SECTION 2

TRADE AND INVESTMENT INSURANCE IN A GLOBAL CONTEXT

CHAPTER 1

THE GLOBAL SCENE

INTERNATIONAL PERSPECTIVE

(a) ORIGINS AND DEVELOPMENTS

Credit insurance, as it is known and recognised today, had its origins in the insurance of domestic credit risks in a number of European countries, especially France, Germany and Switzerland, commencing in the middle of the last century. In Britain, in the latter part of the 19th Century, British merchants shipping goods to Australia created one of the first recorded demands for export credit insurance. After the First World War, the perceived need of many European countries to protect and expand their external reserves and to stimulate employment through the promotion of export activity, added a new dimension to the conception of export credit insurance. This was clearly illustrated in 1919 when the British Government launched the original official export credit scheme with the object of encouraging exports to Eastern Europe where credit risks were considered to be a serious deterrent to the development of British exports.

From that time to the present day, a steadily increasing number of countries in both the developed and developing world have seen in the establishment and development of an export credit insurance scheme an important tool for promoting their export trade, increasing employment opportunities and improving the credit side of their balance of payments. At the same time, the growing incidence of risk in international trading arising from political unrest, trade embargoes and the restrictions imposed by importing countries in balance of payments difficulties on the transfer of foreign exchange required to make payment to foreign suppliers, has boosted the demand from exporters and their financiers for the protection of credit insurance.

(b) THE BERNE UNION AND RECENT DEVELOPMENTS

As long ago as 1934 the emergent practitioners of export credit insurance realised the wisdom and value of co-operating in the development of underwriting techniques and in exchanging information on payment experience and other matters of mutual interest. In that year the export credit insurers in France, Italy, Spain and the United Kingdom founded the Union whose full title today is the International Union of Credit and Investment Insurers.

Since the 1939/45 War, insurance against political and commercial risks in international trade has assumed steadily increasing importance. Both state controlled organisations and private insurance companies constitute the membership of the Union, all participating as insurers and not as representatives of their governments.

The Statutes of the Union provide that its purpose shall be to work for:-

(i) the **international acceptance** of sound principles of export credit insurance and the establishment and maintenance of discipline in the terms of credit for international trade;

(ii) international co-operation in encouraging a favourable investment climate and in developing and maintaining sound principles of foreign investment insurance; and

(iii) to provide for the exchange of information, assistance, expertise and advice in relation both to the commercial and political risks involved in export credit insurance, to the political risks involved in foreign investment insurance and to the range of associated matters relating thereto.

The break up of the Comecon trading bloc has presented a major challenge to the exporters of all the member countries of that group since they now have to compete for business in the international market place.

The responsibility of the management of individual enterprises for the assessment of the creditworthiness of individual countries and individual customers and the need to go to the emerging private market to obtain finance for export activities are new concepts which had to be absorbed and developed once the Berlin Wall came tumbling down. This caused governments to explore and recognise the need for export credit institutions and now only Bulgaria of the old Eastern Bloc countries is without an officially supported export credit institution. Moreover, in the countries of the former Soviet Union there are also developments in this field -in Russia itself and in some of the newly independent States such as Kazakhstan and Uzbekistan.

In other parts of the world, export credit schemes have been.. or are in the process of being, set up in such diverse places as Botswana, Colombia, Chile arid Trindad.

2. THE ROLE OF GOVERNMENTS

Export credit insurance is provided or supported by Governments because they want to encourage national exports. Government intervention has been considered necessary since it is generally believed that the risks, especially the political ones, are too large and unpredictable to be borne by private insurers who need to make a profit to live.

There is no fundamental reason why export credit insurance should not be provided by private sector insurers, at least as far as the commercial risks noted above are concerned. Their evaluation calls for judgements similar to those made by banks and other providers of credit in the ordinary course of their businesses; there are many private sector companies who provide credit insurance against the commercial risk to both domestic traders and exporters. There is, however, much less involvement by the private sector in the insurance of the political risks and such. insurance is often only available directly or indirectly from governments interested in furthering their national interest by encouraging exports. Large and unusual commercial risks may also be insurable only with governmental insurers or reinsurers.

In the countries of the European Economic Community it has been determined that Government support in the export credit insurance field should not be applied to business which can be insured or re-insured by the private sector. This lead to the British Government selling the U.K. insurers (E.C.G.D.) short-term business to the Dutch insurer, N.C.M. E.C.G.D. remains as a Government insurer confined to medium and long-term business. In recent years the private insurance market has shown an increasing willingness to become involved with export credit business, including some greater involvement in political risks. However, outside Europe Governments are still by far the major players in this field.

3. INSTITUIONAL STRUCTURES

The involvement of Governments in the structure and management varies widely from country to country. The main categories are:

(a) Government departments: ECIS in Cyprus, EID/MITI in Japan, ECGD in U.K.

(b) State bodies or government agencies: OND in Belgium, SACE in Italy, BANCOMEXT in Mexico, EXIMBANK in U.S.A.

(c) 100% government owned corporations: EFIC in Australia, EDC in Canada, HKEC in Hong Kong, ECGC in India.

(d) 100% privately owned companies:

- (i) operating as agents of government: OEKB in Austria, HERMES in Germany.
- (ii) with partial reinsurance from government: CASC in Argentina, NCM in Holland, CGIC in S. Africa, ZCIC in Zimbabwe.
- (iii) with no official link with government but with reinsurance agreements with national ECA's: SIAC in Italy.
- (iv) purely private: T.I.C. in U.K., FEDERAL in Switzerland, EXGO in New Zealand.

CONTROL AND DECISION MAKING PROCEDURE

Most ECA's have Boards of Directors but their composition varies very much from one agency to the other: representation of shareholders, mixture of private and public bodies, representation of various public bodies and of regions, exporters and export associations and financial institutions, especially Banks, etc.

The role of the Board, its involvement in the daily business, in the setting of guidelines also differs widely from one agency to the other. In some countries the Board has only an advisory function.

