COMMISSION OF THE EUROPEAN COMMUNITIES

COM(75) 500

Brussels, 23 July 1975

A EUROPEAN EXPORT BANK

(Communication from the Commission to the Council)

COMMISSION OF THE EUROPEAN COMMUNITIES

COM(75) 500 /2

Brussels, 3 december 1975

A EUROPEAN EXPORT BANK

(Communication from the Commission to the Council)

REVISED TEXT OF ANNEX I

A EUROPEAN EXPORT BANK

(Communication from the Commission to the Council)

I. INTRODUCTION

1. In recent years, the idea of creating a new Community instrument in the export credit field has often been referred to. In his speech to the European Parliament in February this year, the President of the Commission indicated the importance which the Commission attaches to a European Export Bank. In the present communication the Commission examines the opportunity of creating such an instrument, and the objectives and methods which it might adopt. This analysis shows that both the world context and the problems which Community exporters already face make it important to make progress in this area without delay. The Commission considers that a European Export Bank (E.E.B.) should initially concentrate on the provision of finance and insurance for multinational contracts of a Community nature for the export of capital goods (and related services) to all destinations outside the EEC. The Commission will pursue its consultation with public and private sector export credit insurers, banking and industrial circles in the Community, and will submit to the Council a full proposal in the light of the results of these opinions and consultations.

II. GENERAL ANALYSIS

(a) The world economy

Very rapid changes are now taking place in the world economy, in the light of the oil crisis of 1973 and the consequences which have followed from it affecting all countries of the world. It is clear that if the present economic difficulties of the industrialised countries are to be overcome, and if the redistribution of wealth between developing and industrialised countries which the former seek is to take place, there must be continued and increased expansion of world economic growth. It is vital that world trade should be able to regain and maintain the momentum it showed in the two decades after the Second World War.

.../3

3. The Community now faces the threat of a long term deficit in its balance of payments by reason of the very large increase in the price of oil and the possibility of a further increase in the price of certain essential raw materials from third countries. Fluctuations in the price of raw materials - increases as well as decreases -, the overheating of their economies and the inflation experienced by the Western countries have brought about considerable alterations in international terms of trade. In these circumstances, the growth of exports represents an immediate necessity to Member States of the Community.

4. The effect of the increase in the price of certain raw materials and fertilisers is very serious for certain developing countries which lack energy and foodstuffs. These countries are obliged in the short term to reduce the volume of their imports. It is in the interest both of these countries and of the Community to find means to reduce these difficulties as much as possible.

5. On the other hand, the capacity of some developing countries to build up their competitive industrial production capacity has greatly increased. Some are already seeking to use their enlarged foreign currency resources to increase the pace of their transformation into industrialised societies and of the development of their natural resources. The Community cannot resist this process; indeed it has declared its readiness to help it, has already taken measures to this end and has made further practical suggestions in the same direction. It may, however, be possible to do more.

6. These three objectives raise many issues, to which a broad range of solutions is needed. But these solutions overlap in an important respect; the attainment of each objective would be helped by means to stimulate Community exports, particularly of capital goods. This will help the Community's balance of payment situation and the growth of world trade; the exports

will contribute to the economic expansion of the developing countries; and if appropriate financial arrangements can be made the situation of the least developed countries will be eased.

7. The threat of recession and the increase in unemployment which is affecting the European economies as well as those of the United States of America and Japan, will increase competition for export orders not only in traditional markets where demand is likely to contract, but also in the expanding markets of the oil producing countries.

8. The Community countries will therefore be confronted in these markets with:

(i) projects (e.g. engineering, infrastructure, turnkey plants, raw material exploitation) on such a scale that multinational consortia may well be the best means of response for both technological and financial reasons, and

(ii) competition from third country firms, notably American and Japanese, whose national authorities provide extremely sophisticated systems of export subsidies perfectly geared to their foreign trade policy (see descriptions of the existing systems of these two countries at Annexes I and II and a comparison at Annex III).

9. It is not in the interest of the Community to respond to such competition by a war of export credit terms. The Community is not alone in needing to expand its exports in the face of economic difficulties. It has undertaken not to seek to improve its position by action harmful to others. And in the export credit field the Community is trying with our major trading partners to find a way of limiting competition on export credit terms. But while an export credit race is to be avoided, within such rules as exist and as may be agreed (e.g. the proposed Gentleman's Agreement) the Community should nevertheless try to establish means of matching the advantages now available to Community firms' main competitors in the US and Japan, notably the provision of export credit facilities in a single currency.

.../(b)

(b) The coherence of the Community

10. At present, each Member country has a different administrative system and differing institutional arrangements for assuming the availability of export credit finance.

There are, furthermore, differences in philosophy between different Community countries on the question of subsidy of export credit finance. The result is a lack of coherence in the Community's arrangements, and a number of disparate systems serving economies individually less powerful than the Community's competitors and, moreover, competing with each other in foreign markets to the mutual disadvantage of the Member States.

11. In an area as economically critical to the Community's commercial policy, such a situation cannot be regarded as satisfactory. With the objective of economic and monetary union also in mind, it is clear that comprehensive arrangements covering the whole field of export finance must be made by all Member States to avoid possible internal competition and distortion as a result of official intervention, to give Member States' capital goods exporters the capacity to combine together and to compete with the full weight of the Community's economic strength to support them, and to give the Community the ability to make its voice felt in international negotiations. Adequate arrangements are increasingly needed to harmonise first the principles and then the practices of the Member States in the export credit field.

12. Work in the Community to this end has gone on for many years, but has accomplished little. The Commission last year proposed a fresh approach, and work is now making some progress. But this is necessarily a long term matter. This fresh approach which deals essentially with a better coherence between the different export credit systems within the Community in no way affects the necessity for the Community to provide itself with the means to support collaborative joint ventures between Community exporters.

13. This need has already been appreciated. Collaborative arrangements exist between the export credit insurers of the Community; these are described in Annex IV. Such arrangements have undoubtedly helped in several cases. But for the reasons indicated in the Annex, the techniques developed do not cope with the central problem of export credit for multinational contracts, which as the next section shows is the provision of finance in one currency.

