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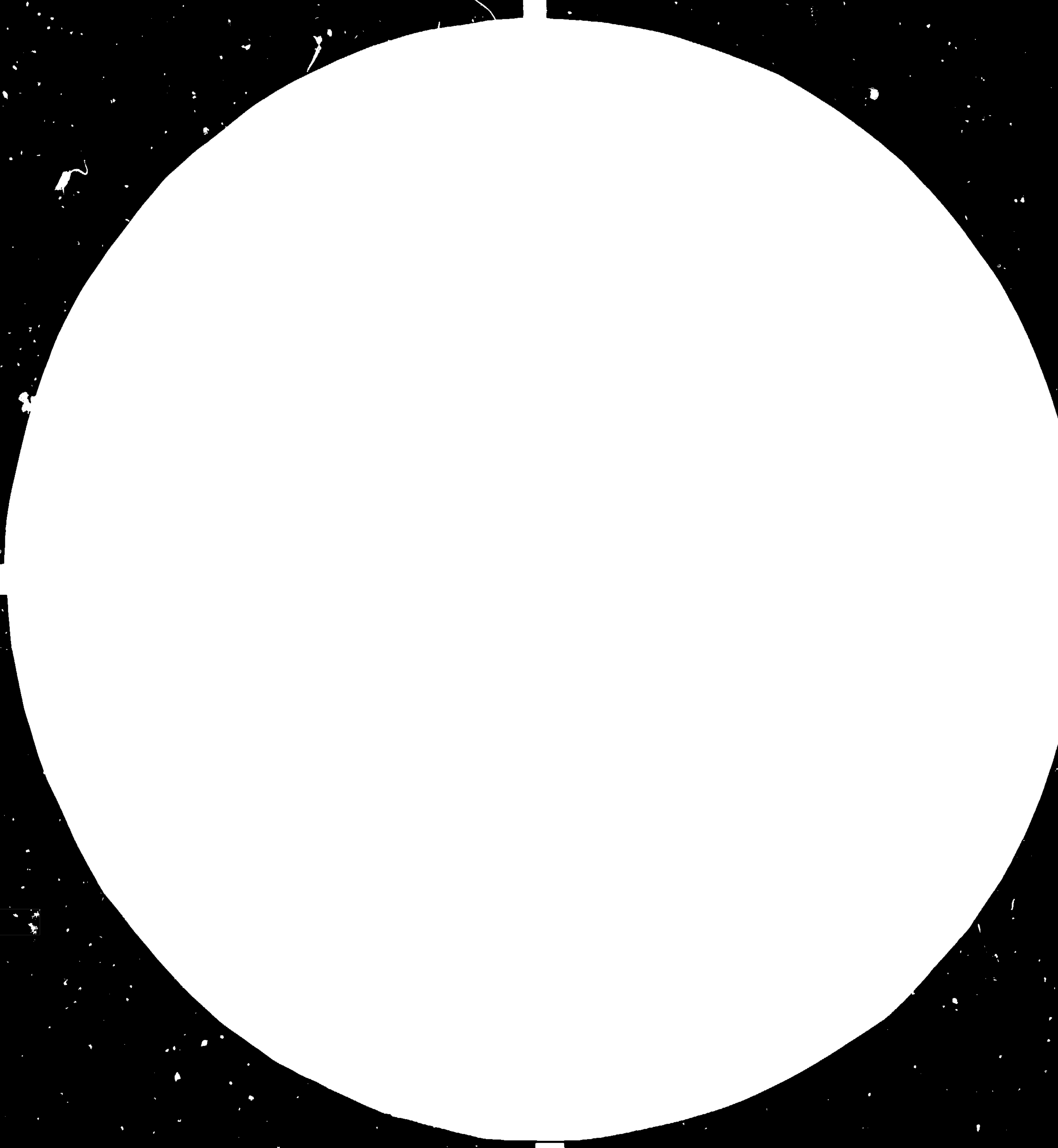

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Information Paper

Policies of Export Credit Agencies in Financing of Training Component in Industrial Projects

1984

"There is no such thing as export credit policy that one can put one's finger on: it is made up of a lot of strands of views, aspects of policy, which have to be brought together from time to time in the context of a particular question."

In most countries, official support is chiefly confined to medium- and long-term credit which is used to finance exports of capital goods. Since these are usually large, complex, one-off orders, the provisions for export credit are often determined in the context of an individual transaction. Exporting countries have not consciously derived policies in this area. In so far as training is distinguished from other components, its treatment reflects the importance assigned to it in relation to various policy objectives.