Some members also have to report to or receive guidelines from other (guardian) authorities, advisory bodies etc., who usually are an arm of their government or dependent upon it. The impact of these various bodies on the -decision making, again, varies from country to country.

In summary, you are involved in a significant, growing, diverse and challenging aspect of international trade.

4. TRADE INSURANCE

The purpose of export credit agencies (ECAs) is to provide exporters with insurance against the risk of non-payment for. their sales to foreign customers. The provision of such insurance often has the additional benefit of facilitating the generation of export finance from banking sources; some ECAs provide export finance themselves.

(a) THE RISKS

ECA's are concerned with two types of risk:

(i) the commercial (or buyer) risk - the risk that a foreign buyer will fail to meet his payment obligations to his supplier due to default or insolvency, and

(ii) the political (or country) risks, including:

The transfer risk i.e. the risk that a buyer with adequate local funds available to meet his obligations, is unable to obtain the foreign exchange required to meet those obligations;

the risk that previously issued authorities to import and/or pay for goods ordered and/or supplied may be revoked by the relevant authority in the buyer's country;

the risk that the occurrence of war, revolution etc. may prevent the completion of a transaction either so far as the shipment or delivery of goods, or payment for them, is concerned;

the risk that the authorities in the exporter's country may cancel a previously issued export licence or introduce new licensing requirements that frustrate an exporter's contract.

(b) FINANCIAL OBJECTIVES

As with all insurance operations, ECAs charge a premium for their services. Private sector ECAs seek to operate profitably and therefore charge market rates that they consider likely to achieve this aim. Government or government-backed ECAs are required by the provisions of the WTO[*] not to operate as a subsidy mechanism and generally, seek to at least break even on their operations over time by charging premium rates adequate to cover claims payments and administrative expenses. The imponderability of the political risks is illustrated by the balance of payments problems experienced by many third world and other countries in the 1980's, which gave rise to very large claims payments by the larger ECAs and to the build up of substantial cumulative deficits on their operations in recent years, which have only recently started to be redressed.

Some ECAs have a 'national interest' provision in their constitutions which enable them to refer to government., propositions which do not satisfy their established underwriting criteria but which are of significance, in terms of the national interest of their country. If government accepts such a risk the premiums and the responsibility to pay any claims are for the account of government and not the ECA.

Australia, United Kingdom, Belgium, Sweden and USA are amongst many countries which have some form of national interest provisions. While there are no generally accepted guidelines, the main criteria for giving support under 'national interest' can be summarised as follows:-

importing country risk (off cover for normal business, not judged creditworthy considering the amount of the transaction, uncertainties as to future, etc.)

risks linked to the project (very high value, long term, aid nature of the contract)

home country consideration (goals set for national policy, especially in relation to support for certain industries, matching unconventional credit terms, encouraging the private sector to get into certain developing markets, i.e. pump priming)

[*] World Trade Organisation

These criteria are often applied in conjunction with one another.

(c) TYPES OF BUSINESS COVERED

Export credit insurance schemes were originally designed to provide protection for an exporter who entered into a contract of sale with an overseas buyer on credit terms evidenced by a sight draft, bill of exchange, promissory note or some such well established payment instrument. As the provision of credit facilities to oil the wheels of international trade has become both more extensive and increasingly sophisticated, embracing virtually the whole gamut of trading activities in goods and services, export credit insurers have increased the range and scope of their insurance facilities to meet the demand for protection against the various risks of loss.

Consequently most export credit insurers now offer cover against the particular risks arising when services are provided either alone or in tandem with the supply of goods, when constructional works contracts are entered into, when the goods are leased rather than sold or when goods are delivered to stock or sold through the overseas subsidiary of the insured exporter. These are but a few examples of the growing sophistication of export credit insurance facilities.

Moreover, some export credit insurers in countries which are important suppliers of capital equipment, whose sales involve the most extended risks horizons, have introduced various forms of cover in relation to the foreign exchange risk where their exporter is contracting in a currency other than his own. Such cover is usually only applicable from the time the normal forward exchange market facilities are no longer available and/or where the exporter has to quote a firm price in foreign currency and then be exposed to possible currency fluctuations. while the buyer decides whether or not to award the contract to him.

The type of business covered by ECAs can, generally, be divided into two basic categories:

1. short term credit business involving the sale of raw materials, commodities and consumer goods on credit terms of not usually longer than 6 months, and

2. medium and long term credit business involving the sale of capital and quasi capital goods on credit terms up to 5 years or more, depending upon the nature of the equipment to be supplied and the value of the contract. Contracts for the supply of complete projects may attract longer credit terms up to 10 years or beyond in exceptional circumstances.

Cover on transactions on short credit terms is usually made available under an umbrella policy that requires the exporter to offer for insurance, if not the whole of this export turnover, a spread of his business that is acceptable to the ECA. Cover may be made available against the risks outlined above from date of contract or from date of shipment. Exporters of specialised goods likely to suffer a loss should an insured risk occur before shipment, are likely to be interested in the former cover; exporters of more standard items normally find cover from date of shipment adequate for their needs. Premium rates reflect the credit terms involved and the ECAs perception of the risk, in particular its political risk component. The proportion of loss covered is usually less than 100% in order to leave the exporter with an interest in the debt and its recovery. In the case of most causes of loss claims are paid at a set period after the occurrence of loss to allow time for delays in payment for administrative reasons etc. to be remedied.

Cover for transactions on medium and long-term credit is, usually, provided by the issue of an individual policy for each transaction. The general terms and conditions of such cover are similar to those noted above in respect of short-term cover.

A number of ECAs also provide guarantees to banks who finance the exporter's costs of production. These facilities are especially important for many small and medium sized exporters who would not otherwise be able to satisfy the security requirements of their financiers. This has emerged as a major problem in many developing countries and such facilities play an important part in the activities of ECAs in countries such as India, Philippines and Indonesia.

