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WRI REPORT

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EXECUTIVE SUMMARY

Export credit agencies (ECAs) are bilateral public institutions that facilitate financing for home country exporters and investors doing business overseas, particularly in developing countries and emerging market economies. Over the last decade, critics have scrutinized ECA financing decisions from political-economic and sustainable development perspectives, with some questioning the need for ECAs' continued existence.

Calls for the reform or even elimination of ECAs come in the broader policy context of government commitments to meet Millennium Development Goals (MDGs) that set targets for poverty alleviation, health, education, and environmental protection. A key concern in development circles is how to secure the resources, including financing, needed to achieve these internationally recognized development priorities. To date, public resources directed via ECAs to support export promotion have contributed very little to sustainable development or the MDGs more broadly. Questions thus arise as to whether ECA reform can increase those agencies' contribution to sustainable development, and whether reform is preferable to the elimination of official export credit supports. This report proposes that reform continues to be preferable to the abolition of ECAs, suggests structural and governance reforms that can enable ECAs to make modest but significant contributions to sustainable development outcomes, and identifies national and international opportunities for stakeholders to work toward these changes.

Two key international disciplines governing export credits are analyzed in the report, and will require renegotiation to enable the adoption of some of the reforms proposed here. The first is the Arrangement on Officially Supported Export Credits ("the Arrangement"), which is a voluntary agreement negotiated within the Organisation for Economic Cooperation and Development (OECD). The second is the Agreement on Subsidies and Countervailing Measures (ASCM), managed by the World Trade Organization (WTO). These two disciplines and their corresponding governance processes establish a legal framework for export credit provision and limit the reforms that ECAs can undertake autonomously.

A proposed reform agenda for ECAs that would support sustainable development includes two sets of recommendations. Reforms in the first set of recommendations would

minimize the negative development impacts of current ECA activities. These “do no harm” measures include:

- Upward harmonization of environmental and social standards for all ECAs;
- Increased transparency in ECA lending practices;
- Creation of grievance/recourse mechanisms at ECAs that have not yet established such procedures or structures;
- Adoption by ECAs of a comprehensive agreement on sustainable debt management to better support “Highly Indebted Poor Countries”;
- Adoption by national governments of legislation to implement measures to combat bribery and corruption in projects that receive ECA support; and
- Increased monitoring of the development impact of ECA portfolios.

The second set of recommendations consists of reforms that would maximize the positive development benefits to be gained from ECA support. This set of “do good” reforms include:

- Invitations to developing countries with significant exports to join negotiations on export credit disciplines;
- Amendments to the OECD Arrangement in the form of special sector arrangements, longer terms, increased coverage of local costs, more flexible repayment profiles, and greater flexibility on use of development aid;
- Local currency financing;
- Bundling of small-scale projects to reduce costs and risk profiles;
- Sharing of risks with private financial institutions;
- Portfolio balancing of developing-country risks with less risky emerging-market investments; and
- Monitoring and management of sector exposures.

Short-, medium-, and long-term opportunities for the pursuit of broad reform efforts are identified with specific targets and timetables that must be met to achieve the proposed recommendations. A potential future for ECAs begins with the adoption of reforms that allow ECAs to remain relevant in the global marketplace and lead ECAs to shift a share of their support to projects and exports that contribute significantly to sustainable development. If reform is to remain preferable to elimination of ECAs, however, it will be necessary for national governments to take meaningful and timely steps in that direction.

1

EXPORT CREDIT AGENCIES

CAN THEY BACK SUSTAINABILITY?

A number of governments, representing both developed and developing countries, have made historic commitments to contribute directly to poverty alleviation and to the promotion of development that enhances environmental and social well-being. The most visible evidence of these commitments is the adoption of the Millennium Declaration and associated Millennium Development Goals (MDGs) by the General Assembly of the United Nations in September 2000.[1] The MDGs set specific targets for poverty alleviation, health, education, and environmental protection, which UN members promised to reach by 2015 (see Box 1) — a challenge that will require the mobilization of public and private resources on an unprecedented scale.[2]

As governments struggle to meet this challenge through traditional aid, an unexpected question arises: do export credit agencies have a role to play in meeting the MDGs? Export credit and investment insurance agencies, collectively referred to as ECAs, are public financial institutions that facilitate short-, medium-, and long-term finance to home-country exporters and investors doing business overseas. The majority of this financing takes the form of political risk insurance and guarantees — essentially an agreement by the exporting government to cover banks', exporters' or investors' losses in the event of political or commercial upheavals (e.g., civil war, currency devaluation, breach of contract by a government or importer, etc.) in exchange for a premium payment. Most industrialized countries and a growing number of emerging market economies have established ECAs to support their exporting industries. The public policy rationales for ECAs are that they contribute to domestic job creation through the expansion of exports, counter foreign export subsidies, and help fill a market gap unmet by private financial institutions — namely, providing finance for exports and investments in risky overseas markets.

Over the last decade, ECAs have come under increasing pressure from social and environmental advocates to address the environmental and social consequences of the large infrastructure projects and capital equipment the agencies back through their financing. These advocates have raised questions about whether ECA-supported exports and projects undermine industrialized governments' commitments to sustainable development. As a result, ECAs have

BOX 1 — **THE MILLENNIUM DEVELOPMENT GOALS**

In September 2000, the 191 member states of the United Nations agreed on a comprehensive set of specific development objectives to be achieved by 2015. These "Millennium Development Goals" (MDGs) represented a historic commitment on the part of all nations to a more just and prosperous future. For ECAs to back sustainability, their financing practices should align with the eight overarching MDG objectives:

1. Eradicate extreme poverty and hunger
2. Achieve universal primary education
3. Promote gender equality and empower women
4. Reduce child mortality
5. Improve maternal health
6. Combat HIV/AIDS, malaria, and other diseases
7. Ensure environmental sustainability
8. Develop a global partnership for development

The MDGs were designed to be ambitious but achievable — not endpoints in development, but significant milestones. Each MDG includes a set of specific indicators and targets; for example, the seventh MDG includes commitments to reduce the proportion of urban residents without access to sanitation and improved drinking water by half relative to 1990. Appropriately, the MDGs have become central points of reference for government aid programs. They have also become important benchmarks for civil society organizations, and receive frequent mention at summits, conferences, and other official fora.

Source: United Nations Department of Economic and Social Affairs, http://www.unmillenniumproject.org.

been the target of a significant public campaign for reform. This push for reform has focused largely on shifting ECA support away from the most damaging projects and toward exports and projects that can contribute positively to sustainable development. But dissatisfaction with reform has led some advocacy groups to focus instead on the elimination of ECAs altogether. Is such a shift possible? What opportunity would be lost if ECAs were eliminated?

This report argues that ECAs can provide some, but by no means all, of the financing needed to realize sustainable development. Furthermore, serious institutional and policy reforms would need to be implemented both nationally and internationally for ECAs to make even a modest contribution to sustainable development. Nonetheless, ECA reform continues to make sense given the enormity of the financing needed to achieve environmentally and socially sustainable development.

SUSTAINABLE DEVELOPMENT: THE FINANCING GAP

During the last 35 years, official development assistance (ODA)[3] has stagnated or declined in absolute and relative terms. Between 1967 and 2001, ODA as a percentage of industrialized countries' gross national product (GNP) fell from 0.4 to 0.22, falling far short of the U.N. target of 0.7 percent of GNP for industrialized countries.[4] In absolute terms, ODA increased every year between 1967 and 1991 (peaking at US$63.7 billion in 1992), only to decline thereafter and hover at roughly $50 billion a year through the late 1990s and early 2000s.[5] The last three years have witnessed a welcome reversal of this trend, with total ODA reaching $69 billion in 2003.[6] However, this recent upturn in aid comes with some important caveats: much of it can be attributed to technical cooperation grants, disaster relief, and debt forgiveness, none of which directly support the Millennium Development Goals.[7] And after accounting for about $25 billion in loan repayments collected by official creditors, the *net* flow of public resources to the developing world is now lower than at any point in the last eight years.[8]

By contrast, net *private* flows in 2004 reached an estimated $301 billion ($192 billion in equity and foreign direct investment, and $109 billion in debt). This amount is twice the level reached in 2001, and exceeds the peak in private flows that occurred in 1996.[9] Foreign direct investment (FDI) in 2004 increased in every region of the world except the Middle East and North Africa, reaching an estimated total of $166 billion. While it dwarfs official development assistance, however, the flow of private capital is sharply skewed towards a handful of rapidly growing developing countries. FDI to sub-Saharan Africa in 2004 accounted for just 6.8 percent of the total, while countries in East Asia and Latin America accounted for 38 percent and 26 percent, respectively.[10] Within these regional totals, the concentration of FDI is even more striking; about 88 percent of the *increase* in FDI in 2004 went to just five countries: Brazil, China, India, Mexico, and Russia. And although the share of FDI flowing to low-income and least-developed countries has risen dramatically in the last ten years, most of that growth can be accounted for by investment in India's service sector and in oil and gas development in Angola, Chad, Equatorial Guinea, and Sudan.[11]

The ascendance of private investment in the fastest-growing developing countries, and those countries' increasing integration into global capital markets is leading to a bifurcation between the needs of the poorest countries and the "emerging markets." Emerging markets are able to privatize state-owned companies and sell bonds and float currencies in international markets. Financial liberalization in many developing countries has extended the market dominance of major commercial banks. But private investment today largely bypasses the sectors that produce the greatest developmental benefits, such as education, healthcare, rural electrification, sewage treatment, and mass transit. Meanwhile, the poorest countries continue to have little or no access to capital markets, while the limited foreign direct investment they receive tends to concentrate in sectors that generate high private returns.

The United Nations (U.N.) and the World Bank agree that ODA commitments fall far short of the estimated $100 billion per year that will be required to meet the MDGs by the agreed 2015 deadline.[12] Indeed, the U.N.'s most recent report on the MDGs notes some achievements, but also glaring setbacks and disappointing progress, particularly in the broad areas of maternal mortality, infectious disease, and environmental health and sustainability.[13] Absent external resources, progress towards the MDGs in many countries will remain mired in a 'poverty trap.' The poorest countries simply do not have the wherewithal to make the investments in basic infrastructure needed for development: roads, electricity, ports, water and sanitation, environmental management, nutrition, disease control, education, and public administration. In the current policy environment, the private sector is unlikely to step up to fill these needs because the private returns in these areas are much lower than the social returns. In addition, the risks are high, and the complementary investments needed to make individual projects worthwhile are not guaranteed.[14]

This mismatch between social and private returns is the underlying reason there is a limited pool of private sector projects that contribute directly to sustainable development. Not surprisingly, then, investments to developing countries tend to be concentrated in sectors such as telecommunications and oil and gas development, while investments in public transportation, water treatment and sanitation, public health, and rural electrification lag. As a result, policy frameworks that send the right signals and incentives for investment, eliminate harmful subsidies, provide effective enforcement and regulation, and weed out corruption are necessary to create the climate for investment in sustainable development in recipient countries. The absence of such policy frameworks is a key reason ECAs can play a complementary, although not central, role in generating finance for sustainable development.

The actions of both the international community and governments of developing countries that are potential destinations of ECA-supported exports and investments are critical because they set the basic policy frameworks and incentives that drive investment. For example, the elimination of subsidies for fossil fuel consumption would level the playing field for investments in cleaner and more sustainable forms of power generation. Terms of reference established by host country governments for a project, such as whether a new power plant incorporates co-generation or serves a specified proportion of the rural population, establish the conditions for private-sector investment and influence the quality of development outcomes.