III. THE IMMEDIATE ISSUES

(a) Multinational capital goods contracts

14. As already explained, the main problem is that of developing adequate arrangements for multinational projects in which firms from different Member States combine for the export of capital goods (and related services). Opportunities for which such consortia are an appropriate response already exist; their number is likely to grow and should be encouraged.

15. Consortia of this kind may take the form of a lead firm from one country who is responsible for the contract and who assumes all the responsibility on behalf of a network of subcontractors. But in large projects it is more likely that two or more firms will jointly conclude the contract with the buyer, though subcontracting will add to the complexity of the arrangements. In such cases, firms from more than one Community country cannot at the moment readily offer a single contract in a single currency, unlike their US and Japanese competitors who have no currency problem and for whom export credit and guarantee arrangements are of course the same.

16. So far, two courses of action have been taken by Community firms. First, arrangements have been made to channel separate streams of foreign currency to a single buyer under the aegis of separate official support schemes. However, this does not match the increased preference shown by overseas buyers for negotiating one contract with one single currency and one set of payment conditions subject to one law. Indeed, multi-currency contracts are becoming increasingly impossible to negotiate, particularly for large projects. Matters are complicated further by the lack of a focal point for administration or negotiation.

17. Second, many large projects have been financed by Euro market borrowing, either directly or through commercial banks.

.../This enables

This enables single currency finance to be provided to the buyer. But it does not seem that the Euro market should be regarded as a permanent channel by which firms should have to finance their international transactions. It is not wholly reliable as a source of funds whenever necessary, and also because direct access to it is de facto restricted to relatively few firms and because in many cases such funds are not available at fixed interest rates. Moreover, provision of finance to the buyer in a single currency does not relieve the members of the consortia from the exchange risk, while it does nothing to solve the problem of a single form of export credit guarantee and insurance arrangement. And of course, such funds are only available at market rates which may at times be appreciably higher than export credit funds available to competitors.

18. In addition, given the scale of some large projects calling for multinational participation and their increasing technical content, the size of the risks involved is very considerable and exceeds that normally borne by national insurers.

19. These considerations point to the need to improve existing arrangements in the Community for multinational financing of export credits in a single currency. It is clear that simplicity would be served if integrated arrangements were devised which promoted the drawing up of a single contract in a single currency incorporating a single interest rate and which provided for official intervention so that interest rate subsidies could be provided when necessary to match third country competition.

(b) Flow of investment financing

20. In the context of multinational capital goods contracts, export credits are tantamount to the financing of investment. Funding of export credit activity must therefore be placed in a more general context. It is now generally accepted that funds should flow

.../from

from developing countries with surplus funds towards investment in less favoured developing areas. At present the flow of such funds for "triangular" re-cycling is sluggish. A Community organisation to provide export credits which had access to international capital markets could be an important mechanism in this re-cycling, and would therefore increase the availability of export credit.

IV. THE EXPERIENCE OF THE EXPORTING INDUSTRIES IN THE EEC

21. Some recent examples seem to indicate that European firms, working in isolation, have in several cases failed to win important contracts because they could not depend upon an export credit system as efficient as those of their American or Japanese direct competitors.

22. The absence of such a system has certainly made it more difficult to arrange group tenders by firms of different Member States. In some cases it has been possible to fill this gap by the pragmatic methods referred to but the complexity of these solutions often discourages our exporters as well as their customers; such solutions are purely "ad hoc", and leave the basic problem unsolved. Thus, the examples given us in confidence by Community firms bring out clearly the dynamic role played by the export credit institutions in the United States and Japan.

23. In general, industrial as well as credit insurance circles with whom the Commission has had discussions have stressed the desirability of (1) reorganising and clarifying existing credit institutions' practices, especially export credit practices at Community level; (2) setting up a financial institution similar to the Japanese or American Eximbanks which will enable European firms to face up to international competition by offering finance on terms at least as good and at least as speedily as their competitors.

24. One might mention in this context certain problems which have arisen in connection with negotiations for the sale of Community aircraft. Negotiations were opened with a third country which wanted to buy either the Community aircraft or a competitor. Because of the existing fleet structure of the purchaser the offer needed to be particularly competitive. The competitor was able to offer credit for 12 years at a fixed rate of interest of 7%, the amount of the credit being divided between the official sources (45%) at a 6% interest rate and a private bank (55%) at a 7.75% interest rate. The Community firms'offer was credit for 12 years provided as to 40% from public services at a fixed rate of interest of 7%, the remaining 60% of the credit in Eurodollars at a 9% interest rate. However, the interest rate on the Eurodollars was guaranteed to remain at 9% for only 5-7 years, after which the rate was to "float". Even if the rate were to remain fixed for the entire period of the loan and in the absence of any other monetary complications occurring in the meantime, the Community firms' offer was 1½% above the competitor's offer. For a contract value of $79 million, the difference represented about $8 million which the purchaser would have had to pay in addition.

25. The idea then was to sell the Community aircraft through only one of the participating firms in order to obtain for the whole of the operation the benefit of certain financial facilities granted to exporters in the Member Country concerned. For various reasons this solution was not practicable. Other solutions, even more complicated, were considered such as a mixture of selling and leasing, but without success.

26. Another example was a proposed capital goods contract to supply the third country government with a turnkey plant to make heavy constructional works equipment. The contract value was $ US 120 million. There were to be French, UK, German and Belgian suppliers with a small foreign content. The credit requested was 85% of contract value in 20 equal consecutive half yearly instalments, the first payable 6 months after completion of delivery in month 44. The contract was lost because the offer contained four sets of payment terms in four currencies in four laws.

27. These examples, very briefly analysed here, show how multinational projects of undoubted European interest can be lost against competitors whose offers are not only more favourable from a financial point of view, but also clear and neat from a commercial point of view. The Commission's contacts with the credit insurance circles, with many industrial organisations and with industry direct confirms that this is not an isolated example. The lack of adequate export credit facilities has played a part - often significant - in the loss of many contracts especially for medium sized firms. And this lack also hinder the development of joint ventures by Community firms for which such facilities are very important.