(d) PROCEDURES

The administration of cover involves:

- The establishment of an underwriting policy towards particular foreign markets and the assessment of the creditworthiness of particular buyers.

This requires the export credit insurer to build up a database of credit information and payment performance on the overseas customers of their export clients. Such information is obtained primarily from specialist credit enquiry agencies and banking sources. However some limited discretion to operate without reference to the ECA may be agreed for short term cover on the basis of the ECAs evaluation of the exporter's past experience and credit control system;

- the notification by the exporter to the ECA of business conducted under short term cover thus providing the basis for the periodic collection of premium and the monitoring of the insured's performance; premium for medium and long term cover is usually collected when the insurance policy is issued;

- the notification by the exporter to the ECA of potential losses;

- the establishment of claims examination and payment procedures;

- procedures for the pursuit of debts that have given rise to claims payment i.e. recoveries.

(c) INTERNATIONAL CONSTRAINTS ON ECAs OPERATIONS

The terms of payment supported by ECAs are, in the interest of prudent underwriting and the desire not to distort normal trading practices, regulated by voluntary agreements between ECA members of the International Union of Credit and Investment Insurers (the Berne Union). Additionally, the terms of payment for medium and long term credit transactions two years and over are regulated by the OECD Arrangements on Guidelines for Officially Supported Export Credits (the Consensus) which sets minium interest rates, minimum down payments and maximum credit periods permissible for such transactions.

The Berne Union understandings on maximum terms of payment are:

i)	Raw materials and semi manufacturers	- 6 months
ii)	Consumer goods and consumer services	- 6 months
iii)	Consumer durables (including related. services)	- Normally 6 months but maximum of 2 years
iv)	Parts or components (including related services) to be incorporated into quasi capital or capital goods	~ Normally 6 months but up to 5 years depending on life of the part and unit value
v)	Quasi capital goods (including related services)	see below
vi)	Capital goods and project services	- 5 years or longer

Minimum Contract Value	Credit Length
$75,000	3 years
$150,000	4 years
$300,000	5 ycars

The following specific agreements apply

The current Agreements are:

<u>Breeding Animals</u>

Normal credit terms are 180 days

The maximum credit terms currently permitted for cattle are:

2 years credit for contracts up to $150,000 and 3 years for contracts over $150,000 but, where more than 2 years credit is granted, a downpayment by delivery of 15% of the contract price should be stipulated.

<u>Bus and Bus Chassis</u>

The maximum credit terms currently permitted are:

5 years from delivery with 15% on or before delivery

<u>Containers and Semi-Trailers</u>

The maximum credit terms currently permitted are:

5 years from delivery with 15% on or before delivery

<u>Agricultural Vegetable Reproduction Material</u>

The maximum credit terms currently permitted are:

360 days from delivery

<u>Paper/Pulp and Lumber/Timber</u>

The maximum credit terms currently permitted are:

180 days from delivery

<u>Fertilisers, Insecticides, Pesticides and Fungicides</u>

The maximum credit terms currently permitted are:

12 months from delivery

<u>On-highway Lorries and Lorry Chassis</u>

The maximum credit terms currently permitted are:

5 years from delivery with 15% on or before delivery

5. INVESTMENT INSURANCE

(a) PURPOSE

Apart from supporting the export of goods and services, twenty four of the Berne Union Members provide a foreign investment insurance facility to protect investments by their nationals in foreign enterprises against loss from such events as expropriation, non-transfer of dividends, war and civil strife. The outstanding amount insured is approximately US$ 43.5 billion.

Two (TREUARBEIT in Germany and OPIC in USA) are specialised in investment insurance, while the others are also export credit insurers. In addition, MIGA, the Multilateral Agency created by the World Bank to guarantee investment is also a member.

CHAPTER II

EXPORT CREDIT AND EXPORT FINANCE

Introduction1. The provision of export credit insurance is a very effective way of stimulating exports. it is, however, a separate activity from the provision and funding of export finance, although they can be closely linked.

Background

2. Each year the 46 Members/Observers of the Berne Union the International Association of Export Credit and Investment Insurers cover about $420 billion of exports and about $15 billion of foreign exports, 90% is in respect of goods and services sold on cash or short term credit (i.e. up to 180 days) and about 75% is in respect of exports sold to buyers in OECD countries.

3. It is clear from these figures that it is quite wrong to see export credit as involved only (or even mainly) with:-

(a) Medium and Long term credit for capital goods or manufactured goods

(b) Exports to Developing Countries or non-OECD countries

4. Indeed a key reason for having an Export Credit Agency is to encourage and support exports sold on cash or short credit to OECD countries.

Bad Reasons for Having an Export Credit Agency

5. As the rest of this paper shows, there are many good reasons for establishing an Export Credit Agency.

6. However, there are also a numbers of <u>bad</u> reasons. For example:-

(a) It is not helpful to either exporters/banks or the exporting countries themselves to stimulate, encourage or support exports to countries or buyers who will <u>not</u> pay for them.

(b) It is expensive and wasteful to use medium and long term export credit as a way of <u>subsidising</u> interest rates paid by overseas buyers. The beneficiary of the subsidy is of course the overseas buyer. OECD countries have learned the hard way how expensive and distorting and wasteful of public expenditure these blanket subsidies can be; this is why they are being phased out. They are, of course, much easier to introduce than to withdraw.

(c) It is not necessary to establish an ECA in order to provide bank finance to exporters in the manufacturing or preshipment stage; especially if such finance is provided at subsidised rates of interest. In any case, the provision of this kind of “overdraft" finance is a normal commercial bank function and it gets banks into bad habits if the Government involves itself in these day-to-day market / commercial decisions, as well as being very expensive for Governments who normally end up with all the bad debts.

Political Risks and Commercial Risks

7. There are many risks involved in exporting but the two categories most usually covered by export credit are political risks and commercial risks.