At the global level, international agreements on global environmental problems are also crucial drivers of policy and investment decisions. The Montreal Protocol on Substances that Deplete the Ozone Layer and the Kyoto Protocol to the United Nations Framework Convention on Climate Change are two major examples. The former prompted rapid innovation in the development of substitutes for ozone-depleting compounds and established a successful phase-in timetable for all countries. The latter agreement will likely spur technological innovation, encourage investments in less carbon-intensive infrastructure, and create markets for reductions in greenhouse gas emissions.

WHAT ECAs CAN CONTRIBUTE TO SUSTAINABLE DEVELOPMENT

ECAs are not directly integrated into international environmental agreements, nor do they shape the policy frameworks of the countries that benefit from the projects and exports they support. Nevertheless, because ECAs use public funds to reduce risks to private investors, they are obligated at some level to play a supportive role in financing sustainable development.

Consequently, within their own arena of export financing, ECAs can and should put into effect changes that can increase the shares of their portfolios that have a high environment and development value. Indeed, this is a role that other major players in development finance are beginning to recognize. The latest World Bank report on development finance notes that loans and guarantees to mitigate political, contractual, regulatory, and foreign-exchange risks are crucial because they help to draw investment into poor countries, particularly for infrastructure. The report specifically suggests that ECAs should intensify their assistance to private investments in poor countries that support the development goals of the recipient countries.[15]

The International Monetary Fund (IMF), World Bank, and the United Nations Environment Programme (UNEP) have also noted the need for the development of new financial products and approaches in the service of sustainable development. In 2002, these agencies released a brief on sustainable development finance that asks, "If the sophisticated thinking that has seen the development of derivatives, hedge funds, exotic futures markets, and other risk diluting products were applied with full force to sustainability challenges, what results could be achieved to create new capital to serve sustainable development?"[16] The authors of that brief declare a need to expand and improve the current financial "tool kit," perhaps by changing the way risk is assessed and priced, creating public-private partnerships to improve the risk-return profile of projects with high development value, and developing new assessment methodologies for projects that are not in mainstream sectors and for which there are lower volumes of financing.[17]

In the quest for financial innovation to support private investment in sustainable development, ECAs bring a number of strengths to the table. Most ECAs are supported by a powerful domestic constituency — exporting industries. Tapping this constituency to support exports and investments that contribute to poverty alleviation and improvements in environmental quality would produce a positive and potentially large ripple effect. Although exporters might not be enthusiastic advocates of incorporating development objectives into ECA-supported projects and exports, they are likely to accept such a trade-off if the alternative is the elimination of export credit supports altogether. In this context, governments would likely support efforts to create new ECA products and services that are coherent with sustainable development, and would agree to changes in international law that give ECAs greater leeway to finance technologies or business models that directly support development. Additionally, ECAs' experience in aggressively securing deals in risky environments provides an opening to leverage private investment in a way that complements ODA priorities, permitting a more effective and efficient allocation of public resources.

Sustainable development advocates could also gain from greater ECA support of sustainability. Development professionals and civil society could exert greater oversight over how ECAs allocate public resources in support of export promotion, and as a consequence, secure significant improvements in the current due diligence procedures ECAs employ to assess the environmental and social impacts of major exports and infrastructure projects. Finally, a more systematic and integrated approach to the allocation of ODA and ECA support would provide an opening for the development community to direct more of their resources to sectors with high social returns and lesser private returns, while strategically directing ECA support to commercially viable projects with significant social returns.

ECAs are not a silver bullet to the problem of financing sustainable development, but they could be a part of the solution. Consequently, the pursuit of ECA reform at international and national levels, while fraught with difficulties and challenges, remains a worthwhile endeavor.

2

WHY ECA REFORM IS RELEVANT

Rapid and radical changes in the global economy and capital markets over the last decade have fundamentally altered demand for ECA financing and have raised questions about whether ECAs are needed to fill market gaps supposedly underserved by private banks. Some fiscal conservatives refer to ECA financing as "corporate welfare" because it supports large corporations in markets where private equity is already readily available.[18] At the same time, social and environmental advocates have raised questions about whether efforts to reform ECAs have produced any genuine environmental or social benefits, with a rising chorus of voices also calling for the elimination of these agencies.[19]

A debate about which of these two alternatives — reform or elimination — is more warranted must begin with a more complete understanding of where ECAs fit in the spectrum of public and private financial institutions, and how they operate. ECAs were created in the early 20th century by a handful of industrial countries to promote those countries' exports to markets that were considered strategically or politically important, but which posed such high risks that private sector bankers were unwilling to extend financing for export or investment to these countries (see Box 2).

For most of the last 50 years, ECAs have competed fiercely to win business, including export and turnkey contracts, for their domestic exporters. Until the late 1970s, this competitive dynamic led governments, through their ECAs, to offer increasingly subsidized financing to their exporters in order to win major export deals. This emerging export subsidy war placed significant fiscal pressures on governments and led to complaints from the private sector that ECAs were causing undue distortion in trade.[20] Consequently, the governments of the Organisation for Economic Cooperation and Development (OECD), with a big push from the United States, agreed in 1978 to a set of rules that limit the amount of subsidy for export financing. This set of informal rules is known as the OECD Arrangement on Officially Supported Export Credits, or "the Arrangement." Under the Arrangement, ECAs continue to compete, but within the strict limits established therein.[21]

ECA financing is necessarily tied to exports from the ECA's home country and often entails a minimum level of domestic content (*e.g.,* the

BOX 2 | **A BRIEF HISTORY OF ECAs AND THEIR MAJOR INSTITUTIONAL TYPES**

The first modern export credit agency was established by the United Kingdom (U.K.) in 1919. Most industrialized countries followed suit after World War II, with an initial wave of ECA creation in the 1940s and 1950s and a final wave in the 1970s. In the 1980s and 1990s, new ECAs began to appear in the Eastern European states and the largest developing-country economies.

Governments created ECAs to increase national exports, expand employment in export-oriented sectors, retaliate against foreign export subsidies, and enlarge overseas markets for major domestic firms. ECAs are also supposed to address specific capital market inadequacies — excessive risk aversion, information asymmetry, and poor repayment incentives. Almost all ECAs cover political risks, and some cover commercial risks as well. Political risks are the risk of non-payment due to political unrest in the buyer's country or unforeseen actions taken by the buyer's government (such as the revocation of a license or the introduction of foreign exchange controls). Commercial risks include the risk of non-payment due to default, insolvency, or failure to take delivery of goods.

ECAs come in many shapes and sizes, and every agency offers a slightly different suite of services. Nevertheless, most ECAs conform to one of the following institutional forms:

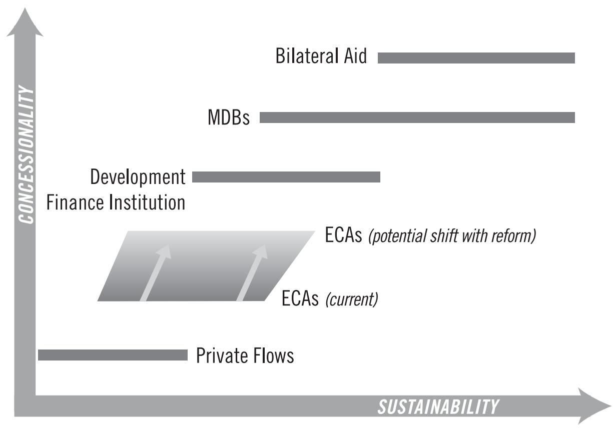
- Private company with an exclusive government charter to administer public funds for export credit and/or investment support to domestic exporters and firms (*e.g.,* Compagnie Francaise d'Assurances pour le Commerce Exterieur; Hermes in Germany).
- Specialized government department within the executive branch or reporting to a central authority (*e.g.,* the Export Credits Guarantee Department in the U.K.'s Department of Trade and Industry).
- An autonomous state-owned agency that provides either insurance or lending or both (*e.g.,* Japan's Bank for International Cooperation; the United States Export-Import Bank).
- Government provider of re-insurance (*e.g.,* Australia's Export Finance and Insurance Corporation).
- Government provider of working capital and short-term export credits (*e.g.,* Brazil's Bank for Economic and Social Development).

Sources: Stephens, 1999; Stephens and Smallridge, 2002.

domestic content requirement is 85 percent for the US Export-Import Bank, but generally lower for other OECD ECAs). ECAs also tend to enter at the tail end of the deal process, after a project or export opportunity has been identified by the private sector. Given these constraints, ECAs are largely reactive, demand-driven institutions. While ECAs can screen out projects that fail to meet certain requirements, they have limited leeway to seek out socially and environmentally preferable exports or investments, as they have no expressly stated sustainable development mandate. However, because ECAs rely on the public purse to support private exports and investments, they have a responsibility to ensure that export promotion is coherent with other public policy commitments and goals.

ECAs straddle the divide between purely public (grant) and purely private (commercial) financing, and their focus on development is secondary. This role as a "bridge" is both constraining and potentially powerful. ECAs often co-finance projects with multilateral development banks (MDBs), such as the World Bank, which provide concessionary financing (ranging from 100 percent grant to near commercial finance). Other institutions that are closely related to ECAs, development finance institutions (DFIs), often partner with ECAs as well. DFIs are not numerous — examples include the Overseas Private Investment Corporation (OPIC) and Germany's Kreditanstalt für Wiederaufbau (KfW) — but they differ from ECAs in that they are mandated to finance projects with sustainable development benefits, and their support is not strictly tied to home country exports. DFIs often tout their projects' export and job creation benefits just as ECAs do, and in fact the types and quality of projects financed by the respective agencies are often only marginally different. DFIs, however, direct more of their support toward investment, while ECAs focus on export trade and project finance.

FIGURE 1 DEGREE OF CONCESSIONALITY AND SUSTAINABILITY ASSOCIATED WITH VARIOUS PUBLIC AND PRIVATE FINANCIAL FLOWS



This graph provides an illustrative comparison of the degree of concessionality and sustainable development focus associated with various types of public and private financial flows. The shaded area represents the proposed shift in the nature of ECA funding that would result from the recommendations in this report.

Finally, ECAs provide backing directly to private sector banks and banking institutions. The difference along this spectrum is that projects with predominantly multilateral or donor funding tend to emphasize social and environmental returns, while those with predominantly private sector funding must have high private returns, and place less emphasis on development value or social returns (Figure 1 compares the concessionality and sustainability associated with various international funding streams). Thus, ECAs have a role to play in drawing private sector financing towards projects with both private returns and some significant or adequate measure of social or development value.

Given the bridging role played by ECAs, what is fueling the call for the reform or even elimination of these agencies? Two strands of criticism are fueling these demands: the first strand centers on a set of political and economic critiques, and the second on a related set of human rights, environmental, and social concerns.

THE POLITICAL-ECONOMIC CRITIQUE

Over the last ten years the demand for ECA financing — particularly for short-term financing — has declined. Large exporters have discovered alternate ways of financing expensive capital equipment, including self-finance, leasing, and private insurance products. Local capital markets (especially in Asia and Latin America) have developed increasing medium- and long-term import financing capacity. As of 2002, private-sector financial institutions had successfully taken over the bulk of ECAs' short-term portfolios, or about $570 billion per annum in export credit insurance.[22] At the same time, ECA provision of medium- to long-term export credit insurance[23] and investment insurance in 2003 stood at roughly $66 billion and $15 billion, respectively,[24] a substantial decline from the $80-100 billion per annum ECAs facilitated in the mid-1990s.