Official export credit facilities

Initially, official support was given to export credit to prevent export orders being lost through lack of finance. Further the reluctance of banks to take on additional risks increased the involvement of Governments in insurance activities and export finance. In some cases, official export-banks made direct loans while in others, the central bank refinanced export credit advanced by commercial banks.

Lately, due to the deterioration of the economic climate, protection against inflationary pressures, volatile exchange rates and slack demand have become a major reason for seeking official support. Export credit agencies have also introduced new facilities, including cover for performance and other bonds, support for pre-shipment finance, exchange rate guarantees and cost escalation schemes.

The supply and demand for industrial training

As capital goods have become large and more complex, emphasis on training of manpower for efficient utilisation of machinery has increased. This has been reinforced by the tougher competition that exists among exporters due to the recession in the world economy. Importing countries have also begun to realise that full benefits, even from a "turn-key" project can only be reaped if their personnel are adequately trained to ensure smooth production. Hence, training, at least as a concept, is now more widely accepted than it was a few years ago.

The cost of export credit

All the OECD countries, except Iceland and Turkey, offer some measure of official support, and so do some non-OECD countries (including Argentina, Hong Kong,

India, Israel, Korea, Pakistan and South Africa). Some 85 per cent of the export credit supported by OECD countries comes from five countries: France, the Federal Republic of Germany, Japan, the United Kingdom and the United States; and some 70 per cent is for exports to developing countries.

In exporting countries, at the least, the export credit agency provides an official guarantee for a commercial loan. In addition it may deal with a lower rate of interest for a longer period of time than would be available for a commercial loan. This can be done either by making a direct loan, refinancing a commercial loan or subsidising the interest rate on a commercial loan. Some countries even provide mixed credit in which export credit is supplemented by aid funds. Other facilities which are sometimes subsidised include premiums, pre-shipment finance, cost escalation insurance and foreign exchange guarantees. Hence, given governments' readiness to guarantee export credit and often to refinance it, export-credit business is virtually risk free and moreover, once an agreement is completed, it generates very few costs.

Normally, the predominant policy considerations in deciding whether or not to guarantee/finance (in some countries one is synonymous with the other) an export credit or how much subsidy to provide, are the impact on the balance of payments and domestic employment. A further stage in decision making is to assess competititon from other exporters with respect to price, quality of design etc., and accordingly make the financial terms more favourable. The costs considered are usually those imposed on public expenditure or the indirect ones borne through the distortion of the financial market.

From the point of view of the importing country, the effect of the export credit should be seen against the background of the overall development strategy employed and the foreign and domestic planning policies.

The international framework

During the 1970s export credit was seen by exporting countries as being increasingly wasteful. The subsidy was placing a growing burden on public expenditure, while international demand for capital goods slackened. The purpose of the subsidy was to promote exports and/or widen the share of the country's market. However, in the face of the prevailing economic climate and matching subsidies by other countries, this objective was coming to the nonce.

Various agreements in 1974, 1976 and 1978 were laid down regarding the minimal rules of export credit. Guidelines were established concerning minimum down-payments, maximum repayment periods, and minimum interest rates. Further, certain categories of exports were excluded - military equipment, agricultural commodities and the like.

Within a short period after these agreements, however, market interest rates rose sharply, thereby increasing the cost of subsidy to most countries. There were clammers by major governments to increase minimum rates. Eventually, in mid 1982, the participants compromised on increases of 1.15% for rich countries, 0.35% for intermediate countries, and no change for poor countries (classified according to per capita GNP figures). Two other important and substantial changes took place:

(a) Establishment of a buffer zone between export credit and mixed credit. In future mixed credit with a grant credit below 20 per cent will not be permitted; and

(b) revision of the prior commitments clause in the arrangement. This implies that the terms of a prior commitment can apply only for six months after minimum rates have been changed.

Prospects

There is little evidence of clearly defined policies towards official financing of training, apart from a few instances of specific limitations, such as those set by Coface for the repayment period. Training is regarded as comparatively risky because the scope for dispute is greater and recourse in the event of non-payment is more limited; it contributes little to domestic employment, a major objective of export credit policy; and, unless there is a particular incentive, the general tendency to approach financing for training cautiously dampens competition among export credit agencies in this field.