(a) <u>Political Risks</u>

The main kinds of risk are those relating to the actions of Governments of buying countries in preventing payments being made for imports, e.g. problems with transferring foreign currency, the imposition of import controls, war/civil war, defaults by Government or Public Sector buyers/guarantors.

(b) <u>Commercial Risks</u>

The main risks are the insolvency of the buyer, default or repudiation/refusal to accept goods/services.

8. It is a very common - and very expensive - mistake to believe that it is only political risks which give rise to problems and losses and thus that exports to OECD countries are "safe". Most of the Members of the Berne Union pay substantial commercial risk claims every year - and especially during recessions - on the United States and EC countries. This simply reflects the large number of private companies who every year become insolvent or default on payments.

Protection Against Risks

9. The traditional and still the major reason for having an E.C.A. is first to provide exporters with the confidence to export (i.e. confidence that they will be paid) and second to protect them against losses. For new or smaller companies, one bad debt can be significant enough to cause them to become insolvent.

Access to Bank Finance

10. Export Credit Insurance provides a very useful security for exporters to use with their banks to obtain bank/overdraft finance. In addition, to provide even greater security to a bank, the insurance cover can be given direct to the financing bank by the E.C.A. This is a very important point in most countries but especially in countries where the banking system is undergoing significant change or where new banks may be unfamiliar with the mechanisms and techniques of foreign trade financing.

Information

11. Information on overseas buyers and countries is expensive to obtain and keep up to date. It is not, therefore, cost effective for all exporters (or banks) to try to do this for-themselves. Worse still, is for them to sell (or finance) "blind" with no information. An E.C.A. thus offers the possibility of a single/central body collecting and maintaining

information (and exchanging it with similar bodies overseas) and thus obtaining economies of scale to the potential benefit of all those in the country involved with foreign trade.

Expertise

12. Like information, expertise in technic al aspects of foreign trade and trade financing is scarce and expensive. An E.C.A. provides a focal point within which to concentrate these scarce resources (and a cost effective way of obtaining and developing them).

13. In other words, an E.C.A. offers more to exporters and banks than insurance only.

The Importance of Marketing

14. The need for export credit insurance and the many varied benefits it can bring (see paragraphs 9-13 above) are not always obvious to companies, banks and administrators, especially where an economy has been operated on a "State Trading" basis, i.e. effectively where the Government made all the key decisions and took all the risks.

15. Thus there is a vital need:-

(a) for an E.C.A. to develop its products with particular reference to the situation in its own country (and not simply transfer/import products and facilities offered by E.C.A.s in other countries).

(b) to give great attention to and emphasis on active and professional marketing to both companies and banks. In other words, it is no use simply waiting for customers to come to see the E.C.A.. The E.C.A. must get out into the business and banking community and vigorously market its products and services.

Political Risks

16. It is unusual for political risks on buyers and countries outside the OECD to be underwritten either on its own account by a private company or E.C.A. or for the Private Reinsurance market to be willing to reinsure such risks.

17. It remains diificult to reinsure medium and long term political ' risks (including risks on Government / Public Buyers) in the Private Reinsurance Market.

18. Thus, for all those Members of the Berne Union who provide Medium and Long term insurance cover, this business is either reinsured by the Government or written on a "National Interest" basis on the account of the Government. Some short term business may also, in specific circumstances, be handled in this way.

Decisions on Political Risks

19. Decisions on political risks (especially on Medium and Long Term cover) are thus usually taken by the Government. It would be a normal arrangement in most countries for political risks on buying countries or on individual cases to be considered by a Government Committee of some sort. Such a Committee would either take the decision or make Recommendations to the Ministry or Ministers who will take the decision(s).

20. In many countries, the Chairman of such a Committee will often come from the Ministry of Finance or Treasury.

21. Amongst the Government Ministries or Departments or Institutions which would usually be represented at a very senior level on such a Committee would be the following:-

(a) Ministry of Finance or Treasury
(b) Ministry of Trade or Foreign Trade
(c) Ministry of Foreign Affairs
(d) Ministry of Foreign Economic Relations
(e) Ministry of Foreign or External Affairs
(f) Ministry of Industry or Commerce
(g) Ministry of Agriculture
(h) Central Bank

22. The decisions taken by such a Committee would either set the limit on business which can be insured on a particular market (e.g. exposure on, say, New Zealand can be underwritten of up to $25 M on short credit terms and up to $50 M on a medium and long

credit terms) or to approve an individual case (e.g. exposure of $15 M can be underwritten on a project to supply engines to the Electricity Board in Turkey). Often such Committees will also approve the premium rates which will be charged for such business/cases.

23. It is often helpful for the Secretariat for the Committee to be provided by the E.C.A. and for recommendations on countries or cases to be made to the Committee by the E.C.A.

Accounting

24. It can be helpful when underwriting such business for two things to happen:-

(a) First, from the premium paid by the exporter for the cover, a fee for the administration of the cover should be deducted and retained by the Export Credit Agency to meet its costs.

(b) Second, for the balance of the premium on such cases to be retained in a special foreign currency account and not paid into general Government revenues. This special account can then be used to finance or pay any claims on such business, which may be submitted in due course by exporters. Thus only if there is not sufficient funds in the account to pay claims would the Government be asked for funds.

Export Finance

25. The points above relate to export credit insurance. However, in many countries there can be problems in funding or financing export credit. They can arise in two main ways.

Pre-Shipment Finance

In some countries, it can be difficult for the commercial banks to provide finance to exporters to enable them to carry out export contracts. In OECD countries, such finance normally comes from an exporter's working capital or from his overdraft from a commercial bank.

However, in other countries, the commercial banks may not be either liquid enough to provide working capital on the necessary scale or they may be cautious about lending on the scale required or may require special security from exporters for such lending.

In such cases, the exporter can sometimes be helped to obtain the necessary working capital for pre-shipment finance if either the insurance from the E.C.A. is assigned to the bank or if the E.C.A. can give some kind of insurance direct to the banks.