THE CASE FOR A NEW INSTITUTION

28. The preceding analysis demonstrates the problems which have to be resolved. Can an answer be found in the existing framework of collaboration between Community institutions?

29. As already noted, collaborative arrangements of various kinds exist between the export credit insurers of the Community. These provide a partial response to the problems of multinational contracts through reciprocal cover, coinsurance, joint insurance, reinsurance and special financial packages. Such arrangements have been a useful means of combining the efforts of different national institutions. It would be prima facie attractive to develop this cooperation, possibly even to the point of a formal agreement. But the full range of the existing techniques is not available to all Community exporters as some national institutions are limited by their legislation from taking part in certain of these operations. More important, none of these techniques can overcome the central problem of multinational contracts - that of the exchange risk which must arise when different currencies are involved with the objective of providing a single steam of single currency finance and insurance under one contract. The only way in which this problem could be resolved in the existing framework would be for each Member State to pass legislation enabling its export credit and insurance institutions to fully finance and pay claims in currencies other than their own (at present this is not possible in any Member State). Separately, many other differences in approach to credit insurance and guarantees would also need to be resolved; experience to date in the Community shows that it is not easy to make progress in this field. For these different reasons, the possibility of constructing unified arrangements on the basis of the existing institutions is not encouraging, to deal with the problems of multinational contracts of which the number is likely to grow appreciably in the future.

30. The Commission has considered the possibility that the functions of the European Investment Bank (EIB) be enlarged so as to include that of a EEB. This however raises many difficult problems - institutional, financial and technical. Nevertheless, the Commission will consult the EIB in the course of its future work.

31. In the light of this analysis, the Commission considers that a new institution is needed to deal with the problems of multinational projects. This institution should be created alongside existing institutions and without the prior need for further coordination of their practices or for major changes in national legislation. Once established it could help with the harmonization of Community practice in other areas of export credits. But this process need only be gradual, as patterns of Community commercial behaviour develop. In any event, the creation of a new institution should in no way hamper initiatives taken in the private sector, for the new institution would not act as a substitute for commercial and merchant banks who generate export business, but rather as a complement to them.

32. More immediately, a new institution would be able to develop a role in the provision of finance. The scale of finance needed for multinational capital goods projects is already very large and is likely to grow further. In view of this, the commercial banks and existing official institutions cannot be relied on to provide all the necessary finance, even if the essential requirement of exchange risk cover were guaranteed them; this may be a particular problem for medium and small exporters. A new institution could have direct access to the markets in order itself to tap large scale funds as appropriate.

33. When set up, the main objective of an EEB would be to offer, both to the Community exporters and to foreign buyers of capital goods and services produced within the Community, credit and insurance on terms comparable to those available in other major exporting countries. Thus its primary function would be the provision of export credit

finance and credit insurance for multinational capital projects of a Community nature to all destinations outside the EEC, including:

- the financing of exports of capital goods and of ancillary costs;
- related management, training and other service contracts.

34. In stating this as the immediate objective, it must be remembered that other possible roles exist. In the export credit field, the activity of the E.E.B. could if so desired at a later stage be extended to cover other activities of a particular priority. Other possibilities are:

- provision of investment guarantees against political risks;
- support for imports posing a particular problem (raw materials);
- finance for medium and long-term supply contracts notably in the agricultural sector.

These possibilities are examined further in Section VII.

VI. SPECIFIC CONSIDERATIONS

(a) Operations

35. The functions of the E.E.B. would be to provide export credit insurance, supplier and buyer credits for multinational consortia of a Community character (not excluding consortia in which a minority interest is taken by non-Community firms). Contracts of this nature will inevitably be for periods of 5 to 10 years, and probably for amounts above a level to be defined later. The E.E.B. would seek to work alongside the existing credit insurers, commercial banks, and institutions in this field. The Bank would in most cases expect to provide only part of the finance needed because adequate arrangements would be made with commercial banks and/or institutions for the supply of the rest, it being understood that adequate arrangements entail the provision of export credit insurance facilities by the Bank.

36. It will be necessary for the E.E.B. to adopt practices which respond to as many as possible of the following requirements:

(i) that the Bank should aim to break even;

(ii) that it must be ready to help exporters to match competition from other countries in the commercial export credit field;

(iii) that within the framework of internationally agreed practice its terms both in respect of interest rates and length of credit may need to take account of the situation of developing countries.

(b) Structure

37. The E.E.B. should take the form of a banking institution. It would need to have day-to-day management independence, but on the other hand it is clear that the Community institutions will need to keep under regular review the policy directions given to the Bank.

38. The E.E.B. can be established on the basis of Article 113, and possibly completed by Article 235 of the EEC Treaty.

.../(c) ...

(c) Financing

39. The E.E.B. will need to be endowed with an initial fixed capital. The amount of this capital will depend on an analysis of the likely involvement of the E.E.B. in export credit and other transactions, and may be influenced by its financing pattern. The capital could be subscribed in part by existing institutions in the Member States, and could be paid up in several instalments according to the development of the Bank's activity in the field of export credit, since at a later stage it may be desired to expand the role of the Bank.

40. It is to be expected that borrowing activity will be a major source of finance for the E.E.B. Therefore, it is important that it should have access to national and international capital markets. To enable the Bank to become a major Community instrument of borrowing arrangements will have to be made to assure the market of the security of any claims on the Bank, which could involve some form of recourse to the Community (presumably to the Community Budget).

