official export credits is to support domestic corporations in doing business abroad, in particular in riskier markets such as developing countries. This means that, in return for the payment of premium and/or interest for ECA support, a company gets the certainty of obtaining the anticipated revenues from its business. In case the counterpart in the developing country does not pay up, the ECA will compensate the company. Because of the ECA support, the private risk of the company is effectively transferred to the public sector ECA.

After the company has been compensated, the ECA will try to recover payment from the developing country. A key characteristic is that the support of an ECA for an export or investment deal includes a so-called counter-guarantee from the government of the developing country pledging payment in case of default. Many ECAs have for this reason a specific debt collection or recovery department that will apply pressure on governments of developing countries to negotiate and enforce repayment schemes for export credit debt. Due to the counter-guarantee mechanism, the ECA is able to shift the original private risk of the company involved to the government of the developing country. That is how ECAs become responsible for 30-40% of the total external official debt of developing countries mentioned above.

#### **EXAMPLE: Export of medical systems to Uganda**

A manufacturer of medical systems wants to sell US\$ 10 million worth of high-tech equipment to a private clinic in Uganda. The manufacturer requests an export credit from a commercial bank to finance the transaction. This bank will only do so after obtaining an export credit insurance from an ECA. With the premium for the export credit insurance and the interest of the export credit itself incorporated in the price of the equipment, the manufacturer obtains a deal, and the medical systems are exported.

If the private clinic fails to pay for the exported equipment, the manufacturer and its bank will submit a claim with the ECA. The ECA will provide compensation under the insurance scheme on behalf of the domestic government. This government will claim the full nominal amount of the original transaction from the government of Uganda, and add this to other export credit claims on that country. In the meantime the private clinic will be deprived from any necessary maintenance or the supply of spare parts.

<sup>3</sup> Latest version is of 11 June 2004, see:  
[www.oecd.org/topic/0,2686,en\\_2649\\_34169\\_1\\_1\\_1\\_1\\_37431,00.html](http://www.oecd.org/topic/0,2686,en_2649_34169_1_1_1_1_37431,00.html)

### **Debt cancellation**

The government supported ECAs of industrialised countries have a major responsibility for the fact that the risks taken by their domestic private companies are becoming the burden of developing country governments. Together with other bilateral debt, the export credit debt of these countries amounts to more than half of all external official debt. In the cases that indebted countries are not able to pay off their debt, they have to call on the so-called Paris Club<sup>4</sup> to negotiate a rescheduling of the unpayable debt. In line with their responsibility for debt collection, representatives of ECAs are generally part of the delegations of creditor countries to such negotiations.

A rescheduling agreement generally includes a partial cancellation of the unpayable debt. Any such debt cancellation results in the removal of part of the outstanding, and – due to interest accrual – ever growing export credit debt claims from the balance sheet of a creditor country. The total amount of debt that is cancelled is ultimately booked as an expense. The Development Assistance Committee (DAC) of the OECD allows creditor countries to report such expenses as Official Development Assistance (ODA).

#### **Export credit debt of IRAQ**

Two decades ago, the regime of Saddam Hussain was an important business partner for most industrialised countries. Since Iraq had a lot of oil, exports to this country were booming, and so was the support of ECAs for such transactions. After the invasion of Kuwait and the Gulf War of 1991, sanctions against Saddam Hussain were imposed, and all business came virtually to an end. Since then, the former Iraqi government refused to pay any outstanding bill for previous imports. This resulted in a substantial export credit debt that according to some estimates currently totals an amount of at least US\$ 127 billion.

The case of the Netherlands shows that this amount may be more than double the original debt. The Dutch government announced in July 2004 that it claims an export credit debt on Iraq of at least € 245 million (more than US\$ 300 million). However the export credit claims it submitted after 1991 to the Claims Commission of the UN-Security Council (UNCC) totalled a nominal value of only US\$ 135 million. This example illustrates that export credit claims may well double in 12 years time due to interest charges.

### **RECOMMENDATIONS**

- **ECAs should cancel all export credit debt to developing countries**

The fundamental purpose of official export credits is to support domestic corporations in doing business abroad, in particular in riskier markets such as developing countries. The ECAs of all OECD member countries agreed at the end of 2003 to so-called Common Approaches for evaluating their environmental impacts. Similarly the ECAs decided to introduce limited safeguards to prevent corruption and bribery. Also initial agreements were made to avoid support for unproductive (military) expenditures in heavily indebted poor countries. All these agreements, however, not so much enable ECAs to contribute to sustainable development; they simply make ECAs avoid some of the negative impacts of the transactions they support. It is customary knowledge that unpayable debts as generated by ECAs present an insurmountable obstacle for any sustainable development in the South. In

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<sup>4</sup> The Paris Club is an informal group of official creditors who consider it their role to find "coordinated and sustainable solutions to the payment difficulties experienced by debtor nations". The Paris Club has 19 permanent member countries, while other creditor countries may be invited on a case-by-case basis. See: [www.clubdeparis.org](http://www.clubdeparis.org)

light of this it is hard to perceive how ECAs can ever make such a contribution without the cancellation of all export credit debt.

- **Cancellation of export credit debt should not be reported as ODA but as additional non-ODA expenses**

Currently all export credit debt that is cancelled after debt-rescheduling agreements in the Paris Club may be reported as ODA expenditure. According to the DAC of the OECD, only one country – unfortunately not named – creates the excellent precedent of not reporting such expenses as ODA. To achieve the Millennium Development Goals as adopted by the United Nations substantial extra funds are necessary. In the case of the Netherlands annually an amount of € 300 million is reserved for export credit debt cancellation. This costs 10% of the annual ODA-budget at the expense of other development programmes. Although it may be argued that any debt cancellation is good for developing countries, it needs to be reminded that the transactions that resulted in the export credit debt did not necessarily serve any development purpose. Export credits often back environmentally and socially destructive projects rather than serving the public good.<sup>5</sup> This must be considered as another reason to report the cancellation of export credit debt as additional non-ODA expenses.

- **ECAs should ensure that the premiums they charge fully cover long-term operating costs and losses, including the costs for the cancellation of all unpayable export credit debt**

Corporations receiving financial backing from ECAs are required to pay premiums and/or interest for such support. The legally binding Arrangement on Officially Supported Export Credits of the OECD requires that the premium rates are fully adequate to cover long-term operating costs and losses. For this reason all ECAs are required to charge at least a Minimum Premium Rate for country and sovereign credit risk. Similar legal requirements are reflected in other documents, such as the EU-Directive on Medium and Long Term Export Credit Insurance. Such requirements imply that any losses due to the cancellation of export credit debt are to be covered by the income of ECAs generated by premium and interest. In summary the multilateral legal requirements for the ECAs do actually imply that they are not allowed to shift the private risk of a company to developing country governments, and therefore should stop such practices immediately.

### ***More information?***

- International campaign for ECA-reform: [www.eca-watch.org](http://www.eca-watch.org)
- European ECA Reform Campaign: [www.fern.org/pages/eca/eucamp.html](http://www.fern.org/pages/eca/eucamp.html)

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<sup>5</sup> cf. [http://www.eca-watch.org/eca/race\\_bottom\\_take2.pdf](http://www.eca-watch.org/eca/race_bottom_take2.pdf)