29. ECA's need to be cautious about underwriting the exporter (as opposed to the overseas buyer) as there can be problems in sharing security etc. with the banks. However, in some countries, special schemes exist under which the E.C.A. gives cover to the banks who provide working capital/preshipment finance to the exporters (e.g. in Indonesia and Mexico).

Medium and Long Term Finance

It will sometimes be the case that the commercial banks are unable or unwilling to fund medium or long term credit. For example, if an exporter sells on 5 year credit to a buyer overseas, he (the exporter) will normally expect to be paid by his bank by delivery and then the bank waits to be repaid by the overseas buyer/borrower over the 5 years. Repayments of principal and payments of interest will normally be made at six monthly intervals during the credit period. The repayment risks (both political and commercial) will normally be covered by the insurance from the E.C.A. but this still leaves the financing bank with the funding problem. In many countries, this is a problem, which the commercial banks cannot solve, i.e. they are unable or unwilling to raise either from domestic or international sources to the 5 year deposits to "match fund" the credit extended to the overseas borrower/buyer.

-In some countries, this problem/difficulty has been approached by the Export Credit Agency giving guarantees direct to the banks but, in other countries, this has not solved the underlying funding problems and so the Export Credit Agency or some other Government institution have been involved in funding.

The funding, in some countries has been taken over by Eximbanks. There are two main kinds of organisation:-

(a) Direct Lenders

There are institutions who lend direct to overseas borrowers or buyers (e.g. as in the USA and Canada). The advantage of this arrangement is that it is direct and often raises and disperses funds in the lowest cost way. The main disadvantage is that it prevents the commercial banks from developing the ability to borrow and lend for medium/long term credit and can also inhibit the development by the commercial banks of other export and trade finance skills.

(b) Refinancing

There are institutions who raise funds but do not lend direct to borrowers or buyers but refinance or fund facilities extended by the commercial banks (e.g. as in Austria).

33. There is no single best way of organising these institutions and so there are various kinds of banks. For example:-

(a) Institutions such as those in the United States (similarly in Australia, Canada and Turkey) both provide long term loans direct to overseas borrowers and also provide associated and, where necessary, free standing export credit insurance.

(b) Institutions such as those in Sweden, India and Korea operate <u>separately</u>. In other words, the funding and finance is provided for long and medium term exports direct to overseas borrowers/buyers but the associated (or free standing) export credit insurance is provided by a separate institution. It is possible for the export credit institution <u>to</u> provide insurance to the export \ import bank.

(c) In Japan the export credit institution (EID/MITI) and the Exim bank are quite separate and insurance is <u>not</u> provided by the export credit institution 'to the Export Import Bank. In other words, where the Export Import Bank lends on a medium and long term basis, then no insurance will be provided. Conversely, where export credit insurance is provided in respect of medium and long term credit transactions either to exporters or to commercial banks, then the Export Import Bank will not be involved.

(d) In Austria (and soon in the Czech Republic), the institution can raise funds in its own name (or with a Government or Central Bank guarantee) and can then refinance medium and long term credit facilities extended by the commercial banks. Such institutions can either be part of or separate from the E.C.A.'s. However, if they are part of the same institution then it is very important that the activities (or certainly the Accounts) are kept separate.

<u>What is the Best Kind of Organisation?</u>

34. There is no single "model" which is the best one in all circumstances in all countries.

35. The key should be to produce an institution and an arrangement, which are best suited to the particular needs of the country involved. They may need to change as, for example, the activities and expertise of the commercial banks increase.

<u>Main Activities</u>

36. It is helpful to distinguish between three major kinds of activity in a Financing (or Refinancing) Institution. The major ones are:

(a) <u>Raising Funds</u>

This will probably need to be done in the international capital markets and, for many countries, the finance will need to be raised in the name of, or with the guarantee of, the Government. The "cleaner" the guarantee, the lower is likely to be the margin, which has to be paid to the lenders/providers of the finance. It is important that the borrowing or capital raising activity is very closely aligned with the other international borrowing of the Government and/or the Central Bank. Advice on trimming and pricing and terms can be obtained from foreign merchant banks etc.

(b) <u>Holding Funds</u>

Since it is very unlikely that it will be possible to raise the funds at (a) above exactly to match loans for medium and long term export credit on a case-by-case basis, there will be a need to "hold" funds. In other words, there will be mismatches between borrowing and lending/refinancing. Since interest will have to be paid on the borrowings, the funds must be used so as to raise income to pay the interest until such time as the funds are used for the export credit contract. This is a "Treasury Management" function but it requires special skills if losses of various kinds are to be avoided.

(c) Lending/Refinancing

This nature of this activity will depend on whether the institution is to be a direct lender or a provider of refinancing. An important point will of course be whether such funds are to be restricted to export contracts which are insured by the E.C.A.

37. In all of these activities the links with the Central Bank will be of central importance but much will also depend on the skills and experience/expertise and balance sheet strength of the commercial banks. The role of the Bank Supervisors will also be important in terms of how they treat (for balance sheet weightings and risk ratios) the export credit lendings of the commercial banks.

Summary and Conclusions

38. The role of the E.C.A. is very important. This can be concentrated on insurance but this can also involve or have a very close relationship with financing and funding. There is no single or best solution of universal applicability. Systems need to be designed with particular reference to the individual circumstances of the country concerned.

39. What is best for an individual country at a particular time depends on a number of factors. It is a mistake to try simply to "transplant" a model from another country. Many countries have tried this and have failed or have had to make rapid changes to the model they "imported".

40. Thus the essential first stages are:-

To analyse the needs of the individual country and its exporters and banks.

(b) To be aware both of the various arrangements which apply elsewhere and the various kinds of institutions which operate in different countries (some of which are referred to above).

(c) To try to develop the institution(s) for the country from the "models" at (b) which should fit the needs of (a).