41. Given the need to match competition from other countries, the particular range of the Bank's business may lead to the need for subventions in order to permit interest to be charged below cost. On large contracts involving long term finance official export credit funds have been made available in recent years by most (though not all) major trading countries at interest rates which are often below the true cost in market terms, though by differing amounts. This may change in the future, as market rates fall. But the possibility of subsidy cannot be excluded. It will be necessary to examine different means of limiting whatever subsidy is necessary, e.g. by limiting the amount of finance provided for each projet by the Bank. It may be that in the early stages

.../the resources

the resources required to permit preferential interest rates can be provided from the income earned by the initial paid-up capital of the Bank. But it is likely that some continuing financial assistance of the Bank will be needed until a possible future stage when its business will be sufficiently broad to encompass profitable as well as loss-making activities. This assistance will be the reflection of exports by Community firms; it could be shared between the Member States in accordance with the split of these exports between the Member States, but this would be difficult to establish because of the amount of subcontracting involved in multinational projects and would involve a series of ad hoc keys for the cost of each project. It would seem more sensible and more desirable that the assistance (if any) should be a charge on the Community budget. Conversely, arrangements would have to be envisaged to cover transfer to the budget of any profit which might arise after the necessary establishment of reserves by the Bank.

42. It is not possible at this stage to indicate the size of the fixed capital needed or any possible operational costs. These will depend on the number of projects financed and the percentage of contract value to be financed, and on the changing relationship between credit terms and market rates. At the outset, therefore, it will be necessary to fix guidelines within which the E.E.B. should work, to be renewed in the light of experience.

(d) <u>Exchange risks</u>

43. The aim of the E.E.B. would be to enable multinational export credit and insurance contracts to be expressed in a single currency. This poses a series of problems:

(i) suppliers' costs are incurred in their own national currencies. They are reluctant to take on an exchange risk and therefore require to recover costs in their own currencies. This is generally possible during the period up to delivery of the goods by forward sales of the currency the supplier is due to receive from the buyer in final settlement at that time. However, the facilities

.../of the forward

of the forward exchange market might not prove adequate for very long delivery periods except on a rollover basis, and recent developments have done much to contract the forward market in certain currencies.

(ii) given that the E.E.B.'s main source of finance may be international borrowing, the choice of borrowing units will have to match as much as possible the currencies in which the Bank is to give credits. In recent years, the dollar has been predominant in international transactions. But in future, there may well be scope to expand the role of the European unit of account. (The problems of borrowing and contracting currencies must be studied further. Some points are discussed in Annex V.)

(iii) Some exchange risks may remain, however, if a complete matching of finance and credits is not possible. Apart from buyer credits, the problem of supplier credits is likely to give rise to risks to the extent that any finance provided to Member States' suppliers is in national currencies. This problem might be reduced if the E.E.B. were better endowed with working funds in the national currencies of the Member States or borrowed in national capital markets.

(e) <u>Spreading the risk of export credit insurance</u>

44. The risks which arise from insurance of important contracts are already large and likely to get larger as the size and technical complexity of the projects covered increase. Thus in addition to the burden of financing and interest rates already discussed there is a problem of risk, which to be well spread and well balanced must take account of export projects to all destinations outside the EEC.

45. In due course a decision will be needed on the proportion of risk to be covered. In addition, a major technical problem which would have to be resolved if it proved possible to devise integrated arrangements, is that of recourse. The existence of multinational supply contract implies that a lead contractor (or contractors) would have to undertake the proper fulfilment of the contract. Recourse arises where an overseas borrower defaults under a loan agreement at a time when the exporter is

.../in default

in default under his supply contract. In these circumstances an insurer or guarantor, while paying whatever loss is due to lending banks, would have to consider how best it might take recourse to the exporter or exporters since it is a cardinal principle in any policy of insurance that it is up to the assured to take due diligence. If he himself creates a loss situation then he must be made to pay back to the insurer or guarantor all sums which that insurer or guarantor has disbursed to lending banks. This is a problem which exists to a greater or lesser extent in each Member country.

46. The scale of the risks involved might require the E.E.B. to reinsure with other institutions. One possibility would be for the Bank to reinsure with national agencies either part or all of the risks relating to the supply from that country. If this course were followed, problems could arise as to the currency in which the reinsurance could be organised.

(f) Relationship with commercial banks

47. The commercial banks will wish to continue to maintain their role in the export credit field and the relationship with their clients that results. For its part, the E.E.B. will wish to keep its financing role to the minimum necessary and should wish to take advantage of the present expertise of the banks in assessing projects. It therefore seems desirable to envisage that the commercial banks should continue to play their role in providing a certain percentage of export finance, backed by guarantees from the Bank. One possibility is that the Bank might finance the later maturities of an export credit, with the commercial banks financing the earlier maturities against a guarantee, as is done in the USA.

VII. OTHER POSSIBLE ACTIVITIES

48. As noted above, there are other important areas in which an E.E.B. could at some stage in its development be called upon to play a role.

.../(a) ...

(a) Financing of raw material supply

49. If at a first stage the E.E.B. deals only with multinational capital goods export credit contracts, its role could later be extended to other activities of priority interest in the export credit field. For example, large investment projects which are of particular Community interest but which do not involve multinational consortia could be financed in cases where the cost would be excessive for a national institution on its own. But for the time being existing arrangements appear adequate outside the field of multinational consortia, while the E.E.B. would be better able to deal with any other export credit fields after it had gained some initial experience.

(b) Investment guarantees against political risks

50. As mentioned above, the functions of an E.E.B. could include the provision of investment guarantees against political risks. It is probably true that investment is held back in a number of countries by political uncertainties. Insurance against political risks may be a solution. Some Member States have schemes of cover against political risks. But the scope of such schemes is limited, and could perhaps be usefully expanded. But, at least as a measure in isolation, such insurance has a number of disadvantages. The first disadvantage is that political risks of foreign investments of the classical pattern are now very great in most developing countries. The potential costs are thus very large indeed, and not readily reinsured. Second, the capital base required to deal with investment guarantees is of a different type from export credit insurance, given that investments are made normally for 20-30 years whereas sales of goods are dealt with in general for no longer than 10 years. Third, a failure to pay for economic reasons in a sale of goods transaction does not produce dead loss money but becomes the subject of a claim and perhaps in due course a re-scheduling operation which means that the money is finally repaid.
It is universally recognised that the availability of insurance against political risks in the investment guarantee field is a determining factor for an investment to take place. The absence of a coherent pattern of protection for Community investors means that reliance can only be placed on existing national investment guarantee schemes which are evaluated differently.