In addition, export credit agencies' macroeconomic benefits — including export growth, employment, and competitiveness for national industries — have been challenged in recent years by interest groups, academics, and even government analysts. These critics have cited not just the relatively small percentage of industrialized country exports receiving official support, but also economic theory suggesting that official export finance can do little to elevate the real productive potential and international competitiveness of the economy. [25]

Finally, globalization in the emerging markets where ECAs do most of their business has altered the nature of the risks ECAs have customarily assumed. An increasing number of infrastructure and other services in developing countries are now built, owned, and delivered by private firms rather than governments as a result of privatization, liberalization, and deregulation. Consequently, private-sector projects (for example, independent power projects, gas pipelines, aluminum smelters, and pulp and paper mills) came to occupy an overwhelming share of ECAs' medium- and long-term business in the 1990s. But these commercial projects still face risks resulting from actions by national governments, a situation which has blurred the distinction between political risk and commercial risk. The consequences of this blurring became clear to ECAs during the rush of claims resulting from the financial crises in Southeast Asia, Russia, and Argentina, in which government decisions to devalue or "float" local currencies caused many firms to suffer major losses. Although currency exchange risks are usually classified as "commercial risks," many firms holding political risk insurance sought claims for these losses, arguing that they were the direct result of actions by governments.[26]

Even within the declining market for official export credits, the field of competitors is growing more crowded, with the exception of Sub-Saharan Africa. A number of developing countries have mounted aggressive efforts over the past decade to expand and diversify their export finance programs (see Box 3). The Compagnie Francaise d'Assurances pour le Commerce Exterieur (COFACE) representative at the 2003 Bankers' Association for Finance and Trade conference specifically pointed to the rise of these new programs as an important explanation for the eroding demand for COFACE finance.[27]

BOX 3 | **EMERGING MARKET ECAs**

ECAs in some emerging market economies are quite large; the ECAs of Korea, China, and India easily rival those of industrialized countries in terms of volume supported. Much of this finance supports short-term transactions, probably because, with a few exceptions, these economies face a comparative disadvantage in major capital equipment and construction contracts. Nonetheless, several emerging market ECAs with a strong industrial base, *i.e.,* China, India, and Korea, devote a significant share of their resources to medium- and long-term guarantees and insurance. Of the 11 emerging market ECAs reviewed, only the Turkish and Korean agencies had put in place a set of environmental assessment procedures as of summer 2004 (likely due to OECD members' adoption of The Common Approaches on ECA environmental procedures in 2003). A snapshot of recent transactions for major emerging market ECAs is provided below.

Brazil	Export-Import Division, Banco Nacional de Desenvolvimento Economico e Social (BNDES-EXIM)	2001 disbursements	$3.1 billion
China	China Export & Credit Insurance Corporation (SINOSURE)	2003 insured business	$5.71 billion
	Export Import Bank of China (China Eximbank)	2003 approved credits	$8.3 billion
India	Export Credit Guarantee Corporation (ECGC)	2003 export credits covered	$8.3 billion
	Export-Import Bank of India (Ex-Im India)	FY2004 loan commitments	$2 billion
Israel	Israel Foreign Trade Risks Insurance Corporation (IFTRIC)	2000 insured exports	$6.3 billion
Korea	Korea Export Insurance Corporation (KEIC)	2001 business underwritten	$30 billion
	Export-Import Bank of Korea	2003 loan commitments 2003 loan guarantees	$9.9 billion $13.5 billion
Mexico	Banco Mexicano de Comercio Exterior (Bancomext)	2003 loans or credit 2003 guarantees & insurance	$5.4 billion $742 million
Taiwan	Export-Import Bank of the Republic of China	2003 export credit insurance 2003 guarantees	$466 million $76 million
Turkey	Türk Eximbank	2003 short-term export credits 2003 medium- & long-term credits 2003 export credit insurance	$3.3 billion $3 billion $66 billion

Source: Carbonell (2004c).Note: Disbursements would present a more accurate view of actual transactions than do approved credits; however, this data is currently unavailable for most of these ECAs.

The combination of decline in demand, alteration in risks, and debate over macroeconomic benefits of export finance forms the basis of the call for ECA reform on political and economic grounds, but there is also a powerful sustainable development critique to be considered.

THE SUSTAINABLE DEVELOPMENT CRITIQUE

ECAs by and large answer to elected governments that have committed in rhetoric and in action to eliminating poverty, curing disease, fighting corruption, reducing debt, and aiding environmental protection efforts in the developing world. These same governments have undertaken difficult negotiations to take action on climate change; impose standards of transparency, accountability, and social and environmental performance on bilateral and multilateral development agencies; and adopt numerous international agreements meant to curb corruption and defend human rights. Yet in many of these policy areas, governments have only reluctantly imposed minimal requirements on their ECAs. In many instances, ECA practices and policies are simply at odds with the broader commitments of their governments. Indeed, the recent World Bank and IMF report monitoring progress towards the Millennium Development Goals urgently calls on developed countries to "improve policy coherence for development," noting "contradictions in policies, with support provided in one area undercut by actions in another."[28]

A number of advocacy groups and journalists have documented the negative environmental impacts from ECA-backed mega-projects such as large dams, hard-rock mining, gas pipelines, and pulp and paper mills.[29] In many cases the environmental standards and procedures ECAs apply to such projects fall short of those that have long been in place at the World Bank and were adopted at the insistence of the same donor governments that supply the bulk of official export credits.[30]

ECAs rarely address human rights violations committed by client companies or partner governments. The Ilisu hydroelectric dam in Turkey, for instance, was preliminarily backed in 1999 by a number of OECD ECAs despite clear problems with the resettlement of minority Kurds. The private sponsors of the project withdrew from the project in 2001 (eliminating the need for ECA support) after a United Kingdom (U.K.) parliamentary committee concluded that the affected Kurds had no effective means to appeal or contest the dam.[31] Critics of ECAs have also drawn attention to some of these agencies' large-scale finance for arms exports to repressive regimes. In one notable example, the U.K. provided £488 million in export credits to Indonesia's Suharto regime during the mid-1990s, a large fraction of which purchased Hawk aircraft used in the repression of East Timor.[32]

ECAs' track record in combating corruption is weak. A number of ECAs have provided support to clients who bribed officials to win engineering or supply contracts. The most prominent recent example is the Lesotho Highlands Water Project (LHWP), where German, Canadian, and Italian firms have been convicted or are under investigation for paying the LHWP authorities large sums to win contractual work.[33] Similar allegations are being investigated by the United States' Securities and Exchange Commission and Department of Justice in the case of the U.S. firm Halliburton and its role in obtaining a contract to build the Bonny Island liquefied natural gas plant in Nigeria.[34] To date, ECAs have taken few, if any, actions in these cases, even though ECAs have officially committed to canceling export credit coverage and loans when there is evidence that an export contract has been obtained by bribery or corruption.[35]

ECA lending accounts for a large share of the external debt burdens of many developing countries. In 2002, ECAs held 30 to 40 percent of developing countries' debt to official creditors, and 16 percent of their total external debt.[36] Some countries — including Nigeria, Algeria, and Iran — owed ECAs over 50 percent of their debt as of 2001.[37] Meanwhile, countries classified as Heavily Indebted Poor Countries (HIPCs)[38] received more than $3 billion in medium- to long-term export credits between January 2001 and December 2004.[39] While debt service on export credits can represent a significant drain on public resources, debt is not inherently bad for development. However, in countries with overwhelming human needs and few resources to pay off loans, new debt must deliver direct and tangible development benefits resulting in poverty alleviation. The IMF has introduced measures to help ensure that ECA lending to HIPC program countries does not increase those countries' debt burden, such as requiring that their financing be made on concessional terms (at least 35 percent in the form of a grant)[40].

On the other hand, a critique that assumes that ECA lending is important for development notes that ECA support is highly concentrated, with the majority benefiting a handful of high- and middle-income countries (see Table 1). These countries already enjoy greater access to global capital markets than do their low-income counterparts. Most Sub-Saharan African countries and the poorest developing economies

TABLE 1 TOP DEVELOPING AND TRANSITION ECONOMY DESTINATIONS OF MEDIUM/LONG TERM EXPORT CREDITS FROM OECD GOVERNMENTS IN 2003[a]

Country	Total (US$ billions)	Percent of total
Indonesia	2.96	6.9
Mexico	2.88	6.7
Poland	2.74	6.4
China	2.19	5.1
Turkey	1.90	4.4
Iran	1.62	3.7
Brazil	1.55	3.6
Russian Federation	1.53	3.5
Malaysia	1.44	3.3
Saudi Arabia	1.44	3.3
Algiers	1.26	2.9
Chinese Taipei	1.20	2.8
Totals	22.71 [b]	52.6

Source: OECD, 2005c, Table 2.
Notes:
a. Converted from Special Drawing Rights (SDRs) using the year average exchange rate.
b. This total and the accompanying percentage figure are drawn from OECD statistics for 2003 that exclude investment insurance and official credits offered by multilaterals. As a result, the totals may seem small relative to Berne Union statistics for 2003 which estimate about $66 billion in medium- to long-term credits and investment insurance.

receive relatively small volumes of OECD export credits.

The already pronounced skewing of export credits to rapidly growing emerging markets has worsened in the last seven years. Since the East Asian financial crisis, medium- and long-term export credits have declined most precipitously for the least developed and low-income developing countries, while they have risen as a share of the total for upper middle- and high-income developing countries (see Table 2).

These social and human rights critiques are compounded by the lack of transparency in export credit financing. Official statistics on export credit financing reported by the IMF are buried within a broader category known as "other official flows."[41] Most ECAs do not disclose individual transactions before — and in many cases even after — deciding to provide financing. Only a few publicly disclose the results of environmental impact assessments conducted for projects seeking ECA support. ECAs adopted a set of Common Approaches on Environment in 2003, leading to apparent improvement in due diligence and environmental assessment practices.[42] But a general lack of transparency makes it difficult to assess the degree to which ECAs are in compliance with the Common Approaches and whether the new policies have led to significant changes in the kind or quality of projects receiving ECA support.

TABLE 2 DEVELOPING COUNTRY RECIPIENTS OF MEDIUM/LONG TERM EXPORT CREDITS BY LEVEL OF INCOME AS PERCENT OF TOTAL

	1998	2000	2002	Trend
Least Developed Countries	3.3	0.8	1.0	↓
Low Income Countries	10.7	5.2	5.3	↓
Lower Middle Income Countries	27.5	35.1	28.7	↔
Upper Middle and High Income Countries	20.5	25.8	30.4	↑

Source: OECD 2005c, Table 2

WHY REFORM STILL MAKES SENSE

Given these critiques, why does pursuit of a reform agenda make more sense than elimination of ECAs? Four realities provide a compelling case for reform. First, although there have been efforts to cajole governments to increase their ODA — namely, repeated commitments by industrialized-country governments to contribute .7 percent of GNP, the United Nations Finance for Development Summit in 2002, and more recently, efforts by U.K. Prime Minister Tony Blair at the 2005 G8 summit to substantially increase aid to Sub-Saharan Africa — these are unlikely to lead to a sustained increase in ODA.[43] In light of this, ECA reform offers some hope of using public resources to leverage a modest amount of private sector investment in support of sustainable development. ECAs annually provide anywhere from $40 to $80 billion in medium- to long-term financing. If just five percent of that were to support private-sector projects with high development and environmental benefits, it would translate to two to four billion dollars annually in new resources for sustainable development.

The second compelling argument for continued efforts to reform ECAs is the fact that these institutions are still critical sources of financing for poor countries — particularly for the kind of infrastructure and services needed to meet the MDGs — even if such projects and countries represent a small overall share of ECA portfolios. The World Bank notes that among the 70 "poor countries," ECA finance represents 80 percent of gross capital market financing.[44] Between 1997 and 2002, every commercial bank loan larger than $20 million to these countries was backed with an official guarantee.[45] Elimination of ECAs would likely mean cutting off poorer developing countries from much of the private sector financing they now receive, as few private sector companies are likely to risk entering these economies without public guarantees.