CHAPTER III

OPPORTUNITIES AND RISKS ININTERNATIONAL TRADE

INTRODUCTION

At the request of the conference organisers, concentration will be mainly upon short term business which constitutes the bulk of international trade. Accordingly there will be no reference to business conducted on medium to long term credit.
Technicalities will be referred to only briefly. The focus will be on those issues with which managements should be concerned.

OPPORTUNITIES AND RISKSFew opportunities are without risk. However many risks do not necessarily represent opportunity.
To a significant degree they are indivisible elements in the larger picture.

Before turning to a consideration of specific Risks and specific Opportunities several observations of a more general nature, but which bear upon the specifics.
Exploiting opportunity, having first identified it, depends partly on the nature and magnitude of the risks you are prepared to assume.

The identification and exploitation of opportunity in International Trade should flow from the Basic Objectives of your enterprise eg. is International Trade to be Y% of your total revenues or 3Y%? Is it to come from developed countries or undeveloped countries? What is the Maximum Risk Exposure you will accept? The answers will obviously influence strategies and outcomes.

But the first imperative is that the Objectives are clearly defined.
Successful outcomes will rest to an extent upon the Resources committed to the objectives.
The most vital Resources are Capital, Strategic Alliances and People.

Sound capitalisation is fundamental. Although it states the obvious, many have failed to recognise that thin capitalisation may cause the enterprise to falter and perhaps topple in adverse winds. Conversely, sound capitalisation gives both a solid base to the business and an important flexibility - such as the chance to try new markets and to assist in the diversification of your sources of revenue, whilst keeping to the business you know.

Strategic or Operational Alliances often play a valuable part in international trade. Knowledge of local trade and conditions in a foreign country is invariably an advantage and may help cement a profit or avoid a loss! Local partners of good repute and substance are frequently the difference between success and failure offshore. Such partnerships may well be at different levels - Strategic where you are seeking to establish direction and purpose, or Operational for the day to day needs of the business and vital linkage to your home-based staff.

However the most important resource is your people. Successful enterprises usually have quality staff, well selected, well trained, well motivated and rewarded, but above all they will be well led. In tomorrow's world it will be more important than ever for leaders and their people to have the knowledge, intelligence and flexibility to recognise changing economic and industry trends - which will occur faster than in today's world. Then, having recognised them, to devise successful strategies for change.

RISKS

What is the nature and magnitude of the risks in International Trade? How are they to be managed? It is tempting to assume that all risks are external. The fact is that some of the principal risks are internal - with your own enterprise.
They include: failure to clearly identify the Objectives of the enterprise; undertaking business risks with which the business is unfamiliar; setting unrealistic revenue and profit targets, especially in the short term, and finally but not exclusively; having the wrong people in positions of responsibility.

All of these risks are controllable if management is effective. Unfortunately, inadequate management has sometimes ignored or failed to perceive these risks. They can have serious consequences for profit, asset values and at worst, may imperil the very existence of the enterprise.

A common fault in the management of risk (in addition to the failure to understand the risk!) is failure to place monetary limits on the exposure of the enterprise to any one country, industry or buyer. Compounding this problem is the difficulty of recognising the interrelationships, which may exist between different buyers to whom there is an exposure. Ideally your enterprise should be able to withstand the failure of your major debtor risk. This however is a test, which many creditor companies would not survive.

The external risks are perhaps more apparent, if only because they are further away and we are able to focus more objectively upon them.
By definition International Trade involves dealing with buyers in foreign countries whose culture, legal system, and economic well being may be quite different from
that to which you are accustomed. Accordingly your knowledge, whether of country, industry, or buyer may not be of the order you would expect of a domestic transaction.

International Trade will frequently involve a greater degree of uncertainty and unpredictability than domestic trade, and your ability to influence or control outcomes will almost certainly not be of the same order.

It is interesting to note that in the period from 1990 to 1995 a significant change took place in the direction of the exports of Thailand and of all of its major export markets. In 1990 Industrialised Countries (excluding Japan) accounted for 50% of Thailand's exports and from 41 % for Singapore to 59% for Japan. By 1995 these figures had fallen to 36% for Thailand, 35% for Singapore and 48% for Japan.

Perhaps not surprisingly, exports to Asia, including Japan, had risen sharply. In 1995 they accounted for 53% of Thailand's exports (39% in 1990), 55% of Singapore'51 % in 1990) and 44% of Japan (31 % in 1990).

These figures, a representative few, give some indication of how significantly the risk element attaching to the direction of a country's trade had shifted in a short period. Intra - Asian trade had become much more significant than trade with the non Asian world in the relatively brief period of five years.

Adversity can arise with bewildering speed. The events in Asia during recent weeks provide a graphic illustration. The global market place is with us, and nowhere is there a haven from economic or commercial damage.

The rate of change in economies, industries and enterprises is rapid, and not likely to become less so in the near future. It is profoundly important that the risk of change is both anticipated and recognised --- and then turned to advantage.
In today's world, external events are more likely than ever to influence not only international trade but also, and possibly more significantly on occasions, domestic trade.

Globalisation will continue to bring many benefits. It will also create risk. One example is the increasing demand for more liberal terms of payment, Buyers who would in earlier days have almost automatically paid by Letter of Credit are now quite often calling for terms - and, not infrequently, on Open Account. There is little doubt this development is exposing more Exporters to more risk, a risk that can be mitigated by the use of Credit Insurance.

From the technical perspective of a Credit Insurer the specific risks in International Trade fall into two broad categories, Commercial Risk and Political Risk.

Commercial Risk covers the, Insolvency of the Insured Buyer and the Buyer's Protracted Default. The latter comprises only a modest percentage of Commercial claims against Credit Insurers. Coverage is usually for 85% of loss, incurred - With individual Insurers varying this percentage by 5% up or down.

Political Risk covers loss arising from events in the Buyer's country such as war, civil riot or commotion, exchange transfer delays or blockage, and cancellation of import licences. Insurers usually cover approx. 90-95% of the amount of loss incurred due to Political causes.