51. There are various answers to these problems. One lies in adequate agreements of protection with the host governments.

.../...

Another lies in the development of international arbitration procedures (e.g. through the IBRD sponsored ICSID). And in the long term the solution lies not in the field of political risk guarantees but with the extension of ownership by local interests of investment in developing countries. This will give rise to new problems of financing, in the solution of some of which the Bank may have a role to play. For this, however, the Bank would need to dispose of considerable additional funds.

(c) Support for imports posing a particular problem

52. It would also be possible for the E.E.B. to provide finance for imports posing particular problems. The most obvious case is of certain raw materials. Here, whether on its own or in the framework of international commodity agreements, the Community could for certain products decide to build up a stock which would require financing. This could be an appropriate occasion for financial support from the Bank. However, it is clear that the initial costs and the risks involved in such an arrangement are considerable and that at the present state of development of international thinking on raw materials it would be premature to ask the Bank to undertake this task.

(d) Long-term supply contracts

53. In the years ahead, the Community may develop a new form of action - that of pluri-annual contracts (for 3 to 5 years) with some developing countries who may wish to secure their supplies from the Community of essential agricultural commodities. For the financing of such imports, these countries seek credits to avoid initial excessive foreign exchange costs so that their foreign exchange resources can be devoted to industrial development. At present, no machinery exists at the level of the Community to provide such credits, and the E.E.B. could be asked to play a role.

.../But such

54. But such operations would increase the financing needs of the Bank, and are perhaps not readily compatible with current practices in the field of commercial export credit operations. It is also unlikely that such contracts would be multinational. In these circumstances, it does not seem appropriate that the E.E.B. should undertake this task at the outset.

(e) Aid activities

55. The objectives and considerations above make mention, inter alia, of activities of the E.E.B. in relationship with developing countries. It should be stressed, however, that these activities (even if, as may now be normal, a degree of concessional finance is involved) are not development aid in the strict sense (DAC definition), but come within the range of regular export credit activity of official organisations. They would be fully covered by, and subject to, any international rules limiting competition in the export credit field.

56. Apart from these activities however, it would be possible for the E.E.B. to play a part in aid activities properly defined in relationship with business otherwise coming within its scope. These activities could follow the pattern of activity of some export credit institutions both within the Community and elsewhere. Activities of this kind would involve considerable regular subventions. They seem more appropriate for a possible later stage in the Bank's development.

VIII. CONCLUSIONS

57. The analysis above sketches the main problems which have to be resolved in deciding the scope and methods of a E.E.B. It will be apparent that the problems are considerable. Yet as the initial analysis demonstrates, there is an urgent need, if the Community is not only to match the efforts of its main trading partners and to increase its own economic coherence, but also to be able to fulfil its undertakings to the developing world. It is of paramount

.../importance

importance that this new institution should be in a position to give decisions quickly without being overburned by bureaucratic regulations. In effect, the E.E.B. should be able to respond rapidly and tailor its offers of finance and insurance protection to meet exporter requirements on a case by case basis. It is only if such action is taken that Community firms will have an equal chance in the competition for the increasing number of large scale projects it is reasonable to expect.

58. In drawing up this analysis, the Commission has had the benefit of contact with official and private sector experts in banking, credit insurance and industrial circles. But much more work remains to be done before the detailed structure and methods of an E.E.B. can be proposed. The Commission intends to pursue this work actively, and will to this end invite the assistance of national official experts as well as of others. It will submit a formal proposal to the Council on these aspects as soon as progress with these consultations permits.

THE EXPORT - IMPORT BANK OF THE UNITED STATES

I. History

The Export-Import Bank of Washington (Eximbank) was established by Executive Order of the President of the United States as a banking corporation in February 1934. Its function and status altered over the years to meet changing world trading conditions, and in 1945 it was re-constituted as an independent agency of the US Government responsible directly to Congress. In recent years it has concentrated on its direct lending and credit insurance facilities for expanding US exports.

II. Eximbank is a self-supporting agency. It has a basic capital of $ 1,000 million subscribed by the US Treasury and the annual dividends paid by Eximbank to the Treasury usually amount to 5 % of the Bank's capital (Eximbank's dividend, for fiscal year 1975, was reduced to $ 20 million or 2 % of its capital). It has the right to borrow up to $ 6,000 million from the US Treasury, but such borrowings have been relatively small in recent years. Instead Eximbank has sold certificates of participation in export folio, debentures, and short-term promissory notes in the public money market; it should be noted that Eximbank no longer raises funds directly from the private money market, all borrowings being made from the Federal Financing Bank, which is administered by the US Treasury. It is authorised to take commitments in respect of loans, guarantees and insurance totalling $ 25,000 million, though this total "exposure" can go to $ 40.000 million. Business supported by the Bank must have a "reasonable assurance of payment" but since 1968 more risky business can be undertaken under the Export Expansion Facility provided it offers "sufficient likelihood of repayment". Liability under this Facility must not exceed $ 500 million at any one time.

../..

III. Main types of activity

1. One of Eximbank's major operations is its direct loans, which are dollar credits extended by Eximbank from its own resources directly to borrowers outside the United States for the purchase of US goods and services. The minimum period for which direct loans are extended is normally 5 years. Disbursements are made to the US suppliers and the loans are repaid by the borrowers under a loan agreement entered into with Eximbank. Originally, Eximbank's practice was to provide direct finance for 100 % of the credit, but pressure on its funds led it to introduce in 1968 a programme of Participation Financing, Eximbank's direct lending currency supports from 30 to 55 % of a contract's export price, and financing provided by private commercial banks may be guaranteed by Eximbank.

2. Under a separate programme, Eximbank also gives Guarantees to Commercial Banks who finance medium-term credits without recourse to the supplier. The commercial bank carries part of the commercial risks and Eximbank carries the balance of these risks and the political risks on the whole credit. Eximbank will also under its Medium-Term Discount Programme, give an advance commitment to purchase from commercial banks on a case-by-case basis export debts which the banks have financed involving a maturity of 1-5 years and occasionally longer, but this facility is not available for bank lending provided under the Participation Financing Programme.