Third, achieving sustainable development will require new tools and new pathways; ECA reform offers an opportunity to develop such methods. Private-sector financial institutions could benefit from the testing of new financial tools with government support. In this regard, ECAs offer a modest opportunity to develop and test new approaches in collaboration with development institutions and the private sector. As the IMF, UNEP, and the World Bank have noted, the current toolkit needs to be updated, improved upon, and expanded. ECAs could play a part in such a process.

Finally, ECAs have demonstrated an ability to respond to regional development challenges, and to innovate and evolve. For example, ECAs have supported trade expansion and reconstruction and modernization of infrastructure in post-conflict countries. After World War II, the US Export-Import Bank was the first agency to help reconstruct Western Europe before the Marshall Plan went into effect.[46] ECAs played a similar role in Eastern Europe after the fall of the Berlin Wall and the collapse of the Soviet Union.[47] In recent years many ECAs have been experimenting with changes to their mandates, institutional structure and financial products. Examples of such evolution include an exploration by the U.S. Export-Import Bank of partnerships with private investment firms to attract more private capital to developing countries and to leverage the Bank's resources;[48] and specialized programs targeted at small and medium enterprises[49] put into place by Australia's EFIC, Canada's EDC and the Netherlands' Nederlandsche Credietverzkering Maatschappij NV.[50]

But reform must be genuine and significant. A number of nominal ECA efforts to address sustainability have produced few tangible results (the most notable being the U.K.'s commitment of £50 million in funds for renewable energy,[51] which has disbursed none of the earmarked funds to U.K. exporters).[52] And lip service to reform unsupported by action (the ECA statement on bribery mentioned above, for example) only increases the risk that critics currently working on reform will redirect their efforts toward the elimination of official export credit support.

The sections that follow propose a far-reaching reform agenda encompassing changes to institutional policies, products and services, and portfolio management practices. These measures will inevitably affect and be influenced by international law regulating official export credits. Thus, it is necessary to briefly explore these legal constraints before presenting the proposed reforms at the heart of this analysis.

3

INTERNATIONAL DISCIPLINES GOVERNING EXPORT CREDITS AND THEIR RELEVANCE TO ECA REFORM

Two important international agreements govern the provision of official OECD export credits and have a significant influence over whether and how ECAs can pursue a sustainable development agenda. The first is the Arrangement on Officially Supported Export Credits ("the Arrangement"), negotiated as a voluntary "gentleman's agreement" under the auspices of the OECD.[53] The second is the Agreement on Subsidies and Countervailing Measures (ASCM), administered by the World Trade Organization (WTO).

Adopted in 1978, the Arrangement is negotiated within but is not an official agreement of the OECD. A country may only join the Arrangement at the invitation of its participants, which currently include Australia, Canada, the countries of the European Union, Japan, Korea, New Zealand, Norway, Switzerland, and the United States. The Arrangement covers all transactions with repayment periods of two years or more, including the following common categories of ECA finance: a) "pure cover," which means an agreement to protect exporters or investors against certain commercial or political risks through insurance premiums or the issuance of guarantees; b) "official financing support," which could include loans, refinancing, and interest rate subsidies provided to exporters or investors; and c) any combination of the two.

The Arrangement was designed to limit the intense rivalry among ECAs that led to exorbitant subsidies of capital goods exports — and large government losses — in the 1960s and 1970s. Over time, the Arrangement has expanded to allow relaxed financing terms for particular sectors (ships, nuclear power plants, civil aircraft, and recently renewable energy), set minimum premia for sovereign risks, dictate special terms and conditions for project finance, and regulate how governments combine official export credits with development assistance.

The other relevant international agreement, the ASCM, is a key component of the WTO's regulation of trade in goods. The principal function of this agreement is to define different forms of government subsidy that are or are not permissible in the area of international trade, and establish the legal remedies and dispute resolution mechanisms for WTO members harmed by prohibited trade subsidies. All members of the WTO are parties to the ASCM.

Three sections of the ASCM are of particular relevance to official export credits: Article 1, Article 3, and Annex I ("Illustrative List of Export Subsidies"). Article 1 defines a "subsidy" as any form of financial contribution by a government that also confers a "benefit." Article 3 prohibits subsidies thus defined which are "contingent in law or in fact" on "export performance," and makes reference to the Illustrative List in Annex I. Annex I, in turn, includes two provisions directly pertaining to export credits. Item (j) of the Annex bans the provision of export credit guarantees and insurance at premium rates that are too low to cover their long-term costs. Item (k) prohibits governments from offering or facilitating export loans at interest rates lower than their cost of borrowing.

Crucially, item (k) also contains a unique clause, known as the "safe haven" or "carve-out," that links the ASCM to the Arrangement. Under the ASCM, WTO members may not facilitate finance at interest rates lower than their cost of borrowing *unless* the member complies with the interest rate provisions of the OECD Arrangement. In other words, WTO members may only subsidize official financing support to the extent permitted in the Arrangement. If a WTO member fails to show that its official export finance qualifies for the protection of the "safe haven," the legality of that finance is then determined by the "market test" implicit in Articles 1 and 3.

As a result of the safe haven, all WTO members must abide by the rules on interest rates set out in the Arrangement. But only a subset of countries — those whose governments are parties to the OECD Arrangement — can negotiate those rules. This legal framework excludes developing-country governments from participating in the determination of the boundaries and rules that constitute the safe haven. In effect, developing countries that are signatories to the ASCM are bound by a set of provisions over which they have no say.

Parties to the Arrangement traditionally interpreted the safe haven broadly, to include almost all forms of official export finance. Recent challenges to the safe haven brought by Brazil and Canada, and ruled on by WTO arbitration panels, narrowed the scope of the safe haven such that it applies only to fixed-rate direct loans or interest rate subsidies. Other forms of ECA financing — most importantly, political and commercial risk insurance and guarantees, often referred to as "pure cover" — therefore do not fall under the safe haven. Pure cover and floating-rate finance supplied by ECAs must instead satisfy a "market test," as implied in Article 1 of the ASCM, to escape outright prohibition. Because most ECAs increasingly offer pure cover rather than direct finance, the narrowing of the safe haven limits policy space for ECAs to develop new forms of finance that privilege exports or investments that generate sustainable development benefits.

International law and jurisprudence concerning ECAs, as discussed above, may seem obscure and convoluted. However, these rules are taken seriously by most governments and have potentially important consequences for the reform agenda proposed in this paper. Some of the proposed reforms can be carried out within the existing set of soft law and legal disciplines; some will require amendments to the Arrangement but are otherwise consistent with the ASCM; and some will require high-level changes to both documents. Table 2 summarizes the implications of various general categories of export credit reforms for these disciplines.

A more detailed discussion of the implications of the Arrangement and ASCM for export credit financing supportive of sustainable development is contained in Appendix I.

TABLE 3 IMPLICATION OF PROPOSED EXPORT CREDIT REFORMS FOR INTERNATIONAL DISCIPLINES GOVERNING OFFICIAL EXPORT CREDITS

Type of Reform	Examples of Reforms	Illustration of Potential Impact on the Ground	Implication for International Disciplines
Affects non-financial terms of transactions	Strengthened consultation, disclosure, and monitoring requirements; uniform policies on environmental and social due diligence; human rights, corruption, and debt sustainability screening	An ECA finances equipment for a road project in a sub-tropical forest. The project sponsor holds meetings with communities along the road route, compensates households displaced by the road, re-routes the road to avoid sensitive natural habitats, and enacts plans for the control of internal migrants and illegal loggers.	Consistent with both the OECD Arrangement and the WTO's ASCM. No changes required to either set of disciplines.
Affects terms of fixed-rate finance and interest-rate subsidies	Increased repayment periods; adjusted interest rates; minimum allowable local costs	An ECA provides a loan for an OECD developer to build a waste-to-energy plant or wind farm in a developing country to sell power to rural power cooperatives. Thirty percent of the loan may be used to purchase equipment locally, as well as to hire and train local staff to operate and maintain the power plant. The ECA establishes a custom, flexible repayment schedule to reflect the high up-front capital costs and unique cash flow of the project.	Requires amendments to OECD Arrangement, since fixed-rate finance falls under the "safe haven." No changes required to the WTO's ASCM.
Affects terms of pure cover, floating rate finance and other instruments	Minimum risk premia; special low-cost or long-term facilities for sustainable development projects and exports	An ECA guarantees a set of commercial bank loans to export medical equipment to hospitals and clinics located in different districts and regions of a developing country. The ECA "bundles" together the bank's loans to the individual medical facilities to reduce administrative costs and lower the premia; it also shoulders some of the currency risk, allowing the hospitals and clinics to repay the loans in local currency at much lower interest rates than are available from domestic credit markets.	Requires amendments to OECD Arrangement because pure cover and other instruments do not fall under the "safe haven," language of the WTO's ASCM. It will also require changes to the ASCM to avoid running afoul of Article 3, which prohibits subsidies tied in fact or in law to export performance.

4

A REFORM AGENDA SUPPORTIVE OF SUSTAINABLE DEVELOPMENT

Far-reaching and genuine reform of ECAs must encompass change in three areas: institutional mandates and policies, financial products and services, and portfolio management practices. Reforms to date have mostly taken place in the realm of mandates and policies, while largely ignoring financial products and portfolio management. One reason for this is that institutional mandates and policies must usually occur first as they are necessary to spur and guide further reforms toward sustainability. In addition, as the previous discussion makes clear, some changes to products and services as well as portfolio management practices are subject to the constraints of the Arrangement and the ASCM, and thus require collective action by ECAs to implement — making the reforms more difficult to achieve. Such reforms are also more technical in nature and require specialized knowledge of financing and the intricacies of the ASCM and the Arrangement, so it is not surprising that there has been relatively limited progress on this front.

Regardless of the category of reform, ECAs must strengthen their capacities to "do no harm" as well as their abilities to "do good." Generally speaking, "do no harm" efforts minimize the negative development impacts of current ECA activities by preventing support for destructive projects, imposing strong environmental and social conditions on other transactions, opening ECAs to greater public scrutiny, and making ECAs more accountable to project-affected communities. The "do good" agenda maximizes the positive development benefits to be gained from ECA support by directing it to projects, and sectors with significant development value, and countries or regions with the greatest development needs. Strengthening ECA capacity to do no harm is a top priority for the near term; nevertheless, the "do good" agenda is no less important and the two should go hand in hand. By implementing the "do good" items, ECAs will maximize the development effectiveness of their work — harnessing their talents and resources to exploit all possible opportunities for their products to promote progress towards the Millennium Development Goals.

REFORMS TO STRENGTHEN ECA CAPACITY AND ACCOUNTABILITY FOR "DOING NO HARM"

Upward Harmonization of ECA Environmental and Social Standards

Externally credible social and environmental due diligence procedures are necessary to avoid or minimize negative development impacts of ECA-backed or -financed projects. ECAs should establish a common minimum standard of due diligence so as to prevent any ECA from gaining competitive advantage by relaxing its standards, and this minimum standard should be renegotiated and strengthened over time, a process known as upward harmonization.

The question of upward harmonization is timely given the considerable changes to environmental and social due diligence procedures and policies for financial institutions now in play. This is due primarily to two recent developments. First, the IFC is updating its environmental policies and procedures; initial drafts suggest a move away from the World Bank's prescriptive social and environmental safeguard standards and toward less specific, more discretionary "performance standards."[54] Second, a group of about thirty major commercial banks that are involved in over 80 percent of international project finance has adopted a document called the Equator Principles, which commits the banks (with some qualifications, particularly in the areas of accountability and disclosure) to apply IFC's environmental policies and procedures to all project finance with a total capital cost of at least $50 million. The Equator Principles may be revised in the coming year to incorporate the outcome of the aforementioned policy review at IFC, although this outcome is not definite.[55]

In 2003, ECAs adopted the Recommendation on Common Approaches on Environment and Officially Supported Export Credits at the OECD. The 2003 Common Approaches set forth the following requirements:[56]

- Projects should, in all cases, comply with the environmental standards of the host country. When the relevant international standards against which the project has been benchmarked are more stringent, the higher standards would be applied.
- The relevant international standards are those of the World Bank Group and, where applicable from a geographical viewpoint, those of regional development banks. Members may also benchmark against any higher internationally recognized environmental standards, such as those of the European Community.
- With regard to the most sensitive projects, the environmental standards to be applied will be reported and monitored by the Export Credit Working Party (ECG), and exceptional deviations below international standards will have to be justified.
- For the most sensitive projects, ECG members will seek to make environmental information, particularly environmental impact assessment reports, publicly available 30 calendar days before final commitment.