Developing countries could adopt three lines of approach in seeking to improve the terms on which they obtain this financing. First, they can try to turn the existing system more to their advantage; second, they can endeavour to bring about a change in the attitude of export credit agencies. And, thirdly, a greater proportion of aid can be used to finance training.

To use more aid funds in the financing of training associated with capital goods exports may appear on obvious and satisfactory solution but it has several drawbacks. Countries allot only a limited sum of money to their aid budgets. When an exporting country provides aid funds to finance an export of training, the amount of aid for other purposes is lowered. It imposes constraints, bureaucratic procedures have to be followed and if the results of training are unsatisfactory a developing country has little recourse. Furthermore, the less training is regarded as a commercial activity, the less competitively it is likely to be supplied, and the less inclined export credit agencies will be to treat it on a par with other exports. It is important to recognize the distinction between aid policy and export credit policy, whereas aid policy is directed, albeit imperfectly, to the needs of developing countries, export credit policy aims to advance the interests of the exporting country by promoting its

exports. Developing countries should, as they have in the past, exert influence through exporters to bring about adjustments to policy which they considered desirable but they should also make their increasing market power felt more directly.

The relatively high risk attributed to training derives in part from the fact that historically training was included in capital goods exports almost as an afterthought and still is often only summarily covered in contracts. To avoid problems the training clauses of contracts should be drafted in greater detail, specifying precisely what the supplier is to accomplish and providing for resort to arbitration if this becomes the subject of dispute.

Another reservation that export credit agencies have about training is that it generates very little employment in the domestic economy. Training can, however, help secure orders which do generate employment. It also has a high added value and earns foreign exchange. Most important at a time when world trade is in a serious recession, training is a product for which demand is growing. Financing of training is an area in which export credit agencies can assist in creating new business, rather than merely winning orders from competitors, and so carry out the function for which they were originally intended.

Table 1: Effective cost to borrower of officially supported export credit[1/]

(per cent per annum)

	Britain	France	FRG	Japan	United States[2/]
Interest rate	7.50[a]	7.50[b]	7.50	7.50[b]	8.40
Fee	n.a.	n.a.	0.10	0.10	0.10
Insurance premium	0.60	0.85	0.80	0.30	n.a.
Total cost[3/]	8.30[a]	8.55	8.40	8.00	9.30

n.a. not applicable

1/ These are typical interest rates on direct credits with a repayment term of more than five years, extended or supported by official agencies for a 'relatively poor' borrower in the first half of 1979.

2/ This is the 'standard' rate. Eximbank also quotes an 'exceptional" rate of 8.10 with a fee of 0.20, and total cost of 8.30.

3/ Includes bank fees, and for the FRG and the United States, also the effect of a proportion of commercial bank finance at a rate that is different from the official rate.

a Rate for US-dollar credits. For sterling credit rate is 0.25 higher.

b This rate varies, so that when private funds are included, the 'blended' rate for the whole credit is the minimum interest rate specified in the Arrangement.

Source: Export-Import Bank of the United States, Report to the US Congress on Export Credit Competition and the Export-Import Bank of the United States (Washington, DC, January 1980), pp. 15-18.

Table 2: Export credit arrangement: Interest rates from 6 July 1982

Category of borrower	Length of loan (years) 2-5	over 5	Minimum credit term (years)	Minimum down-payment
Relatively rich	12.15%	12.4%	5 *	15%
Intermediate	10.85%	11.35%	8 1/2	15%
Relatively poor	10.0%	10.0%	10	15%

* 8 1/2 exceptionally

Policies of some major exporting countries

1. France

French companies have tended to regard training as a function separate from production and as one for which the State is largely responsible. This view, however, has changed since 1971 when a law was passed requiring companies to allocate 1 per cent of their salary bill to training. The attitude too, both official and industrial, has over time become more geared towards training.

Aid is also now largely being used to provide industrial manpower training, and furthermore projects which include training are generally given preference. In fact, when aid funds are involved, training can be financed on more favourable terms than goods. Credit insurance is provided by the Compagnie française d'assurance du commerce extérieur (COFACE) which takes up business relating to "national interest". All credits guaranteed by COFACE automatically get official funding.

Besides these basic facilities there is a wide range of insurance and financing for capital exports which benefit from official support. There are also provisions for cover against cost escalation and exchange rate fluctuations.

For separate exports of training, however, the position has become easier only after 1977 in response to pressure from companies specializing in export training. Here every export is dealt with case by case and no real policy is laid down.