3. Since mid- 1969, Eximbank have operated a "Cooperative Financing Facility" under which they make available loans to overseas financial institutions to enable the latter in turn to make loans to small and medium-sized buyers to finance the import of US goods on terms similar to those which Eximbank would be prepared to support for a direct sale. The Eximbank loan is for half the amount of the advance, the other half being provided by the overseas financial institution from its own resources. The risk on the borrower is carried by the financial institution.

4. Eximbank does not itself handle the Credit Insurance Programme for supplier credit business. This is administered by the Foreign Credit Insurance Association (FCIA) - a syndicate of private insurance companies in New York which nevertheless works closely with Eximbank, to

../.

whom it passes back the political risks and the larger commercial risks together with part of the premiums.

5. Eximbank and FCIA's premiums are based on the length of credit and market classification and charged in relation to the percentage of the contract value insured. For Financial Guarantees to banks under the participation finance arrangements, however, Eximbank charges a flat rate "guarantee fee" which currently ranges from 0,75 % to 1,5 % per annum.

IV. Interest rates

1. The blending of Eximbank direct financing with private commercial funds (at a fluctuating rate related to US prime rates) results in current rates of 8,8 - 10,2 % based on a prime rate of 8 % and Eximbank's interest rates which range from 8,25 to 9,5 %.

An important provision of Eximbank's current interest rate policy in that its standard interest rate may be reduced when the Bank is provided with evidence of meaningful foreign officially-supported export credit competition. However, Eximbank will not reduce its standard interest rates to such an extent that the blended interest rate for a transaction falls below 7.5 percent, the internationally agreed-upon minimum export credit interest rate.

2. Eximbank and the commercial banks also charge a commitment fee of 1/2 % per annum on the undisbursed part of a loan.

V. PEFCO

The Private Export Funding Corporation (PEFCO), owned mainly by US commercial and industrial corporations, was formed on the initiative of the Bankers' Association for Foreign Trade to mobilise additional private capital to assist in financing US exports. Its function is to provide funds to fill any financing gap between the loan maturities commercial banks are prepared to take and those Eximbank finances. Eximbank guarantees repayment of any finance provided and makes arrangements with PEFCO to enable it to offer a fixed interest rate. However, the amount of finance provided by PEFCO in recent years has been small, as the commercial banks have been prepared to put up virtually the whole of any finance not provided by Eximbank.

ANNEX II

THE EXPORT-IMPORT BANK OF JAPAN

The Export Bank of Japan was established in December 1950 under the Export Bank of Japan Law as a government financial institution for medium and long-term export financing. In April 1952 import financing was added to its activities and the name changed to the Export-Import Bank of Japan (Exim). The expressed purposes of Exim relevant to this note are to supplement and encourage the financing of exports by private financial institutions (supplier credit), and to extend yen loans to foreign governments and corporations for imports of Japanese goods and services (buyer credit). [Its other functions relate to import finance and the provision of funds for overseas investment.] It may carry out its functions by making loans, discounting notes, acquiring bonds and guaranteeing liabilities - only (according to the Law) where it is "difficult" for the banks to provide funds on "ordinary" terms and where repayment etc. is considered certain, but it is doubtful whether the former of these two provisos has much meaning in practice.

I. Resources and Accountability

1. Exim's capital is wholly subscribed by the Government through appropriations from time to time from the Industrial Investment Special Account. It may also borrow funds from the Government or from foreign financial institutions: so far all borrowing (Yen 271,000 million as at end-March 1972) has been supplied by the Trust Fund Bureau of the Government (which consists mainly of postal savings and welfare insurance deposits) - the rate for this borrowing in September 1972 stood at 6.2%, but has since risen. Further resources stem from repayments of credits and loans.

2. Exim may not, however, raise funds by receiving deposits, borrowing from the Bank of Japan or other financial institutions, or by issuing debentures. Its maximum liability limit is equal to three times the total of its capital and reserve fund.

3. Exim is managed by a President and a Vice-President, both appointed by the Prime Minister for a term of four years and re-appointable, with a Board of not more than six Directors, appointed by the President. It is under the supervision of the Ministry of Finance and its annual budget and accounts must be submitted to Parliament for approval. Rates of interest charged must cover operating expenses as well as borrowing rates.

./.

II. Operations

At the end of the 1972 financial year (March 1973) loans outstanding amounted to Y 2,035,300 million. Of this total 64% was for export credit (i.e. supplier credit - 38% of total for ships), 18% for Yen loans (including buyer credit), 9% for overseas investment and 8% for imports.

III. Supplier Credit

1. Exim does not itself issue credit insurance policies. This aspect is dealt with by the Ministry of International Trade and Industry.

2. "Medium and long-term" export credit (normally over six months and up to 5 years - but this can be extended in particular cases) is made available by Exim to exporters or manufacturers of equipment etc. produced in Japan "when finance is not available from private sources". It does not normally provide all the credit - unless for any reason commercial bank finance is not available and/or the export is of particular importance - but finances 70% of the financeable portion (contract value less downpayment and profits) with the authorised foreign exchange banks providing the remainder at market rates.

3. There appears to be no shortage of funds for export credit from the banks, who provide their share direct to the exporter at a market rate fixed for the length of credit. Exim provides its share at a rate which may vary between 5.5% and 8.5% (it was until 21 February 1974 between 4.75% and 5.75%). It is understood that the lower rate is not often available in practice and that the "standard" rate is at present around 7.5% but this can be varied to produce the desired overall rate to the exporter in conjunction with the Banks' share. The resulting overall range of rates is believed at present to be approximately 7.5% - 8.5%.

4. Exim are empowered to provide pre-shipment finance, but this is made available only exceptionally and in the vast majority of cases (90%) for ships. Exporters and manufacturers now generally have to pay market rates for this type of finance.