However, the Common Approaches allow for exemptions to these standards, including in the application of a number of relevant World Bank safeguard policies. The Common Approaches need to be brought in line with the strongest set of international standards, whether those belong to the World Bank or another organization.[57] Furthermore, public release of environmental impact assessments is not mandatory, and the Common Approaches do not address broader human rights impacts of sensitive investments. There is an opportunity going forward to revise the Common Approaches at the OECD so that they include a bottom-line, universally applied standard for all relevant environmental and social concerns and include mandatory transparency requirements.

Of course, ECAs should not stop at meeting the minimum responsible due diligence embodied in international standards articulated by multilateral or regional development banks. Various public interest groups have proposed comprehensive, enhanced standards of social and environmental due diligence (see Box 4) and have advocated that these be overtly defined and adopted through the OECD process.[58] These standards represent the best-practice "gold standard" for which ECAs — and, for that matter, IFC and the Equator banks — should strive.

Increased Transparency of ECA Lending

New governance structures are necessary to ensure that ECAs are both transparent and accountable for the development impact and quality of their financing decisions. However, ECAs must also balance management of commercially confidential information with their public mandates and responsibilities. This requires defining what information regarding an ECA's activities and transactions involves a public interest and must be disclosed. ECAs will also need to establish how information to be disclosed will be shared with and made accessible to both a domestic public (taxpaying citizens of the country the ECA represents) and an international public (taxpayers and citizens in countries where the ECA's portfolio of projects or exports might produce a potentially negative impact).

Best practice in this area means releasing basic details (name, applicants, location, and size) about socially and environmentally sensitive transactions under consideration, as well as the results of preliminary social and environmental assessments, in an accessible and timely manner. The U.S. Export-Import (Ex-Im) Bank has shown leadership in this area by making it a practice to release environmental impact assessments for sensitive projects 60 days before making a final decision on whether to proceed with financing.

Creation of Grievance/Recourse Mechanisms

To ensure accountability, ECAs need clear, fair procedures or structures to address grievances and claims from external parties. While a grievance mechanism may be used rarely, its existence creates an assurance that an ECA is in fact delivering on its own obligations and mandate. Such mechanisms need to be independent and must clearly state what grievances or claims are considered legitimate. The remedies to be imposed should be clearly defined and meaningful, and may include monetary penalties; cancellation of ECA loans, guarantees or insurance; or other remedial actions by the ECA.

Two ECAs — the Japan Bank for International Cooperation and Export Development Canada — have recently created ombudsman offices that represent a step in the right direction. The World Bank Group's Inspection Panel and Compliance Advisor/Ombudsman could also serve as models. It should be noted, however, that such a mechanism may be more difficult to

BOX 4 | CONSIDERATIONS FOR CREDIBLE ENVIRONMENTAL AND SOCIAL DUE DILIGENCE PROCEDURES

Due diligence procedures should feature the following steps and characteristics:

- Broad applicability to a wide range of transactions, including modifications to an existing project and exports that are minor parts of large projects.
- Transparency throughout the process, especially prior to final decisions of support but also during project monitoring.
- Clear standards to deal with accounting for and reducing ECA lending impact on global environmental concerns, particularly climate change and biodiversity loss.
- Monitoring of sensitive projects during construction and operation to ensure that environmental and social commitments are respected. Credible and pre-announced use of legal leverage points (for example, withdrawal of all or part of a guarantee) to bring projects into compliance.
- Pre-screening of transactions with reference to comprehensive development criteria, including environmental and social impacts (including displacement, employment, and food security) and human rights implications. Large transactions in heavily indebted countries (not just HIPCs) should also be evaluated for their impact on debt sustainability. It may be appropriate to use "exclusion lists," to rule out or give special consideration to transactions with problematic characteristics —such as projects displacing large numbers of people— or categories of projects in "unproductive" sectors, such as weapons. Client exclusion lists for companies with poor environmental and social records may also be appropriate.
- Evaluation of the most sensitive transactions prior to final decision, again with reference to a comprehensive list of development criteria. Evaluation results should be compared with appropriate international standards (*i.e.*, World Bank or Development Assistance Committee), and made to comply with host country law. Where a project falls short of international standards, its sponsors should provide credible plans for satisfying those standards.

Sources: Bruce Rich, "Established Common Elements of International Good Practice for Environmental Assessment," Background Memorandum for a Presentation before the OECD Trade Directorate Working Party on Export Credits and Credit Guarantees, Paris, 26 October 1999; Watson, 2003.

implement in cases where the ECA does not have the jurisdiction to monitor projects on the ground. For instance, there is some debate in the United States as to whether monitoring responsibilities belong to the U.S. State Department or to the Ex-Im Bank.

Adoption of an ECA Agreement on Sustainable Debt

ECAs hold a substantial share of developing countries' debt to official creditors. Unlike other forms of official debt, most of the outstanding export credits were incurred on a non-concessional basis and had no direct policy linkage to development. Moreover, for many developing countries — not just those considered the poorest, classified as HIPCs or eligible to receive grants from the World Bank's International Development Agency (IDA) — debt service on export credits represents a significant drain on public resources (and foreign exchange) that limits investments in health, education, infrastructure, and environmental protection.

In July 2001, the OECD's Export Credit Group adopted a set of principles discouraging the use of export credits for "unproductive" (loosely defined) projects in HIPCs; however, the OECD's definition still explicitly permitted arms sales. ECAs could better support HIPCs if they were to develop an agreement on debt that included the following elements:

- Adherence to a shared definition of the types of expenditures classified as "productive" (ideally in terms of the Millennium Development Goals) and "unproductive";
- Prohibition of unproductive expenditures by countries with high debt-to-GDP and debt service-to-export ratios;
- Agreement to coordinate debt relief to countries with abnormally large volumes of outstanding export credits; and
- Development of debt sustainability analyses for large medium- and long-term transactions in heavily indebted countries.[59]

Implementing Commitments to Combat Bribery and Corruption

OECD governments adopted a Convention on Combating Bribery in 1997 that requires signatories to criminalize the bribing of foreign officials. The OECD's Export Credit Group followed up this Convention in 2000 with an Action Statement on Bribery and Officially Supported Export Credits, which required that OECD ECAs inform applicants about the legal consequences of bribery in international business transactions; refuse to approve credit or cover where "sufficient evidence" of bribery exists; and take action against clients who are proven to have bribed after credit or cover was approved.[60]

As discussed above, a significant minority of ECAs has failed to uphold the strongest components of the Action Statement — the commitment to withhold support for transactions with "sufficient evidence" of bribery and to take action (legal and financial) against companies that are proven to have bribed after a transaction is approved. Hawley recommends a number of practical measures that are stronger and more specific than those included in the 2000 Action Statement: she argues that ECAs should require their clients to make a full reporting of all "commissions" paid and should refuse support when these constitute more than 5 percent of project costs (typical commissions account for 2-3 percent of project costs). ECAs could also, as part of due diligence, take account of companies' track records with respect to bribery, possibly excluding for a fixed time period companies that have been proven guilty of bribery. In addition, Hawley proposes the withholding or suspension of support in cases of suspected bribery, along with referral of the suspected bribery to national authorities.[61]

One way to more vigorously combat corruption is to make ECAs themselves more transparent, if not to the wider public, at least to national parliaments. Legislation obligating ECAs to make detailed reports of project costs or at least commissions paid may be in order in some cases.

Monitoring the Development Impacts of ECA Portfolios

Assessing and monitoring the development impact of ECA portfolios is important to ascertain the alignment of ECA practices with sustainability. Monitoring could take the form of very specialized tracking and reporting — *e.g.*, greenhouse gas accounting — or involve periodic and random samplings of development projects that reflect the ECA portfolio's overall development quality. All monitoring and reporting should be done in an independent and verifiable manner. Once ECAs gain more experience in this area, it would also be useful for them to agree on uniform procedures for tracking and reporting on the development impacts of their activities — including the indicators to be monitored, the methods for measuring those indicators, and the way in which that information is formatted and presented. This would allow ECAs to more readily identify emerging best practice, enable the public to monitor ECAs more easily, and give ECAs a means by which to track their own performance and those of their peers.

REFORMS THAT CREATE THE SPACE FOR ECAs TO "DO GOOD"

Invite Developing Countries with Significant Medium- and Long-Term Business to Become Parties to the OECD Arrangement

The ASCM effectively excludes developing countries that are WTO members from setting the terms for export credit financing. Consequently, developing countries are vulnerable to having their export credit practices invalidated, perhaps intentionally, by negotiations conducted among the wealthy countries participating in the Arrangement. This inequity could be remedied by inviting developing countries to join the Arrangement and take part in its negotiations.

The alternative is to revise the substance of the ASCM related to export credits through the WTO's Doha Round negotiations. In this vein, the European Union (EU) floated a proposal in the fall of 2002 to explicitly extend the safe haven to include pure cover (guarantees and insurance), and allow ECAs party to the OECD Arrangement to match terms made by non-Arrangement ECAs. As a peace offering, the EU was "prepared to address" developing country concerns about being excluded from Arrangement negotiations. However, Brazil, Egypt, and India rejected this proposal, claiming that the plan would only benefit OECD members.[62]

Whether through the OECD or the WTO's Doha Round, developing countries need a seat at the table in negotiations on export credit disciplines. This is particularly important for developing countries that supply significant medium- and long-term export credits. Such participation would open a policy space for incorporation of development impacts and concerns into official export credit disciplines as well as the re-crafting of such disciplines so that these support development objectives. The easiest way to achieve this in the short term is to invite developing countries with significant exports into the Arrangement, perhaps in exchange for a commitment that these countries' ECAs implement the Common Approaches. This would maintain the safe haven while initiating a process to address developing country concerns and supporting upward harmonization of due diligence procedures.

Amendments to the OECD Arrangement

- *Negotiation of special sector agreements*

  In May 2005 the parties to the Arrangement agreed to a special sector agreement for renewable energy technologies and water projects that allow such projects to obtain cover or loans that can be repaid over 12 to 15 years.[63] This compact appears to represent a significant step forward. In the recent past individual ECAs have created set-asides (examples include environmental export and renewable energy funds created by the United States and the United Kingdom) that have not addressed the particular financing requirements of individual sectors, including the need for longer repayment periods or greater coverage of local costs. As a result, these set-asides for the most part have not been tapped by either exporters or developing country importers.

The potential pitfall of the renewable energy and water agreement, and of potential future special sector agreements, is that ECAs retain the power to define which renewable energy and water projects qualify for special treatment. ECAs have an inherent interest in lobbying for relaxed rules on exports from politically influential domestic industries, no matter how tenuous the link to sustainable development. The inclusion of large hydropower projects in the recently adopted special sector agreement is a case in point. Many environmental and social advocates argue that hydropower projects must abide by the processes and criteria set out by the World Commission on Dams (WCD) guidelines in order to be considered sustainable.[64] Dams that do not meet the criteria for sustainability set out by the WCD have proven to be the root of much social disruption and environmental degradation, yet the special sector agreement fails to require hydropower projects to follow the WCD guidelines.