The majority of claims paid by credit insurers are caused by commercial events. Moreover, from an historical viewpoint, political events causing loss are far more likely to arise in the less industrialised countries. Examples of political events causing claims for credit insurers in recent years have been: conflict in Kuwait; the collapse of the Soviet Union; and banking difficulties in Turkey, Venezuela, Argentina, and Bulgaria.

It is a fact that the distinction between Commercial Risk and Political Risk is becoming a little blurred around the edges. A significant devaluation of the currency of the buyer's country may well have a serious impact on the buyer's ability to meet import costs in his now, devalued currency - a commercial event caused possibly by political developments after the goods were imported.

Traditionally the bulk of Political Risk support has come from Governments standing behind their State owned insurer. However there has long been a private reinsurance market for Political Risk provided partly from Lloyds and partly from the general reinsurance market. There are some indications that the private market may be developing a larger appetite for Political Risk than has been the case for many years. Should this prove to be the case then the demand for such cover may increase still further to capitalise on the additional capacity available.

THE ROLE OF CREDIT INSURANCE IN MITIGATING RISKBriefly put, credit insurance provides policyholders (trade creditors) with protection against loss arising from the insolvency of their trade debtor, or from loss arising from defined "political" causes of loss. Europe was the birth-place of credit insurance. It remains the dominant force to the present time, although strong growth has occurred beyond Europe.

The industry is represented by two world wide bodies. The Berne Union of Credit and Investment Insurers, and the International Credit Insurance Association. Both were formed in the 1920's. The Berne Union membership is composed mainly of Government Departments or Agencies, or corporations in which Governments have a majority shareholding. Of the Berne Union membership of 46 (from 38 countries) most are public enterprises although some of the largest members are from the private sector. The ICIA membership of 45 (from 28 countries) includes a number, which are also members of the Berne Union.

Between them they insure an estimated 10% of exports from member countries. ICIA members also insure an estimated US Dollars 1000 Billion of domestic trade.

It is undoubted that credit insurance has become an important facilitator of trade. This is perhaps not surprising given that credit insurance protects cash flow, profits, assets, and not infrequently the very existence of the policyholder.

It is however important to recognise that credit insurance is not a substitute for effective credit management. Rather it is a particularly useful aid to the competent credit manager. And, most importantly, credit insurance cannot turn a bad risk into a good risk. Credit insurance is also a valuable marketing and sales weapon, an aspect of the industry which has not been sufficiently well presented by the industry, and which accordingly, is not clearly recognised by industry and commerce.

Credit insurers have access to economic, industry sector and credit intelligence on a worldwide basis, so not unreasonably they should be able, and are indeed expected, to add value. Additionally the credit insurer would be expected to have formidable export, and where appropriate, domestic trade sector expertise.

To illustrate the point, Trade Indemnity was the UK's largest privately owned credit insurer, covering in excess of US Dollars 100 billion of trade credit annually of which approx. 25% was export business. Of its 800 staff approximately 130 were engaged in Underwriting or Risk Management for both, Domestic and Export business. They were expected to have trade sector competence (if not expertise), and, for the export business, a strong knowledge of international trade practice and country risk.

A final point before turning to Opportunities is that a close working relationship between the policyholder and the credit insurer is important. The relationship is closer than that of many bank / customer relationships - usually with beneficial results.

OPPORTUNITIESInternational trade is the economic life force of many nations. It has grown strongly and consistently for many years. In particular it has grown strongly in Asia, where the rate of growth has outstripped that of North America and Europe by a wide margin.

Despite recent upheavals, it is more than likely this story will be repeated over the longer term.

The emergence of China in the next two decades, as an economic powerhouse will itself impact significantly upon world trade, and Asia's role in particular.

There are numerous other influences. Trade barriers are gradually being removed. The wealth of nations is increasing. New middle classes are emerging. International barriers are being lowered. Overseas investment by many countries is increasing. Globalisation has become a fact of life. Bul perhaps most importantly of all, we have entered a new information / communication revolution which will transform economies, trade and enterprises to a degree we cannot at present imagine.

Each of these developments will create opportunities in international trade. More specifically the ability of an enterprise to be competitive will create opportunity - or lose it! But so it has always been. In future however the pressures to be competitive on an international basis will be far greater.
As an example let us consider some of the opportunities, which may lie ahead for Thailand - somewhat similar considerations would apply to other Asian countries.

A brief backward glance is educational. Thailand's rate of export growth has been exceptional by world standards, but in line with most other Asian countries. However, as mentioned earlier, most of the growth has occurred within Asia. Of the increase in Thailand's exports from 1990 to 1995 some 63% went to other Asian countries, 28% to the U.S.A. 4.2% to the Middle East, 3.6% to Eastern Europe, 1.1% to Africa and less than 1% to the South Americas.

Whilst these figures suggest that opportunities have been captured, they also highlight an undue concentration on two geographical areas. Penetration of Continental Europe is extremely low. Given the size of that market, and the greater dynamism which one would expect from acceleration of the E.U., there would seem to be attractive possibilities in that part of the world. Neighbouring Eastern Europe also has a very low penetration by Thailand. There are some markets which would present opportunity, Poland and Slovenia for example, but their scale and time horizon would be decidedly more modest than those of Western Europe. A somewhat similar observation may be made of the South Americas.

Developing opportunities takes time, money and effort. We are back to the Resources issue discussed earlier. There is good reason to believe that if the resources are made available, and if an innovative approach is taken to product development and the establishment of alliances, then Thai exporters should be able to diversify their markets to a greater extent than evident in recent years. However we must not expect too much too soon. This is a strategic and tactical error made frequently by Western companies seeking out opportunities in Asia. There is no substitute for sound medium long term planning accompanied by stringent financial objectives and controls.