2. Federal Republic of Germany

There is a long tradition of on-the-job training in the FRG. Training is regarded as vital to maintain the reputation of FRG products.

Official support for export credit is comparatively small, the bulk being financed by the commercial banking system (between 85 and 90 per cent). It is channelled through three entities: the Hermes Kreditversicherungs S.A., the Kreditanstalt für Wiederaufbau (KfW), and the Ausfuhrkredit GmbH (AKA).

The KfW provides long-term financing of overseas trade whereas Hermes covers the exchange risk and insurance against unfair calling of bonds due to a political factor.

In addition regular consultations on training for developing countries take place between government and private organizations.

Although financing for training is occasionally supported through aid funds, emphasis is on direct investment. For about a decade there has been a scheme to encourage firms to provide apprenticeships of 18 months to three years in the industrial sector of a developing country. This, however, has not been altogether successful.

3. Japan

To compensate for its late arrival in world industrial trade Japan has promoted exports vigorously. Japanese companies attach great importance to training and expect their more senior employees to have obtained an academic education in a relevant subject and training in technical skills, the latter often being provided by the companies themselves.

Industrial manpower training in developing countries is provided chiefly by Japanese companies with direct investments but also by exporters. In both cases government financial support is available through the Export-Import Bank of Japan (Eximbank of Japan). Official support for credit insurance is channelled through the Export Insurance Division (EID) of the Ministry for International Trade and Industry, and for export finance through the Eximbank of Japan.

There is close co-ordination among all the agencies involved, the commercial banks and the business community. The EID provides cover against unfair calling of bonds and also a limited exchange risk guarantee. Official financing of local costs is generally available for turnkey projects up to the limits stipulated in the arrangements. This generous treatment reflects the Japanese view that local costs are an integral part of the financing of a project, particularly in a developing country. The training it supports is mostly confined to large projects in newly industrializing countries.

4. United Kingdom

Exports of industrial goods have continued to be of major importance to the UK economy and strenuous efforts have been made to promote them. Official support for export credit is administered by the Export Credits Guarantee Department (ECGD). ECGD's principal function is that of a credit insurance organization but it also gives support to financing. There are two categories of insurance business undertaken by ECGD: on Section 1 business, the Export Guarantees Advisory Council, which is appointed by the Secretary of State for Trade from among leading bankers and businessmen, advises the ECGD using criteria of commercial acceptability; Section 2 is business that is unacceptable to the Advisory Council because of, for example, the spread of risk or the size or horizon of risk, or the experimental nature of the facility, but for which ECGD can give guarantees "in the national interest". Exports of capital goods to developing countries almost invariably fall into Section 2.

Export finance is provided by the commercial banks though until 1980 ECGD refinanced a proportion of it. Among the additional insurance facilities which ECGD offers is a cost escalation scheme which gives exporters limited protection against increased costs for capital goods projects with long manufacturing periods.

An export of training in connection with a plant being installed by the same company or by another British company may be incorporated into the same financial package as the export of goods or may be arranged under a separate contract. Funds have been made available for independent exports of training, sometimes for almost 100 per cent of the financing, from the Aid and Trade Provision (ATP) on occasions when the provision of training was thought likely to secure the contract for a major project.

5. United States

Official support for export finance is channelled through the Export-Import Bank (Eximbank) whose objective is to contribute "to the promotion and maintenance of high levels of employment and real income and to the increased development of the productive resources of the United States".

The Eximbank has to make a small profit which implies lending at a higher rate of interest than it borrows. The Eximbank's major activity is long-term export financing under its direct credit programme. The percentage financed by Eximbank depends on the extent to which commercial banks are willing to participate, the degree of competition in the sector, the repayment period, and offers from other officials export credit agencies. Besides making direct loans, the Eximbank also refinances medium-term fixed-rate loans by commercial banks and provides bank guarantees for medium and long-term credit advanced by commercial banks. Eximbank will insure or guarantee but does not itself offer foreign currency financing through the possibility has been discussed.

There is extensive co-operation between Eximbank and other government departments at various levels. The Eximbank is charged with the role of fostering the expansion of exports of services as well as goods. For several reasons the Eximbank is less prone than export credit agencies elsewhere to discriminate between goods and services:

(a) Eximbank is more disposed to assess a project on the basis of its expected productive life and the income it is likely to generate rather than the existence of collateral security;

(b) Eximbank's comparatively liberal attitude towards extended repayment, which is relevant when a service is rendered after completion of a project, as tends to happen with training.