5. Guarantees are available from Exim for export credit provided by the banks, both that given in conjunction with Exim and that given without any Exim participation, but terms and conditions are not known.

./.

ANNEX II

IV. Yen Loans (buyer credit)

Yen loans of 10 years' term and over may be extended by Exim to foreign governments or their institutions, or to foreign corporations, to provide funds for the import of equipment and technical services from Japan (i.e. buyer credit - which is apparently not available for shorter periods). Such loans are usually (but not always) given in conjunction with the authorised foreign exchange banks and terms and conditions are considerably more favourable than those for private credits. Refinance can also be provided in special circumstances to facilitate repayment of these loans. Exim guarantees the banks' portion of the yen loans. Overall terms are not standard and have varied from 10 years with no grace period to 18 years with 5 years' grace. The interest rate also varies; the current average is said to be in excess of 7%. It is clear that the system is extremely flexible.

V. Main differences from EEC countries

(a) The feature of the Japanese system is flexibility as regards interest rate and other terms. The aim of Japanese export credit policy is to ensure that their exports are competitive and to this end Exim's interest rate and other terms are in practice determined on a "case by case" basis. On the other hand, some major Japanese exporters would like more stability of interest rates as this would help them in fixing prices, and there has been pressure for a move towards a system of fixed rate or rates.

(b) The Japanese do not make the same rigid distinction between export credit terms and aid terms as do EEC countries except France. This is apparent from the very long terms and low rates available for buyer credit referred to above: moreover there is some evidence of a willingness to "mix" aid and export credit money in certain cases - for example the Hong Kong underground scheme, where it is understood that the Japanese might be prepared to make available 20-year aid funds proper (from the O.E.C.F.) in conjunction with Exim money.

(c) The Japanese, like the US, have managed to keep the commercial banks involved in financing a portion of export credit, and, by allowing them to charge market rates direct to the exporters, have avoided the need for a refinance system.

(d) Exim can borrow from the Government at relatively low rates of interest and this helps to keep down the cost of export finance. However, there is a lower limit beyond which Exim cannot lend as it must balance its books. This is facilitated by the predominance of ship export credit, which attracts higher rates because of the OECD Ship Understanding.

ANNEX III

I. The following are the main differences between the US system and EEC systems:-

1. Eximbank was originally an investment bank and its main activity remains direct and participation finance where it injects some of its funds to finance projects which it approves and controls after assuring itself of their viability by detailed technical and economic studies.

2. Eximbank itself is primarily concerned with over 5 year term finance of specific transactions. The equivalent of the European supplier credit insurance facilities is provided, although on a much smaller scale, in the US by the Foreign Credit Insurance Association (FCIA).

3. Because of its investment bankers' approach Eximbank is often supporting longer credit terms based on the "pay off period" for a particular project than European credit insurers.

4. Eximbank can guarantee loans made by financial institutions outside the USA to finance US exports and associated local costs and can express its guarantee in the same currencies in which the borrower has agreed to repay the lender, although in practice this is usually US dollars. Within the EEC credit insurers can only guarantee in national currency terms.

II. The following are the main differences between the Japanese system and EEC systems:-

1. The feature of the Japanese system is flexibility as regards interest rate and other terms. The aim of Japanese export credit policy is to ensure that their exports are competitive and to this end Exim's interest rate and other terms are in practice determined by a "case by case basis".

2. The Japanese do not make the same rigid distinction between export credit terms and aid terms as do all EEC countries excepting France. This is apparent from the very long terms and low rates available for buyer credit; moreover, there is some evidence of a willingness to "mix" aid and commercial export credit in certain cases.

3. As in the USA, the Japanese have managed to keep the commercial banks involved in financing a portion of export credit and, by allowing them to charge market rates direct to the exporters, have avoided the need for a re-finance system.

./.

4. Exim can borrow from the Government at relatively low rates of interest, and this helps to keep down the cost of export finance. However, there is a lower limit beyond which Exim cannot lend as under current legislation it has to balance its books. This is facilitated by the predominance of ship export credit which attracts higher rates because of the OECD Ship Understanding.

COLLABORATION BETWEEN CREDIT INSURERS TO DEAL WITH CONTRACTS INVOLVING SUPPLIES FROM MORE THAN ONE COUNTRY

This annex summarises existing practices in this area.

1. Reciprocal cover

A Community Agreement exists amongst the credit insurers of Member States to provide cover for certain exports emanating from another Member State on a reciprocal basis. As a result, goods to be supplied under subcontracts placed in one EEC country are treated for the purposes of cover in the same way as the goods to be supplied by the main contractor who will be situated in another EEC country.

The credit insurers have agreed to limit the EEC subcontract element to 40% of total contract value for contracts under 7.5 million units of account, and thereafter to provide for a sliding scale to 30% of total contract value for contracts over 10 million units of account.

The goods which are to benefit from the reciprocal cover must form an integral part of the main contract. Other goods which may be used in conjunction with the project being financed may not be aggregated for the purpose of obtaining the benefit of this Agreement.

The terms of this Agreement cover credit insurance as well as finance provided from official sources. As a result, the main

.../...

contractor may undertake to obtain goods under a subcontract to which these reciprocal arrangements apply on cash or near cash terms.

This is the simplest way of obtaining insurance for a foreign subcontract. It is subject, of course, to the over-riding principle that a credit insurer may refuse to grant cover in respect of a contract which, in his view, presents unusual features or risks which are unduly large. In practice, in evaluating the risk, the insurer will take the total contract value, including its foreign element, into account. Where the amount available for covering a certain market or a certain buyer is limited, a national credit insurance scheme will in the last resort always give preference to its own exporters.

There are differing views on what is understood by reciprocity in this connection. It has been argued, within the EEC, that this involves not only insurance cover, but also the financing credit so as to strike a balance, in quantitative terms, between the participants. Where large contracts are concerned therefore, the existing arrangements are not capable of meeting all exigencies. For instance, one important problem, that of the exchange risk and how to share it, is left to the determination of the contracting parties.