OECD governments must be wary of industries and sectors that might vie to create additional sector agreements that serve those industries' own economic interests while ignoring sustainable development. To avoid this phenomenon, and to ensure that the current sector agreement on renewable energies and water projects meets basic standards of sustainability, special sector agreements must incorporate independent processes that establish a definition of "sustainability" or "high development value." There are many such independent forums or processes in addition to that of the WCD; examples include the OECD's own Development Assistance Committee and the Commission on Capital Flows to Africa, as well as other bodies that focus on specific sectors (*e.g.*, water and sanitation, transportation, education, health).

Assuming that an orderly and rigorous process can be established to identify technologies, sectors, or regions deserving of a special sector agreement, a number of changes to the Arrangement might be considered. The relaxation of Arrangement terms within properly constructed special sector arrangements could give ECAs the policy space they need to develop innovative financial instruments tailored to neglected projects with sustainable development benefits. Some changes to the Arrangement that might facilitate this are discussed below.

- *Longer terms*
  Many development projects that have significant localized benefits (a municipal water project or local electricity distribution grid) recoup investments over longer periods of time and would benefit if the Arrangement permitted coverage of risks or the provision of credit that exceeded the current limit of 8.5 to 10 years. The Arrangement currently grants nuclear power plants the longest tenures (15 years).

- *Increased coverage of local costs*
  Many developing countries have an interest in developing indigenous labor, technology, and management capabilities, and in including local technologies and content in development projects. Such steps can enhance local employment and technology assimilation or acquisition. However, the Arrangement currently limits expenditures on local costs to 15 percent of an export credit package. A special sector arrangement could raise this cap to allow ECAs to provide coverage or financing for projects with as much as 49 percent local cost.

- *More flexible repayment profiles*
  The Arrangement sets out explicit guidelines for the timing and repayment of officially supported export credits. In particular, repayment must begin no later than six months after the issuance of credit; principal must be repaid in equal installments made no less frequently than every six months; and interest payments shall be made no less frequently than every six months. This repayment profile, however, may not match the cash flow of projects in environmentally and socially responsible sectors. It also restricts the freedom of official lenders to adjust repayment profiles to the realities of commercial risk in low-income markets.

- *Greater flexibility on use of development aid (tied and untied)*
  Retaining the requirement that projects demonstrate commercial non-viability in order to combine export credits with development aid will prevent a return to past practice of using development aid as a "sweetener" to win export supply contracts or project development deals. Once projects meet such a test, greater flexibility could be permitted in setting concessionality requirements. "The Arrangement" currently requires countries that "tie" development assistance and export credits to make no less than 35 percent of the total package available as grant aid.[65] Although the practice of officially tying aid has

declined as a result of the Arrangement, it has not been completely curbed, as a number of governments, particularly Japan, simply claim they are providing "untied" aid. In other words, the recipient of the aid is technically free to purchase goods associated with the project from any country, but in fact purchases it from the provider of the aid.[66] Greater flexibility in setting concessionality rates would make commercially non-viable development projects less expensive for the exporting government, thereby opening up more opportunities for ECA involvement.

Local Currency Financing

Many businesses face a major challenge in developing countries in gaining access to medium- to long-term financing at reasonable rates in their own currency. At the same time, various financial crises in Southeast Asia have affected ECAs' own medium- to long-term business, as many exporters and investors now see currency devaluation and currency transfer risks as a major source of political and commercial risk.

ECAs might provide a partial solution to this impasse by providing local currency financing. This could be done in partnership with other public financial institutions, such as MDBs, DFIs, or even financial intermediaries that on-lend money from multilateral development banks, donors, and governments to local projects and development activities. [67] ECAs could agree to use hard currency to cover a share of the intermediary's loan portfolio supporting imports (buyer credits) that is to be repaid in local currency. The risk of currency devaluation would be shared by the ECA and the other collaborating financial institutions. This would allow ECAs to assume some, but not all, of the currency transfer risk, and would increase the supply of long-term financing to the developing country in question. A number of private suppliers of infrastructure have noted that the "development of local-currency financing would disarm one of the major mechanisms by which a particular level of debt can suddenly switch from sustainable to unsustainable."[68]

Bundle Small-Scale Projects to Reduce Costs and Risk Profiles

Many development-friendly projects pose significant challenges for ECAs because they have unknown — and therefore higher — risk profiles, and are often very small in scale. Negotiating financing for a group of projects with similar profiles, or bundling projects, offers a way for ECAs to share in and reduce the overall risk and administrative cost of financing. If multiple ECAs agree collectively to cover a bundle of projects, as a group they might be able to finance more exports or investments that are cutting-edge or small in scale. Bundling would also permit ECAs to address the mismatch between their larger volumes of financing and the smaller scale of development-friendly projects (*e.g.*, smaller municipal water systems, or photovoltaic systems). Bundling might address problems with limited "deal flow" by avoiding competition over relatively small numbers of commercially viable sustainable development projects in sectors such as renewable energy. Collective assessment of the commercial and political risks posed by such projects could reduce the overall transaction costs of assessing their viability. Different ECAs have different documentation and processing requirements, however, and bundling would need to be supported by uniform administration.

Bundling would pose a challenge to ECAs because it might effectively dilute the connection between ECA financing and the national origin of the project developer or exported capital goods. However, this might be solved by attempting to calibrate ECA exposure to the level of export content from their home country or level of investment by a home country firm. OECD ECAs could agree in principle to provide coverage up to a certain amount and under certain terms, but in the end each ECA would cover or co-finance only those projects included in the bundle that meet the requirement for export content from their home country. For example, the German ECA, Hermes, would assume the coverage for those projects where German export-content predominated.

Share Risks with Private Financial Institutions

The volume of medium- to long-term financing supplied by ECAs has fallen dramatically since the mid-1990s. At the same time, although private sector investment entering developing countries has rebounded since the late 1990s, reaching $166 billion in 2004, it remains concentrated in a handful of emerging market economies.[69]

Risk-sharing partnerships with private financial institutions that are significant players in capital markets would enable ECAs to draw these institutions into risky markets that remain under-supplied or under-served by foreign direct investment (*i.e.*, developing countries outside the cluster of emerging market economies).

Private investment and banking institutions could partner with ECAs through schemes involving re-financing (ECA provision of loans to commercial banks to cover loans those banks have made to national exporters or investors), re-insurance (agreements with private re-insurers to indemnify the ECA against all or part of the loss that it sustains, or alternatively, an agreement by the ECA to act as the re-insurer to private insurers of political risk), credit derivatives (fees paid by the ECA to a counter-party that in exchange will assume the risk of default of the ECA's loans or guarantees), and securitization (conversion of ECAs' medium- and long-term guarantees into shares or securities and the sale of these on capital markets). Such partnerships would also leverage ECA resources to cover more investments and exports.

Balance Poor Developing Country and Emerging Market Exposure

While measures to balance exposures could take several different forms, they should ultimately attempt to increase the share of an ECA's portfolio that reaches low-income and poor developing countries. Portfolio balancing can be accomplished by diversifying risks, such that the investments in less risky emerging market economies offset potential losses in riskier and poorer economies. This assumes that there are a sufficient number of bankable projects in lower-income developing countries to effectively balance more profitable projects in higher-income emerging market economies. Such balancing also requires care that an increased volume of projects in lower-income economies does not exacerbate unproductive debt burdens in the most heavily indebted countries.

Pay Close Attention to Sectors with Both Positive and Negative Impact

To manage and enhance developmental impacts it is important to track and actively manage lending or exposure to both sectors with potentially positive effects (*e.g.*, renewable energy, water supply, public transport) and those with potentially negative developmental impacts (*e.g.*, fossil fuel extraction and development, weapons exports, commercial forest plantations, surface hard mineral mining). Such monitoring may take the form of "portfolio targets" or "caps," or may simply involve analysis, tracking and reporting on an ECA's exposure in such sectors. Management of exposures in particular sectors could contribute to "doing good" by limiting exposure to projects with highly negative impacts as well as increasing exposures to those that have high development values.

RESOURCE AND CAPACITY CONSIDERATIONS

The above proposals will require significant investment in staff capacity to perform environmental and/or development quality project assessments. There is a general consensus within export credit and political risk insurance circles that ECAs need to enhance their ability to assess new risks as a result of their loss of monopoly over short-term insurance, the shrinking volume of medium- to long-term business, and the blurring of political and commercial risks.[70] Some of these new risks include currency devaluation, environmental and social risks, and reputational risk. In the process of augmenting staff and institutional capacity to assess these risks, ECAs have an opportunity to enhance their capacity to evaluate the environmental and social quality of the medium- to long-term guarantees and financing that make up their portfolios, and to acquire the skills and know-how that will be needed to develop new business products and services.

An assessment of efforts by ECAs to support exports by small and medium-sized enterprises found that the most successful programs were those with staff and resources dedicated to the specialized needs of small exporters.[71] Enhancing the environmental and social quality of ECAs' portfolios will require a similar commitment in staff and resources. A larger benefit could be gained from such an investment, as a decrease in environmental or social problems and liabilities would likely reduce ECAs' overall risks, and therefore their losses.[72] Nevertheless, the question remains as to where the fiscal resources can be obtained for the building of such new capacity, since governments are generally cutting ECA budgets. Some of the options proposed above, including risk-sharing with private financial institutions, might free up resources or bring in additional resources to build the necessary capacity.

5

CONCLUSIONS AND RECOMMENDATIONS

ECAs are crucial suppliers of medium- and long-term finance for major transactions in developing countries, annually channeling tens of billions of dollars into emerging markets for a wide range of exports and projects ranging from power plants and oil pipelines to aircraft and telecommunications equipment. Although ECAs are export promotion institutions, their collective effect on developing economies, environments, and societies is just as real as — and possibly greater in magnitude than — those associated with bilateral aid agencies and the multilateral development banks. For this reason, ECAs have received justified scrutiny from development and environment organizations seeking to improve these agencies' environmental and social performance.

Despite their continuing importance, ECAs are struggling to maintain their relevance in a volatile and difficult global marketplace. Demand for ECAs' medium- and long-term products has declined in the face of expanded offerings from the private sector. The field of export credit competition is growing more crowded thanks to the emergence of large ECAs in major developing economies and of private-sector providers of political risk insurance.

A possible future is the adoption of reforms that allow ECAs to remain relevant in the market place, and also lead ECAs to shift a share of their support to projects and exports that contribute significantly to sustainable development. In this scenario, ECAs would explicitly integrate sustainable development into core objectives; adopt rigorous and transparent due diligence policies and practices; actively monitor and manage portfolios to maximize development effectiveness; and collaborate with other public international financial institutions — particularly MDBs and DFIs — to develop and test new financial instruments, products and services. Under such circumstances, ECA risk transfer from the private to the public sector could be leveraged to generate public benefits for exporting and importing countries alike.

RECOMMENDATIONS

Many of the measures proposed to increase the development effectiveness of ECA financing will involve significant reforms at national levels as well as changes to the multilateral disciplines or rules that govern export credit financing. Reform will be difficult, given the complex range of actors, vested interests, and policy arenas in which official export credit policies are negotiated. Coalitions of actors interested in ECA reform — policy makers, parliamentary bodies and representatives, bilateral and international aid agencies, industry associations, human rights activists, and environmental groups, among others — should position themselves to influence the debate over and negotiations of official export credits policies. Opportunities for pursuing ECA reform are presented below.

Short-Term Opportunities for Pursuit of ECA Reform

- *Improvements to Special Sector Agreements under the OECD Arrangement (2005-2007)*

  The OECD Arrangement has been under review since 2004. In 2005, participants to the Arrangement adopted a special sector agreement for renewable energies and water projects. This agreement is being implemented on a trial basis for two years, beginning July 1, 2005. The opportunity exists during this process to influence the specific terms and conditions to be applied to renewable energy and water projects, including whether independent processes and tests of sustainability and development value, such as the WCD guidelines for large dams, are incorporated into special sector arrangements.