None of this is to argue for pessimism within the Asian region. You are now experiencing what many of us elsewhere have gone through, and unpleasant as it may be, there are numerous examples of such adversity leading to enhanced strength. There is good reason to feel that Asia will continue to represent one of the major areas of opportunity for Thailand's exporters.

Finally it is impossible to ignore the United Stales - one of Thailand's major export markets, and one which will continue to provide attractive opportunity, The world's largest economy has considerable underlying strength and flexibility It will surely remain a vital area of opportunity.

What are the risks for exporters in developing these opportunities? First it can reasonably be said that the U.S. and Western Europe represent very low risk from a political cause of loss standpoint. The same cannot be said of Eastern Europe, Africa, the Middle East or the South Americas, where stability, both political and economic, is of a somewhat lower order. Bearing in mind that in the near future both the U.S. and Western Europe could have interesting potential for Thai exporters, this assessment, if valid, is encouraging.

Whether the potential can be captured will depend on the results of research. For example, are your products appropriate, if not can they be adapted for the export market, what is the likely level of demand, what is the level of competition - these and many other questions need to be examined. Your country's Trade Offices often have good market intelligence, international banks should provide helpful advice, and of course so should credit insurers. These avenues, together with your own research, will help you decide the quality of the commercial risks (as distinct from political risks) you face in developing a new market or more business in an existing market.

Many payment problems for exporters arise from either their excessive optimism about their buyer, based on years of satisfactory payment experience, or from relative ignorance about a buyer new to them. Both of these hazards can be lessened, by a combination of research, effective relationships with Trade Offices and international banks, and perhaps most especially, credit insurers.

A potential for Thai exporters to diversify their markets does seem to exist, and interestingly, if Western Europe is seen as a target, it is an area about which a great deal is known, thereby, one hopes, lessening the risk of engagement.

THE ROLE OF THE CREDIT INSURER IN EXPLOITING OPPORTUNITY

The Credit Insurer should be an essential element in the strategic considerations of any enterprise engaged in international trade. It has the capacity to enable the enterprise to step more broadly and yet more safely in the international arena. Skilfully used, credit insurance should assist in the diversification of markets, (thereby reducing any overdependence on any one market), in product innovation and in the broadening of the customer base. It can and has done all of these things, with enterprises of all sizes.

It has been said earlier that credit insurance protects cash flow, profit, and assets.
It also provides valuable market intelligence and an unrivalled quality of credit and risk assessment.
Close and effective cooperation between Credit Insurer and Policyholder should give the Exporter the potential to make increased sales to existing customers, to develop new customers in existing overseas markets, and to open up new markets.

The principal commodity possessed by Credit Insurers is Risk Capacity, which can be more effectively utilised by the Exporter and the Credit Insurer working in harmony.

The Banks have an important role to play. They are obviously heavily engaged in International Trade. Not infrequently Banks will have as collateral security policies of credit insurance, effected by the Exporter and assigned to the Bank. Whilst it is interesting to observe that Exporters seem to make more effective use of Credit Insurance than domestically oriented enterprises, there is still a good deal of room for better use to be made of Credit Insurance by both Banks and Exporters. Essentially, Banks should be able to lend more support to the Exporter, with a greater degree of security via the Credit Insurer, than would normally be the case in an uninsured transaction.

Competition is creating demand for credit. Many buyers who would previously have paid by Letter of Credit are now demanding terms - and quite often on Open Account. Credit Insurance has a particular value in such circumstances, enabling the Exporter to offer credit terms with the comfort of the Insurer behind the transaction.

Credit Insurers therefore have a practical and valuable contribution to make to the development of opportunities in International Trade. But there is ample scope for more to be achieved.

LOOKING AHEAD

It has often been said that there are only three certainties in life - Birth, Death, and Taxation. There is however another - Change.

The rate at which change now takes place is often literally breathtaking, and so on occasions, is its magnitude. But change so often brings with it Opportunity. Part of the challenge is to recognise the change and then to see how it can be turned to advantage.

The communication and information revolution which we have entered is but one example of tomorrow's opportunities. The emergence of China as an economic giant will be another. So too will opportunity flow from the continuing privatisation of Government enterprises - as will the changing nature of enterprises themselves in the coming decades.

Some of these opportunities will arise in International Trade. They cannot and should not be ignored. But Exporters, Banks and Credit Insurers will need to exercise imagination, intuition and innovation to seize the initiative. This may well require the leaping of a few conceptual hurdles, especially on the part of Credit Insurers and the Banks. But an ability to look beyond the horizon will be an invaluable asset.

The Export Community should regard credit insurance as a potent financial management and marketing and sales weapon. Credit Insurance is a dynamic, not a static weapon. Skilfully brandished it has the potential to Protect and Promote enterprise.

Those present today are either engaged in or about to embark upon careers in International Trade. It is in my experience a highly stimulating career, one which offers not only intellectual challenge but also the immense satisfaction of daily practical application.

There is one special challenge, which has both intellectual and practical application. It is to seek ways for the international community of manufacturers, traders, bankers and credit insurers to work more closely together. In so doing you will truly capitalise on opportunities whilst mitigating your risks.

Appendix 1 - Summary

(Global view on trade and investment insurance)

1. General characteristics of trade and investment insurance -covers risks for which private companies often cannot provide insurance -measure for the promotion of sound external activities -principle of balanced budget

2. Role of trade and investment insurance
   - providing security against risks
   - facilitating finance for external transaction
   -measure for trade policy of Government

3. Administration systems of trade and investment system
   - involvement of government

4. Underwriting policy
   - spread of risks
   - individual contract / comprehensive contract
   - risk analysis necessary for underwriting policy
     political risk : country risk analysis
     commercial risk : rating of overseas buyers etc.
   - underwtiting condition

5. Future issues related to trade and investment insurance
   -positive underwriting policy as a governmental insurance
   -response to new type of finance
   -implementation of debt-relief
   -cooperation amongst the trade and investment insurance organization