2. Co-insurance

Where it is impossible to obtain cover on the reciprocal

.../...

basis described above, it may be possible to arrange for co-insurance. Thus, if a buyer either enters into separate contracts with his various suppliers, or into one contract with all suppliers (setting out clearly under the terms of the latter the rights and obligations of each supplier), then those suppliers may be able to obtain insurance from their own national credit insurers. These in turn will agree among themselves to act together with regard to all insurance matters concerning that project, and in particular, they will undertake to consult each other in the event of loss or threatened loss.

It would appear that buyers now show a certain preference for one contract comprising all elements of supply ("turnkey" contracts). Under these contracts responsibility for performance generally falls on the main contractor and finance is made available from one source.

3. Joint insurance

Where a buyer insists on a single contract and the main supplier is unwilling or unable to bear the whole payment risk himself, he may try to pass on some of the risk to sub-contractors by making their right to payment from him conditional upon his having received payment from the buyer ("if and when" contracts). Normally such sub-contracts are not eligible for cover by credit insurers because the sub-contractor has no legal rights against the buyer. However, in an attempt to remedy this situation, the EEC countries have come to an agreement whereby "joint insurance" is granted, the main contractor and any sub-contractors being covered separately by their respective national credit insurers. Again, the credit insurers concerned agree to advise each other concerning the progress of the project. A particular feature of joint insurance is that the main insurer agrees to take action by requiring the main contractor to minimise loss and effect recoveries for the whole of the contract. In this way the main insurer looks after the interests of the sub-contractors as well.

This technique has been used so far only for supplier credit but, as far as is known, it has not yet been put to the test in a loss situation. Whether it would then be possible for the main insurer to provide adequate protection for the interests of sub-contractors remains to be seen. In any event, this method in no way assists the financing of sub-contracts nor does it solve the problem of the exchange risk.

4. Re-insurance

Here the main insurer agrees to cover the whole contract and in turn receives re-insurance cover from the national credit insurers responsible for the amounts of the sub-contracts involved. On this basis, the main contractor can undertake to pay sub-contractors on a certain date. Under this method reinsurers (i.e. the insurers of the sub-contractors) have to accept the decisions of the main insurer and the main contractor on matters such as how to prevent or minimise loss, the admission of claims and so on.

There has as yet been little practical experience of the operation of re-insurance in the field of export credits. Some important credit insurers are not authorised by their domestic legislation to enter into re-insurance arrangements. The system is only likely to be practicable where either the terms of cover of the two insurers are similar or where the re-insurer is prepared to adjust his normal terms of cover to those of the principal insurer. As with joint insurance, re-insurance does not in itself ensure that finance for sub-contractors will be forthcoming or deal with problems which may arise from the exchange risk.

5. Multinational buyer credit financial packages

In a few cases arrangements have been made to offer a buyer a coordinated financial package based on loan contributions from two or more supplying countries. Experience in this field is again very limited and the arrangements so far made have not gone beyond the introduction of parallel credit lines, each lender obtaining separate bills of exchange and guarantees from the borrower. Such loans have been made in different currencies and at different interest rates.

ANNEX V

EXCHANGE RISKS AND THE ROLE OF THE UNIT OF ACCOUNT

1. General

An exchange risk, in the broad sense of the term, occurs where an exporter or importer acquires an "exchange position", that is, becomes the creditor or debtor of his foreign counterpart in a currency other than his own.

Recently, particularly in connection with the joint float, currency rates have fluctuated markedly, thus increasing exchange risks proportionately.

An exporter or importer has very frequently to agree to his trade contract's being in a currency other than his own. In that event the exchange risk can sometimes be neutralized or reduced by the inclusion in the contract of an "exchange clause" providing for the limitation or sharing of any losses.

Obviously, this device, owing to the variation in prices which it entails, is very liable to have adverse effects on the importers' or exporters' competitive position. Accordingly, in practice another method is used - coverage of the exchange risk by forward buying or selling of currency.

But in the present monetary situation this method too has considerable drawbacks:

(a) at best it is hardly possible at present to cover an exchange risk beyond one year ahead. For instance, as things now stand the French franc and the lira cannot be covered for more than six months. In the case of long-term contracts, moreover (five years or longer), it is necessary to effect "rollover" forward exchange operations, which come very expensive;

./.

(b) furthermore, some countries impose limits on this class of operations. The unit-of-account method would dispose of some of these problems: in particular the great advantage of the "basket"-type of account is that its variations are smaller than the variations in its component currencies.

2. Monetary medium of EEB contracts

(a) Preliminary remarks

The use of a single monetary instrument, whether an actual currency or a created unit of account, is essential to the financial management of an agency with pluri-national relations.

In addition, as the EEB would not be supposed in principle to assume exchange risks, the nature of the loans granted by it would depend on the nature of the funds assembled. It is planned that it should be able to raise loans in the various money markets, both in national currencies and in EUC; in this regard the role of the market would be decisive.

(b) Units of account

Contracts, and indeed trade transactions, could quite well be in units of account: the choice lies in practice between the two official "basket" units of account, SDR and EUC.

The SDR is a basket based on the sixteen most important world currencies, of which the Community currencies account for only just over half. Its use would have the great disadvantage of obliging Community nationals to assume commitments, and hence exchange risks, in a unit of account moving 50% independently of their currencies.

The EUC is a basket based solely on the nine Community currencies, the initial percentages being determined for each country on the basis of its GNP and intra-European trade. Calculated according to the exchange rates, and with its conversion rates published daily in the Official Journal of the European Communities, it would thus be representatives of the average movement of the exchange rates of the Community currencies.

./.

It could be employed in the balance-sheet of the EEB and as the medium for contracts.

It could also be used for EEB loans, even if the contracts were actually expressed in the currency of one of the joint suppliers: the supplier whose currency was used would derive no particular benefit since all the suppliers could use the currency of the contract for repaying the EEC loans.

The exchange risks in connection with loans based on the EUC/contract currency conversion rates would be smaller than between two currencies, since the EUC would necessarily move within the span between the Community currencies.