- *IFC Standards Revision and Equator Principles Implementation (2005–2006)*

  As discussed above, the standards for environmental and social due diligence procedures are in considerable flux. A new cadre of private sector banks with significant business in emerging markets has agreed to abide by the IFC's environmental and social standards, and at the same time the IFC is in the process of revising these very standards. These circumstances present an opening to address how ECAs, which co-finance and collaborate with both the IFC and private banks, fit into this convergence, and also opens the door to a broadening of current due diligence procedures beyond environmental impacts to include human rights and social concerns.

- *Sixth and Seventh WTO Ministerial Conferences (2005–2007)*

  The upcoming 2005 WTO Ministerial Conference in Hong Kong, China, will carry forward a revised Doha Development Agenda (DDA). The revised agenda includes negotiations on agricultural export credits and trade facilitation — both of which are relevant to export credit agencies. The revised agenda has dropped negotiations on what are collectively known as the "Singapore issues" — competition policy, investment, and transparency in government procurement. The Singapore issues, particularly competition policy, are also highly relevant to export credit financing. An opportunity exists at both the 2005 and 2007 WTO Ministerials for OECD governments to open the Arrangement to the participation of developing countries in return for the re-introduction of some or all of the Singapore issues in future WTO rounds (once the Doha round of negotiations is complete). These Ministerials will also provide opportunities to re-negotiate or clarify the boundaries of the safe haven given to the OECD Arrangement under the WTO's Agreement on Subsidies and Countervailing Measures.

- *OECD Review of Export Credit Agencies' Common Approaches on the Environment (2006)* In 2006, parties to the Arrangement will review experiences with the implementation of the Common Approaches on the Environment adopted in 2003. This review opens the door to debate about where the Common Approaches stand vis-à-vis parallel and evolving standards at the World Bank Group and Equator Principles Banks, and other relevant international standards. The review should also create space for civil society advocates to push for a broadening of the Common Approaches to include commitments on debt, human rights, and corruption. Finally, the review should also be used to foster a debate about when and how the Common Approaches should be more formally incorporated into the Arrangement.

- *Sunset or Extension of HIPC Initiative (2006)* The HIPC Initiative is scheduled to sunset in 2006, when the last of the countries in the initiative would be approved for debt relief (*i.e.*, once they are deemed to have met IMF/World Bank conditions for managing their debt burdens, referred to as the decision point). The HIPC initiative has been extended beyond its original sunset clauses (originally 2000, 2002, and again in 2004) a number of times. The extension to 2006 provides an opportunity to evaluate the contribution of ECAs to the debt burden of the HIPC countries, and to incorporate debate on elements of an agreement on sustainable ECA debt in HIPC and other low-income countries.

- *OECD Working Group on Bribery (2005–2007)* The OECD Working Group on Bribery was created by signatories to the OECD Anti-Bribery Convention to monitor and review progress in implementation of Phase 1 (introduction and adoption of supporting national laws and legislation) and Phase 2 (enforcement of laws and legislation adopted under Phase 1). During 2005–2007, the Working Group will conduct 35 Phase 2 national reviews of countries' enforcement of anti-bribery and anti-corruption laws and commitments. As the Anti-Bribery Working Group accepts input from private sector and civil society organizations, the Phase 2 reviews provide an opportunity for ECA advocates to request that the Working Group review the adequacy of national ECA commitments to sanction ECA clients that obtain export contracts through bribery or corrupt practices.

Mid- and Long-Term Opportunities for Pursuit of ECA Reform

- *Negotiations of New Terms and Sector Agreements Under the OECD Arrangement (2007–)* Beginning in 2007, the opportunity will exist to amend the current special sector agreement on renewable energy and water projects to include additional changes to financing terms (such as increasing the percentage of local costs that ECAs can cover or co-finance), the introduction of new portfolio management practices, the introduction of new products or instruments, and most importantly, the incorporation of independently developed guidelines to assess sustainability and development, such as those developed by the WCD. In addition, the negotiation of new special sector agreements is likely to emerge for other sectors, including transportation, information technology for the delivery of health care and education, and agriculture.

- *Basel II Accord on Capital Requirements for Banks and Bank Supervision (2008–)*
  In 2004, the Basel Committee under the Bank for International Settlements (BIS) — both the bank and the committee are made up of representatives of central bank authorities from industrialized and developing countries — revised an informal or soft law agreement adopted in 1988. The original agreement, known as the Basel Accord, established minimum capital requirements for banks and supported stronger bank supervision with the aim of ensuring global financial stability. The renegotiated accord, Basel II, adopted in 2004, updates the original accord to address the evolution of capital markets since 1988. The Basel II accord allows for more sophisticated risk assessment and risk weighting to determine minimum capital requirements, and establishes complementary requirements for bank supervision and information disclosure to ensure market discipline.

  Basel II's pillar on market discipline, which is focused on increasing the transparency of financial institutions and transactions, creates opportunities for ECA advocates to deepen and broaden commitments to information disclosure made by ECAs themselves, their private sector peers, and their clients. At a national level, Basel II also provides an opportunity to review ECA track records in disclosing risks and liabilities. Future efforts under BIS and the Basel Committee to revisit Basel II could also open the way for advocates of ECA and private sector bank reform to incorporate environmental and social risk assessment into the Accord.

- *8th WTO Ministerial Conference (2009)*
  The WTO's 8th Ministerial Conference, which will take place in 2009, should usher in a new round of negotiations addressing the issues of competition policy and investment (the Singapore issues) that were dropped from the Doha Development Agenda. In reconsidering the Singapore issues, developing-country governments have the leverage to set the conditions for their negotiation. Such conditions might include ensuring policy space for competition, investment, and trade promotion policies that are directly supportive of development that generates significant social and environmental benefits.

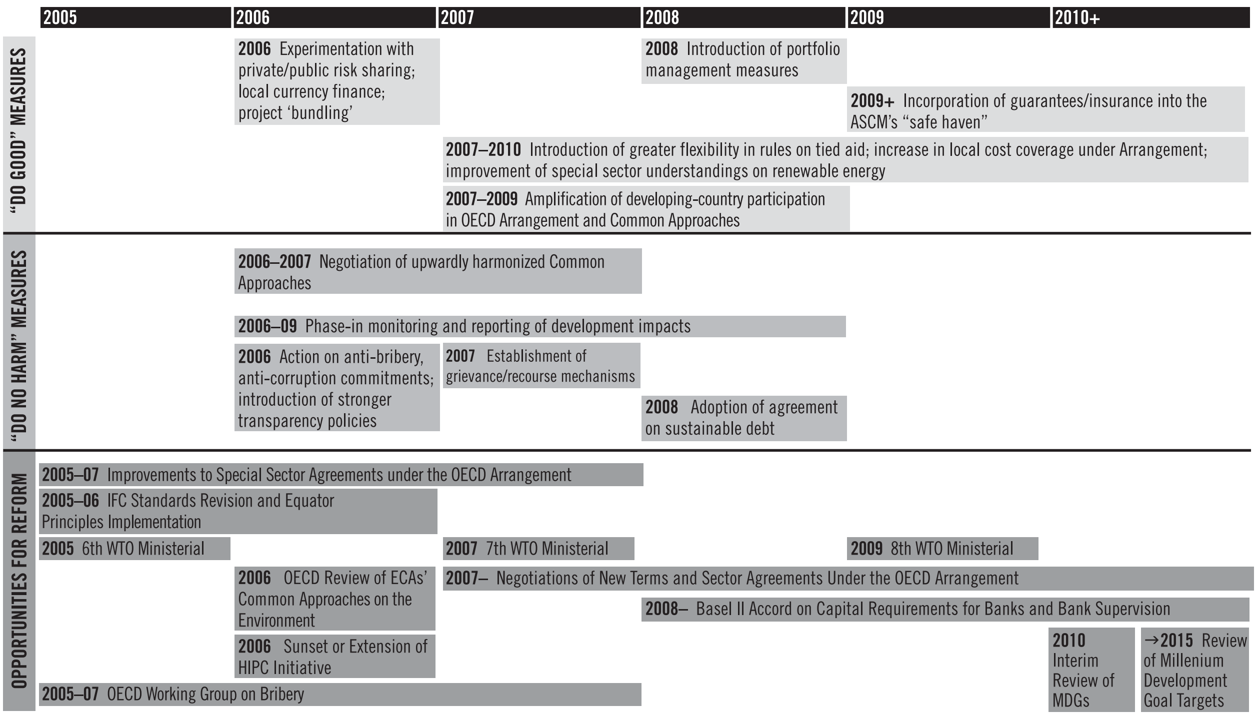
- *Review of Millenium Development Goal Targets (2015)*
  The run-up to 2015, the target date for achievement of the Millenium Development Goals (MDGs), provides an opening to review industrialized-country governments' commitments to the MDGs, and to introduce stronger policy changes or proposals to achieve or meet MDGs that remain unfulfilled. In this context, it might be possible to generate the collective political will necessary to more fundamentally change or reform ECAs as institutions, and to carry that commitment to other fora, in particular the WTO and OECD arenas.

THE NEED FOR MEANINGFUL AND TIMELY REFORMS

It was suggested earlier in this policy report that governments face two broad policy avenues for ECAs at this critical juncture — reform or elimination. We believe that the reform agenda presented here is preferable to the elimination of these agencies, in that it represents an opportunity to harness ECA skills and resources to support sustainable development, while minimizing the harmful development outcomes that have sometimes resulted from ECA finance. However, reform is only preferable to elimination if governments take meaningful and timely steps in the direction outlined here. The negative development effects of many current ECA activities are simply too great to allow for an insincere or half-hearted reform effort. In addition, many civil society groups are growing disillusioned with the halting progress in establishing common environmental standards at ECAs, and with the lack of seriousness with which some ECAs have implemented even those rudimentary standards.

ECAs should build trust with civil society and their domestic public by committing to specific, credible timetables and targets for reform. In that spirit, and taking note of the short- and long-term opportunities for reform indicated above, we offer the reform sequence in Figure 2 as a suggested pathway for ECAs to back sustainability.

FIGURE 2 | SUGGESTED TIMETABLE FOR SUSTAINABILITY REFORMS AT ECAs



APPENDIX 1

IMPLICATIONS OF THE ASCM AND THE OECD ARRANGEMENT FOR EXPORT CREDIT REFORMS

Article 1 of the ASCM defines a "subsidy" as a financial contribution by a government that confers a "benefit." Not all subsidies are prohibited by the ASCM. In fact, the treaty distinguishes among three types of subsidies:

- *Prohibited subsidies* are those linked to or contingent upon exports, or which favor the use of domestic inputs over imported goods.
- *Actionable subsidies* are those that cannot be defined as "prohibited," but nonetheless cause substantial harm to the trade interests of other WTO Members and are subject to contestation through the WTO's dispute resolution mechanism.
- *Non-actionable subsidies* are not "specific" to a firm or industry and are therefore permitted under the ASCM.

Official export credits are, of course, a financial contribution by a government that arguably confers "benefits" on exporters. Obviously, export credits are also linked to or contingent upon exports. Thus, without the "safe haven" in Annex I of the ASCM, any official export credit containing a demonstrable element of subsidy would technically be prohibited under WTO rules. Until recently, the safe haven for export credits was interpreted by Participants to the Arrangement to have broad scope, shielding not only direct financing (lending, interest rate support, and refinancing), but also "pure cover" (insurance and guarantees). In addition, the safe haven gave Participants the ability to match offers made by competing ECAs that did not conform to the Arrangement.[73]

However, a recent series of disputes brought before the WTO by Canada and Brazil, each challenging the other's export support programs for regional jets, has resulted in a significant narrowing of this safe haven. The WTO panels that dealt with the Brazilian and Canadian challenges determined that the safe haven protects only transactions that conform to those specific provisions in the Arrangement that deal *directly* with interest rates.[74] Since these interest rate provisions do not apply to other ECA products and practices, particularly insurance and guarantees ("pure cover") and so-called "matching offers," those products and practices cannot enjoy the protection of the safe haven. Instead, they must meet a "market test" as implied in Article 1 of the ASCM, or risk being deemed a prohibited or non-actionable subsidy.[75]

What is the implication of the narrowing of the safe haven for efforts to introduce or change export credit financing and instruments to better support sustainable development? Surprisingly, significant room or "policy space" remains to change ECA financing and rules to better support sustainable development without violating the spirit of the Arrangement or the more narrowly defined “safe haven” of the WTO’s ASCM. Many of the specific proposals for change made in this report are either unaffected by the narrow definition of the safe haven, or have been defined by the WTO as provisions that reinforce or support the Arrangement’s provisions on direct finance — and thus continue to be protected by the safe haven.[76]

Turning to specific reform proposals, the Brazil-Canada rulings have little to say about the non-financial conditions that ECAs may apply to transactions. Proposed reforms to ECA mandates, due diligence procedures, and portfolio management procedures thus remain completely compatible with both the Arrangement and the ASCM. Arrangement conditions that do not affect the level of subsidy in ECA finance — for example, the limits on “local costs” eligible for ECA support — are also largely unaffected by recent changes in the interpretation of the ASCM.

With regard to direct finance, there is still significant policy space for ECAs to change their terms to better accommodate the needs of sustainable development projects. From the WTO’s perspective, the Arrangement constitutes a bundle of constraints that jointly determine the most generous “price” ECAs can offer to the recipients of direct finance. But the WTO has not issued any guidance as to what that price should be, or specified what interest rate terms the Arrangement should impose. The WTO, for example, has no opinion as to whether the maximum repayment period for a renewable energy plant or water supply project should be ten, fifteen, or twenty years; whether interest rates charged should be one percent or five percent above government bond rates; or whether repayments of loan principal are to be made in equal or fluctuating installments. All of these specific constraints fall under the safe haven of the Arrangement, and can therefore be re-negotiated at the will of Participants without fear of violating the ASCM.

It is important to emphasize here that countries do *not* enjoy policy space to change the terms of direct finance on their own. Were a country to unilaterally implement some of these measures, the resulting transaction might very well be deemed inconsistent with the “interest rates provisions” that fall under the safe haven of the Arrangement. That country’s export credit practices would then lose the protection of the safe haven and run the risk of being deemed illegal export subsidies.

In addition, recent WTO decisions have explicitly excluded pure cover and floating interest rate finance from the safe haven, and must instead meet a market test in order to escape outright prohibition under the ASCM. In other words, offers of pure cover and floating rate finance on terms more favorable than those available in the marketplace generally constitute prohibited subsidies, in accordance with the Brazil-Canada rulings. Since many ECAs increasingly offer pure cover rather than direct finance, the narrowing of the safe haven resulting from the Brazil-Canada rulings places a significant constraint on large portions of ECA finance. Unfortunately, the only obvious way to undo this constraint is for WTO Members to revisit the language in Annex I of the ASCM itself – something that, due to the politics behind this section of the agreement, appears unlikely to happen in the current Doha Round of trade negotiations.[77]

Another recent WTO case filed by Brazil, challenging US agricultural export credits (*United States — Subsidies on Upland Cotton*), places a potential additional constraint on pure cover by resurrecting the ASCM's requirement that such programs recover their costs over time. Formerly a "dead letter" due to its ambiguous phrasing,[78] this requirement may have new teeth as a result of the Panel's verdict in favor of Brazil on this point. However, the impact of *Upland Cotton* should be taken with a grain of salt. *Upland Cotton* dealt with export credits for agricultural products; more importantly, the Panel failed to resolve much of the ambiguity in the cost-recovery requirement and only ruled against the US after reaching a holistic judgment that the program was clearly not designed to account for its own risks. *Upland Cotton*, in other words, should not stop most ECAs from experimenting with sustainable development projects. Ultimately, national governments – not the ASCM – are the principal sources of pressure on ECAs to recover costs.[79]

ENDNOTES

1. United Nations, 2000.
2. International Monetary Fund, United Nations Environment Programme, and the World Bank (IMF, UNEP, and World Bank), 2002.
3. ODA is defined by the World Bank to include almost all forms of official aid — including loans from the International Monetary Fund and the multilateral development banks, bilateral grants and loans, debt rescheduling and forgiveness, disaster relief and humanitarian aid, peacemaking efforts, and technical cooperation. World Bank, 2005: 3.
4. White and Feeny, 2003: 117.
5. *Ibid.*, 118.
6. World Bank, 2005: 24.
7. *Ibid.*, 23.
8. *Ibid.*, 14.
9. *Ibid.*, 14.
10. *Ibid.*, 16–17.
11. *Ibid.*, 16–17.
12. World Bank, 2004b; United Nations Department of Economic and Social Affairs and the United Nations Department of Public Information, 2004: 3.
13. World Bank and International Monetary Fund (World Bank and IMF), 2004: 33-34.
14. United Nations Millennium Project, 2005: 39.
15. World Bank, 2005: 107–108.
16. IMF, UNEP, and World Bank, 2002: 5.
17. *Ibid.*, 5.
18. Moore testimony, 1999.
19. Hampton, 2001: 2.
20. Levit, 2004: 75.
21. OECD, 2005a.
22. International Union of Credit and Investment Insurers (Berne Union), 2005: 22.
23. These figures relate to those ECAs that are members of The Berne Union, an association of both official ECAs and private providers of commercial and political risk insurance. "Medium- to long-term" is defined as credits with maturities of greater than two years.
24. Berne Union, 2005: 22–23.
25. Jackson, 2001: 6.
26. Stephens and Smallridge, 2002; Wilkinson, 2004; Godier, 2004a and 2004b.
27. de Ricolfis, 2003.
28. World Bank and IMF, 2004: xx.
29. Watson, 2003; Rich, 200b; Grimaldi, 2002:A1, Miles and Zhdannikov, 2005.
30. Goldzimer, 2003.
31. Hildyard, 1999: 5.
32. Goldzimer, 2002: 15.
33. Rich et. al., 2001: 11.
34. Robert O'Harrow, Jr., "Justice Broadens Halliburton Inquiry, Ex-KBR Chairman Being Investigated," *The Washington Post* (August 5, 2004): E04.
35. Drew, 2002; Hawley, 2003a.
36. World Bank, 2004a; Both Ends and European ECA Reform Campaign, 2004: 2.
37. International Monetary Fund (IMF), 2001: 13.
38. The group of HIPCs now includes 38 countries, all of which are eligible for International Development Association (IDA) loans and the IMF's Poverty Reduction and Growth Facility, and have external public debt greater than 150 percent of exports or (for extremely open economies) 250 percent of government revenue (World Bank, 2004a); World Bank, "HIPC: Debt Initiative for Heavily Indebted Poor Countries." Online at http://siteresources.worldbank.org/INTDEBTDEPT/DataAndStatistics/20263217/hipc-pages.pdf (last visited September 15, 2005).
39. OECD, 2005b.
40. World Bank, 2004a:133.
41. Other official flows (OOF) are official transactions for which development is not a main objective, or if it is, the funds are insufficiently concessional to qualify as ODA. The main OOF items are export credits, official sector equity and portfolio investments, and debt reorganization at non-concessional terms. (White and Feeny, 2003: 114, footnote 2).
42. OECD, 2001.
43. White and Feeny, 2003: 117-118.
44. In *Global Development Finance 2002*, the World Bank defines "poor countries" as those eligible for highly

concessional IDA loans, as well as countries that receive few standard World Bank loans and have almost no access to international capital markets.
45. World Bank, 2002.
46. Becker and McClenahan, 2003.
47. Lankes and Stern, 1997.
48. Export-Import Bank of the United States, memoranda, May 30, 2000 and January 24, 2001.
49. Stephens and Smallridge, 2002: 30–35.
50. In 2001, NCM NV, the Dutch export credit agency, merged with the private Swiss firm Gerling Credit Insurer, and was renamed Atradius in 2004.
51. Export Credit Guarantee Department (ECGD) press release, 1 April 2003. "CGD Boosts Renewable Energy Sector with £50 million Export Help." Online at: http://www.ecgd.gov.uk/news_home.htm?id=5089.
52. Informal communication with the U.K.'s ECGD at a meeting of UNEP's working group on ECAs held in Paris, France, February 2004.
53. OECD, 2005a.
54. The most recent draft of the IFC's Policy on Social and Environmental Sustainability and Performance Standards is available online at http://www.ifc.org.
55. OECD, 2001.
56. OECD, 2003.
57. This discussion refers to the IFC policies in place as of January 2005, not the draft IFC Performance Standards undergoing consultations and revisions in mid-2005.
58. Watson, 2003.
59. Greenhill and Petifor, 2002.
60. Hawley, 2003a.
61. Hawley, 2003b.
62. Carbonell, 2004b.
63. OECD, 2005a.
64. The World Commission on Dams, 2000.
65. OECD, 2005a: 21.
66. Evans, 2004.
67. Curmally, Sohn, and Wright, 2005.
68. U. K. Parliament, 1999: 2.
69. World Bank, 2005: 16 (Table 1.2).
70. Berne Union , 2004.
71. Stephens and Smallridge, 2002.
72. Rich and Carbonell, 2002.
73. If a Participant to the Arrangement finds itself competing against a rival ECA offering terms more generous than those allowed under the Arrangement, the Arrangement allows that Participant to make an equivalent offer — a so-called "matching offer" — to win the sale, even though the matching offer is itself more generous than the rules allow.
74. Carbonell, 2004b.
75. The "market test" is implied in the ASCM's definition of a subsidy as a payment that confers a "benefit." Successive WTO panels have found that in the area of export credits, a "benefit" exists when the exporter or investor obtains terms from the ECA that are more generous than the best available commercial offer for a comparable transaction.
76. Carbonell, 2004b.
77. *Ibid*.
78. Ray, 1995.
79. Carbonell, 2004b.

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ABOUT WRI

The World Resources Institute is an independent nonprofit organization with a staff of more than 100 scientists, economists, policy experts, business analysts, statistical analysts, mapmakers, and communicators working to protect the Earth and improve people's lives. WRI's work is concentrated on making progress toward four goals:

Healthy Ecosystems: Reverse rapid degradation of ecosystems and assure their capacity to provide humans with needed goods and services

Stable Climate: Protect the global climate system from further harm due to emissions of greenhouse gases and help humanity and the natural world adapt to unavoidable climate change

Sustainable Enterprise: Harness markets and enterprise to expand economic opportunity and protect the environment

Access to Environmental Information and Decisions: Guarantee public access to information and decisions regarding natural resources and the environment

WRI's strength is our ability to catalyze change through partnerships that implement innovative, incentive-based solutions that are founded upon hard, objective data. And we know that harnessing the power of markets will ensure real, not cosmetic change. Our strategy is based on:

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THE INTERNATIONAL FINANCIAL FLOWS AND THE ENVIRONMENT PROJECT

WRI's International Financial Flows and the Environment (IFFE) project works to align public and private investment with sustainable development that results in positive outcomes on the ground. IFFE influences upstream decision- making in order to enable change downstream at the project and community levels. The project concentrates on both public and private finance.

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Established more than five years ago, the Institutions and Governance Program at World Resources Institute was one of the first policy research centers to focus explicitly on issues of environmental governance.

The Program partners with governments, international institutions, and public interest groups to foster inclusive and accountable decision-making processes that result in more socially just and environmentally sound decisions.

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